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Electric Utility Reform Fosters Consumer Choice

Congress and many state legislatures are reviewing proposals or have enacted legislation to deregulate the electric utility industry. Deregulation should enhance consumers' ability to choose their service providers, improve customer service, and open the market for competitive pricing. Utility companies, though not vehemently opposed to deregulation, want to maintain nationwide continuity in industry regulation and are lobbying Congress for federal legislation that would preempt state-enacted deregulation. Utility companies currently operate as site-specific monopolies, where a single utility produces and provides the electricity directly to the consumer for a geographic region. These regional utility companies would compete with independent service provider companies that would purchase electricity at wholesale prices and distribute electric power to consumers at competitive prices.

Many deregulation laws require that utility companies allow an independent system operator to handle scheduling of electric line usage so that smaller service providers are not excluded from the transmission system. The providers would then compete with the electricity producer to supply electricity to residential and commercial customers. This competitive process, known as "retail wheeling," allows customers to choose their suppliers, instead of having to buy from a sole regional producer/provider, creating an appealing marketplace.

Consumer Advocates Wary of Deregulation

Although open competition usually favors the consumer, some consumer advocacy

groups, such as the Consumer Research Foundation ("CRF") of Mill Valley, California, contend that electricity deregulation may not benefit low-income consumers. A recent CRF study found that competitive markets tend to put poorer customers at a disadvantage from a quality control perspective. Based on this study, CRF has suggested several ways policymakers could safeguard universal electricity service after the industry has been deregulated, including mandating that: (1) all consumers have access to affordable electric service; (2) electric utilities connect each consumer to the electric service providers of the consumer's choice; (3) electricity producers and providers have consistent rules regarding customer deposits and denial of service; (4) electricity producers and providers follow a standard set of rules to protect consumers against arbitrary or life threatening shut-off of electric service; (5) consumers have access to bill-related assistance; (6) consumers have sufficient information to decide from which providers to buy service; and (7) regulatory agencies have sufficient resources to educate consumers, handle complaints, and protect against abusive practices.

Residential consumers are not the only group concerned about the effects of deregulation. Small business trade groups worry that deregulation will favor large corporate customers to the detriment of smaller businesses. The Small Business Survival Committee ("SBSC") is concerned that the utilities may shift the costs associated with deregulation onto small business consumers. In particular, SBSC is concerned that utilities will give price breaks to its large corporate clients because of the companies' size and electric consumption advantage.

Advocates, like SBSC, are concerned that these breaks will be given at the expense of smaller clients. Currently, corporate price structuring does not adversely affect residential and small business consumers because the prices are regulated by the government. SBSC argues that the government, rather than the utilities, should restructure the utility industry to prevent the utilities from arbitrarily shifting their restructuring costs onto residential and small business consumers. SBSC further contends that legislators should ensure that the transition to a competitive electricity market does not unfairly burden small consumers.

Some States Recently Have Enacted Deregulation Legislation

Pennsylvania has lead the way to reforming the electricity market and enabling competition. *See* 66 PA. CONS. STAT. §§ 101-25 (1997). Pennsylvania's consumers are able to choose their electricity provider, and competition has reduced their average electricity cost by 10%.

Like Pennsylvania, Illinois has enacted a deregulation plan that mandates significant rate cuts and gives residential consumers the right to chose their electricity provider by May 1, 2002. *See* 220 ILL. COMP. STAT. 5/16-35 (West 1997). The Illinois legislation permits electric utilities to recoup a substantial portion of their "stranded cost" — mostly capital investments in nuclear power plants — that, otherwise, would be unrecoverable in a deregulated market. Utility producers will recover "stranded costs" by selling corporate assets and retaining the income to offset capital expenditures spent on the nuclear power plants. In a regulated market, the utility producers would have to distribute income from asset sales, or securitization, to all of its customers. The new law also allows electric companies to charge

consumers a fee to recover transition costs that the companies incur when consumers switch to a competitor's service. This charge will be assessed to current customers who choose to buy their electricity from alternate suppliers through the end of 2006. Though Illinois's major electric utilities are satisfied with the new law, they, like the entire industry, would prefer to see a national plan for deregulating electric industry.

Federal Deregulation Coming Soon

Soon, states that have not opened their electricity markets to competition may not have a say in the matter. Congress is considering a measure, House Resolution 655, that permits the Federal Energy Regulatory Commission ("FERC") to implement retail choice in states that do not do so by December 15, 2000. Additionally, the utility industry is urging Congress to enact preemptive federal legislation to bring national continuity to the restructuring process. The Electric Power Supply Association, argues that without federal legislation, suppliers are left with a "patchwork quilt" of state legislation regulating the industry. The association maintains that electricity is a commodity in interstate commerce that should be regulated by Congress, not the states.

