

Report by the
Comptroller and Auditor General

**The Office of Fair
Trading:
Protecting the
Consumer from
Unfair Trading
Practices**

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Executive summary

This Report examines how well the Office of Fair Trading (OFT) protect consumers from unfair trading practices

1 There are 25 million households in the United Kingdom and domestic consumer spending runs at over £400 billion a year. Competition provides powerful incentives for businesses to offer the consumer a good service at a keen price. But even in the most competitive markets the consumer can suffer harm, through lacking the information needed to make informed decisions, lacking the ability to assimilate such information, or through falling victim to negligent or dishonest traders or unfair selling practices.

The OFT aim to enforce competition policy and protect the consumer from unfair trading practices.

2 The Office of Fair Trading (OFT) are a regulatory body responsible for:

- enforcing United Kingdom competition policy;
- enforcing certain aspects of consumer legislation, such as licensing traders who wish to offer credit, combating unfair terms in consumer contracts and acting against traders who persistently infringe consumers' statutory rights.

They work in concert with local authority trading standards services and other bodies.

3 The OFT work closely with 200 local authority trading standards services, other regulators, other government departments and consumer organisations. The OFT employ around 180 staff on consumer protection work and overall costs are £7 million a year. Of this, £5 million is spent on consumer credit licensing, which is recovered from businesses through licence fees. The 200 trading standards services employ some 4,400 staff and running costs are £140 million (Figure 1 overleaf).

We examined how successful the OFT are at protecting the consumer.

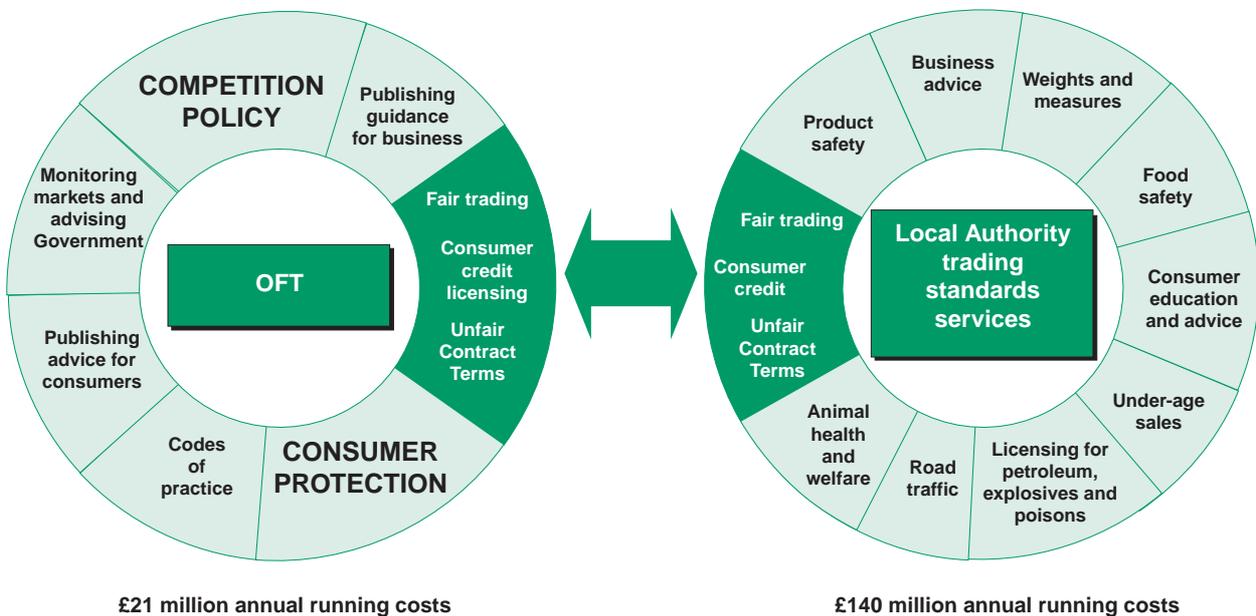
4 In this Report we examine how successful the OFT are at protecting the consumer, drawing out recommendations designed to assist them in further developing their effectiveness. We looked at the OFT's work in publishing advice for consumers and business, and their work on consumer credit licensing, on unfair contract terms, and under Part III of the Fair Trading Act 1973. We also looked at how the OFT and trading standards services have worked together, and with what results. Our recommendations are informed by surveys we have commissioned of consumers and their representative bodies, used car dealers,

and trading standards services. We have worked closely with the Audit Commission on this study and they are publishing a separate report focusing on the complementary role of trading standards services¹.

