

Consumer Protection

Safeguarding consumers while continuing to supply them with the goods and services they want, at the prices they want, is a prime social responsibility of business. Many companies recognize that providing customers with excellent service and product quality is an effective, as well as ethical, business strategy. Consumers, through their organizations, have advocated for their rights to safety, to be informed, to choose, to be heard, and to privacy. Government agencies serve as watchdogs for consumers, supplementing the actions taken by consumers to protect themselves and the actions of socially responsible corporations.

This chapter focuses on these key learning objectives:

- Understanding why a consumer movement arose in the United States and other nations.
- Knowing the five major rights of consumers.
- Assessing the ways in which government regulatory agencies protect consumers and what kinds of products are most likely to be regulated.
- Determining how consumer privacy online can best be protected.
- Examining how the courts protect consumers and efforts by businesses to change product liability laws.
- Evaluating how socially responsible corporations can proactively respond to consumer needs.

When Hurricane Katrina slammed into the Gulf Coast in 2005, it severely damaged more than 500,000 vehicles. Consumer advocates quickly warned that unscrupulous dealers might try to resell cars and trucks that had been soaked in sewage, petrochemicals, and salt water. Dealers could buy the tainted vehicles from insurers, superficially clean them, provide them with phony titles, and then trick unsuspecting used-car buyers, often in other states. One automobile insurer, the Progressive Group, decided to address this problem directly. The company announced it would crush and incinerate all cars recovered from the New Orleans area, rather than selling them at auction. “We simply don’t want to see these cars back on the road,” said a Progressive spokesperson.¹

Every year, millions of high school students fill out classroom surveys run by the National Research Center for College and University Admissions that ask for their names, addresses, grades, and interests. As students expect, this information is sent to colleges that may be interested in recruiting them. But unknown to most, it is also sold to direct-mail marketers that provide it, for a fee, to companies that want to sell young people everything from credit cards to CDs. In 2003, National Research settled charges brought by the federal Bureau of Consumer Protection and agreed to stop using the information for any marketing unrelated to education.²

In the mid-2000s, a new Internet scam known as “phishing” emerged. Computer users would receive an e-mail message that looked as if it came from a legitimate business, such as a bank or online retailer, asking them to verify their account information. If recipients responded, they would be directed to a Web site that appeared real but in fact was a clever fake. The scammers would then use account numbers, credit card numbers, and passwords entered by users to steal their money or even identities. One of the problems ~~is that of businesses losing money and their customers' credit~~ ~~from China~~ ~~to Vietnam.~~ “It’s very difficult working international cases,” said an officer of the Federal Bureau of Investigation.³

These three examples demonstrate some of the complexities of serving consumers today. Companies face challenging—and often conflicting—demands to produce a high quality product or service, keep prices down, protect privacy,

prevent fraud, and meet the changing expectations of diverse customers around the world. This chapter examines these issues and the various ways that consumers and their advocates, government regulators, the courts, and proactive business firms have dealt with them.

Advocacy for Consumer Interests

As long as business has existed—since the ancient beginnings of commerce and trade—consumers have tried to protect their interests when they go to the marketplace to buy goods and services. They have haggled over prices, taken a careful look at the goods they were buying, compared the quality and prices of products offered by other sellers, and complained loudly when they felt cheated by shoddy products. So, consumer self-reliance—best summed up by the Latin phrase, *caveat emptor*, meaning “let the buyer beware”—has always been one form of consumer protection and is still practiced today.

However, the increasing complexity of economic life, especially in the more advanced industrial nations, has led to organized, collective efforts by consumers to safeguard their own rights. These organized activities are usually called *consumerism* or the **consumer movement**.

In the United States, the consumer movement first emerged in the Progressive Era of the 1910s; later waves of consumerism occurred in the 1930s (during the New Deal) and in the 1960s (as part of the broader movement for social change at that time). Today, many organized groups actively promote and speak for the interests of millions of consumers. One organization alone, the Consumer Federation of America, brings together 300 nonprofit groups to espouse the consumer viewpoint; they represent more than 50 million Americans. A nonprofit organization, Consumers Union, conducts extensive tests on selected consumer products and services and publishes the results, with ratings on a brand-name basis, online and in *Consumer Reports* magazine. Other active U.S. consumer advocacy organizations include Public Citizen, the National Consumers League, the Public Interest Research Group (PIRG), and the consumer protection unit of the American Association for Retired People (AARP). Consumer cooperatives, credit unions, Web sites catering to consumers, and consumer education programs in schools and universities and on television and radio round out a very extensive network of activities aimed at promoting consumer interests.

Many countries have experienced movements for consumer rights, such as the following example.

In central Europe, a consumer movement blossomed after the fall of communism. In Latvia, for instance, activists formed a national federation of consumer clubs, joining groups that had sprung up independently in many cities and towns. “Our clubs,” said the group’s Internet site, “are operating as complaints-handling and campaigning agencies, carrying out small-scale investigative studies, representing consumers on consultative bodies and working with the government . . . on education and information programs.”⁴

Consumerism and government regulation protect consumers from unfair trade practices. Adapted from “Consumerism: A Guide to Consumer Rights,” *Consumer Reports*, 2004, available at <http://www.consumerreports.org/consumerism/consumerism.html>.

Reasons for the Consumer Movement

This consumer movement exists because consumers want to be treated fairly and honestly in the marketplace. Some business practices do not meet this standard. Consumers may be harmed by abuses such as unfairly high prices, unreliable and unsafe products, excessive or deceptive advertising claims, and the promotion of some products known to be harmful to human health.

