



Department
for Business
Innovation & Skills

**PROTECTION OF SMALL
BUSINESSES WHEN
PURCHASING
GOODS AND SERVICES**

Government Response
to the Call for Evidence

FEBRUARY 2016

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Ministerial foreword

Micro and small businesses are vital to the UK economy. There were 5.3 million of these businesses at the start of 2015, 99% of all private sector businesses in the UK. Over 5.1 million were micro businesses (0 to 9 employees), with total employment of 8.5 million and combined annual turnover of around £670 billion.

The Government wants to make sure that these businesses prosper. Last year, the previous Government launched the “Protection of Small Businesses when Purchasing Goods and Services Call for Evidence”. This asked whether the current legislative framework regarding the sale and supply of goods and services to micro and small businesses sufficiently protected them; or whether there was a gap in the law; and the potential impacts – both the costs and benefits – of applying certain consumer protections to MSBs, or other options.

The responses to the Call for Evidence were mixed. They were fairly evenly split between those respondents arguing that small businesses – and micro businesses in particular – required increased protections; and those arguing that the current arrangements were appropriate and any further protections may increase costs for all businesses, including micro and small businesses.

Because of the importance of micro businesses to the economy and the Government’s desire to help them overcome any barriers to productivity and growth, we believe we need to move forward from the Call for Evidence with a further consultation on this subject. Although the Call for Evidence uncovered reasons to be mindful about the unintended consequences of any change, it also identified areas that merit further investigation. We will therefore explore what options would provide most benefit, taking into account all the evidence received, and we will consult on this in 2016.

I would like to thank all parties who took the time to respond to the Call for Evidence. Your contributions have played a valuable part in the development of this policy. I look forward to our continuing work and the engagement of a wide selection of parties interested in this important subject.

Anna Soubry MP
Minister of State for Small Business, Industry and Enterprise

Executive summary

Introduction

1. On 30 November 2015, HM Treasury published “A Better Deal: Boosting competition to bring down bills for families and firms”¹, which outlined the Government’s approach to encouraging open and competitive markets that are free from distortions.
2. *A Better Deal* included two announcements on micro and small businesses (MSBs) and the protections they have when they purchase goods and services for use in their commercial activities. These announcements were as follows:
 - The Government will ensure greater focus on the needs of small businesses through the Policy Statements it gives to Ofgem and Ofwat, which give guidance on their policy priorities. The Government will ask the regulators to look in particular at giving small businesses further protections, for example, to protect them from mis-selling, ensure more transparent prices and to make switching easier. Beyond energy and water, the UK Regulators Network (UKRN) will also consider the protections needed by the smallest businesses across regulated sectors as part of its work in 2016; and
 - The Government will consult on whether further protections are needed for the smallest businesses in non-regulated sectors.
3. These announcements follow on from the *Protection of Small Businesses when Purchasing Goods and Services Call for Evidence*, published by the previous Government on 24 March 2015. This Call for Evidence looked at whether the current legislative framework regarding the sale and supply of goods and services to MSBs sufficiently protected them; or whether there was a gap in the law; and the potential impacts – both the costs and benefits – of applying certain consumer protections to MSBs, or other options.

Background to the call for evidence

4. The Call for Evidence was published following concerns raised that MSBs, and micro businesses in particular, might lack sufficient protections when they purchase goods and services. There were also concerns that micro businesses were likely to face many of the same problems as individual consumers when making purchasing decisions. This issue received a high profile following reforms to consumer rights, introduced in the Consumer Rights Act 2015. Some groups argued that if consumers needed these reforms to make confident purchasing decisions, then so would MSBs.
5. The Call for Evidence closed on 30 June 2015 and received 30 responses in total. In Chapter 2 of this document, we provide a summary of the responses and the main

¹ <https://www.gov.uk/government/publications/a-better-deal-boosting-competition-to-bring-down-bills-for-families-and-firms>

arguments made in response to the Call for Evidence. In Chapter 3, we provide our analysis of these responses and our overall conclusion.

Government response to the call for evidence

6. The Government's decision is that further work is needed on this subject, before deciding whether reforms need to be made to the existing legislative framework which provides protections to MSBs when they purchase goods and services. The Government sees two areas where further work may benefit MSBs.

Regulated sectors

7. The first area is in the regulated sectors covering the utilities, communication and finance. These sectors were outside the scope of the Call for Evidence, because protections here (both for consumers and for businesses) are determined by separate regulatory (and legislative) frameworks, overseen by independent regulators. Nonetheless the Call for Evidence stated that we would welcome views on the extent to which MSBs had sufficient protections as customers in these sectors. It was clear from the responses received that these are important sectors for MSBs – and especially for micro businesses. Some of these services, such as energy, are essential services for MSBs, just as they are for consumers.
8. These separate regulatory frameworks provide existing channels through which the Government can provide a steer to regulators. While the independent regulators in each sector are responsible for making the regulations, the Government's Policy Statements (in energy and water) provide guidance to the regulators (Ofgem and Ofwat) on policy priorities. In *A Better Deal*, the Government announced that it would ensure a greater focus on the needs of small businesses through Ofgem's and Ofwat's Policy Statements. In addition, the UK Regulators' Network², which is the body that brings together UK economic regulators to ensure effective cooperation, will take into consideration micro-businesses when looking at consumer issues as part of its forward programme.