Figure 1

The work of the OFT and local authority trading standards services

This Figure shows that the OFT and local authorities need to work together to combat unfair trading practices and regulate consumer credit. The OFT also work closely with other regulators, other government departments and consumer organisations.



Note: The OFT's annual running costs are for their activities in the United Kingdom. The costs of the trading standards services are for Great Britain.

Improving regulation and enforcement is an important element of the Modernising Government agenda.

5 Our examination was conducted against the background of:

- the White Paper, *Modernising government*, published in March 1999 (Cm 4310), which emphasised that “regulations should be necessary, fair, effective, balanced and enjoy a broad degree of public support. The primary function of central and local government enforcement work is to protect the public, the environment and groups such as workers. But at the same time, we need to ensure that enforcement functions are carried out in an equitable, practical and consistent manner in order to promote a thriving national and local economy.”

¹ *Measure for Measure: The Best Value Agenda for Trading Standards Services* (Audit Commission, December 1999).

- the annual report of the Better Regulation Task Force, published in September 1999, which stressed that: “As far as possible, enforcers should help people to comply, as opposed to penalising them for non-compliance. Businesses perceive that, too often, those who want to comply are subjected to excessive scrutiny, whilst those who ignore their obligations avoid inspection altogether.”

We carried out our work and sought to frame our recommendations within this spirit.

The OFT aim to help consumers to look after their own interests and to encourage traders to act responsibly

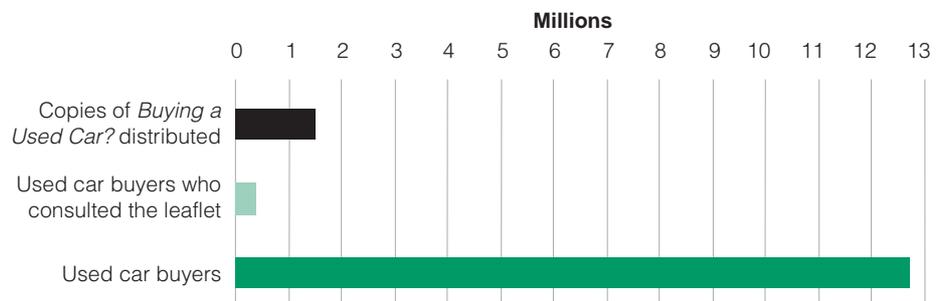
The OFT publish high quality information for consumers.

6 The OFT publish high quality leaflets for consumers. Some 95 per cent of respondents to our survey found the OFT’s *Buying A Used Car?* leaflet relevant and 97 per cent said that it was easy to understand. But the OFT recognise that getting information to people who want it and will use it when they need it poses an enormous challenge. Their *Buying A Used Car?* leaflet reached 380,000 people who bought a used car, equivalent to 25 per cent of the leaflets distributed, but only 3 per cent of the estimated 12.7 million people who bought a used car over the 18 months since the leaflet was published (Figure 2) (paragraphs 2.5 to 2.13).

A quarter of the OFT’s *Buying A Used Car?* leaflets reached people who had bought a used car in the 18 months to March 1999

Figure 2

This Figure shows that of 1.5 million copies of the leaflet distributed in the 18 months to March 1999, 0.38 million reached used car buyers. The figure also shows that this was a small proportion of the nearly 13 million people who bought a used car during the period.



Source: OFT and NAO/MORI survey

The OFT aim to encourage and help traders to behave responsibly through improving trade associations' codes of practice.

7 The OFT have a duty under the Fair Trading Act 1973 to encourage trade associations to adopt codes of practice and have given formal support to over 30 codes. The OFT believe, however, that these voluntary codes could be improved and extended to set higher standards and improve compliance and redress arrangements. The Government have announced that they intend to give the OFT new powers to approve and monitor codes of practice which give consumers more effective protection based on core principles set out by the Government (paragraphs 2.14 to 2.16).

Many businesses require a consumer credit licence, the loss of which would usually put the trader out of business.