Additional reasons for the existence of the consumer movement are the following:

- *Complex products have enormously complicated the choices consumers need to make when they go shopping.* For this reason, consumers today are more dependent on business for product quality than ever before. Because many products are so complex, such as a personal computer or an automobile, for example, most consumers have no way to judge at the time of purchase whether their quality is satisfactory. In these circumstances, unscrupulous business firms can take advantage of customers.
- *Services, as well as products, have become more specialized and difficult to judge.* When choosing lawyers, dentists, colleges, or hospitals, most consumers do not have adequate guides for evaluating whether they are good or bad. They can rely on word-of-mouth experiences of others, but this information may not be entirely reliable. Or the consumer may not be told that service will be expensive or hard to obtain.
- *When businesses try to sell either products and services through advertising, claims may be inflated or they may appeal to emotions.* Abercrombie & Fitch, the fashion retailer, for example, has been criticized for promoting its clothing to teens in magazine-style catalogues that are packed with sexual imagery, like scantily clad young men playing with water hoses.⁵ In the process, consumers do not always receive reliable and relevant information about products and services.
- *Some businesses have ignored product safety.* Business has not always given sufficient attention to product safety. Certain products, such as automobiles, pharmaceutical drugs, medical devices, processed foods, and children's toys, may be particularly susceptible to causing harm.

The Rights of Consumers

The central purpose of the consumer movement around the world is to protect the rights of consumers in the marketplace. It aims to make consumer power an effective counterbalance to the power of business firms that sell goods and services.

As business firms grow in size and market power, they increasingly acquire the ability to dominate marketplace transactions with their customers. Frequently, they can dictate prices. Typically, their advertisements sway consumers to buy one product or service rather than another. If large enough, they may share the market with only a few other large companies, thereby weakening some of the competitive protections enjoyed by consumers if business firms are smaller and more numerous. The economic influence and power of business firms may therefore become a problem for consumers unless ways can be found to promote an equivalent consumer power.

Consumer advocates argue that consumers are entitled to five core rights. These are:

1. *The right to be informed:* to be protected against fraudulent, deceitful, or grossly misleading information, advertising, and labeling, and to be given the facts to make an informed purchasing decision.
2. *The right to safety:* to be protected against the marketing of goods that are hazardous to health or life.

3. *The right to choose*: to be assured, wherever possible, access to a variety of products and services at competitive prices; and in those industries in which competition is not workable and government regulation is substituted, to be assured satisfactory quality and service at fair prices.
4. *The right to be heard*: to be assured that consumer interests will receive full and sympathetic consideration in the formulation of government policy and fair and expeditious treatment in the courts.
5. *The right to privacy*: to be assured that information disclosed in the course of a commercial transaction, such as health conditions, financial status, or identity, is not shared with others unless authorized.

Consumers' efforts to protect their own rights, through direct advocacy, are complemented by the actions of government regulators, the courts, and businesses themselves.

How Government Protects Consumers

The role of government in protecting consumers is extensive in many nations. This section will describe legal protections afforded consumers in the United States and offer some comparisons with other countries.

In the United States, the government's involvement in protecting consumers' interests has evolved over time. During the 1960s and 1970s, Congress passed important laws to protect consumers, created new regulatory agencies, and strengthened older consumer protection agencies. These developments meant that consumers, rather than relying solely on free market competition to safeguard their interests, could also turn to government for protection. During most of the 1980s, a deregulatory attitude by the federal government tended to blunt federal initiatives on behalf of consumers. However, state governments became more active, particularly regarding price-fixing, car insurance rates, and corporate takeovers that threatened jobs and consumer incomes. The 1990s and 2000s witnessed a revival of regulatory activism in some areas of consumer protection, such as the government's effort to shield people from unwanted telemarketing calls at home.

Goals of Consumer Laws

Figure 16.1 lists some of the safeguards provided by U.S. **consumer protection laws**. Taken together, these safeguards reflect the goals of government policy makers and regulators in the context of the five rights of consumers outlined above. Many of these safeguards are also embedded in the laws of other nations.

First, some laws are intended to provide consumers with better information when making purchases. Consumers can make more rational choices when they have accurate information about the product. For example, the Truth in Lending Act requires lenders to inform borrowers of the annual rate of interest to be charged, plus related fees and service charges. The laws requiring health warnings on cigarettes and alcoholic beverages broaden the information consumers have about these items. Manufacturers, retailers, and importers must specify whether warranties (a guarantee or assurance by the seller) are full or limited, must spell them out in clear language, and must give consumers the right to sue if warranties are not honored. Europe is catching up with the United States in this regard; for example, in 2006 the European Parliament approved tough new rules to protect consumers from false or misleading health claims on foods.⁶

Deceptive advertising is illegal. Manufacturers may not make false or misleading claims about their own product or a competitor's product.

For example, in 2003 the Food and Drug Administration warned Allergan that its ads for Botox were illegal. The agency said the company had minimized the drug's risks and overstated its approved use. The FDA had originally approved the drug to treat crossed eyes and uncontrollable blinking, and had later extended its approval to include relaxing deep vertical lines between the eyebrows. But the pharmaceutical company had aggressively marketed the drug, a purified neurotoxin, under the slogan, "It's not magic, it's Botox Cosmetic."⁷

Deceptive advertising is also illegal in Europe, where, for example, U.K. regulators recently slapped a huge fine on the French insurance company AXA Sun Life for misleading promotion of various life insurance products.⁸ (Deceptive advertising is further discussed in Chapter 20.)

U.S. law also requires food manufacturers to adopt a uniform nutrition label, specifying the amount of calories, fat, salt, and other nutrients contained in packaged, canned, and bottled foods. Labels must list the amount of trans fat—partially hydrogenated vegetable oils believed to contribute to heart disease—in cakes, cookies, and snack foods. Nutritional information about fresh fruits and vegetables, as well as fish, must be posted in supermarkets. Strict rules also define what can properly be labeled "organic."

A second aim of consumer legislation is to protect consumers against possible hazards. Required warnings about possible side effects of pharmaceutical drugs, limits placed on flammable fabrics, restrictions on pesticide residues in fresh and processed foods, the banning of lead-base paints, and inspections to eliminate contaminated meats are examples of these safeguards. In 1998, following several outbreaks of bacterial poisoning, the government required most fresh fruit and vegetable juice producers to implement good manufacturing practices to ensure safety and mandated that all unpasteurized juice carry a warning label. One incident of bacterial contamination in food that occurred before these rules were implemented, involving fresh fruit juice made by Odwalla, Inc., is described in a case study at the end of the textbook.

