

Extended warranties on domestic electrical goods

A report on the supply of extended warranties
on domestic electrical goods within the UK

Volume 2: Background chapters



COMPETITION COMMISSION

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**Presented to Parliament by the Secretary of State for
Trade and Industry by Command of Her Majesty
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Members of the Competition Commission as at 30 September 2003

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¹These members formed the Group which was responsible for this report under the Chairmanship of Sir Derek Morris.

Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which she considers would not be in the public interest to disclose and which, in her opinion, would seriously and prejudicially affect certain interests.

The omissions are indicated by a note in the text or, where space does not permit, by the symbol ✂.

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Part II

Background and evidence

3 Origins of the reference

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Introduction: the OFT referral

3.1 On 2 July 2002, the DGFT referred to the CC for inquiry and report the market for extended warranties on domestic electrical goods. The terms of reference of the inquiry are set out in Appendix 1.1. The CC was required to report by 1 July 2003.

3.2 On 26 June 2003, the Secretary of State announced that she had agreed to a request from the CC to extend the reporting date to 30 September.

Background to past investigations

3.3 EWs have been a subject of public interest for some years. At least one major supplier of EWs (Multiguarantee Ltd) collapsed in the late 1980s, with consumers left unprotected due to that supplier not being an authorized insurer and thus within the umbrella of the Policyholders Protection Board.¹ Much more recently, there have been cases where retailers offering service-backed warranties have found themselves in financial difficulties and unable to meet their liabilities: examples are Colourvision, Tempo and, in respect of some of its warranties, Powerhouse (in August this year). CA also expressed concern about aspects of EWs in periodic reports, particularly about what it saw as high-pressure selling of EWs by retailers and a diminishing need for them at all as electrical goods became more reliable.

3.4 In February 1994, the then DGFT announced that the OFT was investigating the selling of EWs on DEGs. His announcement referred to the wide range of EW prices; lack of information about such prices; pressure on consumers to make snap decisions without being able to shop around and a lack of competition from alternative suppliers (particularly insurers) to the retailers that dominated the EW market. His concern was that consumers were thus unable to make informed choices about the value for money of the EWs they were being offered.

3.5 The OFT report in December 1994 concluded that there was very little transparency in the manner in which EWs were sold, with very little advertising and very little price display. This was in contrast to the related DEGs. The EWs were often sold in a way which could bring undue pressure to bear on consumers to make snap, ill-informed decisions. Shopping around for an EW was difficult because so little information was available at POS of the DEG or elsewhere. There was also virtually no competition in EWs either at POS or, later on, if providers sought to sell directly to consumers who had bought DEGs. The only area where effective competition existed was in the underwriting of EWs by insurance companies. EW prices varied considerably on the same products, with no apparent relationship to product reliability or levels of service. While EWs at reasonable prices could be attractive propositions for people who valued peace of mind, for many retailers they were profitable additional lines of business whose prices were not sensitive to competition or consumer choice (and had the additional benefit of generating receipts in advance for the retailers).

3.6 The OFT recommended that retailers should display EW prices clearly, with informative and prominent display materials and leaflets available for customers (and others such as consumer organizations or journalists) to take away. More should be done to encourage competition from insurers and manufacturers in supplying EWs, including details of manufacturer EWs being available to customers before purchase of the goods. The OFT also endorsed a proposal by CA that all interested parties should work towards a code of practice to self-regulate the way in which EWs were marketed and sold. A code should cover such matters as fair sales practices and information about the terms and conditions of the EWs, including the differences between insured EWs and others with no insurance backing.

3.7 The outcome, in 1995, was a code of practice for selling EWs sponsored by the BRC, with OFT support. The code was reviewed in 1996 and monitored by means of annual monitoring reports to the OFT from the BRC. The code was slightly revised and renamed a best practice code in 2001.

¹The PPB was set up under the Policyholders Protection Acts 1975–1997 to provide compensation for policyholders of authorized insurance companies unable to meet their liabilities to policyholders. The PPB arrangements were subsumed, with analogous arrangements in other financial service sectors, in the Financial Services Compensation Scheme set up by the Financial Services and Markets Act 2000.

OFT reasons for the referral

3.8 In referring the issues to the CC, the OFT published a report on their market investigation which had led to it. This report noted that the investigation, announced in October 2001, was partly prompted by concerns about poor quality of the BRC's monitoring information. In the light of those concerns, the OFT had in May 2001 commissioned a mystery shopping survey of 1,000 retail outlets. That survey had, in the OFT view, demonstrated that retailers' compliance with the BRC code was poor.

3.9 The OFT for their investigation also commissioned, and published at the same time as their main report, surveys of over 2,000 consumers and 1,000 independent electrical retailers. The OFT in-house analysis of the market was supported by two externally commissioned research studies on the markets for electrical goods and EWs.

3.10 The OFT report found that there were a number of areas of concern:

- the similar behaviour of electrical retailers limited consumers' ability to make accurate assessments of the value of buying EWs. There was not only limited information available to consumers but EWs were priced by reference to the goods prices rather than, say, product reliability and repair cost data;
- there was a lack of effective competition in the EW market. This was due, in particular, to electrical retailers' POS advantage and EWs representing a secondary market in which consumers had often planned the purchase or shopped around for better alternatives;
- consumers were largely unaware of their alternatives to buying EWs, yet the OFT research showed that independent electrical repairers provided a good alternative; and
- consumer protection in the market was inadequate, given the scope for sales pressure; the ineffectiveness of the BRC code; and the absence of specific consumer protection legislation or a comprehensive regulatory framework governing both insured and service-backed EWs.

3.11 The OFT also noted that the BRC did not feel able to seek approval for its code under the new codes regime being introduced, which would have required the BRC to satisfy the OFT that it had, *inter alia*, the means to ensure that its members enforced any code endorsed by the OFT. The OFT also did not consider it to be practicable to obtain satisfactory remedies by way of undertakings from the numerous suppliers of EWs. Finally, the powers available to the Secretary of State following adverse findings from a CC investigation and report were significantly more extensive than those available following an OFT report.

3.12 The OFT concluded that a reference to the CC, therefore, provided the best prospect for making the market work better for consumers by improved competition, information and consumer choice, and hence better value for money.