Unregulated Sectors

9. The second area is in the unregulated sectors, those parts of the economy not overseen by an independent economic regulator and which were the main focus of the Call for Evidence.
10. It was clear that many of the respondents in favour of increased protections saw the perceived unequal bargaining position between an MSB and a larger supplier as a significant concern. Alongside this, access to suitable redress was also a major concern, as was the ability of MSBs to understand their current legal rights. There were

² The UKRN's members are: the Civil Aviation Authority; the Financial Conduct Authority; the Legal Services Board; the Office of Communications; the Office of Gas and Electricity Markets; the Water Services Regulation Authority; the Office of Rail Regulation; the Payment Systems Regulator; the Northern Ireland Authority for Utility Regulation (Utility Regulator); Monitor, the sector regulator for health, participates in the network and its projects as appropriate; the Water Industry Commission for Scotland (WICS) is a contributing member which generally participates in projects as an observer; the Competition and Markets Authority (CMA) has observer status in UKRN.

also views expressed that micro businesses were particularly vulnerable and that policy should be focused on this group as a priority.

11. Amongst the responses against increased MSB protections, the additional cost of any change was a foremost concern. Respondents also questioned how they would be able to identify an MSB at the point of purchase, so that they could have certainty on their statutory obligations. Some of these respondents also saw a potential adverse effect on MSBs who supplied to other MSBs. It was claimed that MSB suppliers would be caught in any new regulations when selling goods and they would therefore face cost implications: consequently, a policy designed to help MSBs could inadvertently lead to harm for at least some of this group.
12. The Government sees the need for further investigation into this subject. Our overriding concern is to ensure that micro businesses are receiving the support they need. As announced in *A Better Deal*, the Government intends to progress this issue by consulting on whether further protections are needed for micro businesses in non-regulated sectors. This consultation will build on the outcomes of the Call for Evidence by identifying those areas of most concern and making proposals to address them. These proposals will also take into account the points made by those who were against any change and we will launch this shortly.
13. One other point which emerged from the Call for Evidence was that many MSBs may be unaware of their current protections when purchasing goods and services, or they face difficulties in understanding them. The Government is currently taking forward proposals to establish a Small Business Commissioner. The Commissioner is to have a function of providing general advice and information to small businesses, which can include advice and information on their rights when purchasing goods and services. The Small Business Commissioner will provide a valuable service to small businesses and assist in helping them to understand and exercise their rights and seek appropriate redress.

Chapter 1: Consultation process and engagement with stakeholders

- 1.1 The Call for Evidence ran from 24 March to 30 June 2015. It asked whether the current legislative framework regarding the sale and supply of goods and services to MSBs sufficiently protects them; whether there is a gap in the law; and the potential impacts – both the costs and benefits – of applying certain consumer protections to micro and/or small businesses, or other options.
- 1.2 30 responses were received in total to the Call for Evidence. We also held two stakeholder sessions – on 26 May and 2 June – which were attended by a total of 10 respondents. In general terms, the responses were fairly evenly split between those who considered that the current arrangements were sufficient and those who argued that MSBs – and micro-businesses in particular – needed greater protection. The following chapters provide our views on the overall position based on these responses.

Chapter 2: Analysis of responses and Government response

Introduction

- 2.1 The Call for Evidence explained (in Chapter 2) that there are existing statutory protections for MSBs. The main parts of generally applicable (rather than sector-specific) legislation which apply when MSBs purchase goods and services are:
- Supply of Goods (Implied Terms) Act 1973 (“SGITA”);
 - The Unfair Contract Terms Act 1977 (“UCTA”);
 - The Sale of Goods Act 1979 (“SoGA”);
 - The Supply of Goods and Services Act 1982 (“SGSA”);
- 2.2 In the Call for Evidence – and in the rest of this Government Response, the above are collectively referred to as “the current arrangements”. These provide MSBs with:
- Rights when buying goods, or contracting for goods under other transactions (such as hire, hire-purchase);
 - Rights when contracting for services; and
 - Protection from unreasonable exclusions or limitations of liability in contracts.
- 2.3 Full details of these rights were set out in paragraphs 2.5 to 2.36 of the Call for Evidence. This can also be found in Annex B.

Applying consumer rights to MSBs

- 2.4 The Call for Evidence explained that the consumer protections it was referring to, in the context of applying these to MSBs, were:
- (i) The rights and remedies in relation to contracts for goods, services and digital content in the Consumer Rights Act 2015 (CRA);
 - (ii) Protections under the CRA regarding terms limiting liability for key protections being automatically non-binding, and for certain contract terms to be fair; and
 - (iii) Requirements to provide certain information before a contract is made and a right to withdraw from distance and off-premises contracts, under Regulations (referred to as the “CCRs”) to implement the EU Consumer Rights Directive.
- 2.5 Full details of these rights were set out in Chapter 3 of the Call for Evidence.

- 2.6 The Call for Evidence sought views and supporting evidence on the following areas:
- Costs and benefits of the current arrangements;
 - Approach to purchasing decisions;
 - Position of suppliers to MSBs;
 - Application of (any of) the rights of consumers when buying goods or services, under the Consumer Rights Act 2015 and the Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013.
- 2.7 The Call for Evidence received 30 responses in total. We also held two stakeholder sessions, which were attended by a total of 10 respondents. (See Annex A for details.) In general terms, the responses were fairly evenly split between those who considered that the current arrangements were sufficient and those who argued that MSBs – and micro-businesses in particular – needed greater protection. The next chapter provides our views on the overall position based on these responses. In this chapter, we set out a summary of the responses.
- 2.8 Table 1, below, breaks down the main areas identified by the respondents who favoured some form of increased protection for MSBs – and the number of respondents who raised the issue. This table is a summary of the views and is intended to give a broad flavour of the types of issues identified. The categories themselves are also broadly drawn and there is likely to be overlap between some categories (for example, unequal bargaining positions and unfair contract terms have similarities as the latter is often – but not always – a consequence of differences in bargaining position). This table is therefore indicative of views expressed.

