



Department for Business, Innovation & Skills

PROTECTION OF SMALL BUSINESSES WHEN PURCHASING GOODS AND SERVICES: CALL FOR EVIDENCE RESPONSE FORM

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

The closing date for this consultation is 15 June 2015.

Your details

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Please tick the box below that best describes you as a respondent to this consultation:

<input checked="" type="checkbox"/>	Business representative organisation/trade body
<input type="checkbox"/>	Central government
<input type="checkbox"/>	Charity or social enterprise
<input type="checkbox"/>	Individual
<input type="checkbox"/>	Large business (over 250 staff)
<input type="checkbox"/>	Legal representative
<input type="checkbox"/>	Local Government
<input type="checkbox"/>	Medium business (50 to 250 staff)
<input type="checkbox"/>	Micro business (up to 9 staff)
<input type="checkbox"/>	Small business (10 to 49 staff)
<input type="checkbox"/>	Trade union or staff association

	Other (please describe)
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ABOUT THE SPECIALIST ENGINEERING CONTRACTORS' (SEC) GROUP

The Specialist Engineering Contractors' (SEC) Group represents a sector in the construction industry comprising 60,000 firms employing over 300,000 people. They account for the largest single component (by value) of construction output. The SEC Group comprises the construction industry's premier trade associations: Plumbing and Heating Contractors' Alliance, British Constructional Steelwork Association, Electrical Contractors' Association, Building & Engineering Services Association, Lift and Escalator Industry Association and SELECT (Electrical Contractors Association of Scotland).

Question 1

What examples are there of problems with the current arrangements?

Comments:

For MSBs in the construction industry there is often a mismatch between their contracts with suppliers and their upstream contracts (which are contracts for the supply of work and materials). Under their construction contracts they are forced to accept greater liability for deficiencies in goods and services supplied by their suppliers.

Suppliers and manufacturers insert disclaimers or limitation of liability clauses in their supply contracts.

Some examples:

- Supplier excludes all liability if defects not reported within 30 days of purchase.
- Supplier limits liability to replacement of defective goods and will not be liable for any ensuing delays to the works or other consequences.
- Supplier will place a cap on damages.
- Supplier excludes MSBs' rights of set-off.

Whilst these disclaimers/limitations of liability may be challengeable under the Unfair Contract Terms Act 1977 the likelihood is that the MSB will not challenge them in the courts. The 600% increase in court fees from April this year has made it even more unlikely that MSBs will resort to the courts.

For MSBs this disparity in liability between supply contracts and construction contracts (or sub-contracts) is exacerbated by other provisions in their construction contracts. If a third party higher up the supply chain becomes insolvent the MSB is unlikely to receive payment from its paying party. This is because of the operation of pay when paid clauses in construction contracts (which apply when the immediate payer isn't paid because of an insolvency up the supply chain). But the MSB still has to pay its suppliers.

MSBs also provide retentions under their construction contracts. These are deducted from payments made as a form of security in the event that the work and/or materials prove to be defective. Retentions are not finally released until two or more years after handover of the works. If goods or materials are found to be defective it will be too late for the MSB to obtain recompense from the supplier.

Finally there is a disparity in the dispute resolution processes in construction contracts and supply contracts. If goods/materials prove to be defective the MSB may be liable to make recompense by virtue of an adjudicator's decision. Adjudication is a short and relatively inexpensive way of dealing with disputes on an interim basis. But the MSB cannot bring the supplier of the goods into the adjudication unless the supplier has agreed to be bound by the decision and indemnify the MSB. This would be highly unlikely.

Question 2

Are these problems one-off examples, or are there problems which suggest trends, or structural issues, in certain sectors?

Comments:

These problems relate to structural issues in the construction sector but they are likely to be relevant to other sectors such as IT where there are long supply chains and where MSBs are often involved.

Question 3

Why are these problems not resolved through market mechanisms or current protections (including, for example: the ability to contract; trust, goodwill and supplier reputation or long-term supplier relationships; or the ability to switch supplier)?

Comments:

These problems are not resolved through market mechanisms because of the gross imbalance of bargaining power between the MSB and suppliers. Furthermore if the MSB has become dependent upon particular suppliers, withdrawal of supplies will have costly consequences for the MSB (e.g. liability for delays to the construction project).

Question 4

What examples are there of advantages with the current arrangements?

Comments:

Some suppliers will provide extended credit terms to the MSB.

Question 5

Are these advantages one-off examples, or are there advantages which are ongoing, or which occur in certain sectors?

Comments: The above tends to be negotiated in one-off arrangements but are also available where there is a long-standing relationship between the MSB and a supplier.

Question 6 **What features of the current arrangements are most beneficial to MSBs?**

Comments: Extended trade credit arrangements are most beneficial but they are unlikely to compensate for the MSB's increased risks in respect of faulty goods and materials.

