

## **Dispute Resolution in England and Wales**

FSB is a non-profit making, grassroots and non-party political business organisation that represents 160,000 members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

In 2016, FSB published a report on the topic of dispute resolution called Tied Up<sup>1</sup>, and some of the data used in that report will be re-used in FSB's submission to this Call for Evidence.

### **The scale of the problem for small businesses**

Larger businesses, with more staff and greater ability to plan, will often be able to factor into their business plans the need to resolve legal disputes. Larger businesses often have in-house lawyers or legal teams that they can call upon. These lawyers will have a sophisticated understanding of the range of options that are available to them in resolving a dispute. This is not to say that dispute resolution is not costly for larger businesses, but the disruption and impact on the business can often be managed.

For small businesses, it is a different story. Typically, in a small business, resources are focused on sustaining and growing the business and, in particular, maintaining cash-flow and a reasonable level of working capital. Any spare resource is targeted at meeting key legal requirements, such as paying tax or regulatory compliance. Therefore small businesses are more susceptible to sudden shocks, like the need to deal with a legal dispute.

While challenging to plan for, legal disputes do happen. According to the FSB report – Tied Up – 70% of small businesses had at least one legal dispute in the prior five-year period. With an average value of £18,000, this suggests that at least £12.4bn a year was tied up in legal disputes for small businesses. These disputes would have meant that commercial relationships were disrupted, with resources allocated inefficiently across the economy.

More significantly, the average cost of resolving a dispute was reported as being £17,000. This is comprised of both direct costs, including legal and court fees, and indirect costs. This shows how costly it is for small businesses to resolve legal disputes, and would represent a further £11.6bn<sup>2</sup> being spent each year in the costs of resolving a dispute.

Our research also found that the larger the business, the more likely they would be able to resolve their disputes. On average, 17% of businesses responding to FSB's survey were unable to resolve their disputes. However, this is much higher for the self-employed where 27% of individuals reported that there was no action taken to resolve their dispute and it had remained unresolved, in comparison to 11% of small businesses with more than 10 employees.

The scale of the problem is significant, and consequently, so is the scale of the opportunity if dispute resolution can be made simpler and cheaper.

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<sup>1</sup> <https://www.fsb.org.uk/resources-page/tied-up--unravelling-the-dispute-resolution-process-for-small-firms.html>

<sup>2</sup> This figure may well be conservative. In 2018, the Legal Services Board estimated the cost to the economy of small business legal problems at £40bn a year.

### What types of disputes do small businesses typically have?

When asked to list the type of disputes that they had experienced in the prior five-year period, the majority of small businesses said they had been involved in a contractual dispute relating to payment, with 42% relating to late payment and 30% relating to non-payment. The next highest figure was for contractual disputes related to non-payment-related contract terms (28%), and next highest was intellectual property disputes, at 5%.

Since our 2016 report, late payment has only grown as a problem for small businesses. In 2020, FSB surveyed its members on the degree to which COVID-19 had affected late payment. 44% of small businesses had seen an increase in late payments from customers, and 30% had seen payments frozen completely as a result of COVID-19<sup>3</sup>.

If Government can simplify the dispute resolution process, and reduce the cost, particularly for late or non-payment cases, then it would be a huge win for small businesses and the economy.

At the moment, small businesses are faced with a lose-lose quandary every time they encounter a legal dispute related to payment. They could look at the £17,000 average cost to resolve the dispute, and decide to leave it unresolved, on the basis that the costs of pursuing their claim would outweigh the benefits. But this would mean businesses would be foregoing taxable revenue which they are due, simply because of the high cost of resolving disputes, which would quickly become an unsustainable approach. They have no choice but to engage with the existing dispute resolution system, which is not ideally suited to their needs.

The Small Business Commissioner has a partial role to play here, but can currently only be used in disputes between a small business (defined as fewer than 50 employees) and a large business (defined by the Commissioner as over 50 employees). Although it was considered prior to the Small Business Commissioner being launched, the Commissioner does not go as far acting as a small business conciliation service, nor can it mediate in disputes. It is worth thinking about whether the Small Business Commissioner can play more of a role here, but even if it does, there will be a need for the more radical solutions that we propose below.

### Small businesses should be treated similarly to individual consumers

Similar to individual consumers, small businesses will often not know where to turn when they experience a legal problem. When the Competition and Markets Authority carried out its 2016 market study into legal services, they defined consumers as being individual consumers and small businesses with up to ten employees. In respect of both of these groups, the CMA found that:

*“These consumers generally lack the experience and information they need to find their way around the legal services sector and to engage confidently with providers.”<sup>4</sup>*

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<sup>3</sup> <https://www.fsb.org.uk/resources-page/late-again--how-the-coronavirus-pandemic-is-impacting-payment-terms-for-small-firms--.html>

<sup>4</sup> CMA Legal Services Market Study, Final Report, 2016, paragraph 2.

