
Competition Commission report on extended warranties for domestic electrical goods

To: Secretary of State for Trade and Industry

From: John Vickers
Chairman

30 October 2003

ISSUE

1. Section 86 of the Fair Trading Act 1973 (FTA) requires me to advise you on the report by the Competition Commission (CC) made under the monopoly provisions of the FTA and submitted to you on 30 September 2003. The CC find that a complex monopoly in the supply of extended warranties for domestic electrical goods operates against the public interest. The CC panel, by a majority of four to one, recommends a remedy (called 'Package 1') to address the adverse effects. The dissenting member favours an alternative remedy (called 'Package 2').

RECOMMENDATION

2. I recommend that you:
 - accept the report and adverse findings made by the CC
 - accept the recommendation of the CC majority and adopt Package 1 to remedy the adverse effects
 - implement the remedies by statutory Order.

TIMING

3. Routine.

BACKGROUND

4. The supply of extended warranties (EWs) for domestic electrical goods (DEGs) was referred to the CC by the OFT on 2 July 2002. The OFT analysis had indicated a lack of effective competition and consumer choice. The CC report confirms the key findings of the OFT analysis that led to the reference.
5. An EW is a contract which extends the manufacturer's guarantee on a DEG. EWs extend the period of cover for the consumer normally by three to five years and may also provide broader protection than repair or replacement by, for example, covering against accidental damage and in some cases loss or theft. They may also provide assistance for users, such as helplines for purchasers of computer equipment.
6. The CC estimates the DEG market in the UK at between £15 billion and £20 billion a year. In round figures the annual volume of EWs is about 19 million and their value about £900m. About 80 per cent of new EWs are provided by retailers at the point of sale (POS) of the DEG. This is therefore a significant market. The consumer normally pays for the cover in full in advance.

THE CC'S FINDINGS

7. In summary, the CC conclude that there is insufficient competition in selling the EWs. Those selling EWs at the POS of the DEG have a very strong advantage. The CC find that a complex monopoly exists, and is engaged in practices which operate against the public interest. (It also finds that the Dixons Group has a scale monopoly position, but does not conclude that the company benefits from the scale monopoly.)
8. The complex monopoly comprises all those retailing EWs to consumers at the point of buying DEGs, the insurers which underwrite or otherwise provide EWs, and the service companies contracted with them.
9. The practices include DEG retailers offering and selling only their own EWs at prices which are not displayed and are not cost reflective; requiring payment in advance; setting short cancellation periods and tough cancellation conditions to discourage switching; and subjecting consumers to pressure selling.
10. As a result, consumers lack information and choice of EWs at the POS and pay excessive prices. The CC estimates that EW prices from the five largest retailers would have been up to a third lower if profits on EWs had been in line with the cost of capital.

THE CC'S RECOMMENDED REMEDIES

11. The CC panel examined two alternative remedy packages. Both include:
 - a requirement to display EW prices alongside the DEG price
 - rights for the consumer to terminate an EW and get a pro-rata refund if they change their mind or want to switch to another EW provider
 - provision of information leaflets by the retailer explaining statutory rights, other sources of EWs and the financial status and backing for the EW being offered.

12. The CC majority in addition propose measures to improve the information available to the consumer and allow them more time to compare available EWs. Package 1 would do this by providing:
 - a requirement for a retailer to provide on request, and in any event before a sale, an EW quotation valid for 30 days so that the consumer can shop around
 - a requirement for the retailer to give the consumer the information leaflet before selling an EW
 - a right for the consumer to cancel with a full refund within 45 days of EW purchase
 - a requirement for the retailer to give the consumer written confirmation by post after the sale of the EW of the right to cancel.

13. The CC minority proposals (Package 2) would limit the duration of the EW available at the DEG POS to one year. During that time the consumer could shop around before deciding on a longer term EW. The consumer would also be able to opt for longer term cover from the DEG retailer 30 days after the purchase and from anyone else straight away. With this option it would not be necessary to require the retailer to provide written quotations or posted reminders of cancellation rights.

OFT ASSESSMENT AND RECOMMENDATION

14. Package 1 would provide customers with much improved information, compared to the current situation, and they would be much better placed to make informed decisions. Greater freedom of choice should enhance competitive pressure. On the other hand there is a risk that the POS advantage would not be significantly weakened if consumers remain relatively passive and do not exercise the improved ability to choose.
15. In contrast, Package 2 would require each customer to act positively to secure a long term extended warranty. This would require a change of EW purchasing habits by most consumers. On the supply side, Package 2 is more likely to stimulate competition for EW business because it would further reduce the POS advantage enjoyed by the DEG retailer. The panel majority is concerned, however, that Package 2 may be a disproportionate restriction on ways of buying and selling EWs and in particular that it would make it more complicated for the customer to secure a long term EW.
16. The CC carefully considered the relative merits of Packages 1 and 2 and the majority recommended Package 1. I support that recommendation, noting that it should improve conditions for competition and consumer choice without restricting consumers' freedom of action.
17. It is not certain that Package 1 will succeed in remedying the detriments identified by the CC. The CC majority recognise this (at para 2.466) and say that if Package 1 turns out not to be effective, then only the deferral of POS sales of EWs with duration longer than a year, as envisaged in Package 2, would address the lack of competition. If you accept the recommended remedy package, we therefore intend to review its effectiveness in 2007.
18. The CC recommend implementing the remedies by Order. We agree. Indeed, since the number of parties affected runs to several dozen, we consider that it is the only practicable route to implement your chosen remedy. OFT officials are ready to liaise with yours on the design of the Order provisions if you would find that helpful.