The third and fourth goals of consumer laws are to promote competitive pricing and consumer choice. When competitors secretly agree to divide up markets among themselves, or when a single company dominates a market, this artificially raises prices and limits consumer choice. Both federal and state antitrust laws forbid these practices, as discussed in Chapter 10. Competitive pricing also was promoted by the deregulation of the railroad, airline, trucking, telecommunications, banking, and other industries in the 1970s and 1980s and of the telecommunications industry in the late 1990s. Before deregulation, government agencies frequently held prices artificially high and, by limiting the number of new competitors, shielded existing businesses from competition.

A fifth and final goal of consumer laws is to protect privacy. This issue has recently received heightened regulatory attention, as discussed later in this chapter. The Children’s Online Privacy Protection Act, which took effect in 2000, limits the collection of information online from and about children under the age of 13. In 2003, the Federal Trade Commission established a “do not call” list to protect individuals from unwanted telemarketing calls at home. Such calls to a person’s mobile phone are also illegal.

Major Consumer Protection Agencies

Figure 16.2 depicts the principal consumer protection agencies that operate at the federal level of the U.S. government, along with their major areas of responsibility. The oldest of the six is the Department of Justice, whose Antitrust Division dates to the end of the 19th century. Its functions were described in Chapter 10. The Food and Drug Administration was founded in the first decade of the 20th century. The Federal Trade Commission was established in 1914 and has been given additional powers to protect consumers over the years, including in the area of online privacy. Three of the agencies—the Consumer Product Safety Commission, the National Highway Traffic Safety Administration, and the National Transportation Safety Board—were created during the great wave of consumer regulations in the 1960s and early 1970s. Not included in Figure 16.2 are the Department of Agriculture, which has specific responsibility for the inspection of meat and poultry, and the Environmental Protection Agency, which has authority over genetically modified food and some chemicals that may affect consumers.

The Civil Rights Division of the Department of Justice enforces the provisions of the Civil Rights Act that prohibit discrimination against consumers. One such case brought by this division is described in Exhibit 16.A.

The National Highway Traffic Safety Administration affects many consumers directly through its authority over automobile safety. For example, the agency developed a standard for air bags that required deployment of the occupant’s right-side air bag to be dependent on the occupant’s weight. In 1998, a child passenger died because the child’s weight was too low for the air bag to deploy. The NHTSA said it would require so-called “smart” air bags that would adjust the force of deployment according to the weight of the occupant.⁹

One consumer protection agency with particularly significant impact on the business community is the Food and Drug Administration (FDA). The FDA’s mission is to assure the safety and effectiveness of a wide range of consumer products, including pharmaceutical drugs, medical devices, foods, and cosmetics. The agency has authority over \$1 trillion of products, about a quarter of all consumer dollars spent each year.

One of the FDA’s main jobs is to review many new products prior to their introduction. This job requires regulators to walk a thin line as they attempt to protect consumers. On one hand, the agency must not approve products that are

ineffective or harmful. On the other hand, the agency must also not delay beneficial new products unnecessarily. The FDA can also pull existing products off the market or put restrictions on their use, if they are found to harm consumers. For example, in 2005 the agency adopted a rule requiring women taking the acne medication Accutane to use two forms of birth control, because the drug was known to cause miscarriages and severe birth defects.¹⁰ Historically, the FDA has had a reputation as a cautious agency that has advocated tough and thorough review before approval. This policy has stood in contrast to those of its counterparts in Europe and nations with a tradition of a quick approval process. In the mid-2000s, the FDA, operating under new leadership, was praised by some for speeding up the review and approval process for new drugs and devices, while others thought it was not exercising sufficient care.¹¹

One group of products that is *not* regulated by the FDA is dietary supplements, such as the vitamins, minerals, and herbal remedies often sold at health food stores. In 1994, the supplement industry successfully lobbied Congress for a law that exempted their products from most government regulation. As a result, unlike pharmaceutical drugs, supplements do not have to be proven safe or effective before being brought to market. This issue received fresh attention after several people, including a professional athlete, died after taking ephedra, an herbal stimulant. Saying that ephedra “appears not to be safe,” the editor of the *Journal of the American Medical Association* called for regulation of all supplements claiming a biological function.¹²

The FDA’s role in the approval and subsequent review of Vioxx, a pain medication withdrawn from the market by its manufacturer after it was associated with heart attacks and strokes, is discussed in a case at the end of the textbook.

All six government regulatory agencies shown in Figure 16.2 are authorized by law to intervene directly into the very center of free market activities, if that is considered necessary to protect consumers. In other words, consumer protection laws and agencies substitute government-mandated standards and the decisions of government officials for decision making by private buyers and sellers.

The debate over whether government should become involved in protecting consumer privacy is discussed in the next section of this chapter.

Consumer Privacy in the Internet Age

In the early 21st century, rapidly evolving information technologies have given new urgency to the broad issue of **consumer privacy**. Shoppers have always been concerned that information they reveal in the course of a sales transaction—for example, their credit card or driver’s license numbers—might be misused. But in recent years, new technologies have increasingly enabled businesses to collect and use vast amount of personal data about their customers and potential customers, especially those who shop online. The danger is not only that this information might rarely be used fraudulently, but also that its collection represents an unwarranted incursion into personal privacy. Consider the following hypothetical case:

Sandra, a college student, used her personal computer to surf the Web. She established accounts at several online shopping sites to buy books, clothing, and CDs, and downloaded some music and video files onto her hard drive using software a friend recommended. She also established a free e-mail account at a popular Web portal and set her

browser to open to its page. Soon, Sandra began receiving online ads for products similar to ones she had bought earlier, as well as for credit cards, an auto loan, and even a travel package for spring break. Sandra did not realize that several of the Web sites she had visited had tracked her online activity and had used this information to develop a profile of her that they had sold to Internet advertisers.

