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TRADER REGULATION – STRUCTURAL ISSUES

Introduction

There has been an acceptance for many years that the structure of regulation for dealing with trading offences is not satisfactory. The primary responsibility rests with local trading standards departments, which means that monitoring and enforcement activity is diffused, not well coordinated and inadequate to deal with malpractice. Various initiatives have been undertaken to seek to improve the position including the use of the home authority principle, by which the local authority where the head office of a business is based takes overall responsibility for its compliance with trading laws, and more recently the establishment of the Local Better Regulation Office and the implementation of the Hampton Review.

This paper concentrates specifically on how compliance arrangements can be made more effective in sectors where there is no specific compliance mechanism.

The author has relevant experience in this area, having spent a year as Head of Claims Management Regulation at the Ministry of Justice and having had previous involvement in the regulation of car servicing and repairs and as chief executive of five trade associations.

Executive Summary

Services supplied to the public can be sub-divided into five broad categories in respect of regulation -

a) Those subject to strong national regulation, such as financial services and utilities.

b) Those subject to strong regulation at local level, such as licensed premises.

c) Those subject to specific national regulation but with little or no enforcement mechanism, such as estate agents and credit brokers.

d) Those largely provided by businesses operating nationally with no specific regulation, such as car servicing.

e) Those largely provided by businesses operating at local level with no specific regulation, such as window cleaning.

Malpractice by traders includes misleading advertising, misrepresentation, failure to provide adequate information on charges, failure to provide the service paid for and oppressive contracts.

Except where there is strong specific regulation, the regulatory structure at present does not easily cope with malpractice because it is diffused between local authorities.

There is a need for a model which can work across different sectors of the economy, drawing on the existing expertise of trading standards departments.

A suitable model would be a central unit to develop a programme for dealing with malpractice in specific sectors and to implement that programme directly or through one or more trading standards departments under contract. Funding options include use of regulatory fees where possible, voluntary contributions from relevant businesses and central government funding.

A variation on these arrangements is the "register and enforcement" model whereby businesses are required to pay a registration fee, the proceeds of which are used entirely for enforcement of existing legislation and regulations.

Categorisation of Traders dealing with Consumers

Consumers experience most problems in respect of services rather than goods. Generally, people get what they see in respect of goods, and most goods are manufactured by large businesses against which enforcement action can generally be effectively taken. Services are not tangible, difficult to evaluate and often the consumer does not know when he has suffered detriment. For example, a person selling a house through an estate agent may be very satisfied with the performance of the estate agent not realising that the agent has sold the house for 10% less than it is worth to an accomplice. Similarly, somebody may be satisfied with a car repair or car servicing when in fact what has been charged for has not been done.

Businesses that provide services to the public come under five very broad categories in respect of structure of regulation -

a) Services subject to a strong national regulatory regime where there is no involvement of local enforcement agencies. These include financial banking, insurance, the utilities, telecommunications, broadcasting, health services and legal services,

b) Services subject to a strong local regulatory regime, such as licensed premises, sex shops and taxis.

c) Services that are largely, but not wholly, provided by nationally operating businesses which are subject to specific regulation but where there is either a limited or no enforcement mechanism. The best example is estate agency, which is subject to a negative licensing system by the Office of Fair Trading and specific legislation but there is virtually no provision for enforcement. Other sectors are consumer credit, travel agents and bailiffs.

d) Services that are provided predominantly, but not entirely, on a national basis where there is no specific legislation or regulation. Such services include car servicing, dry cleaning and funerals.

e) Services that operate predominantly at a local level where there is no specific regulation. These include restaurants, some retailing, window cleaning and most forms of building and other property related work.

There is a significant overlap between these five groups, in particular, the fourth and fifth groups. For example, much car servicing is done by nationally franchised car dealers but much is also done by local businesses operating from one unit only. Similarly, estate agency comprises both chains and franchises operating nationally

and businesses operating from a single local office. However, the broad categorisation is helpful for the purposes of this paper.

Issues

Malpractice by traders falls into a number of broad categories –

a) Misleading advertising in the media and on websites.

b) Failure to give adequate information on charges.

c) Failure to provide adequate information about the business, particularly on websites and business cards (eg physical address and the name of the business).

d) Failure to deliver the services paid for.

e) Oppressive contracts.

The existing regulatory structure is not easily able to handle much malpractice by traders. Clearly, there is no structural problem in the sectors subject to specific regulation, such as financial services, utilities and licensed premises, although in some such sectors there are concerns about the effectiveness of regulation. There are bigger issues in each of the other sectors, including those ostensibly subject to specific regulation, such as estate agency, and those where there is no specific regulation at all such as building work.