8 The OFT are the sole body entitled to issue traders with a consumer credit licence. Anyone who runs a consumer credit or hire business as defined in the Consumer Credit Act 1974 must hold a consumer credit licence. Many retailers, most motor traders, and all high street banks, mortgage brokers, debt collectors if they collect consumer credit debts need a licence, and there are currently some 150,000 active licences. The licensing system is intended to protect consumers and maintain their confidence in the industry, and the system continues to enjoy wide industry support. Revoking a trader's consumer credit licence is a serious sanction: for many traders, losing their consumer credit licence would put them out of business (paragraphs 3.3, 3.5 and 3.11).

The OFT have combated specific unfair practices by issuing guidelines backed by the threat of revoking traders' consumer credit licences...

9 The OFT have published tailored guidelines designed to combat specific unfair practices, backed by the threat that traders may lose their credit licence if they do not comply. In 1997, the OFT used this approach to address problems in that section of the credit market that lend to borrowers with poor credit ratings. The OFT intend to take a similar approach to combat unfair business practices in the used car market. As a first step, they published in March 1999 an illustrative list of unfair practices that might cost used car traders their consumer credit licence (paragraphs 2.17 and 2.18).

...but they need to do more to ensure that consumer credit licence holders are aware of the standards of behaviour expected of them.

10 We found, however, that some used car traders still believe, incorrectly, that they can lose their licence only if they are convicted of an offence. The OFT issue general guidance on the Consumer Credit Act to all those who request a licence application form. The guidance does not, however, set out the basic standards of behaviour expected of licence holders (paragraph 2.20).

The OFT could do more to combat unfair trading practices

The OFT need to do more to ensure that consumer credit licences are held only by those fit to do so.

11 In deciding whether a trader is fit to hold a consumer credit licence, the Director General of Fair Trading, the head of the OFT, can consider any factors appearing to him to be relevant, and in particular any evidence that the applicant or their present or past associates have (i) committed any offence involving fraud or other dishonesty, or violence; (ii) contravened any legislation regulating the provision of credit to individuals or other transactions with individuals; (iii) engaged in deceitful, oppressive, unfair or improper business practices, whether unlawful or not, or (iv) practised sexual or racial discrimination in the course of business. The OFT carry out various checks against the first three criteria but did not undertake any checks as to whether or not applicants have a history of sexual or racial discrimination in the course of business. The OFT are now introducing such checks (paragraphs 3.6 and 3.14).

12 In practice few consumer credit licences are refused or revoked. In 1998–99 the OFT refused 15 of 21,200 applications for a licence (Figure 3 overleaf) and one of 10,000 renewal applications. They revoked 18 of an estimated 150,000 active licences. Nearly 800 traders who applied for a licence withdrew their applications or allowed them to lapse after queries from the OFT. In addition, the OFT warned over 300 applicants and licensees about their conduct, and some traders were required to sign undertakings about their future conduct (paragraph 3.12).

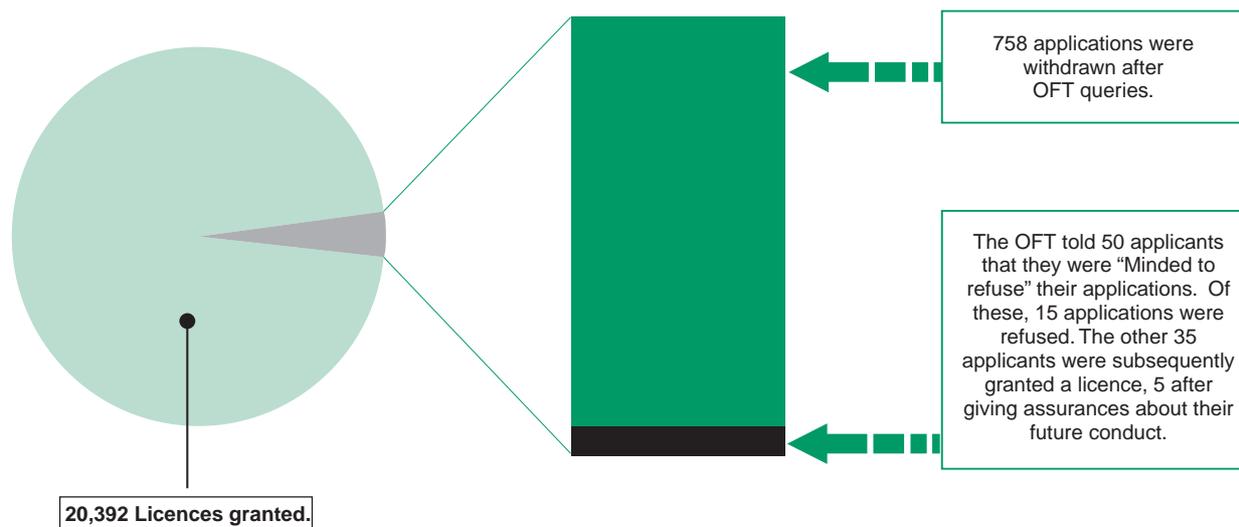
13 The OFT do not always have complete or timely information on behaviour that could cast doubt on traders' fitness to hold a licence. As a result, some traders obtain or continue to hold a consumer credit licence despite behaviour that could call their fitness to hold a licence into question. The OFT have particular problems in obtaining complete and timely information on convictions for fraud or other dishonesty, or violence, since there is no mechanism which ensures that details of all convictions will be passed to the OFT (paragraphs 3.16 to 3.19).