Taxation and regulation of EWs

19. The CC also make a number of recommendations on the taxation and regulatory frameworks for EWs. There has been a shift in recent years from insurance-backed EWs towards service-backed schemes. Unequal tax treatment has been an important factor. Unless the financial backing for a service-backed scheme is fully

protected and ring-fenced, customers do not have the same protection as with insurance-backed schemes. These points raise two issues: whether to bring service-backed schemes within the ambit of FSA regulation; and the tax advantages currently enjoyed by service-backed warranty schemes. These are important questions for the FSA and the Treasury to consider.

20. The CC recommend that customers should have a right to cancel an EW agreement within 45 days. The CC also note that the forthcoming implementation of the EC directive on the distance marketing of consumer financial services, which will apply to insurance products sold at a distance, will provide for a maximum cancellation period of 14 calendar days. Those EWs which are to be treated as insurance products and which are sold at a distance will be subject to the EC directive, which will take precedence. As the CC says, this should not matter greatly, since there is less pressure on the consumer who is buying remotely and they are in less need of the protection afforded by the extended cancellation period.

CONCLUSION

21. I recommend that you accept the report and adverse findings made by the CC; accept the recommendation of the CC majority and adopt Package 1 to remedy the adverse effects; and implement the remedies by statutory Order. There are a number of technical issues associated with the implementation of the remedies and the OFT is ready to help to deal with these in any way that you would find helpful.

ANNEXE A

REMEDIES PROPOSED BY THE CC

Package 1 remedies enforceable under the Fair Trading Act

These are as follows:

- a. A requirement for DEG retailers selling EWs to display the EW price and duration alongside the price of the DEG wherever that is displayed. The requirement applies to DEG prices displayed in store and in press and other printed publicity. It would not apply to retailers with annual sales of EWs below £10,000 p.a.
- b.
 - (i) A requirement for providers (not only retailers) of EWs to allow a consumer to cancel an EW by phone or post within 45 days from purchase of the EW, and receive a full monetary refund providing there has been no claim under the warranty.
 - (ii) A requirement for providers of EWs to allow a consumer to terminate an EW at any time after the 45 day cancellation period and get a pro-rata refund based on the number of full unexpired months warranty coverage.
 - (iii) A requirement for EW providers to write to consumers who purchased EWs at the POS to remind them of their rights to cancel or terminate their warranty agreement. The reminder to be sent at least 20 days before the end of the cancellation period.
- c.
 - (i) A requirement for provider of EWs to provide to consumers on request a written quotation, in standard form approved by OFT, for the price and duration of cover for a DEG. The quote should be valid for 30 days. It should also apply to any conditional discount offered to induce a customer to bring an EW at the POS.
 - (ii) A requirement for providers automatically to provide a consumer with such a quote before concluding an EW sale.
 - (iii) A requirement for the provider to secure the customer's signature to confirm the issue and acceptance of quotation.

The requirements would be conditions of sale of POS EWs. EWs with a retail price of £20 or less, and retailers offering EWs by internet and mail order catalogue, would be excluded from the requirements for quotations.

- d.
- (i) A requirement for DEG retailers who sell EWs to display prominently in store information leaflets, in standard format, for customers summarising:
 - their statutory rights;
 - the types of organisations that sell EWs;
 - the possible relevance of household insurance;
 - cancellation rights and procedures for EWs;
 - the financial status of the warranty booking (whether it is an insurance or a service-backed product supported by a trust arrangement or neither);
 - the status of the EW if the DEG is replaced under the warranty.
 - (ii) A requirement for the leaflet to be given to consumers before they purchase an EW at the POS.
 - (iii) A requirement for internet and mail order retailers to display equivalent information prominently.

Package 2 remedies enforceable under the Fair Trading Act

These are as follows:

- (a)
 - (i) A requirement that EWs sold at the DEG POS are valid for no more than one year.
 - (ii) A requirement for DEG retailers selling EWs to display the price of the one year EW alongside the price of the DEG wherever that is displayed. The requirement applies to DEG prices displayed in store and in press and other printed publicity. It would not apply to retailers with annual sales of EWs below £10,000 p.a.
 - (iii) A requirement that a retailer selling a DEG does not conclude an agreement to supply an EW with a duration of more than one year until at least 30 days after the sale of the DEG.
- (b)
 - (i) A requirement for providers (not only retailers) of EWs to allow a consumer to cancel an EW by phone or post within 45 days from

purchase of the EW, and receive a full monetary refund providing there has been no claim under the warranty.

- (ii) A requirement for providers of EWs to allow a consumer to terminate an EW at any time after the 45 day cancellation period and get a pro-rata refund based on the number of full unexpired months warranty coverage.
- (c)
- (i) A requirement for DEG retailers who sell EWs to display prominently in store information leaflets, in standard format, for customers summarising:
 - their statutory rights;
 - the types of organisations that sell EWs;
 - the possible relevance of household insurance;
 - cancellation rights and procedures for EWs;
 - the financial status of the warranty booking (whether it is an insurance or a service-backed product supported by a trust arrangement or neither);
 - the status of the EW if the DEG is replaced under the warranty.
 - (ii) A requirement for the leaflet to be given to consumers before they purchase an EW at the POS.
 - (iii) A requirement for internet and mail order retailers to display equivalent information prominently.

Other recommendations

The CC make a number of other recommendations and observations:

- (i) the CC consider there is merit in treating insurance and service-backed EWs on a common basis;
- (ii) consideration should be given to making EWs subject to FSA regulation by classifying service-backed EWs as insurance contracts in line with the proposals in the FSA Consultation Paper 150;
- (iii) otherwise they recommend the Treasury consider whether some other way might be found to achieve similar effects;
- (iv) the CC recommend that the Treasury revisit the taxation treatment of insurance and service-backed EWs which currently encourages providers to switch from insurance to service-backed schemes.