Local authorities are responsible for enforcement of the law in respect of trading generally and also some specific areas. Each local authority has its own priorities in respect of trader malpractice and also its own resource position. With a few exceptions, activity by trading standards departments is complaint driven rather than proactive, because there are not the resources for a proactive programme of compliance such as mystery shopping and audits. Nor is there legal provision for such things as audits of businesses unless these are requested by the businesses.

The current arrangements mean that there is little consistency between local authorities. For example, some authorities have developed effective enforcement and compliance mechanisms for building work and car servicing, whereas others choose to give little priority to these areas. Also, there is limited scope to exploit economies of scale and, as a result, substantial reinventing of the wheel. While trading standards officers do network and share best practice, this is not as effective as exploiting economies of scale through a single operation.

The home authority principle works within its limitations. It is concerned with individual businesses rather than sectors. For example malpractice by car dealers is handled by the local authority in which the car dealer is based, which means that different authorities will deal with different car dealers rather than an overall approach to the sector being taken.

There is therefore a position in which enforcement of existing legislation is inadequate and patchy. At the same time government cannot resist the pressure to regulate more and more, putting greater burdens on local authorities to achieve compliance. Home information packs are a recent example of a new regulatory burden on local authorities.

Principles for Reform

New arrangements should be built on the basis on four principles -

a) A model capable of working in different sectors of the economy.

b) Drawing on the skills and expertise that currently exist within trading standards departments.

c) Specific programmes aimed at specific sectors, designed to achieve compliance with existing legal requirements.

d) No new regulations or legislation.

Which sectors

The criteria for the sectors that would most likely benefit from this approach can largely be borrowed from the criteria used by the OFT to invite applications for its approved codes scheme -

a) known problem areas for consumers
b) complex products
c) high-risk transactions
d) low consumer awareness of products and rights
e) likelihood of a successful code [successful compliance operation for this approach]
f) absence of a sector specific statutory regulator
g) absence of an alternative self regulatory regime.

In 2001 the OFT identified the following sectors as its initial targets -

a) used cars
b) car repair and servicing
c) credit, including debt management and credit repair
d) funerals
e) travel
f) estate agents
g) direct marketing.

Subsequently, the following have been added to the list -

a) assistive products
b) caravans
c) car repair and servicing
d) computers
e) dental (excluding clinical care and insurance)
f) domestic appliance repair
g) home furnishing
h) introduction services
i) pest control
j) photography
k) removers
l) renewable energy
m) ticket agents
n) will writing.

Approved codes are currently in place only for the motor trade, estate agents, removers, carpets and direct marketing, although this does not mean that malpractice has been successfully dealt with. There are no approved codes in respect of credit, travel or funerals, three sectors in the original list.

The OFT website also gives details of a variety of scams -

a) letters predicting the future
b) pyramid selling and free gift schemes
c) lotteries, sweepstakes and competitions
d) foreign money offers and advance fee scams
e) work-from-home opportunities
f) online dating – a dream partner from overseas
g) golden investment opportunities
h) miracle health cures
i) phishing.

These lists give a good starting point for sectors where the approach outlined in this paper might usefully be tried.

A Model for the Future

Based on these principles it is possible to construct a model which would lead to more effective enforcement of existing legislation and regulation. At the centre of this model would to be a small unit operating within one or both of the Office of Fair Trading and the Local Better Regulation Office. This unit would develop a programme of projects to deal with malpractice for specific sectors, based on enforcing existing legislation and regulation and, where they exist, industry codes of practice. The sectors would be selected by a combination of the unit itself, the OFT and LBRO.

The central unit might run parts of this programme directly but more commonly it would outsource projects, wholly or partially, to one or more trading standards departments selected after a competitive tendering process. The projects would be time limited – generally for between six months and five years, depending on circumstances. Six months might be sufficient for will writing; estate agency might need five years. The central unit would need the capacity to maintain a more limited compliance programme for the sector after the end of the contract period.

Funding of projects would need to be determined on a sector by sector basis. There are four possible sources of funding -

a) Where there is provision for this, then charges to the businesses being regulated. It may be that in some sectors subject to national regulation but no enforcement, such as estate agency, the legislative provisions allow a fee to be levied.

b) Voluntary contributions from the industry. These would be most appropriate either where the industry has been calling for statutory regulation thereby implying a willingness to pay for regulation (such as estate agency) or where there are a relatively small numbers of large players (such as car servicing and arguable estate agency as well).

c) A specific charge to businesses that sign up to compliance with a regulatory regime and submit themselves to a compliance programme. This would be most appropriate where there was an industry code of

practice and a strong trade association. The businesses that "signed up" to the compliance regime could advertise this and hopefully gain a marketing advantage.

d) Government funding, where no other funding was available.