14 Local authority trading standards services are the most important source of evidence casting doubt on whether a trader is fit to hold a consumer credit licence, although information also comes from other sources. Most trading standards services told us that they would always refer evidence of trader unfitness to the OFT. Nevertheless, the number of cases referred to the OFT by trading standards services fell from 469 cases in 1995–96 to 325 in 1998–99. This has led to a fall in the number of licensees investigated by the OFT, the number of warnings the OFT have issued, and the number of licences revoked. These trends have occurred against a background of rising complaints by consumers and local government re-organisation (paragraphs 3.20 to 3.21).

Figure 3

The results of the OFT's action on the 21,200 new applications for a Consumer Credit Licence in 1998–99

This Figure shows that only a few new applications for a consumer credit licence were refused, but many more were withdrawn, sometimes following queries from the OFT.



Note: In 1998–99, the OFT also processed 10,000 renewals applications and 6,500 applications to vary the conditions of existing licences. During the year, they also warned 327 applicants and licence holders.

Source: OFT

15 Forty-eight trading standards services told us they do not automatically refer their suspicions about licence holders to the OFT. Forty-three of these said that this was because it takes too long to secure a satisfactory outcome. Action by the OFT to refuse or revoke a licence can indeed be a lengthy process. The OFT often need to work with trading standards services to obtain further evidence, and seek evidence from other sources including the courts. In considering traders' fitness to hold a licence, the OFT's adjudicators have to work to strict procedural standards and are subject to the supervision of the Council of Tribunals. The OFT are seeking to work more effectively with trading standards services by fostering closer working relations and making service level agreements with individual authorities (paragraphs 3.22 to 3.25).

16 The OFT would like to make better use of information technology to improve their checking of traders' fitness to hold a licence. The computer system they use to handle applications is outdated and this restricts the checks that they can carry out cost effectively. They had planned to replace their computer system, but implementing a new system was suspended in 1998, mainly on cost grounds. The OFT have also identified a number of other measures that could deliver cost-effective improvements in checking (paragraphs 3.27 to 3.33).

The OFT's action to combat unfair consumer contracts has secured savings for consumers at least fourteen times the cost of OFT's consumer protection work but greater savings are possible.

17 After consumer credit licensing, the OFT's second largest area of consumer affairs work is enforcing the Unfair Terms in Consumer Contracts Regulations. A standard contract term is unfair if it unduly favours the seller or supplier over the consumer and has the potential to harm consumers. The OFT can obtain a court injunction to stop the use of unfair contract terms. In practice the OFT work with businesses and trade associations to secure compliance with the Regulations. Persuasion has been successful: consumers benefited by over £100 million from the OFT's work in 1998 to combat unfair contracts (paragraphs 3.34 to 3.39).

18 Most businesses want to comply with their obligations and, since the Unfair Contracts Regulations came into force in 1995, the OFT have concentrated on explaining to businesses how the Regulations apply and helping them to comply. For example, they publish regular Bulletins that include examples of terms they consider unfair alongside revised versions they have negotiated with businesses. This is intended to help businesses and their legal advisers understand how the OFT view and interpret the law (paragraph 3.37).

19 Negotiations with companies to bring contracts into line with the Regulations can, however, be a lengthy process. Cases typically take around nine months to complete, although some take much longer. Of the 788 unfair contracts cases that the OFT had on hand at the end of May 1999, 96 (12 per cent) had been open for two years or more. Some of these cases, however, related to similar terms in use across whole business sectors, and the OFT had delayed action on individual complaints to deal with as many traders as possible together, often working closely with trade associations. For example, 48 of the 96 cases related to package holiday contracts, and in most cases negotiations with the company concerned had been active for less than a year. The OFT have increased the number of staff on this work to deal with a growing number of complaints about contracts and a mounting number of cases on hand (paragraphs 3.41 to 3.46).