Table 1: Overview of issues supporting change to MSB protections

Issue Identified	Number of Respondents (13 respondents in favour)
Introduce protections to address unequal bargaining positions	7
Understanding rights under the current arrangements	5
Help with redress (seeking redress and the suitability of available redress)	4
Unfair contract terms	4
Opportunity costs (of both making effective purchases and seeking redress)	3
Clarifying MSB rights on digital content	2
Exclude consequential loss claims against suppliers (to reduce cost of any changes)	2
Introduce protections to address misleading sales and advertising to MSBs	2

- 2.9 Against this, Table 2, below, shows the main issues raised by respondents who were opposed to increased protections for MSBs. As with Table 1, this table is intended to give a broad flavour of the issues identified. Again, there are overlaps between some of these categories and the categories themselves generalise the issues raised (for example, increased costs includes concerns raised about increased administrative burdens and possible market distortions).

Table 2: Overview of issues opposing change to MSB protections

Issue Identified	Number of Respondents (13 respondents against)
Increase costs / burdens (including indirect costs as a result of market inefficiencies)	11
Problems with defining an MSB and identifying an MSB at point of purchase	9
Any change would adversely impact on MSBs who supply other MSBs	7
Current arrangements are appropriate for MSBs	7
Current arrangements protect the freedom to contract between businesses	3
No evidence of any problem which needs addressing	3
Any change could lead to large suppliers choosing not to trade with MSBs	2

Part 1: Cost and benefits of the current arrangements

- 2.10 Amongst respondents in favour of increasing protections for MSBs, four noted that in theory the current arrangements do offer protections for MSBs: however, pursuing redress is not an attractive or practical option. One respondent quoted from a report published in 2014 by the University of East Anglia (“the 2014 Report”), which said that *“while all businesses had access to the civil courts if there was a breach of contract or a duty of care and that there were also alternative dispute resolution options, the availability of such remedies may be more apparent than real”*. This respondent argued *“that the opportunity costs of pursuing remedies can be high”*. This opportunity cost is the cost of lost business activity while the business incurs the time and expense of using the courts or alternative dispute resolution, plus also the uncertainty, time and information costs associated with pursuing a claim. This respondent considered that much MSB detriment goes unremedied due to the expense of lost business activity incurred if remedies were to be pursued.
- 2.11 Five respondents mentioned that many MSBs were not aware of the current arrangements, or many MSBs simply did not understand their rights. One of these respondents said that it *“was vital that MSBs understood their right to challenge*

where services were not delivered with reasonable care and skill, in a reasonable time, for a reasonable charge”.

- 2.12 Amongst the respondents who identified benefits in the current arrangements, three specifically mentioned that they provided MSBs with protections while allowing for flexibility in commercial transactions – seen as important in business-to-business (“B2B”) relationships – and protected suppliers from claims of consequential loss, which might include commercial losses and which could be very significant. One of these respondents said that *“the Sale of Goods Act gave a sound basis for retail transactions, allowing healthy relationships between buyers and sellers in B2B contracts where the two parties knew they were transacting on a B2B basis”.*
- 2.13 One respondent said that if MSBs were designated as a “consumer” *“it might expedite the issue of the seller accepting responsibility but it may not lead to better outcomes if the remedy offered is that mandated in consumer law – a repair or replacement of like for like”.* Instead, an MSB *“might benefit from purchasing under a commercial contract with a guarantee of immediate replacement”.*
- 2.14 Three respondents said that there was no evidence of problems for MSBs when purchasing goods and services, or insufficient evidence to warrant changes to the current arrangements. One of these said that there was no evidence that MSB transactions *“stand out as being exceptional in the way problems were resolved – generally speaking if the item was faulty large businesses had no issues in offering an appropriate remedy”*

Part 2: Approach to purchasing decisions

- 2.15 Seven respondents argued that MSBs – and particularly micro-businesses – faced an imbalance in bargaining power between themselves and their larger suppliers when in contract negotiations. One of these respondents said that *“micro-businesses do not have the purchasing power to drive hard bargains, especially with large suppliers”* and concluded that *“many micro-businesses suffer from a number of ‘vulnerabilities’ similar to those that consumers were widely understood to also suffer from”.*
- 2.16 Three respondents said that MSBs incurred opportunity costs in making effective purchasing decisions. One of these said *“The suppliers ... play on the fact that your time is limited and do not offer important contract details unless asked.”* Another respondent said *“micro business owners (face) considerable difficulties in terms of being able to optimally procure, manage and develop communications within their businesses.”*
- 2.17 Seven respondents thought that the current arrangements were suitable to meet the purchasing characteristics of MSBs, or that application of consumer rights would not resolve the approach to purchasing decisions made by MSBs. One respondent said *“the purchase of items for use by small businesses is complicated – the goods may be intended for commercial use, or may be intended for domestic use, and the intention of the contracting parties may not be clear at the point of sale.”*