A Variation on the Model Requiring a Legal Change

The model that has been described would work more effectively if there was provision to allow the government to designate sectors in which those wishing to operate were required to register with a specified body and to pay a modest annual fee (typically no more than a few hundred pounds), the proceeds of which would be used entirely to fund compliance and enforcement work. There would be no new regulation. Such an arrangement would have two major advantages. Firstly, one problem for enforcement agencies is actually knowing what businesses exist, where they are, how to contact them and who is running them. Registration would deal with this. The second benefit is that the registration fees would provide the funding for enforcement activity.

The model in practice

The model as described is based on the regulation of claims management businesses under the Compensation Act 2006. In this case there was specific regulation and also the provision to charge fees. However, the regulatory regime is largely based on enforcing existing legislation and regulation, the bulk of the work has been outsourced to a local authority trading standards department and the whole operation is run very economically on a breakeven basis, regulatory fees and costs being around £1.5 million a year. The model is described in more detail in Appendix 1.

Appendix 2 sets out how the model could work in a number of other sectors.

Appendix 1

Claims Management Regulation

The Compensation Act 2006, providing for the regulation of claims management activities became law in July 2006. When the decision to legislate was made no decision had been made as to who the regulator would be. The Act accordingly allowed for every type of regulatory structure. The Secretary of State (for Justice) was empowered to —

a) Establish a new regulator.

b) Designate an existing body to take on the role of regulator.

c) Undertake the role of regulator.

A tight timescale was set which ruled out the first option. No other regulator was willing to take on the task. Accordingly, the third option was adopted by default. The model adopted had the following structure –

a) The Secretary of State is formally the Regulator.

b) The Secretary of State appoints an individual as "Claims Management Regulator". That individual has responsibility for the implementation of the regulatory regime. However, he is not the designated "regulator" but rather exercises the powers on behalf of the Secretary of State. The individual must be a Ministry of Justice official. A suitably qualified outsider was appointed as a temporary civil servant to hold the position initially.

c) A Regulatory Consultative Group. This has no legal status or powers. It comprises nominees of relevant stakeholders. Its function is to oversee the operation of the regulatory regime and to provide advice and guidance to the Regulator.

d) The administration of the regulatory regime and compliance and enforcement activity is outsourced on a contract, initially for three years, to a Monitoring and Compliance Unit (MCU). This is responsible for handling and vetting applications for authorisation, maintaining a public register of authorised businesses, monitoring authorised businesses including running or managing an inspection process, enforcing the authorisation conditions, policing the perimeter and taking enforcement action. It has no responsibility that has formally been delegated to the Regulator. Rather, it advises the Regulator when he has to take any decision, for example on the granting of authorisation, the removal of authorisation or prosecutions. The nature of the work fitted in well with the work done by trading standards departments. After an open tender process Staffordshire County Council was selected to provide the service.

The Act provided for fees to be charged to businesses seeking authorisation. The fee scale was borrowed from the Financial Services Authority fees for insurance brokers. In the event in the first full year regulatory fees of £1.5 million were almost exactly equal to the costs of regulation.

The Rules of Conduct that businesses must comply with are very brief. Mostly they require compliance with existing laws and regulations. There are just a few specific requirements (such as a prohibition on cold calling in person and a requirement to have a 14 day cooling off period).

The structure proved to be effective -

a) The Act became law in July 2006, Staffordshire County Council was awarded the contract to provide the MCU in September 2006, applications for authorisation were invited from November 2006, and the offence of operating without authorisation was activated in April 2007. The nine month period between royal assent and full implementation is probably without precedent; two to three years is more normal.

b) The arrangement can be extended (the contract has already been extended by a year), upsized or downsized relatively easily.

c) The arrangement is low cost - an entire regulatory structure for an annual cost of £1.5 million. (In passing the arrangement suggests that the Hampton view that small regulators are inefficient is at least questionable.)

d) Malpractice has been successfully deal with. The strategy for dealing with malpractice was devised by the Regulator and permanent Ministry of Justice officials; the MCU was responsible for implementation. The strategy relied heavily on a thorough authorisation process and a highly targeted enforcement programme.

A full description of the model and the impact of regulation can be found in the resource centre at www.boleat.com.