Although House Resolution 655 does not mandate retail competition among electricity providers, it is expected to encourage competition by changing the way the government regulates the electric industry. Among other changes, the bill would: (1) clarify federal jurisdiction over transmission of electricity to consumers; (2) extend the jurisdiction of the Federal Energy Regulatory Commission over rural electric cooperatives; (3) give states the power to ban electricity producers from selling power at retail unless they also were providers

of retail power in the state; (4) confirm that states have authority to levy charges to recover costs, such as stranded costs; and (5) authorize the FERC to establish and enforce reliability standards.

Without federal legislation, the effect of deregulating the electricity industry will greatly vary among the states. States are drafting and

enacting legislation at a feverish pace to put their spin on how their market will be restructured before a preemptive federal law passes. State lawmakers are hoping that consumers realize the importance of maintaining local control and voice that concern to their representatives in Washington this election year.

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False Health Ads Ferreted from Web

Health and consumer protection agencies from the United States, Canada, and Mexico recently held the second annual North American Health Claim Surf Day. Participants surfed the Internet for false or deceptive advertising about treatments for heart disease, cancer, AIDS, diabetes, arthritis, and multiple sclerosis. They identified more than 400 Web sites and numerous Usenet news-groups that contained promotions for products or services purporting to cure, treat, or prevent these diseases.

After identifying Web sites and news groups containing questionable material, Surf Day participants saved and forwarded the information to the Federal Trade Commission's ("FTC") staff. Staff members evaluated the ads and required advertisers whose Web sites contained potentially false advertisements to substantiate their claims with reliable scientific support or change their advertisements. The FTC said it will revisit the targeted Web sites to determine if advertisers have met these requirements. "Deceptive marketers try to take advantage of the Internet to disseminate an advertisement very quickly and anonymously," stated Bernstein. However, he added, "the Internet also makes them susceptible to very quick and sure detection." Bernstein also noted that "the agency's efforts also help legitimate marketers using this medium."

One example of the vulnerability of consumers on the Web is arthritis sufferers. "With 40 million Americans coping with the daily pain and limitations arthritis can bring, marketing of unproven arthritis remedies is an ongoing concern," explained Doyt Conn, the Arthritis Foundation's Senior Vice President of Medical Affairs. "Hopeful and sometimes desperate consumers spend millions of dollars on unproven, deceptively marketed, and often useless miracle cures and the Internet should not become the newest medium for this age-old problem," explained Joan Z. Bernstein, director of the FTC's Bureau of Consumer Protection. "In addition to wasting consumers' money, some products or treatments may even cause [consumers] serious harm or endanger their lives. Even when the advertised remedy is harmless, it can still have a detrimental effect if it causes consumers to stop or slow the use of proven treatments," she added. "In the few hours we surfed the Internet we found numerous Web sites promoting a wide variety of unproven 'cures' for arthritis, and we believe we only hit the tip of the iceberg," Conn stated.

Surf Day participants included the FTC and other U.S. federal agencies, 18 state attorney general offices, numerous nonprofit health organizations, and health and consumer protection agencies. "We are pleased to participate in our second joint Surf Day sweep with the FTC

and for the first time with Mexico," Konrad von Finckenstein, director of investigation and research with the Canadian Competition Bureau stated. Von Finckenstein explained that Surf Day's primary objective was "[t]o identify potentially false or deceptive advertising claims

aimed at a particularly vulnerable segment of society and to cut down on the suffering that victims endure [from] scams on the Internet."

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SEC Cracks Down on Penny-Stock Fraud

Securities and Exchange Commission ("SEC") Chairman Arthur Levitt announced in December 1997, that his agency will form a task force to investigate and prosecute the growing problem of penny-stock fraud. "Penny stocks" are corporate securities that sell for less than five dollars. The SEC estimates that penny-stock fraud costs investors approximately \$6 billion per year. The anti-fraud task force will be comprised of members of the National Association of Securities Dealers and other securities regulatory groups, including the SEC.

Penny-stock fraud occurs when company officials conceal the poor financial data of a failed or failing corporation from prospective investors and then solicit brokers to lure investors into investing in the corporation. Penny stocks are easily manipulated because they are lightly traded and are difficult to monitor for artificial price inflation. Brokers fraudulently selling penny stocks tend to target investors that are less likely to do independent research before investing. Additionally, defrauding brokers target consumer groups that are more likely to have access to pools of cash, maturing certificates of deposit, or other liquid assets, such as senior citizens. Regulators advise investors to ignore broker pleas, threats, or claims of once-in-a-lifetime deals. Also, investors should do independent research on each potential investment before investing by re-

questing legal documentation — a prospectus or registration statements — that provides more information about companies and their securities.