Part 3: Position of suppliers to MSBs

- 2.18 Most of the respondents who were opposed to giving MSBs increased protections commented on the impact this would have on larger suppliers. Eleven respondents claimed that it would create additional costs, which would be passed through to MSBs and to consumers. These included both the direct costs of new compliance regimes and indirect costs resulting from unforeseen market burdens.
- 2.19 One respondent said that larger firms had *“separate ... operational processes and management systems ... to deal with the B2B and the consumer market”* and that any costs associated with changes to those systems *“would then be passed through to all customers – both at the retail and wholesale level”*. One respondent said that *“If rights under (the CRA) are provided to MSBs, businesses may choose to limit their liability in supplying goods and services, on the basis that goods or services may be rejected in the future ... This would restrict business, and constrict growth.”*
- 2.20 Nine respondents also saw problems with identifying which customers were MSBs, or shortcomings in an MSB definition based solely on employee numbers. One respondent here estimated that for a single large general retailer to introduce processes to identify MSBs, even if it added 30 seconds to all transactions, *“could add £7.5 million to the annual costs of the business in question. ... This could frustrate regular domestic customers, whose transactions may be delayed”*.
- 2.21 Another respondent said *“the definition used for MSBs of the number of employees ... is not a good indicator of whether a firm is in need of protections beyond what is provided under existing legislation. Moreover, the number of employees can vary over time ... In our view, a firm’s turnover is often a better indicator of its size.”* This respondent said that parties to a contract might start or complete the contract with any number of employees, which would lead to ambiguity over contractual terms.
- 2.22 Seven respondents said that extending consumer protections could have negative consequences for MSBs who were suppliers to other MSBs. This point is summarised by the following respondent comment: *“One unforeseen impact of the extension of consumer regulation to MSBs is its application to B2B transactions carried out by MSBs themselves. Any additional protection gained by the extension of consumer regulation may well be offset by the need for MSBs to comply with additional regulation themselves when transacting with other businesses. This impact should be subject to careful cost/benefit analysis should proposals be put forward.”*

Part 4: Application of consumer rights

- 2.23 Table 1, above, shows the main issues identified by the 13 respondents who argued in favour of extending some form of consumer protections to MSBs. There were also some specific concerns identified. Two respondents explicitly called for all of the rights identified in the Call for Evidence to be applied to all MSBs. One of these said that all the protections were needed because the overwhelming majority of MSBs were just as vulnerable as individual consumers. In addition, one other respondent made the point that, if MSBs could get remedies under the current

arrangements, then there were unlikely to be substantial extra costs in providing them with consumer rights.

- 2.24 Two respondents noted that costs could be limited by allowing suppliers to restrict or exclude liability in damages for consequential losses, thereby protecting them from large damages claims, while still giving MSBs similar rights to consumers. One respondent also commented on the suitability of the 30-day “right to reject” remedy available to consumers under the CRA. This respondent said that giving MSBs a 30-day right to reject for a full refund may actually weaken current rights, because they could at the moment seek a full refund beyond that time limit (for example, where defects only show up two or more months after purchase).
- 2.25 Eight of the 13 respondents in favour argued that the priority should be micro businesses. One respondent said *“many micro-businesses suffer from a number of ‘vulnerabilities’ similar to those that consumers are widely understood to also suffer from.”* Another respondent said *“anecdotal evidence provided to (us) suggests that micro businesses are generally unaware of the fact that there are different legal frameworks for business and consumer purchases and that this has implications on the type and level of protection afforded for their purchase of goods and services.”*
- 2.26 Two respondents commented on protections when purchasing digital content, with one arguing that the new rights for consumers on digital content should be applied in full, to remove the confusion that currently exist under the current arrangements.
- 2.27 As noted above, seven respondents who argued against introducing additional protections for MSBs said that the current arrangements were appropriate. One of these said *“the current legislative framework ... is fully adequate in dealing with issues that arise in respect of remedies offered for faulty goods or poorly performed services. In particular, the UCTA³ reasonableness test already ensures that such remedies and any consequent exclusion of liability are fair and reasonable, based on the MSB’s bargaining power and resources amongst other things.”*
- 2.28 One respondent argued that application of consumer law to MSBs would be inappropriate and could lead to further problems. This respondent said *“Consumer law is for the private individual and has been designed with this intention. For (our) sector, retroactively providing MSBs with these protections would create a fundamental shift in (existing business models). This shift would likely manifest itself in increased costs to the purchaser, in this case MSBs ... Any such move to legislate on this issue would require a full and comprehensive legal review, as it would change the very nature of business to business transactions.”*

³ Unfair Contract Terms Act 1977 – See Annex B: “How the Current Arrangements Work”

Chapter 3: Overall conclusion

- 3.1 In this chapter, we set out our conclusions under each of the areas identified in the Call for Evidence, provide an overall conclusion and set out the next steps we plan to take in light of the evidence received.

Cost and benefits of the current arrangements

- 3.2 The Call for Evidence asked for both qualitative and quantitative evidence. There was little quantitative evidence offered to support arguments about the costs of the current arrangements. We do, however, recognise that the opportunity cost for MSBs pursuing redress – and micro-businesses in particular – may be greater than that for larger businesses, simply because of the available resources to devote to this. We also recognise that pursuing redress through the courts may not be an easy decision for MSBs. Providing MSBs with consumer rights may mitigate these factors through less reliance on court action, though it may not remove them entirely.
- 3.3 Similarly, there was little quantitative evidence on the benefits of the current framework. The Government recognises however the importance of commercial flexibility and the freedom to negotiate individual terms and its significance in B2B transactions. We accept as a general principle that freedom of contract is beneficial to business. It may be, however, that this is more beneficial to one party than another where there are unequal bargaining positions.