Appendix 2

Examples of how the model could be used in specific sectors

Estate agency

Estate agency is an area where there is substantial malpractice. Estate agents are subject to the law of the land which is particularly relevant in matters such as misleading advertising and misrepresentation. There are also specific legal requirements in estate agency legislation, including most recently in the Consumers, Estate Agents and Redress Act 2006. Under the 2006 Act estate agents must belong to an ombudsman scheme. However, there is no enforcement mechanism for all of this regulation. Rather, with a very small staff, the OFT and the ombudsman act on the basis of complaints. As this is an area where consumers do not know that they have been ripped off, this mechanism is inadequate to deal with malpractice.

Under the proposed model the central unit would analyse the huge amount of existing data on malpractice and develop a program designed to deal with it. In this particular case the programme would concentrate heavily on mystery shopping to test such matters as where estate agents fail to pass on offers or seek to give more favourable treatment to purchasers buying other services from them. Based on the results of mystery shopping, strong enforcement action would be taken which would send a clear message to other estate agents. The intention would be to force all businesses to ensure that they complied with legal requirements otherwise they would face regulatory action. In this particular case, funding for such an operation, which might perhaps run to £3 million to £4 million a year for three or four years, could be sought from the estate agency industry as for years it has been arguing for stronger regulation.

Car servicing and repairs

The total market for car servicing and repairs is huge. In round terms, the UK car servicing and repair market is worth around £10 billion a year. The market lends itself to malpractice. The product is purchased because it has to be rather than because of any intrinsic value. There is a huge imbalance of knowledge between the businesses providing the service and the customer. The customer often does not know what needs to be done to the car, what has been done to it after service or repair and is generally in no position to assess value for money.

Specifically, the market has the following characteristics, all of which are well supported by evidence –

a) Work that should be done is not done.
b) Work is done that is not necessary.
c) Work is charged for that has not been done.
d) Work is done very poorly.

There is ample evidence to demonstrate the extent of malpractice. The most comprehensive analysis was commissioned by the Department of Trade and Industry in 2002. This included as extensive mystery shopping exercising involving vehicles into which seven faults were introduced. The main conclusions on garage servicing were –

a) Only 5% of garages surveyed were rated very good indicating that they had carried out a thorough service, according to the manufacturer's service

schedule, rectified all the introduced faults and other defects found prior to service.

b) 51% were rated either poor or very poor.
c) 17% of garages carried out unnecessary work.
d) 40% of garages missed or did not replace at least one item on the service schedule. For female car owners, the figure was 58%.
e) 86% of garage missed at least one of the introduced faults and 17% missed all four introduced faults.
f) Dealers charged women, on average, £50 (26%) more than men.

The findings for fast fit centres were similar.

On the basis of this data, it seems reasonable to argue that the extent of consumer detriment must be at least 20% of total consumer expenditure, that is around £2 billion a year.

The government has put this issue into the "too difficult" category and has made empty threats to the motor trade which has treated them accordingly. Various attempts have been made to implement a code of practice, as yet none with significant success.

The approach here should be very similar to that for estate agency. Mystery shopping and prosecution of offenders is essential to force businesses to stop malpractice. The large motor dealers could be requested to make a contribution to the costs of running the regulatory system, or a system could be developed in which garages paid a fee for voluntarily registering and being subject to regular audits, in exchange for which they would receive some recognition.

Bailiffs

For over five years the government has been considering various options for regulating civil enforcement agencies (largely synonymous with bailiffs). It has recently reaffirmed its preferred option for the Security Industry Authority (SIA) to be the regulator. However, it is doing this with no enthusiasm. A 2001 green paper outlined options for the future structure for the regulation of enforcement services. Responses indicated a consensus in favour of regulation. The government subsequently identified the SIA as the appropriate body for regulating the sector and a proposal to this effect was published in March 2003. Following a further consultation, in March 2008 the government has reaffirmed that the SIA should be the regulator, but has not taken the matter further forward.

If the government firmly believed that the SIA was the appropriate body to regulate civil enforcement agencies then this would have been completed by now, bearing in mind that the proposal was made as long ago as 2003. The March 2008 Ministry of Justice paper *Regulation of Enforcement Agents* produces no argument as to why the SIA should be the regulator. The exact wording in the Ministry of Justice paper is-

> "We recommend regulation by the SIA. The SIA has a stakeholder engagement strategy and engages with each stakeholder using methods appropriate to that specific group or individual. The benefit of the SIA option would be that they would establish networks that will enable these diverse interests and individuals to contribute to SIA policy-making in a constructive manner."

It seems fairly clear that the government want to regulate, has no confidence that the SIA would be right regulator but sees no other option.
The model in this case would need to use inspections of businesses and investigation of complaints. It would not be easy to obtain funding from the industry so this project would need to be government funded.