Although many of the people committing penny-stock fraud are never caught, the SEC has successfully prosecuted and brought civil actions against individuals and firms whose schemes are detected. Shortly after Chairman Levitt announced the anti-fraud task force, the SEC charged 58 defendants with penny-stock manipulation. The defendants: brokers, brokerage firms, and company officers from New York and Salt Lake City, were involved in five separate schemes. The SEC alleges that the defendants manipulated penny-stock share prices and bribed brokers into selling the stock to their customers. Additionally, the SEC is suing several of the defendant brokerage firms in a civil action to recover millions of dollars lost by allegedly defrauded investors. The SEC expects more criminal and civil charges in the near future.

Brokers primarily sell penny stocks by using "cold calling" techniques. The SEC has reported that while all complaints were up only 10%, complaints about unsolicited sales calls from brokers, or "cold calls," were up by 37% in 1996. See Leslie Eaton, *Investment Fraud is Soaring Along with the Stock Market*, N.Y. TIMES, Nov. 30, 1997, at A1. State securities regulators reported that complaints about stock

market fraud were up 25% mid-way through 1997. In New York, for example, complaints about brokers were up 40% in 1996 and should be higher in 1997, according to Andrew Kandel of the New York Attorney General's Securities Bureau. *See id.* In response to consumer complaints, New York lawmakers are enacting laws to make it easier to identify and prosecute stock

swindlers, including restrictions on "cold calls," a move supported by major brokerage firms like Merrill Lynch. *See id.* Changes to securities regulation of penny stocks, like those sought by New York officials, are sure to crop up in many states as long as the stock market remains attractive to investors.

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Tort Reform Hits Supreme Snag in Illinois

In a much anticipated decision, the Illinois Supreme Court in *Best v. Taylor Machine*, 179 Ill. 2d 367 (1997), ruled that the Illinois Civil Justice Reform Amendments of 1995 were unconstitutional. The law, which overhauled the rules for liability in personal injury lawsuits, had been considered the most comprehensive tort reform law enacted by a state legislature. The high court ruled that several provisions of the law violated Illinois's constitution.

In particular, the court held unconstitutional the legislatively-imposed caps on non-economic damages — compensation for "pain and suffering" — and the law's abolition of joint liability. The court held that capping damages was a type of "special legislation" that conferred an exclusive privilege on a particular group, which is not permitted by the state constitution. These caps were vigorously objected to by the trial lawyer's bar and victim advocacy groups that contended the law was enacted to further the interests of big business and doctors, major contributors to the majority party in the Illinois General Assembly. Writing for the majority, Justice Mary Ann McMorrow wrote: "[t]he legislature is not free to enact changes in common law which are not rationally related to a legitimate government interest." *Id.*

It was the court, not the legislature, that went too far, argued Justice Benjamin Miller in his dissent. "Stripped to its essence, the majority's

mode of analysis simply constitutes an attempt to overrule, by judicial fiat, the considered judgment of the legislature," Miller wrote. *Id.*

Justice Miller's dissent gives supporters of the rejected tort reform law a boost as they prepare for an inevitable second attempt at tort reform. Proponents of tort reform blame excessive non-economic damage awards against corporations and municipalities for driving up insurance premiums, health care costs and taxes. "This ruling by the court does not mean we will sit idly by and watch conditions deteriorate to higher local taxes, reduced access to high quality health care, and an unhealthy business climate for more job creation. We will go back to the drawing board to provide meaningful tort reform," said Illinois House Republican Leader, Lee Daniels of Elmhurst. *See id.*

Tort reform in Illinois had been partially credited with the recent growth of the state's economy. Reform advocates contend that reforming the tort system reduced the number of lawsuits filed, created thousands of new jobs in the manufacturing sector with money from insurance savings, and saved taxpayers millions of dollars in court costs. Opponents of tort reform considered the ruling a major victory. "Just as there is no limit to the injuries a dangerous product can cause, [the court ruled] there can be no arbitrary limits on what makers of dangerous products owe to their victims," stated Nancy A. Cowles, Executive Director of

the Coalition for Consumer Rights. Ms. Cowles expects public debate to escalate when legislators consider alternative versions of the legislation in the Spring session.