This is borne out by the Legal Services Board's 2018 research into small business legal needs<sup>5</sup>, which found that when presented with a legal problem, 50% of small businesses sought to address it on their own, 24% sought to address it with help from a professional (not necessarily engaging a legal professional, as this also includes insurance services), 16% sought help from friends, family members or colleagues, and 10% did nothing.

### **Our solutions**

The Legal Services Board has called on the MoJ to produce a legal support strategy for small businesses, underpinned by data on legal needs, akin to the approach that has been taken for individual citizens. FSB supports this call. It is crucial to start any look at the civil justice system holistically, and when doing so, to look at it from the perspective of the small businesses who use it.

A holistic look at the system should endeavour to deliver the following outcomes. First, it should look to improve small business understanding and confidence in how to resolve legal disputes when they arrive. Second, the system should minimise the need for small businesses to pay for professional lawyers and engage with the courts system, to avoid costs escalating and becoming disproportionate to the size of the dispute. Lastly, where the court system is unavoidable, then measures must be put in place to control the costs associated with resolving disputes, and enable small business litigants in person to recover a reasonable amount in respect of the costs that they necessarily incur.

In order to meet these objectives, FSB is calling for the following:

- 1) Ensuring small business representation on relevant decision-making forums, including the civil procedure rules committee and Litigants in Person Forum;
- 2) The Government should establish a business disputes service, to triage and seek to resolve disputes at an early stage, and identify the most appropriate process and mechanism for doing so;
- 3) If a mediation or other standard ADR process proves unsuccessful, the business dispute resolution service should promote the ability of mediators to provide separate impartial dispute evaluations to each party at the conclusion of the mediation or ADR session (so-called third party or early neutral evaluation). This would involve only a short time extension and be a valuable and cost-effective additional step toward dispute resolution. Provided that it is done privately and separately with each party, it would not undermine the mediator's role.
- 4) A business dispute tribunal could be set up, akin to the employment tribunal service and its linked ACAS Conciliation process (with the business dispute resolution service providing the conciliation component) to deal with cases worth up to £50,000.
- 5) The regimes of IP rights and enforcement, in respect of issues arising out of online commerce, should be re-examined, to ensure that they are suitable for resolving disputes arising from online infringements or unfair digital business practices.
- 6) The Small Claims Track limit should be increased to £25,000 to enable those smaller claims which do require resolution by court process to be cost-effectively determined.

### **1) Ensuring small business representation on relevant decision-making forums**

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<sup>5</sup> <https://legalservicesboard.org.uk/wp-content/media/FINAL-Small-Business-Report-FEB-2018.pdf>

Small businesses are consumers of legal services. They share many of the problems that individual consumers will have when seeking to engage with the legal services market, and consequently need to be represented when policy or regulation is being overhauled. It cannot be assumed that a small business will be a sophisticated consumer of legal services – many will not be.

Yet, small businesses also have vital differences from individual consumers. One is the frequency with which small businesses will face legal disputes. Our research shows around 70% of small businesses will face at least one legal dispute over a five year period. The type of dispute that a small business faces is very different to the type that a private individual would face. Contractual disputes related to late-payment or non-payment make up a large proportion of the issues faced by small businesses.

As frequent users of the justice system, FSB would argue that more needs to be done to ensure that small business interests and experiences are taken into account as the system develops.

Therefore we recommend that:

- The Civil Justice Council should have two consumer representatives, rather than the one it currently has. One of these should represent individual consumers, as they currently do, and the other should represent small business consumers.
- The Civil Procedure Rules Committee should have at least one representative who is specifically able to speak authoritatively on behalf of small businesses. Currently the rules committee has nine judges, three solicitors, three barristers, and only two other members who are meant to cover all consumer and lay advice issues. The make-up of the Committee appears disproportionately weighted towards the legal professions, and insufficiently geared towards ensuring that the individuals and businesses that use the courts are represented. If we want our justice system to be innovative and user-centric, then it would be a good start to ensure the users are better represented.
- The Litigants in Person Forum should have a small business representation so that the particular issues which face small business Litigants in Person can be understood and taken into account and addressed. At present, all Litigants in Person, whether they be consumers or businesses, are treated in the same way in relation to costs recovery. That is unfair to small businesses. If a small business has a dispute, it will address it as part of its business operation and spend time and incur costs which will reduce the gross profit of the business. At present, costs are only recoverable by a Litigant in Person if they can demonstrate a loss. Whilst that may be acceptable for private individuals, it is not appropriate for businesses. There should be an assumption that businesses will address disputes and incur business costs in doing so which they should be entitled to recover, subject to appropriate requirements. The present rules are little known and difficult to surmount. FSB would be willing to engage to help frame a suitable costs recovery regime for small business owners acting as Litigants in Person.