Approach to purchasing decisions

- 3.4 Opportunity cost was again a factor. It is unlikely that MSBs will have “buying teams” and so time spent on purchasing was less time spent on running their core business activities. We note that this is often a feature of available resources and opportunity costs are likely to be higher for MSBs with fewer resources than larger businesses. Replacing the current arrangements with consumer protections will not necessarily reduce those opportunity costs, though it may give MSBs some more confidence when making purchases. But, this final point is of course subject to any additional costs involved, which we discuss elsewhere.
- 3.5 It is not clear that a change in the law is required to address any disadvantages MSBs may face as buyers – and whether a change in the law would provide the right commercial incentives to MSBs. If, however, a large supplier was abusing its bargaining position, then providing MSBs with stronger rights in such situations may help. We have not so far been provided with compelling evidence that such abuses are taking place to justify amending the current arrangements by legislation. However, we do agree that differences in bargaining positions between MSBs and larger suppliers is a factor in negotiations, which may lead to less than favourable outcomes for the MSB.

Position of suppliers to MSBs

- 3.6 Almost all responses to this part came from those who opposed any changes to the current arrangements, where cost implications were a clear concern. It was noted that under the current arrangements, suppliers were protected from claims for consequential loss of business earnings by MSBs. If this was to change, the cost implications could be significant. Though on this point, two respondents in favour of increased protections said that this could be done in a way which allowed suppliers to restrict or exclude liability for consequential losses. There were also worries about how suppliers would be able to identify an MSB at the point of purchase and how much certainty could be attained that an MSB met eligibility criteria. Whilst these issues are not insurmountable, there would need to be clear benefits from any change to justify intervention.
- 3.7 MSBs can be suppliers as well as buyers. This is an important point, because the core of the argument is not exclusively about small firms relationships with larger firms. It is about small firms relationships with their suppliers – and those suppliers may range from the very small to the very large. It would not be beneficial to change the current arrangements in order to help MSBs as buyers, only to discover that it imposed more onerous costs on MSBs as suppliers. Again, this issue may not be insurmountable in policy terms, but it would most likely need a more complex policy solution and so the benefits would need to be clear enough – and high enough – to justify such intervention.
- 3.8 Some respondents also commented on the determination of whether a purchaser falls into the MSB category. Since the launch of the Call for Evidence, the Small Business, Enterprise and Employment Act 2015 (section 33) introduced a statutory definition of micro and small businesses. This is based on headcount of staff; and turnover, or a balance sheet total. Any future policy or legislation is likely to draw on this definition.

Application of consumer rights

- 3.9 Tables 1 and 2 (see Chapter 2) set out the main areas of concern amongst respondents. Although the responses did not provide much in the way of quantitative evidence, there were, nevertheless, some strong arguments to support the points being made on both sides of the debate. However, a number of respondents argued that applying current consumer rights in full to all MSBs would not be appropriate. This might be because the full set of rights may not be needed to address concerns, may increase costs and may be detrimental to MSBs who act as suppliers to other MSBs. We might also conclude that micro businesses face the most serious issues under the current arrangements, through a combination of their bargaining position and access to redress. We also see complexities for larger suppliers in having a dual set of rights to deal with, when selling to other businesses (one for micros, or MSBs, and one for all other businesses).

Regulated Sectors

- 3.10 The Call for Evidence excluded the regulated sectors (e.g. utilities, energy, financial services, and communications) on the grounds that many consumer protection provisions, or the protections afforded to MSBs, were distinct in those sectors and determined by separate regulatory (and legislative) frameworks. However, a number of respondents drew heavily on experiences with regulated firms as part of their submissions. We also received responses from businesses within the regulated sectors. These responses focused on how the regulations worked to support MSBs, or provided recommendations on how the regulations could be improved.
- 3.11 **On 30 November 2015, HM Treasury published “A Better Deal: Boosting competition to bring down bills for families and firms”, (referred to as “A Better Deal”) which outlined the Government’s approach to encouraging open and competitive markets that are free from distortions.**
- 3.12 **A Better Deal included the following announcement:**

The Government will ensure greater focus on the needs of small businesses through the Policy Statements it gives to Ofgem and Ofwat, which give guidance on their policy priorities. The Government will ask the regulators to look in particular at giving small businesses further protections, for example, to protect them from mis-selling, ensure more transparent prices and to make switching easier. Beyond energy and water, the UK Regulators Network (UKRN) will also consider the protections needed by the smallest businesses across regulated sectors as part of its work in 2016.

