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## The Penrose Review: power to the consumer?

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**The Penrose Review investigated the state of competition and consumer protection policy in the UK, as well as economic regulation in network sectors. Some of the consumer protection proposals would be beneficial to consumers; however, others are untested and may have unintended consequences. In regulated sectors, there are unanswered questions around reforms to the appeals process, and the measures proposed to reduce the scope of economic regulation while increasing competition need to be explored in more detail.**

In September 2020, the UK government asked John Penrose MP to write a short independent report on the UK's approach to competition and consumer protection policy. Published in February 2021, 'Power To The People' proposes several changes.<sup>1</sup> As noted in the report, a number of the issues have been explored before—for example, by Lord Tyrie (former chairman of the UK Competition and Markets Authority, CMA), in the Furman Review of competition in digital markets,<sup>2</sup> and in the 2020 CMA state of competition report.<sup>3</sup>

Now that the dust has settled, this article focuses on two important themes of the Penrose Review:

- that more consumer protection should be introduced across all sectors;
- that more competition should be introduced in sectors that are subject to economic regulation.

These are not the only issues covered in the report, but they are the most closely related to applied economics.

## Expanding consumer protection

Penrose recommends expanding consumer protection powers for the CMA and other regulatory bodies, such that they are in line with the UK's strong competition enforcement powers. He argues that the UK lacks a high-profile consumer protection agency, and that consumer rights are relatively weak compared to our European neighbours.<sup>4</sup>

Penrose proposes the following changes.

- **The CMA should raise its public profile.** The CMA should fulfil a role as a 'consumer champion' and a 'micro-economic sibling for the Bank of England'. Specifically, it should publish an annual 'State of Competition and Consumer Detriment' report and monthly reports from its meetings with consumer complaints organisations.<sup>5</sup>
- **The CMA should be given more powers to issue decisions and fines** for consumer law breaches without having to go to court. The CMA already has the power to issue decisions for *competition law* breaches, but currently it is required to take consumer law cases to a non-specialist court. Penrose concluded that this process is slower, more bureaucratic and ultimately weaker.<sup>6</sup>
- **Localised consumer protection bodies should have a greater role.** Penrose argues that consumers should be able to submit complaints to Small Claims Courts or Alternative Dispute Resolution (ADR) services using a simple online process or even a smartphone app. Local Authority Trading Standards (LATS) teams should also be given more resources to investigate local scams and other consumer protection problems that are too small to warrant a full-scale investigation by the CMA.<sup>7</sup>
- The UK should introduce **further consumer protection laws to address harmful business practices**—in particular:<sup>8</sup>
  - price discrimination and loyalty penalties, i.e. when customers who renew an existing contract in industries like insurance or energy are systematically charged more than people who frequently switch;
  - 'rip-offs' hidden in small print or through information asymmetries—for example, privacy and data usage policies included in the terms and conditions of everyday products like public Wi-Fi (which many users do not read);
  - 'sludge', or behavioural nudges that encourage consumers to accept a bad deal—for example, where companies offer a 'free trial' that converts into an expensive subscription (and is often difficult to cancel), or where retailers falsely claim that items are almost sold out in order to create a false sense of urgency.

Many of these proposals are likely to have a positive impact—especially those aimed at strengthening consumer rights. Greater public awareness of this enhanced competition and consumer protection regime will enable consumers to identify unfair business practices and more readily seek redress.

Moreover, upgrading local consumer authorities such as Small Claims Courts, ADR services and LATS will make it easier for consumers to submit complaints and ensure that these are handled quickly and efficiently. These consumer protection bodies should be made more transparent and actively encourage consumers to report faulty products or businesses that do not meet certain standards. Specifically, Penrose suggests that these bodies should adopt a fully digital approach to dispute resolution, comparable to using an app on your phone. This proposal represents a potentially effective solution to improving consumer redress (and ultimately competition).

Greater legal powers for the CMA are another important and pragmatic way to improve enforcement of consumer protection laws. Penrose also argues that the CMA should update its guidelines on what 'treating customers fairly' means in practice, so that businesses, charities and public bodies can identify and avoid problems in advance. The Financial Conduct Authority (FCA) has arguably led the way in this area in terms of what this concept means, within the context of 'outcomes-based' regulation. Oxera has also put together a toolkit for financial services firms to ensure that they treat customers fairly in practice.<sup>9</sup>

## Unintended consequences?

While the Penrose Review's proposals have many advantages, there are some practical considerations and potential unintended consequences. A firm understanding of the economics on both the supply side (competition among firms) and demand side (behaviour of consumers) is required before implementing interventions, particularly in relation to complex pricing.