## **2) The Government should establish a business disputes service**

For reasons already outlined, it is not possible for businesses to avoid disputes altogether. If a business fails to take action for non-payment or late payment, or failed to protect its rights, then it would quickly fail. The aim must be to make the process of resolving disputes as fast

and as cost-effective as it possibly can be. In 21<sup>st</sup> Century digital business disputes this is especially and critically important.

To aid this, FSB would propose that business to business, and suitable business to consumer disputes should first be required to go through a business disputes service before the courts system can be accessed. There are successful examples of 'disputes boards' under the terms of some engineering and construction contracts, whose function is to address potential and actual disputes as early as possible to prevent escalation and entrenchment. A business disputes board could include a similar but slightly amplified function to the role that ACAS conciliation plays in the field of employment disputes.

The aim of the business disputes service would be to triage the dispute, and establish and recommend the process and mechanism most appropriate to resolve it, given its nature and value. The full suite of ADR options and all possible adjudication processes would be considered. In the first instance, a mediator or conciliator might be involved, in order to help the parties better understand the nature of their dispute and explore whether an agreement could be reached without needing to resort to any form of adjudication procedure.

### **3) Mediators should be empowered to provide summaries to both parties**

In many cases, the business disputes service, and the mediation process itself will resolve the dispute, but in some cases it won't. At present mediators in the UK do not (as is common in other jurisdictions, notably USA) seek to change their status or role (for instance to become an arbitrator) if the mediation achieves no resolution, because that is rightly regarded as causing a conflict due the confidences they may have received during the mediation. FSB recommends that a further step, which would aid resolution of the unresolved cases, would be to establish and promote a process of 'Mediation Plus' whereby the mediator would at the end of the unsuccessful mediation be empowered, if the parties agreed, to provide each party with a separate and private neutral evaluation of the strength of their respective cases, to better enable them to achieve a resolution. The neutral evaluation process has become successfully established within the court system but by the time it is deployed, significant costs will usually have been incurred. Introducing it as a standard addition to unsuccessful mediations before or after a court claim has been issued can only increase the percentage of cases being resolved.

This would not go as far as to ask the mediator to step into the role of adjudicator, because the mediator could, during mediation, have received confidential information from a party which it would be inappropriate for an adjudicator to have. Providing a separate and private assessment to each party, would help to give them a realistic sense of the likelihood of success and further nudge them towards a resolution before the matter progressed down more costly dispute resolution routes.

### **4) Cost-effective business tribunals**

In the event that the steps above fail to resolve the dispute, the next most cost-effective step would be to refer the case to a bespoke business tribunal. Mirroring the Employment Tribunal, there could be a panel of prospective adjudicators who were allocated to each case. The adjudicator could be a legal expert or could be knowledgeable in the field in which the dispute arose, or could in appropriate cases be accompanied by either an independent lay business expert, or a technical expert, depending on the circumstances. The business tribunal system could initially cover claims up to £50,000 in value, that were either single issue disputes, or which were factually simple. This would again keep these cases out of the

more costly, and time-consuming court system, and through accelerating dispute resolution and reducing its cost, would significantly benefit the economy.

## **5) Resolving disputes related to online infringements**

We will now focus on some of the issues, relevant to this consultation, that have emerged in more recent years for small businesses due to the growth of online retail and large online platforms.

One might assume (wrongly), that in a business-to-business relationship, there would be more-or-less a level playing field. And in a business-to-consumer relationship, one might assume that there was a power imbalance in favour of the small business. The experience of online platforms demonstrates that both of these assumptions are not correct.

In our Destination Digital<sup>6</sup> report, we surveyed small businesses on the top problems that they experience in the context of using online platforms. The top three were:

- Malicious or fake reviews (stated by 21% of respondents)
- Sudden changes to terms and conditions (19%)
- Infringement of intellectual property rights (13%)

Malicious or fake reviews is one area whereby small businesses are very much at risk as a result of consumer behaviour. Customers put a lot of stock in online reviews and the feedback that a business receives can make or break them. We are aware of one example, in the restaurant business, where an inaccurate rumour started in online reviews about how the food was prepared in the restaurant's kitchen, which cast doubts upon its freshness. Despite the rumour being inaccurate, the restaurant in question was unable to clarify the situation, and a short time later they ended up closing.