Government response and next steps

- 3.13 We recognise the concerns over costs and unintended adverse impacts on markets which many respondents raised. If the Government were to take any action here, we would have to understand these costs and we would only proceed if there was clear evidence of benefits outweighing these costs. On this point, we note the suggestions made by two respondents who said that costs could be limited by allowing suppliers to restrict or exclude liability in damages for consequential losses. But, there is a question of unintended consequences, with some MSBs being affected by measures which are intended to help them. We may also risk introducing unnecessarily complex regulation to address all the various permutations of harm that could result from the application of consumer protections to MSBs.
- 3.14 Nonetheless, we do see that the current arrangements might be detrimental to micro businesses in particular, with the perception that they are likely to be the most vulnerable group. This group is susceptible when negotiating with larger businesses: though, what is not proven is the extent, if any, of larger businesses exploiting their bargaining strength. We also see that the opportunity costs to this group, of making effective purchasing decisions and seeking redress, will be proportionally higher than for larger businesses.

- 3.15 We consider that concerns over the definition of a MSB (and micro businesses), whilst complex, can be addressed. As noted above, the Small Business, Enterprise and Employment Act 2015 introduced a statutory definition of micro and small businesses (section 33). This is based on headcount of staff; and turnover, or a balance sheet total. Any future policy or legislation is likely to draw on this definition. We also consider that if additional rights were introduced for micro businesses, they could apply at the time of sale and would continue to apply to that purchase during the limitation period, regardless of whether the business grew afterwards. This is one possibility: the point being that we do not see this issue as necessarily being a serious barrier to any change.
- 3.16 The Call for Evidence uncovered reasons to be mindful about the unintended consequences of any change, but also identified areas that merit further investigation. The Government's overriding concern is to ensure that micro businesses are receiving the support they need. We do recognise that for many of these businesses, there is a perception that they may be in a vulnerable position when purchasing goods and services. We can see a specific problem here for micro businesses – their capability to respond to the Call for Evidence and provide evidence may prove more challenging than for larger businesses.
- 3.17 Therefore, the Government has decided that further work on this subject will focus on micro businesses. We consider this appropriate given the points raised by stakeholders about potential differences between small and micro businesses and the views of respondents who were in favour of increased protections, where the majority argued that the priority should be micro businesses. While we also recognise that issues may exist for small businesses, we consider that the role of the proposed Small Business Commissioner in providing general advice and information will give important support to both small and micro businesses (see paragraph 3.21 below for further information).
- 3.18 **Alongside the announcement on the regulated sectors, A Better Deal also included the following announcement:**
- The Government will consult on whether further protections are needed for the smallest businesses in non-regulated sectors.***
- 3.19 **This consultation will build on the outcomes of the Call for Evidence by identifying those areas of most concern to micro businesses and making proposals to address them. These proposals will also take into account the points made by those who were against any change. The Government will now develop the terms of reference for this consultation. We will launch this consultation shortly. As described above, the focus of this consultation will be on the main issues of concern to micro businesses.**
- 3.20 One other point which emerged from the Call for Evidence was that many MSBs may be unaware of their current protections when purchasing goods and services, or they face difficulties in understanding them.

- 3.21 **The Government is currently taking forward proposals to establish a Small Business Commissioner. The Commissioner is to have a function of providing general advice and information to small businesses, which can include advice and information on their rights when purchasing goods and services. The Small Business Commissioner will provide a valuable service to small businesses and assist in helping them to understand and exercise their rights and seek appropriate redress.**

List of respondents

There were 30 responses to the CfE coming from a wide range of companies in different sectors including:

- Cross Economy - 10
- Communications - 4
- Energy - 3
- Construction - 2
- Finance - 2
- Retail - 2
- Automotive - 2
- Leisure - 1
- IT - 1
- Legal - 1
- Accountancy - 1
- Manufacturing - 1

There were 10 attendees to the two stakeholder sessions held on 26 May and 2 June. The notes of these can be found at Annex A.

Annex A: Notes of stakeholder sessions

Session 1: Tuesday 26 May

Points discussed

- Applying consumer rights to micro and small businesses (MSB) would create new costs for firms, because they would need to distinguish at the point of sale who they were selling to – a consumer or a MSB. If they were selling to a MSB, there would be additional risks involved. These risks would arise through the higher cost of claims for repair/replacement from MSBs. It is not clear how a firm could make the distinction at the point of sale, especially with cash transactions.
- A similar problem occurs with sole traders who work from home and may have domestic contracts for various services, which are in practice being used for business purposes.
- The liability towards a MSB would also be higher than toward a consumer, if a MSB was able to claim for consequential loss from a faulty good or service. The current system allows firms to exclude such claims, but applying the Consumer Rights Act in full would not provide for such exclusions. Claims on consequential loss could be very significant for some businesses, making the overall risk of transactions much higher than was currently the case.
- Markets do not serve MSBs very well, especially micro businesses and sole traders. Often these types of businesses behave like consumers and so they should have the same rights as consumers. In addition, micros and sole traders can struggle with low value transactions which cause no problems for small businesses, or spend time on non-core activities, such as waste management.
- It would be a useful exercise to clarify which types of MSBs are most vulnerable when purchasing goods and services. The Call for Evidence brings “small” businesses into scope, but it may be that only micro and sole traders are experiencing problems. Is it better to re-focus on these businesses?
- There is a substantial difference between MSBs and it is not always appropriate to apply the same approach to both types of business. Some “small” businesses can have very high turnovers, especially compared to micro and sole traders. Against this, the purchasing power of micro businesses can be very minimal so it may be difficult for them to get the best deal, or they may lack confidence to negotiate the best deal.
- The Call for Evidence may be omitting to consider areas where MSBs need additional protections. For example, there are gaps in legislation protecting MSBs from price comparison sites and mis-selling. This is a situation experienced in the energy sector and which is likely to worsen when the retail water market opens for

businesses in 2017. In the energy sector, there are brokers and intermediaries who sometimes over-charge on commission whilst claiming to be getting the “best deal” on energy prices. This activity is unregulated, though that is not always understood by MSBs. A similar mis-understanding occurs with parcel services, which are also unregulated but which expose some MSBs to scams and mis-selling. Giving regulators the power to tackle this type of behaviour would provide them with a powerful measure which would help MSBs.