Behind Sandra's experience was a technology somewhat whimsically called a *cookie*, an identifying marker placed on a user's computer hard drive during visits to some Web sites. The cookie is used to identify the user during each subsequent visit to the Web site that placed the cookie. Internet businesses can use this information to build profiles of users' online surfing and shopping behavior over time. If sold to advertisers, this information can be used to target online solicitations.

Many e-businesses have welcomed this technology as an efficient way to learn about the characteristics and preferences of customers. For example, a cruise line operator might find out that a visitor to its site was a scuba enthusiast, prompting it to deliver information on tours to prime dive sites. The danger, however, is that detailed personal information, possibly of a sensitive nature, could fall into the wrong hands. Research shows that consumers are increasingly concerned about the potential threat to their privacy. A poll conducted for *BusinessWeek* magazine, for example, found that fully 90 percent of Internet users expressed discomfort about Web sites creating personal profiles that linked their real names with their browsing habits and shopping patterns.¹³

The dilemma of how best to protect consumer privacy, while still fostering legitimate Internet commerce, has generated a wide-ranging debate. Three major solutions have been proposed: consumer self-help, industry self-regulation, and privacy legislation.

- *Consumer self-help.* In this view, the best solution is for Internet users to use technologies that enable them to protect their own privacy. For example, special software can help manage cookies, encryption can protect messages, and surfing through intermediary sites can provide user anonymity. "We have to develop mechanisms that allow consumers to control information about themselves," commented a representative of the Center for Democracy and Technology, a civil liberties group.¹⁴ Critics of this approach argue that many unsophisticated Web surfers, like Sandra, are unaware of these technologies, or even of the

need for them. Moreover, tools for protecting privacy can always be defeated by even more powerful technologies.

- *Industry self-regulation.* Many Internet-related businesses have argued that they should be allowed to regulate themselves. One group of companies, organized as the Online Privacy Alliance, advocated adoption of voluntary policies for protecting the privacy of individuals' information disclosed during electronic transactions. The alliance published guidelines for the essential elements such policies should cover.¹⁵ One advantage of the self-regulation approach is that companies, presumably sophisticated about their own technology, might do the best job of defining technical standards. Critics of this approach feel, however, that industry rules would inevitably be too weak. A 2005 survey found that although most large companies operating online had some kind of voluntary privacy policy, only 17 percent of Web sites were rated "excellent" overall, and nearly three-fourths were rated "poor" on reusing personal data for marketing purposes.¹⁶
- *Privacy legislation.* Some favor new government regulations protecting consumer privacy online. The Federal Trade Commission in 2000 announced its support for new laws that would establish standards governing the online collection of information. Such laws would require businesses, for example, to notify consumers whenever information was collected, ask them to *opt in* (or allow them to *opt out*), and give them access to their files and a means of correcting errors. Under the Bush administration, however, the FTC backed away from this stance, saying that it preferred to enforce laws already on the books. This pleased businesses that felt that further regulations would limit their ability to serve customers. Consumer privacy protections are generally stronger in the European Union than in the United States; in the EU, the right to privacy is strongly engrained in both law and culture. "Simply stated, the Europeans have done a better job safeguarding privacy," commented the executive director of the U.S.-based Electronic Privacy Information Center.¹⁷

Any approach to online privacy would face the challenge of how best to balance the legitimate interests of consumers—to protect their privacy—and of business—to deliver increasingly customized products and services in the Internet age.

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Product Liability: A Special Issue

Who is at fault when a consumer is harmed by a product or service? This is a complex legal and ethical issue. The term **product liability** refers to the legal responsibility of a firm for injuries caused by something it made or sold. Under laws in the United States and some other countries, consumers have the right to sue and to collect damages if harmed by an unsafe product. Consumer advocates and trial attorneys have generally supported these legal protections, saying they are necessary both to compensate injured victims and to deter irresponsible behavior by companies in the first place. Some in the business community, by contrast, have argued that courts and juries have unfairly favored plaintiffs, and they have called for reforms of product liability laws. This section describes this debate and recent changes in relevant U.S. law.

Strict Liability

In the United States, the legal system has generally looked favorably on consumer claims. Under the doctrine of **strict liability**, courts have held that manufacturers are responsible for injuries resulting from use of their products, whether or not the manufacturers were negligent or breached a warranty. That is, they may be found to be liable, whether or not they knowingly did anything wrong. Consumers can

also prevail in court even if they were partly at fault for their injuries. The following well-publicized case illustrates the extent to which businesses can be held responsible under this strict standard.

An 81-year-old woman was awarded \$2.9 million by a jury in Albuquerque, New Mexico, for burns suffered when she spilled a cup of hot coffee in her lap. The woman, who had purchased the coffee at a McDonald's drive-through window, was burned when she tried to open the lid as she sat in her car. In the 1994 case, McDonald's argued that customers like their coffee steaming, that their cups warned drinkers that the contents are hot, and that the woman was to blame for spilling the coffee herself. But jurors disagreed, apparently swayed by arguments that the woman's burns were severe—requiring skin grafts and a seven-day hospital stay—and by evidence that McDonald's had not cooled down its coffee even after receiving many earlier complaints. McDonald's appealed the jury's verdict and later settled the case with the woman for an undisclosed amount.¹⁸

In this case, McDonald's was held liable for damages even though it provided a warning and the customer's actions contributed to her burns.