First, an increased focus on obvious signs of consumer detriment could create a risk of prioritising short-term fixes while harming dynamic competition (and thus consumers) in the long term. For example, the CMA (or another regulatory body) might identify a particular business engaging in practices that are considered to be harmful. It might then impose tough remedies immediately, including a ban on certain pricing behaviours. However, if the remedies are inappropriately designed,

this action might discourage new and innovative firms from entering the market. Furthermore, it is important to understand the behavioural economics: the consumer biases being exploited (e.g. through sludging methods), whether the market will correct itself or not, and which kinds of remedies are likely to work.<sup>10</sup> A balance needs to be struck, the longer term must be taken into account, and the market specifics have to be understood.

Second, interventions prohibiting loyalty penalties should only be made following a case-specific analysis, as there are trade-offs. Penrose raises concerns that in *some* industries (for example, mobile phone contracts, broadband, home insurance and mortgages), consumers who automatically renew their subscription are systematically charged more than consumers who switch more often. This is loosely modelled on the FCA's new ban on insurers charging higher prices to loyal customers.<sup>11</sup> Penrose is proposing that some restrictions are placed on loyalty penalties across all industries.<sup>12</sup> However, the FCA's proposed intervention is as-yet untested. It is not clear whether it will help consumers, and may even harm them—as there is some evidence that customers require a large benefit from switching to compensate them for the associated hassle and uncertainty.<sup>13</sup> If pricing practices are constrained to prevent introductory offers, fewer people may switch, and this may reduce competition over time.<sup>14</sup> It may be better to wait until the impact of the FCA's proposed intervention is fully understood before applying similar regulations more widely.

Third, some of Penrose's proposals rightly focus on protecting vulnerable consumers, such as the proposals that prevent companies from presenting unfair behavioural nudges or hiding unfair terms in the small print. In practice, a balance needs to be struck to ensure that remedies are proportionate and targeted. This is particularly the case where interventions intended to protect vulnerable people lead to decreased choice for others (for example, hypothetically, an absolute ban on all online gambling might protect some while preventing others from enjoying a responsible level of gambling). It is nonetheless usually possible to protect vulnerable consumers in a way that does not unduly disadvantage other groups.

## Pushing back regulation

Penrose also proposes changes in sectors in which consumers are already protected through economic regulation (such as water, energy and telecommunications). In these sectors, in the monopoly parts of the value chain, the respective regulators set price limits. These can in turn be appealed by the companies to the CMA—which can be a complicated and lengthy process in

practice.

The report suggests that the system should be simplified, with any appeals dealt with by the Competition Appeal Tribunal (CAT). According to Penrose, the CMA proposed this solution and it should be implemented promptly.<sup>15</sup>

While this may reduce the CMA's workload, a question arises concerning how the CAT would handle future regulatory appeals. In practice, these appeals can involve technical points around regulation, econometric modelling, and finance. It is not clear if the CAT would develop these skills, or if the whole process should be streamlined to the standard of a Judicial Review or similar. There will be pros and cons to any model. Indeed, in discussing further changes to both the CMA and CAT processes, the report notes that 'the end-to-end process needs fixing, but there is no consensus on how to put it right'.<sup>16</sup> It recommends a taskforce to explore the issues further.

In addition, Penrose focuses on where, fundamentally, the line should be drawn between competition and regulation:<sup>17</sup>

Outside the network monopolies with their Regulated Asset Bases (RAB), there is no inherent reason why most of the rest of each of these sectors shouldn't become a normally-competitive industry, with the same high standards, strong competition and consumer powers as other parts of our economy. The benefits will be same as the ones described for digital industries [...].

The report states that while progress has been made in airport regulation and telecommunications, other regulators 'have only recently begun'; that regulation should be stripped back to the monopoly assets; and that even with respect to monopoly assets, there should be auctioning of contracts for new investment in network sectors. Penrose wants sector regulators to hand over more and more responsibility for market supervision to the CMA.

This does, however, offer a somewhat sceptical view of the status quo. Most regulators have a duty to promote competition. Since privatisation, they have explored where along the value chain competition is likely to be both feasible and desirable—and what form this might take. Many of the sectors' regulators have both *ex ante* powers to promote competition and *ex post* powers to enforce competition law.

In energy, there is now competition in generation/production, retail, storage, metering and ancillary services. Regulation is confined to the network assets, and Ofgem's offshore transmission framework involves 'competition for the market' for

network enhancements. In the case of the water sector in England and Wales, non-domestic retail competition was introduced in 2017, and there are ongoing initiatives to encourage direct procurement of assets, bio-resources markets, bulk supply trading and bidding-in markets for water.

Crucially, in many cases, these energy and water markets retain the need for some form of backstop regulation—and it is not clear whether the CMA would be better placed than sector regulators to do this.

In addition, the statement that there is 'no inherent reason' why non-network parts of the value chain should become a 'normally-competitive' industry does not take full account of the economics (on either the demand or supply side): will there be sufficient savings for consumers to switch and, given the nature of the product and the behavioural biases that may be present, will consumers engage and discipline firms?