- The concerns being raised by MSBs could be due to the lack of an advocate acting on their behalf, leading to a lack of knowledge on existing rights. Or the lack of an enforcement body to uphold rights. It would be useful to explore whether Trading Standards could act as an enforcement body for MSBs; or whether ADR schemes could be extended to MSBs.
- The lack of adequate protection becomes a serious problem for MSBs when it affects their cash flow – so there clearly needs to be an emphasis on ensuring MSBs have the confidence to make high value purchases. Otherwise, this might have a chilling effect on growth, with firms reluctant to commit to major investment decisions. Another important area is continuation of service on core items, such as energy and communications. Loss of service can quickly lead to loss of business and can be as equally important as cash flow issues.

Session 2: Tuesday 2 June May

Points discussed

- It was noted that the Call for Evidence had a specific definition of micro and small businesses (0-9 employees and 10-49 employees respectively). This reflected a wider inconsistency and use of terminology across government and other bodies: this Call for Evidence could be an opportunity to clarify the definitions.
- Although the Call for Evidence said that government could not act in the independently regulated sectors, it should be noted that government could legislate to give regulators specific powers to act on MSB rights. Furthermore, government could use its influence at EU level to make necessary changes to underpinning Directives.
- It might also be useful to consider the approaches taken by regulators in the interpretation of their powers. For example, Ofcom interprets consumers to include all MSBs, whereas Ofgem treats them as a separate category. There may be options to revisit these categories without changing legislation.
- One firm did not differentiate their customers by size of business and instead offered all customers the same protections on standard services. This firm determined the type of customer (i.e., whether consumer or business) by the type of service they purchase. Often, these things only become an issue when a problem occurs, when the firm becomes aware that a business is running services from a consumer product. In those cases, the customer would want a speedy fix (so to resume business activities), but the firm can only work within the terms of the contract (which might specify that repairs could take days to be completed).

- It would be useful to look at the Australian model, where consumer law extends to businesses in the purchase of essential services (i.e., utilities). It might also be useful to look at the unconscionable conduct provisions in Australian law, though these might be less relevant where MSBs are purchasing goods and services (as opposed to where they are supplying goods and services to larger buyers).
- A blanket application of consumer law to all MSBs would be a heavy handed intervention. The more proportionate response would be to identify the most vulnerable firms and sectors and intervene only where necessary. It would also be helpful to clarify the concerns by whether they represented a contractual issue or a pricing issue, as any legislative intervention may take a different approach accordingly.

Annex B: How the current arrangements work

Goods – sales under Sale of Goods Act 1979

When a MSB buys a good from another business (MSB or otherwise), it means they have entered into a contract with that other business, as the supplier of the goods. Under the SoGA there are rules that form part of the contract, which suppliers must abide by (subject to a valid limitation or exclusion of liability – see below).

Key rights or ‘implied terms’

The SoGA says that the goods sold must be as described, of satisfactory quality and fit for purpose. Fit for purpose means both their everyday purpose, and also any specific purpose that the MSB made known to the supplier at or before the time of purchase. Goods sold must also match any samples and any description by which they are sold, e.g. in a brochure. The SoGA also says that the supplier must have the right to sell the goods. Further, the goods must not be subject to undisclosed third-party claims, nor should the MSB’s use of the goods be disturbed by anyone with rights over the goods unless the MSB is made aware of such rights before buying.

These requirements form the “implied terms” of a contract. They have effect in addition to any other requirements in terms directly agreed between the parties, which are known as “express terms” of the contract (subject to any valid limitation or exclusion of liability – see below). If the good sold does not meet the requirements set out above, then the supplier is in breach of contract and the MSB, as purchaser, has a claim under the SoGA.

Remedies

The main remedies available are to reject the goods; terminate the contract and receive a refund; or to claim damages.

Reject/Refund

If the goods are not of satisfactory quality or fit for purpose and do not match their description or sample, the MSB can generally terminate the contract and get a refund, provided it rejected the goods before it is deemed to have ‘accepted’ them. This means they must be rejected within a reasonable time after purchase; or that the MSB has not intimated that they are accepted; or does something inconsistent with the supplier’s ownership, e.g. altering the goods.

Damages

To claim damages means to claim financial compensation which a court can order one party to pay to the other. The MSB can seek damages if they have accepted the goods; or they may choose to seek damages instead of rejecting the goods (if it wants to keep them

but to be compensated for where the goods fall short of requirements). In some cases, the MSB may seek damages as well as rejecting the goods for a refund, if they have suffered loss which goes beyond the price paid for the goods. Generally, an award of damages for breach of contract is intended to compensate the injured party for loss suffered. The level of damages awarded will depend on the specific circumstances and the term which the supplier has breached. Typically, damages would cover the estimated loss directly resulting from the breach, in the ordinary course of events.