Huge product liability settlements, like the McDonald's case, are well publicized, but they remain the exception. In the early 2000s, one in five noncriminal cases was a tort (liability) case, and plaintiffs (the people suing companies) won 34 percent of product liability cases filed. The average settlement in all tort cases was \$201,000, although a few settlements were much higher.¹⁹

The product liability systems of other nations differ significantly from that of the United States. In Europe, for example, judges, not juries, hear cases. Awards are usually smaller, partly because the medical expenses of victims are already covered under national health insurance, and partly because punitive damages are not allowed.²⁰ In a few cases, however, companies have faced tough penalties. Baxter International, the health care company, was forced to pay over \$250,000 each to the families of 10 kidney patients in Spain. They had died after receiving dialysis on machines equipped with Baxter filters that caused lethal gas bubbles to form in their blood.²¹

Japan did not pass a product liability law until 1995, and such cases are still extremely difficult for consumers to win in court. In the Japanese law's first five years, plaintiffs won only 6 out of 37 judgments, and in no case did the company's liability exceed \$50,000. "[Japan] is a place where companies can get away with actions that would never be tolerated in the U.S. or Europe," commented one attorney.²²

Should guns be subject to product liability laws, or are they a special case? This issue is profiled in Exhibit 16.C.

The special issue of whether or not food companies and restaurants should be held liable for obesity is raised in the discussion case at the end of this chapter.

Business Efforts to Reform the Product Liability Laws

Many businesses have argued that the evolution of strict liability has unfairly burdened them with excess costs. Liability insurance rates have gone up significantly, especially for small businesses, as have the costs of defending against liability lawsuits and paying large settlements to injured parties. Moreover, businesses argue that it is unfair to hold them financially responsible in situations where they were not negligent.

Businesses have also argued that concerns about liability exposure sometimes slow research and innovation. For example, many pharmaceutical companies halted work on new contraceptive methods because of the risk of being sued. Despite the

need for new contraceptives that would be more effective and also provide protection against viral diseases, such as herpes and AIDS, research had virtually come to a halt by the late 1990s, according to some public health groups.²³

In 2005, Congress passed the Class Action Fairness Act, the first significant reform of product liability laws in many years. The two key elements of this legislation were:

- *Most large class-action lawsuits were moved from state to federal courts.* This provision applied to cases involving \$5 million or more and that included plaintiffs from more than one state. Supporters of the law said this would prevent lawyers from shopping for friendly local venues in which to try interstate cases.
- *Attorneys in some kinds of cases were paid based on how much plaintiffs actually received, or on how much time the attorney spent on the case.* Under the old system, attorneys were often paid a percentage of the settlement amount. This sometimes led to excessive compensation for the lawyers.

Although most businesses welcomed these changes, many called for further reforms, such as the following:

- *Set up uniform federal standards for determining liability.* Companies would not have to go through repeated trials on the same charges in different states, which would lower costs for companies and help them develop a uniform legal strategy for confronting liability charges.
- *Shift the burden of proving liability to consumers.* Consumers would have to prove that a manufacturer knew or should have known that a product design was defective. Under present law and judicial interpretations, a company is considered to be at fault if a product injures the user, whether or not the company was negligent.
- *Require the loser to pay the legal costs of the winner.* If a plaintiff (consumer) refused an out-of-court settlement offer from the company and then received less in trial, he or she would have to pay the company's legal fees up to the amount of his or her own fees. This would discourage many plaintiffs from proceeding to trial.
- *Limit punitive damages.* (Punitive damages punish the manufacturer for wrongdoing, rather than compensate the victim for actual losses.) Although many punitive damage awards are small, some multimillion-dollar awards have been reached.
- *Establish liability shields for certain kinds of products.* For example, consumers could be barred from receiving punitive damages in cases involving products, such as pharmaceutical drugs, that had been approved by regulators.

Although supported by many business groups, product liability reform proposals such as these have faced vigorous opposition from consumers' organizations and from the American Trial Lawyers Association, representing plaintiffs' attorneys. These groups have defended the existing product liability system, saying it puts needed pressure on companies to make and keep products safe.

A promising approach to resolving product liability conflicts without going to court is called **alternative dispute resolution** (ADR). In ADR, a professional mediator works with both sides to negotiate a settlement. Generally, if this process fails, the parties can still proceed to trial. Supporters of ADR say it saves money that would be spent on lawyers' fees, so that more can go to plaintiffs in a settlement. Cases can be resolved quickly, rather than waiting for an opening on a busy judge's calendar. Some businesses feel that such a process would enable them to better predict, and budget for, future liabilities. Eventually, ADR may be widely

used to settle individual complaints brought under mass torts, such as those involving injuries from asbestos, tobacco, or defective medical devices. In this situation, a court would set up a procedure and a set of rules by which individuals could negotiate a settlement tailored to the facts of their own case.²⁴

Positive Business Responses to Consumerism

The consumer movement has demonstrated that business is expected to perform at high levels of efficiency, reliability, and fairness in order to satisfy the consuming public. Because business has not always responded quickly or fully enough, consumer advocates and their organizations have turned to government for protection. On the other hand, much effort has been devoted by individual business firms and by entire industries to encourage voluntary responses to consumer demands. Some of the more prominent positive responses are discussed next.

Quality Management

One way that many businesses address consumer interests is to manage quality in a highly proactive way. Quality has been defined by the International Organization for Standardization (ISO) as “a composite of all the characteristics, including performance, of an item, product, or service that bear on its ability to satisfy stated or implied needs.” **Quality management**, by extension, refers to “all the measures an organization takes to assure quality.” These might include, for example, defining the customer’s needs, monitoring whether or not a product or service consistently meets these needs, analyzing the quality of finished products to assure they are free of defects, and continually improving processes to eliminate quality problems. Taking steps at all stages of the production process to ensure consistently high quality has many benefits. Responsible businesses know that building products right the first time reduces the risk of liability lawsuits and builds brand loyalty.