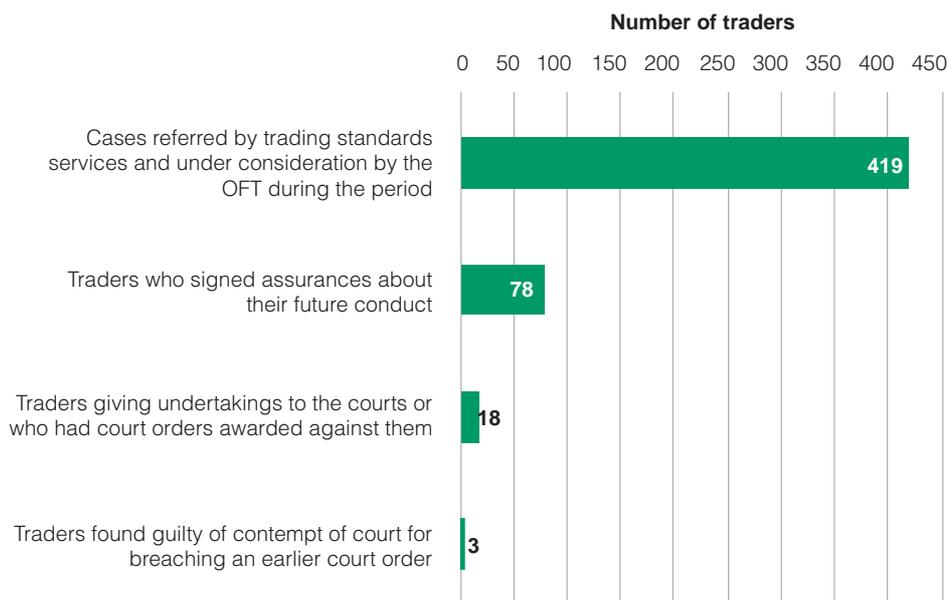
Action against traders with a history of flouting consumers' statutory rights takes too long and is ineffective.

20 Part III of the Fair Trading Act 1973 is intended to stop traders who persist in breaching consumers' statutory rights. Over the last five years the OFT have acted against 96 traders under the Act (Figure 4 overleaf). Such actions usually take well over a year. Some take much longer. Legal requirements make action under the Act a lengthy process: the OFT must be able to prove to the courts that traders have *persisted* in breaching the law; and the OFT must show to the courts that they have used their *best endeavours* to obtain signed assurances from traders that they will stop infringing consumers' statutory rights. Some traders take advantage of the latter by stalling for time, dragging out correspondence, delaying replies or even not replying at all (paragraphs 3.47 to 3.51).

The OFT's action under Part III of the Fair Trading Act 1973, during 1994 to 1998

Figure 4

This Figure shows that between 1994 and 1998 the OFT considered 419 cases under Part III of the Fair Trading Act.



Note: During 1994 to 1998 the OFT acted against 96 traders under Part III of the Fair Trading Act. Of the 18 traders giving undertakings to the court or who had a court order awarded against them, one had breached an assurance signed in 1994. Of three traders found guilty of contempt, two had court orders awarded against them since 1994, which are also included in the figure.

Source: OFT

21 Local authority trading standards services gather the necessary evidence for the OFT to act under the legislation. Forty-eight trading standards services who responded to our questionnaire told us that they did not notify the OFT about the *last* trader they identified where they believed action by the OFT under the Fair Trading Act might have been appropriate. Of these, 39 said that this was because it takes too long to secure a satisfactory outcome (paragraphs 3.53 and 3.54).

The Government plan new legislation to allow faster and more effective action to combat unfair trading practices.

22 Since 1986, the OFT have argued for reform of Part III of the Fair Trading Act 1973 (for example, see Figure 5 opposite).

The OFT have argued that the law intended to stop traders who persistently flout their legal obligations is not working well.

Figure 5

“Despite its laudable objective, the present law is inadequate and does not deal with those who continuously deceive consumers or take advantage of ignorance, inexperience or trust.”

“There is a pressing need for radical reform to make the provisions effective and meet the need for rapid action and effective enforcement.”