Buying a coffee on a day-to-day basis (considered by many to be a normally competitive market) is not the same as buying a one-off subscription utility service (such as energy supply). Utility markets may not work as well as intended. Indeed, as stated in the report, Penrose campaigned for the energy price cap<sup>18</sup>—for increased regulation when it was perceived that the retail market was not working for all consumers. In the water sector in England and Wales, consideration has been given to extending retail choice to domestic customers. However, Ofwat's analysis showed that the benefits to customers from switching would be £8 per year.<sup>19</sup> Will this be sufficient for consumers to engage with the market? In addition, since 2017 the non-domestic retail market, which has been opened to competition, has seen various problems emerge.<sup>20</sup>

These factors indicate that even if a utility market can be liberalised, it is necessary to be realistic about the impacts. In an ideal world, regulation (and regulators) would be peeled back to the bare minimum. However, interventions should be based on the economics, and who undertakes them based on practicality.

## Getting the balance right

The Penrose Review is ambitious in its coverage. The report's consumer protection proposals would lead to greater public awareness, enabling consumers to identify unfair business practices and more readily seek redress. It seeks to push the CMA to do more as a 'consumer champion'.

However, there may also be various potential unintended consequences that would need to be considered further.

An increased focus on consumer detriment could create a risk of prioritising short-term interests while harming dynamic competition. The proposals to reduce the scope of economic regulation and increase competition, while appealing, require further analysis in terms of what is desirable and feasible.

Any interventions would need to be based on the latest economic thinking and evidence, and on a sound understanding of the interactions between firms and consumers.

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<sup>1</sup> Penrose, J. (2021), 'Power To The People: Stronger Consumer Choice And Competition So Markets Work For People, Not The Other Way Around', February—hereafter the 'Penrose Review'.

<sup>2</sup> Furman, J. (2019), 'Unlocking digital competition: Report of the Digital Competition Expert Panel', HM Treasury, March.

<sup>3</sup> The Penrose report expands on many of the proposals set out in the February 2019 letter from Lord Tyrie, then head of the CMA. Similar to the Tyrie letter, Penrose advocates that the CMA has greater focus on consumer protection while relinquishing some of its other responsibilities (for example, the responsibility of reviewing appeals from some sector regulators). Penrose also builds on the ideas of the March 2019 Furman Review, a major independent government review of competition in the digital economy. Both Penrose and Furman recommend establishing a digital markets unit to oversee competition in the digital economy, while Penrose cautions against regulatory scope creep. Finally, Penrose echoes some of the concerns raised by the CMA's November 2020 state of competition report, which highlights the relatively high rates of consumer redress issues and poor complaint handling of companies in the UK.

<sup>4</sup> For example, Penrose highlights that one in eight UK consumers had an experience worthy of a complaint, compared to an EU average of one in 12 (see the Penrose Review, section 1.3).

<sup>5</sup> See the Penrose Review, section 2.1.

<sup>6</sup> See the Penrose Review, section 2.2.

<sup>7</sup> See Penrose Review, sections 6.2 and 6.4.

<sup>8</sup> See Penrose Review, sections 7.2, 7.3 and 7.4.

<sup>9</sup> Oxera (2019), 'Fair ground: a practical framework for assessing fairness', *Agenda*, March.

<sup>10</sup> For a discussion of deception in markets, see Oxera (2017), 'The policy of truth? Deception in markets and in public policy', *Agenda*, April.

<sup>11</sup> FCA (2020), 'General insurance pricing practices: Final Report', September.

<sup>12</sup> Penrose suggests that 'loyalty penalties' should be permitted if they are presented transparently before users sign up and given that firms are able to justify why their pricing structure is pro-competitive.

<sup>13</sup> See Deller, D. et al. (2021), 'Switching energy suppliers : it's not all about the money', *The Energy Journal*, 42:3, pp. 95–120. N.B. Oxera has advised parties that were subject to the FCA's investigation.

<sup>14</sup> See CMA (2018), 'Tackling the loyalty penalty', 19 December, paras 2.39–2.41. N.B. Oxera has advised parties that were subject to the FCA's investigation.

<sup>15</sup> The Penrose Review, p. 18. In Lord Tyrie's 2019 letter to the Secretary of State (BEIS), the (then) CMA Chairman proposed that there was a strong case for removing responsibility for hearing regulatory appeals from the CMA, with these matters consolidated in the Courts (rather than the CAT).

<sup>16</sup> The Penrose Review, p. 19.

<sup>17</sup> The Penrose Review, p. 36.

<sup>18</sup> The Penrose Review, p. 2.

<sup>19</sup> Ofwat (2016), 'Costs and benefits of introducing competition to residential customers in England', September.