Toyota Motor Corporation, a Japanese car company with factories around the globe, earned 11 of the 19 top model awards for quality in the annual J. D. Power survey in 2006. Its Lexus models ranked highest in every segment in which they competed. The company credited a relentless emphasis on worker training. “We strive to get better by reducing variation in our manufacturing,” explained the general manager of the quality division of the company’s North American operations. “Everyone can screw in a bolt, but we teach people to recognize when it’s mishthreaded . . . to recognize a fault and keep the problem from ever leaving the factory.”²⁵

Managing for product quality is an attempt by business to address its customers’ needs. It is an example of the interactive strategy discussed in Chapter 1, where companies try to anticipate and respond to emerging stakeholder expectations.

Business Ethics magazine publishes an annual list of the “100 best corporate citizens.” One of the 7 categories in which companies are rated in determining their overall scores is their product (or service). Firms with a companywide quality program, with leadership in R&D, who provide services to economically disadvantaged customers, and who avoid safety problems, fraud, and antitrust violations, score high. In 2006, high-ranking companies in this category were a diverse group; they included Ecolab (commercial cleaning and sanitizing), 3M (diversified technology), Tennant (insurance), Molina Healthcare (managed care), Graco (fluid handling), and

Xilinx (programmable microchips). Clearly, positive relationships with customers know no industry boundaries.²⁶

The challenging issue of business's responsibility for products that are safe and of high quality—but used by others in illegal or dangerous ways—is profiled in Exhibit 16.D.

Voluntary Industry Codes of Conduct

In another positive response, businesses in some industries have banded together to agree on voluntary codes of conduct, spelling out how they will treat their customers. Often, this action is taken to forestall even stricter regulation by the government. One such voluntary code is described in the following example.

The Air Transport Association, an industry group, adopted a “customer service commitment” in 1999. The airlines promised to notify passengers when flights were canceled, feed and assist stranded passengers, pay more for lost luggage, and quote the lowest available fare over the phone. The industry's action stemmed from an incident the year before, when hundreds of passengers had been stuck for hours on the runway in planes unable to take off during a Detroit snowstorm. In the ensuing furor, Congress threatened to pass a passenger bill of rights. “We have felt the whip,” said UAL's chairman, explaining the companies' voluntary action. The association later launched a Web site, *customers-first.org*, where flyers could learn more about what individual carriers were doing to meet their customer service commitments.²⁷

Consumer Affairs Departments

Many large corporations operate consumer affairs departments, often placing a vice president in charge. These centralized departments normally handle consumer inquiries and complaints about a company's products and services, particularly in cases where a customer has not been able to resolve differences with local retailers. Some companies have installed **consumer hot lines** for dissatisfied customers to place telephone calls directly to the manufacturer.

One of the largest hot lines, General Electric's Answer Center, fields 3.5 million questions a year on thousands of products. One technician diagnosed a mysterious refrigerator noise by asking the customer to hold the phone up to the appliance. Another advised a frantic caller on how to extract a pet iguana from the dishwasher. “This isn't a job for the faint of heart,” said one consultant who works with company consumer hot lines.²⁸

Many companies now communicate with their customers and other interested persons through Web sites on the Internet. Some sites are interactive, allowing customers to post comments or questions that are answered through e-mail by customer relations staff.

Experienced companies are aware that consumer complaints and concerns can be handled more quickly, at lower cost, and with less risk of losing goodwill by a consumer affairs department than if customers take a legal route or if their complaints receive widespread media publicity.

Product Recalls

Companies also deal with consumer dissatisfaction by recalling faulty products. A **product recall** occurs when a company, either voluntarily or under an agreement with a government agency, takes back all items found to be dangerously defective, as Ford and Firestone did following a series of accidents caused by tire tread separation on Explorers in 2000. Sometimes these products are in the hands of consumers; at other times they may be in the factory, in wholesale warehouses, or on the shelves of retail stores. Wherever they are in the chain of distribution or use, the manufacturer tries to notify consumers or potential users about the defect.

In 2006, Reebok, in cooperation with the Consumer Product Safety Commission, announced it would voluntarily recall heart-shaped metal charm bracelets, marked with the company logo, which had been packaged as a free gift in boxes of girls' shoes. A 4-year-old child had died from lead poisoning after swallowing one of the charms. Product safety experts said that lead was common in cheap metal toys and trinkets made in China.²⁹

One problem with recalls is that the public may not be aware of them, so dangerous products continue to be used. For example, several babies were killed when Playskool Travel-Lite portable cribs unexpectedly collapsed, strangling them. Although the Consumer Product Safety Commission (CPSC) ordered an immediate recall, not all parents and child care providers heard about it, and additional deaths occurred.³⁰ Some consumer organizations advocated a system that would require manufacturers of certain products—such as cribs—to include purchaser identification cards so users could be quickly traced in the event of a recall.³¹

The four major government agencies responsible for most mandatory recalls are the Food and Drug Administration, the National Highway Traffic Safety Administration, the Environmental Protection Agency (which can recall polluting motor vehicles), and the Consumer Product Safety Commission.

Consumerism's Achievements

The leaders of the consumer movement can point to important gains in both the United States and other nations. Consumers today are better informed about the goods and services they purchase, are more aware of their rights when something goes wrong, and are better protected against inflated advertising claims, hazardous or ineffective products, and unfair pricing. Several consumer organizations serve as watchdogs of buyers' interests, and a network of government regulatory agencies act for the consuming public.

Some businesses, too, have heard the consumer message and have reacted positively. They have learned to assign high priority to the things consumers expect: high-quality goods and services, reliable and effective products, safety in the items they buy, fair prices, and marketing practices that do not threaten important human and social values.

All of these achievements, in spite of negative episodes that occasionally occur, bring the consuming public closer to realizing the key consumer rights: to be safe, to be informed, to have choices, to be heard, and to privacy.