From *Consumer Affairs: The Way Forward – A Consumer Strategy for the Office of Fair Trading* (OFT, September 1998).

The OFT are working with other enforcement bodies to ensure a consistent approach.

23 The Government have accepted the arguments of the OFT and others that the legislation should be replaced. The Government intend to legislate to give powers to both the OFT and the trading standards service to seek injunctions from the courts to stop specific practices by specified traders, and to ban from trading for a stated period traders with a history of disregarding their legal obligations. This is intended to allow faster and more effective action against such traders (paragraphs 3.57 and 3.58).

24 From October 1999 local authorities, statutory regulators and the Consumers’ Association were given concurrent powers with the OFT to seek injunctions to prevent businesses using unfair terms in consumer contracts. In addition to their enforcement role, the OFT have taken on an advisory role and are working with the other bodies to foster a consistent approach. Furthermore, in July 1999, the Government announced a fundamental review of the OFT’s consumer affairs functions. The review, which is being led by the Director General of Fair Trading, should be completed early in 2000. The Government has also announced a review, to be led by the Department of Trade and Industry, of the consumer credit licensing system (paragraphs 1.10 to 1.12).

Recommendations

Continued development of closer working relationships with trading standards services and other regulators

- (1) The OFT should continue to develop closer working relations with trading standards services and other regulators to encourage a consistent approach and foster a greater understanding of each other’s roles and priorities**

An important theme arising from our examination is the joined-up working necessary between the OFT and trading standards services in acting against traders who engage in unfair trading practices. The OFT work closely with trading standards services and other regulators to share good practice and foster a consistent approach, for example through their Excellence in Trading Standards Awards Scheme. The OFT are looking further at how they work with trading

standards services and other regulators in the fundamental review of their consumer affairs functions. But local practice in referring information to the OFT varies. The OFT need to consider giving – through extending their guidance and service level agreements – a stronger steer to local authority trading standards services on what the OFT expect from them and what they can expect from the OFT in return. We note that the Audit Commission, in their review of trading standards services, have similarly recommended that the Government could assist local authorities by providing consolidated advice and guidance that set out their expectations of trading standards services.

Better evaluation of the impact of consumer information

(2) The OFT should continue to experiment with and evaluate different approaches to delivering information to consumers

The OFT recognise that, to be effective, information should reach those consumers who need it when they need it. The OFT produce a range of useful leaflets informing consumers of their rights and how to avoid common problems. But they need to do more to evaluate the impact of their information campaigns to concentrate on making the limited resources at their disposal go further. They should continue to use the latest marketing techniques – involving the appropriate use of the various media available – to ensure that they reach consumers at the right time.

Better information and advice for businesses

(3) The OFT need to continue to work closely with the business community to foster improved codes of behaviour and to make clear to traders what practices the OFT regard as unacceptable

The Government intend to give the OFT new powers to approve industry codes of practice. The OFT have produced guidelines for some sectors on the standards of behaviour expected of licence holders. On the evidence of the used car trade, however, there are likely to be widespread misconceptions among businesses as to the trading practices that the OFT regard as unfair to the consumer. The OFT need to increase awareness among traders of their responsibilities and the factors that might lead the OFT to act against them. In particular, they should consider giving traders who apply for a consumer credit licence a clear statement of the standards of behaviour expected of them. They should also consider providing this information to existing licence holders.

Improved checking of traders' fitness to hold a consumer credit licence

(4) The OFT should pursue opportunities provided by modern technology to gather better and more timely information to ensure that consumer credit licences are held only by those fit to do so

To become more effective the OFT need to gather better and more timely information on traders' fitness to hold a consumer credit licence. The OFT are reviewing how far the law restricts their access to information on individual traders held by other public bodies and whether the latest information technology could enable them to obtain better and speedier information on traders' fitness to hold a consumer credit licence.

*Speedier action to
combat unfair practices*

(5) The OFT need to monitor how quickly they take regulatory action and take measures to speed this up wherever possible

It is essential that the OFT handle casework expeditiously. This is necessary to command the confidence of consumers and ensure that practices that are unfair to them are quickly stopped; to deter the minority of traders who are dishonest; and to encourage trading standards services to refer evidence to the OFT. The Government plan new legislation to enable faster action to combat unfair practices. The OFT lack regular, up to date information on how long they take to act, although such information can be extracted manually. They aim to update their management information systems early in 2000 to provide this information, which would enable them to pinpoint more readily areas where regulatory action could be speeded up.