The Illinois General Assembly will not be the only legislature debating tort reform this Spring. Congress will consider its own version of tort reform in a bill that Senator Joseph Lieberman (D.- Conn.) introduced in the Senate last year. The primary objective of that bill, the Fairness in Punitive Damages Award Act (S. 1554, 105th Cong. (1997)), would be to cap punitive damages at three times the amount of compensatory damages or \$250,000, whichever is greater. The law would apply to breach of

contract, insurance, and fraud cases, but not to products liability or other personal injury tort cases. The proposed federal legislation, if enacted, likely will encounter separation of powers challenges since it will legislatively impose caps on punitive damages which are usually determined by the court or jury. It also will face stiff opposition from the politically powerful trial lawyers and labor unions that oppose any limits on damages. As the nation and Illinois residents await new tort reform legislation, proponents on both sides will be out in force this Spring to garner public support.

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WorldCom-MCI Merger Under Attack By Consumer Advocates

WorldCom's \$30 billion bid to merge with MCI Communications, Inc. would be the largest merger in U.S. history and would create the second largest telecommunications company in the country, behind AT&T. The proposed mega-merger has drawn the attention of consumer advocacy groups. Some fear that a WorldCom-MCI merger would harm residential consumers and small businesses. This type of mega-merger in the telecommunications industry follows Congress's recent deregulation of the industry to encourage competition. In 1996, Congress passed the sweeping Telecommunications Act to deregulate the telecommunications industry. *See* Pub. L. No. 104-104 (1996). This deregulation enabled MCI to compete for a larger share of the residential market, while WorldCom targeted corporate clients.

It was MCI's position in the residential market that made it an attractive acquisition to WorldCom and its other competitors. MCI, based in Washington, D.C., had been courted

by other competitors, including GTE and British Telecommunications ("BT"), just prior to WorldCom's record-breaking offer. A BT-MCI deal would have been a better match, according to The Utility Reform Network ("TURN"), because it would have allowed MCI to compete even more aggressively in the local and long distance markets with BT's financial support. Analysts speculate that WorldCom will use its newly acquired position in the local markets to create alliances, instead of competition, with the Baby Bells. These alliances would allow the Baby Bells to expand their operations into the long-distance markets using WorldCom-MCI hardware, such as MCI's fiber optics lines, a claim rejected by WorldCom.

WorldCom, based in Jackson, Mississippi, claims its merger with MCI will reduce corporate overhead and marketing expenses which translates into cost savings for consumers. WorldCom is considered one of the most aggressive builders of local phone networks,

directly competing for the Baby Bells' strong positions in the local markets. A WorldCom subsidiary, UUNet Technologies, also is the leader in providing Internet access to businesses. Analysts predict that WorldCom, combined with MCI's leading position over the Internet infrastructure, networks, fiber optics, and local switching hardware, could become the leader in providing Internet access to business and residential customers. WorldCom-MCI's potential dominant position concerns consumer advocates.

Officials of TURN have urged government regulators to reject the proposed merger because it threatens the current competitive environment in the telecommunications market. TURN and other consumer advocates are concerned about the possible elimination of MCI's aggressive marketing and pricing in the long distance and local markets which has led to cost savings for many residential consumers. The Department of Justice's Antitrust Division and the Federal Communications Commission ("FCC") have begun evaluating the merger, a process expected to last at least through the summer of this year, and possibly longer. If approved, the merger would be completed shortly thereafter. However, getting government approval could prove difficult given the objections lodged by consumer advocacy groups and competitors of WorldCom and MCI. Consumers Union, a national consumer advocacy group, has requested that the Department of Justice and the FCC carefully review and reject, if necessary, elements of the deal that subvert telecommunications and antitrust laws.

It is WorldCom's dominance over the

Internet market that causes the most concern for regulators and consumer advocates. WorldCom officials contend that merging with MCI will promote the concept of unified wholesale Internet service providers. WorldCom insists that wholesale providers could offer services at discounted prices to residential Internet users because of the higher volumes of use by business customers. According to WorldCom lobbyist Catherine Sloan, the Justice Department's antitrust review likely will focus on "the combined companies' sway over the Internet." However, the Justice Department could order WorldCom to divest key components of its Internet service because the merged company would dominate more than half of the Internet traffic.

The main attraction of a WorldCom-MCI merger is that it forms a company that provides local, long-distance, and Internet access under one roof. WorldCom believes consumers would benefit greatly from such a deal. Consumer advocates and competitors of the two companies are not quite convinced of the benefit to consumers and expect a lengthy review by government regulators. "For competition to work in the way that Congress envisioned, you have to have choices for residential and small-business customers. Otherwise, what you have are billions of dollars shifting hands between corporations, and customers getting higher prices," said Regina Costa, telecommunications research director of TURN. If the deal survives regulatory scrutiny, it is sure to promote further consolidation of major telecommunications corporations looking to form a one-stop shop of their own.

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