- The consumer movement represents an attempt to promote the interests of consumers by balancing the amount of market power held by sellers and buyers.
- The five key consumer rights are the rights to safety, to be informed, to choose, to be heard, and to privacy.
- Consumer protection laws and regulatory agencies attempt to assure that consumers are treated fairly, receive adequate information, are protected against potential hazards, have free choices in the market, and have legal recourse when problems develop. They also protect children's privacy online.
- Rapidly evolving information technologies have given new urgency to the issue of consumer privacy. Three approaches to safeguarding online privacy are consumer self-help, industry self-regulation, and protective legislation.
- Business has complained about the number of product liability lawsuits and the high cost of insuring against them. Although consumer groups and trial

Major Consumer Protections Specified by Consumer Laws

⁸ “U.K. Fines AXA Unit for Misleading Advertising,” *Asian Wall Street Journal*, December 22, 2004, p. A4.

FIGURE 16.2 Major Federal Consumer Protection Agencies and Their Main Responsibilities

⁹ The most recent rules concerning air bags are available at www.safercar.gov/airbags.

¹⁰ “FDA Puts New Regulations on Severe-Acne Treatment,” *The New York Times*, August 13, 2005.

Chapter 16 Consumer Protection

In 2000, Adam’s Mark settled a class-action lawsuit, brought by the U.S. Justice Department, charging that the upscale hotel chain had systematically discriminated against African-American customers. Although admitting no wrongdoing, Adam’s Mark agreed to pay \$8 million. Some of this amount would go to guests who had been subjected to bias, and some would fund scholarships and internships in hospitality management at historically black colleges. The hotel also agreed to bring in an outside monitor to make sure it complied with a nondiscrimination plan.

The lawsuit arose from an incident that had occurred at the chain’s Daytona Beach, Florida, hotel the previous spring, during an event called Black College Reunion. According to the plaintiffs, African-American guests, unlike others, were made to wear orange wristbands to get into the hotel. Rooms they checked into had had furniture—including couches, chairs, and lamps—removed. Participants in the event had to pay cash for room service and at the hotel restaurant, instead of charging to their rooms as was normally permitted.

One of the guests who originally brought the suit, a 27-year-old African-American insurance adjuster who had come to the reunion, said, “I work as hard for my dollar as anyone else. If I want to spend that dollar for a hotel room, I deserve the same treatment as anyone else. That made me upset, and I was ready to go forward and do whatever it took to get things changed at Adam’s Mark.”

Many observers said the bias shown by the Adam’s Mark was not unusual. In a national Gallup poll, half of blacks surveyed said that within the past month they had personally been treated unfairly because of race in situations such as shopping, dining out, or using public transportation. Some called this phenomenon *retail racism*.

Sources: “Hotel Settles Black Discrimination Suits,” *Atlanta Journal and Constitution*, March 22, 2000, p. 3A; “Hotel Chain Settles Federal Race Bias Case,” *The Washington Post*, March 22, 2000, p. A1; “A Weapon for Consumers: The Boycott Returns,” *The New York Times*, March 26, 2000, p. D4; “New Face of Racism in America,” *Christian Science Monitor*, January 14, 2000, p. 1.

¹¹ “McClellan’s Friendlier, Speedier FDA: It’s Streamlining Drug Approvals—and Winning Industry’s Favor,” *BusinessWeek*, June 16, 2003, pp. 33–34.

¹² Marion Nestle, *Food Politics: How the Food Industry Influences Nutrition and Health* (Berkeley: University of California Press, 2002), Part IV, “Deregulating Dietary Supplements”; and “Ephedra under Siege from New Quarters,” *San Francisco Chronicle*, March 11, 2003, p. A12.

¹³ “It’s Time for Rules in Wonderland,” *BusinessWeek*, March 20, 2000, pp. 83–96.

¹⁴ More information about privacy protection for consumers is available at www.cdt.org (Center for Democracy and Technology) and www.epic.org/privacy (Electronic Privacy Information Center).

¹⁵ Available at www.privacyalliance.org.

¹⁶ The Customer Respect Group, “2005 Privacy Research Report,” summary available at www.customerrespect.com.

¹⁷ “Identity Theft: Europeans Mostly Better Protected,” *Atlanta Journal-Constitution*, March 26, 2006, p. A12.

Chapter 16 Consumer Protection

Part Seven Building Relationships with Stakeholders

In the 2000s, the amount of “spam” cluttering electronic mailboxes escalated at an alarming pace. Spam has been defined as unsolicited bulk e-mail messages, where the sender has no relationship to the recipient. By 2006, 71 percent of all e-mail was unsolicited; this figure was projected to grow to 79 percent by 2010, according to the market research firm Radicati Group. Much of it was offensive—ranging from sex ads to fraudulent business offers—and the e-mail was often disguised with a subject line like “order confirmation” so that people would open the message before realizing it was unwanted. “We are at a tipping point requiring some action to avert deep erosion of public confidence,” an officer of the FTC told Congress. Many disagreed, however, on what action would be most appropriate. Some thought the use of software filters, by both individuals and Internet service providers, was the answer. But others thought only new legislation would put a stop to determined spammers. Thirty states passed laws requiring, for example, that unsolicited messages include “ADV” (for “advertisement”) in the subject line, so they could more easily be picked up by filters, and in 2003 Congress debated national antispam legislation. But some were opposed, including legitimate businesses such as Amazon.com that believed such a law would restrict its right to advertise. And efforts to curb commercial free speech could violate the First Amendment, some thought. “Once the

government starts deciding which speech is valid and which isn't, then you are in a dangerous area," said one legal expert.

Sources: "No Easy Solution to the Spam Problem," Federal Trade Commission press release, July 9, 2003, available at www.ftc.gov; "Tough Anti-Spam Legislation Proposed," *San Francisco Chronicle*, June 21, 2003, p. A4; and "Needed Now: Laws to Can Spam," *BusinessWeek*, October 7, 2002, p. 100. Data on the prevalence of spam are from the Radicati Group and are available at www.radicati.com.

¹⁸ "How a Jury Decided that a Coffee Spill Is Worth \$2.9 Million," *The Wall Street Journal*, September 1, 1994, pp. A1, A5; and "McDonald's Settles Lawsuit over Burn from Coffee," *The Wall Street Journal*, December 2, 1994, p. A14.