Question 7 **What features of the current arrangements are most costly to MSBs?**

Comments: The most costly aspect of the current arrangements for construction MSBs is their greater exposure to liability for goods and materials supplied to them. If, in consequence, a project is delayed or disrupted by faulty goods and materials the MSB is potentially liable for the whole cost of the delay/disruption.

Question 8 **How familiar are MSBs with the current arrangements, as described in Section 2?**

Comments: Most construction MSBs will be unfamiliar with the content of Section 2.

Question 9 **With examples, what types of MSB are affected by any issues identified with the current arrangements, in terms of their size (by employee number and turnover), the nature of their business activity and location of their business?**

Comments: Many high value construction projects are delivered by MSBs in the supply chain (e.g. electrical, mechanical and plumbing contractors, lift contractors and structural steel firms).

Question 10 **What types of transactions are affected with possible reference to the goods or services purchased, the frequency of purchase, the size or volume of purchase, the characteristics of the seller?**

Comments: The transactions are varied from one-off transactions to the regular supply of goods and materials required for everyday installation and maintenance works.

Question 11 **What has been the effect on the terms of trade for the MSB when making the purchase (or purchases) in question?**

Comments: Construction MSBs are unlikely to be in a position to equate their liability for goods and materials to that in their contracts of purchase.

Question 12 **What indirect effects have there been on MSBs, for example, in consequential impacts on trade or competitiveness?**

Comments: Since construction MSBs cannot lay off the greater risk associated with supplying defective goods and materials they may seek to address the risk in their pricing stratagems. If they are able to do this their market share is likely to be reduced. Often they are put into an impossible position by the customer or client who specifies a supplier. This occurs very frequently. The MSB will have no choice but to use the specified supplier; in this situation the MSB will not be able to increase its margin by going to a more competitive supplier.

Question 13 **What other losses has the MSB suffered, for example, in time taken to resolve a problem (please quantify where possible)?**

Comments: It is difficult to quantify this. We have already referred to the fact that the losses flowing from faulty goods/materials could be never-ending.

Question 14 **Or, what additional benefits has the MSB enjoyed as a result of the current arrangements, either as a purchaser, or as a supplier?**

Comments: There are none which are apparent.

Question 15 **What types of problems are occurring with purchases? For example, are any issues identified mainly about problems of redress, i.e., refund or remedy?**

Comments: In our answer to Question 1 we have dealt with this.
Question 16 **Or are they about disputes over contract terms, or related to unequal bargaining positions between two parties?**

Comments: Both.

Question 17 **What other type of problem might there be, if not related to remedy or contract?**

Comments: Even if there is a remedy it is unlikely that MSBs will issue court proceedings.

Question 18 **To what extent do MSBs negotiate contract terms as against accepting standard terms and conditions?**

Comments: The majority of MSBs in construction tend to accept the terms offered to them.

Question 19 **To what extent do contracts for sales and supplies to MSBs tend to limit liability for breach of statutory protections regarding goods and services, or other breaches of contract?**

Comments: Limitation of liability clauses are found in all construction supply contracts.

Question 20 **Do MSBs struggle to make effective purchasing decisions?**

Comments: Most MSBs in construction will understand their marketplace. However many will not be aware of the volume of work likely to be available in the future pipelines of work; this means that they cannot always bulk buy or form consortiums to enhance their buying power.

Question 21 **If so, what are the reasons?**

Comments: See answer to Q.20.

Question 22 **How do MSBs approach different purchasing decisions? For example, do they approach the purchase of core items and non-core items differently?**

Comments: Regular purchases of core items does enable MSBs to establish better commercial relationships with their suppliers.

Question 23 **Do MSBs believe they have sufficient information when entering a contract with a larger supplier?**

Comments: When ordering from suppliers MSBs in construction are often dependent upon the information handed down to them. This generally relates to design and is usually inadequate or incomplete.

Question 24 **If so, what steps can MSBs take to ensure this is the case?**

Comments: MSBs will seek greater clarify about the information handed-down or a specific instruction on how to proceed. In practice many MSBs will not do this for fear of antagonising those parties further up the supply chain.

Question 25 **If not, what types of information, and to what extent, are MSBs lacking?**

Comments: Usually the information relates to the design of the product or system being installed, assembled or constructed.

Question 26 **Does the ability of MSBs to make effective purchasing decisions differ depending on the type of purchase?**

Comments: Yes.

Question 27 **If so, how and for which types of purchases?**

Comments: If the supplier of the product or the materials has been specified the MSB will not be able to make any effective purchasing decisions. This will also be the case where the actual product or materials have been specified and there are very few suppliers. These two situations arise frequently. The MSB is only able to make effective purchasing decisions where it is able to have a free choice of supplier and the market place is replete with the type of supplier it requires. In practice it is better to develop a long-term relationship with suppliers especially in the case of core products/materials.