There are legal tests to be satisfied for a MSB to recover damages: a MSB can only recover damages for loss which was caused by the breach (of the implied term) and which was sufficiently foreseeable; and the MSB cannot recover for loss which they could reasonably have acted to limit or mitigate. A MSB does not have a legal right to have the goods repaired or replaced by the supplier, unless the parties have agreed this in their contract. However if the MSB has the goods repaired or buys a replacement, they are likely to be able to recover the cost of doing so through damages, unless this is unreasonable.

The MSB has six years to take a claim to court for breach of the above requirements regarding goods in England, Wales and Northern Ireland; five years in Scotland.

Other supplies of goods – Supply of Goods and Services Act 1982, Supply of Goods (Implied Terms) Act 1973

Goods may be supplied under contracts other than sales – for example, hire, hire-purchase, under a contract for work and materials or payment-in-kind. Such contracts are not covered by the SoGA, but by the SGSA (hire, barter, work and materials) and SGITA (hire-purchase). For these types of transactions, equivalent rights apply to those for sales contracts: terms are implied in the contract that the goods are as described, of satisfactory quality and fit for purpose, and that they match any sample. Terms are also implied that the supplier has the right to supply the goods and they are not subject to undisclosed third-party claims (other than the rights of the owner, in relation to hired goods).

As with sales contracts, the remedies for breach of these rights are rejection and termination of contract, and/or damages. However, for goods contracts other than sales, these are wholly 'common law' remedies, meaning that the remedies are not specified in legislation but apply as a result of case law. Therefore, the concept of 'acceptance' described above does not apply. Instead, there is a common law concept of affirmation, meaning the right to reject the goods is not lost before the buyer is aware of the fault. The buyer may in theory therefore be able to reject goods for longer under a hire-purchase contract than a sales contract.

The MSB has six years to take a claim to court for breach of the above requirements regarding goods in England, Wales and Northern Ireland; five years in Scotland.

Services

The term 'services' covers a wide variety of work. From a small repair job, to the installation of solar panels, to major building work – all this type of work involves a MSB entering into a contract with a supplier. The SGSA implies into contracts for services that

the work will be carried out with reasonable care and skill⁴ (again, subject to valid limitation or exclusion of liability). The SGSA also requires that services will be carried out in a reasonable time (if there is no specific time agreed); and for a reasonable charge (if no price was set in advance)

What is 'reasonable' will depend on the circumstances, but it is an objective standard. So, for example, the level of care and skill which a business should show in performing a service would usually be that of a reasonably competent service provider in the relevant field, unless the provider had held themselves as having a particularly high level of skill or experience in which case a higher standard would be reasonable.

Remedies

If the requirements above are not met – for example, the supplier did not use reasonable care and skill so the service was poor – the MSB may be able to claim compensation. If the breach was very severe – that is, if the MSB could show that the workmanship was so poor that it got no benefit from it – the MSB may be entitled to terminate the contract and get a refund, although this is less readily available than when buying goods.

The MSB does not have a legal right to ask for remedial work to be carried out or ask for work to be undone (unless agreed in the contract), although they may seek to negotiate this. The MSB could have remedial work done by a third party and is likely to be able to recover damages to cover the cost of this (as above).

The MSB has six years to take a claim to court for breach of the above requirements regarding services in England, Wales and Northern Ireland; five years for breach of common law implied terms in Scotland.

Unfair Contract Terms Act 1977

UCTA provides protection in relation to contractual terms which seek to limit or exclude liability. It does not regulate the fairness of all terms of contracts. There are also legislative controls on the fairness of contract terms more generally (not only terms which limit or exclude liability), but these apply only to business-to-consumer contracts. Under the UCTA, the protections in SoGA, SGSA, SGITA regarding goods being of satisfactory quality and fit for purpose, and conforming with a description or sample, can be excluded in contracts between businesses, but this is subject to a reasonableness test.⁵

The reasonableness test is met if the term was a fair and reasonable term to include in the contract, based on the circumstances that the parties did or should reasonably have known or contemplated when the contract was made. If a clause seeks to limit a party's liability to a particular sum then, in considering whether that term meets the

⁴ In a contract for the supply of a service in Scotland, the implied terms are found in the common law not in SGSA, although there are parallels between the terms implied at common law for Scotland and those under the SGSA.

⁵ In Scottish law, the test under UCTA is whether it was "fair and reasonable" to incorporate the exclusion or limitation clause into the contract. In substance, the tests are very similar, so for brevity this document refers to the reasonableness test.

reasonableness test, the court must consider in particular the party's resources and how far they could insure against the liability.

UCTA sets out factors for the court to consider, where relevant, in deciding whether a term is reasonable which seeks to limit or exclude liability for the statutory rights regarding goods. This does not prevent the court from considering other factors too. The factors are:

- The strength of the bargaining positions of the parties taking into account alternative suppliers available to the purchaser;
- Whether the customer received an inducement to accept the term, e.g. were they given the opportunity to pay a higher price without the exclusion or limitation clause;
- Whether the customer knew or ought reasonably to have known of the term and whether such terms are in general use in a particular trade;
- Where the exclusion or limitation of liability relates to non-performance of a condition whether it was reasonable to expect compliance with the condition to be practicable;
- Whether the goods were made or adapted to the special order of the customer.

Enforcement

The rights explained above are "private rights". This means the MSB can themselves exercise their rights against the supplier. They may sue the supplier for breach of contract if the rights in relation to goods and services are breached, and can challenge the reasonableness of an exclusion or limitation of liability clause in the courts.



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BIS/16/32