¹⁹ U.S. Department of Justice, Office of Justice Programs, Bureau of Justice Statistics, "Federal Tort Trials and Verdicts, 2002–03," August 2005, www.ojp.gov/bjs.

²⁰ "A Tale of Two Tort Systems," *BusinessWeek*, March 14, 2005, p. 76.

²¹ "A Tale of Two Tort Systems," *BusinessWeek*, March 14, 2005, p. 76.

²² "Can Japanese Consumers Stand Up and Fight?" *BusinessWeek*, September 11, 2000, p. 54.

Chapter 16 Consumer Protection

Part Seven Building Relationships with Stakeholders

Two hundred million guns are in circulation in the United States, and a third of all households own at least one. In 2000, almost 30,000 Americans died, and many more were injured, from gun violence.

In the late 1990s, a number of cities and counties brought suit against the firearms industry, demanding compensation for the medical and law enforcement costs of gun violence. The governments argued that gun manufacturers were liable because they had failed to apply common-sense consumer product safety standards to firearms. So-called Saturday night specials—cheap, easily hidden handguns—for example, lacked locks or other protective devices and sometimes misfired, causing unintentional injury. Some guns, such as automatic assault rifles, seemed to have been customized for killing. Moreover, gun makers knowingly made large shipments to regions that had lax gun laws, looking the other way while weapons fell into the hands of criminals.

Most manufacturers, however, disputed these arguments. They pointed out that guns are legal; in fact, they are the only consumer products that the U.S. Constitution (in the Second Amendment) guarantees the right to own. No one, least of all gun manufacturers, has ever claimed that guns do not kill. Guns have a legitimate, even beneficial, purpose in hunting, self-defense, and law enforcement.

The right to own guns is a basic right of Americans, and the government has a duty to protect that right.

²³ "Birth Control: Scared to a Standstill," *BusinessWeek*, June 16, 1997, pp. 142–44.

²⁴ John Gibeaut, "At the Crossroads," *American Bar Association Journal*, March 1998.

²⁵ J. D. Powers and Associates, "Lexus and Toyota Together Capture 11 of 19 Initial Quality Model Awards," press release, June 7, 2006; and "GM's Quality Quandary," *Detroit Free Press*, April 10, 2006, accessed online.

²⁶ "Business Ethics 100 Best Corporate Citizens 2006," www.business-ethics.com.

Chapter 16 Consumer Protection

Part Seven Building Relationships with Stakeholders

What should a company do when a legitimate product it makes is used for an illegal or unethical purpose? This problem confronted the drug company Pfizer, Inc., maker of Sudafed. This over-the-counter decongestant, commonly used to treat colds and allergies, includes pseudoephedrine, a key ingredient in the illegal drug methamphetamine. Commonly known as "meth" or "crystal," methamphetamine is a highly addictive synthetic stimulant that eventually destroys the user's capacity to experience pleasure and causes permanent brain damage, heart attacks, and psychosis. Traffickers manufacture the drug in labs where they cook pseudoephedrine with other ingredients, including ammonia and lye. In 2006, meth was the most abused drug in the world, according to the United Nations, with 26 million addicts. In the United States, 58 percent of law enforcement officials said meth was their most serious drug problem.

What, if anything, could or should Pfizer do to keep pseudoephedrine out of the hands of drug traffickers? In the mid-1990s, the company began experimenting with versions of the chemical that could not be converted into methamphetamine. Pfizer gave up, however, when it discovered that whatever they came up with criminals could find a way around. "The tough lesson we learned," said a company spokesperson, "is, as fast as we could do things, ... the meth cooks could move a

lot more quickly.” Instead, in 2004 the company introduced a version of its medicine, Sudafed PE, which did not include pseudoephedrine. Some critics, however, faulted Pfizer for continuing to sell the old version and for opposing some efforts to restrict the sale of pseudoephedrine-based products.

²⁷ “Airlines Promise Measures to Boost Customer Service,” *The Wall Street Journal*, June 18, 1999; and “Airlines, Being Pressed, Offer Modest Reforms to Customers,” *The New York Times*, June 18, 1999.

²⁸ “What’s This? Confused or Curious, Consumers Know Where to Call,” *Newsday*, October 18, 1995, p. B37.

²⁹ “Child’s Death Prompts Recall,” *The Washington Post*, March 24, 2006, p. D1; and “Rules on Lead Toys Lacking Muscle,” *Star Tribune* (Minneapolis), March 26, 2006, p. A1. Information on this and other recalls is available online at www.cpsc.gov.

³⁰ David Zivan, “The Playskool Travel-Lite Crib (A), (B), and (C),” Center for Decision Research, University of Chicago, November 5, 2002.

³¹ For information on initiatives to protect children from dangerous products, see www.kidsindanger.org.

Key Terms

alternative dispute resolution, 356

consumer hot lines, 358

consumer movement, 344

consumer privacy, 351

consumer protection □ laws, 346

deceptive advertising, 346

product liability, 353

product recalls, 359

quality management, 356

strict liability, 353

www.consumersinternational.org

www.cpsc.gov

www.ftc.gov

www.bbb.org

www.consumerfed.org

Consumers International

U.S. Consumer Product Safety Commission

U.S. Federal Trade Commission

Better Business Bureau

Consumer Federation of America

Internet Resources

³² A summary is available online at www.surgeongeneral.gov/topics/obesity/calltoaction.

³³ Body mass index is calculated as a person’s weight in pounds divided by the square of that person’s height in inches, multiplied by 703. For example, a person who was 66 inches tall and weighed 140 pounds would have a BMI of 22.59 (140 divided by 66 times 66 times 703). “Overweight” is defined as a BMI of 25–29.9 and “obese” as a BMI of 30 or higher. A chart showing BMIs for various weights and heights is available online at www.surgeongeneral.gov/topics/obesity/calltoaction/1_1.htm.

Discussion Questions