Question 28 **How are the current arrangements reflected in the business models of suppliers, both other MSBs and larger firms?**

Comments:

There are two key features of the UK construction industry:

- most firms are poorly capitalised especially the largest which “farm” out most of the work to lengthy and fragmented supply chains with MSBs acting as tiers 2, 3, 4 and 5 contractors (see EC Harris Analysis of Construction Supply Chains published for the Business Department in October 2013);
- this, then, causes large firms to transfer all their risks to their supply chains.

Any attempt, therefore, on the part of MSBs to lay off all or part of the risks associated with faulty goods or materials is likely to fail (even where the MSB has been given little choice but to use a particular supplier(s) or to use a specified product where there are only a few suppliers).

Suppliers are generally aware of the fact that the construction industry is poorly capitalised and, consequently, is very risk averse; over many years these factors have shaped construction business models.

But, construction suppliers do not see any need to change their own business models by accepting greater risks and liability associated with supplying defective products/goods.

Question 29

Would different rights and remedies for MSBs affect the business models of suppliers, both other MSBs and larger firms?

Comments:

Some construction suppliers operating in other markets may focus, instead, on those markets.

Question 30

Would it be costly for suppliers to distinguish between MSBs and other customers?

Comments:

This is a very broad question but, undoubtedly, some suppliers may be able to distinguish between MSBs and other customers without this being costly. Much depends upon the type of goods being supplied. For the regular supply of core items the process could be costly.

Question 31

How would firms supplying MSBs respond to changes in the rights of MSBs?

Comments:

Some may feel inclined to raise prices if the market permits.

Question 32

What might the benefits be of applying any of the consumer protections set out in Part 3 to MSBs?

Comments:

We would prefer that all the protections in Part 3 are extended to MSBs, the overwhelming majority of which are just as vulnerable as individual consumers. The primary benefit would be to reduce the exposure of MSBs to the consequences of passing on faulty goods/materials, which exposure is much greater for the MSB than for the original supplier.

Question 33

We are interested in views, with supporting evidence, on any of the protections – in responding, these need not be considered as a package. The key protections are set out in Part 3, but in summary these are:

- **rights and remedies in relation to contracts for goods;**
- **rights and remedies in relation to contracts for services;**
- **rights and remedies in relation to contracts for digital content;**
- **terms limiting liability for key protections being automatically non-binding;**
- **right to challenging certain terms as unfair;**
- **requirements to provide certain information before a contract is made;**
- **right to withdraw from distance and off-premises contracts.**

Comments:

We are particularly keen on the protections relating to:

- rights and remedies in contracts for goods;
- terms limiting liability for key protections being non-binding;
- challenging certain terms as unfair.

Given that the overwhelming majority of MSBs in construction do not have equality of bargaining power in supply contracts they should have the benefit of these protections; it is this same inequality which is behind the consumer-related protections.

Question 34

Alternatively, is there evidence that regulating MSBs with consumer legislation might have unintended consequences, e.g., chilling effect on the willingness of firms to enter contracts or costs associated with their being less flexibility in contracts etc?

Comments: We are not aware of any such evidence.

Question 35 **If problems arise, to what extent are MSBs also the suppliers and what are the costs to MSBs as supplier of extending consumer protection provisions to SMBs?**

Comments: MSBs, as suppliers, will have similar protection in their contracts with firms that supply them.

Question 36 **Are there any benefits or costs of having rights for MSBs aligned with those for consumers but not with other businesses?**

Comments: A likely benefit is that the additional rights could allow MSBs to reduce prices over the longer-term and, thus, be more competitive.

Question 37 **What other approaches could the Government take to protecting MSB rights?**

Comments: The Government should consider alternative dispute resolution processes. The conciliation service proposed in the Enterprise Bill could be one option. Another option is to introduce adjudication in construction supply contracts.

Question 38 **Does an extension of rights need to be applied on a universal basis, i.e., equally to all MSBs?**

Comments: Not necessarily. In construction there already exists statutory adjudication. This could be extended to supply only contracts.

Question 39 **Or should it be targeted at micro businesses only, or other specific types of MSB?**

Comments: Our above suggestion could be applied to all construction supply contracts.

Question 40 **Should any additional protections apply to certain types of transaction only?**

Comments: See above two answers.

Question 41

How is the option to limit liability in the current arrangements used? Is it a useful option?

Comments:

The option is used universally in all construction supply contracts. For MSBs it is not a useful option because they cannot limit their liability when passing on the goods.

Question 42

How would MSBs – and their suppliers – react if the option to limit liability was removed in all purchases?

Comments:

Construction MSBs would be very much in favour.

Question 43

What impact on enforcement might there be if any of the consumer rights set out in Part 3 were applied to MSBs?

Comments:

Unless alternative dispute forums were made available MSBs will not be using the courts to enforce their rights.

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.
Please acknowledge this reply ✓



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