We acknowledge that online reviews play a really important role in supporting consumer decision-making, and it is important that the law in this area does not stifle legitimate criticism. However, given the importance of reviews to a business's viability, there must be safeguards put in place to ensure that reviews are not deliberately misleading or posted in bad faith.

It is therefore helpful that Government is looking to address some of these issues through the consultation on Consumer and Competition Law, and also looking more closely at the regulation of online platforms through the prospective establishment of the Digital Markets Unit.

In addition to the fake reviews problem, there are other dispute related difficulties which small businesses face when trading online. There is at present no B2B related 'unfair business practices' legislation, only law which protects consumers on that basis. That issue might be resolved if smaller businesses were to be treated as consumers. There is at present no cost-effective process beyond online platforms' own terms of business for resolving platforms related issues and the governments Online Intermediation Services Regulation simply points complainants towards the court system. Both of these issues would be ideal candidates for a business disputes resolution service and tribunal.

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<sup>6</sup> <https://www.fsb.org.uk/resources-page/destination-digital-report-pdf.html>

Another area of consumer related disputes, affecting online businesses, is with regard to customers wrongfully complaining about the quality of goods bought online and seeking a refund from the payment processor, but then not returning the goods. There is no process for freezing the position until a dispute is resolved, and so small businesses can lose their goods without payment. These types of disputes can best be resolved by imposing a 'holding position' obligation on payment processors and compulsory ADR process to resolve the dispute rather than by reference to a service of the type we propose above.

There still remains an obstacle to some dispute resolution, in that it is often challenging to find out the identity of someone who has infringed your rights online, behaved unfairly in business practice terms, or even fraudulently induced payment. This has relevance to the issue of malicious reviews, and also to the broader question of infringement of IP rights and recovery of misdirected payments. Whilst there are some relevant current rules, they are infrequently or opaquely observed, and enforcement of them is sparse. We propose several solutions, which will boost transparency of online activity, deter IP breaches and better enable dispute resolution:

- The Government should review whether the existing law is sufficient to ensure that the identity of the business operating the website, and their contact details, appear prominently. This is an existing requirement, in the Companies Act, but it is still very challenging to discover the identity of various websites because the information is often not prominently displayed.
- Allow the ICO or Trading Standards to take enforcement action, and have an effective enforcement process, perhaps through the magistrates courts.
- Expedite and streamline the disclosure process. In IP infringement cases and many online commerce situations, time is of the essence in resolving disputes or removing trading obstacles. The position is similar when payments have been misdirected as monies seldom stand still within the banking system. Yet laws around privacy and data protection are often used to resist a request for disclosure of essential information, for example around online identities or bank account holders. Therefore the process for obtaining a disclosure order from the courts needs to be expedited in these cases. This could be achieved by creating a bespoke online application process, overseen by a dedicated judge. Evidence in template form could be uploaded and verified and a standard disclosure application form completed, with the outcome being a standard disclosure order to be served on the data holder and requiring them to confirm immediately whether they object to production. If a data-holder did object to production, provision could be made for them to be able to apply online within a prescribed short time for the order to be rescinded or varied, with an online hearing scheduled quickly thereafter to determine whether their identity should be disclosed or not. In order to deter meritless objections from the data-holder, there would need to be costs consequences if their objection failed. This type of approach and innovation is essential if the courts and the dispute resolution system is to keep pace with 21<sup>st</sup> Century digital commerce and complement the government's innovation agenda.

## **6) Increase the small claims limit to £25,000**

The Small Claims Track allows claims to be resolved in an expeditious way, with a regime of fixed costs meaning that parties can have a clearer idea of the likely risk that they take on by litigating. As mentioned earlier, the average cost of resolving a dispute (£17,000) is

disproportionately large, compared to the average amount of money which is under dispute (£18,000).

Whilst solicitors' charge rates and court fees seem to be reviewed periodically, the Small Claims Track limit and related costs and expenses recoverable have not enjoyed that updating. Additionally, a range of evidence shows an unattractive disparity and disproportionality between amounts claimed and legal costs incurred in the £10,000 to £25,000 claim value range. The value of many basic consumer related services and goods such as domestic heating systems or second hand cars (issues related to which should surely be 'small claims') has long since exceeded the current Small Claims Track limit, which FSB has been for some time suggesting should be reviewed.

By expanding the limit from £10,000 to £25,000 it will ensure that a larger proportion of small business and consumer-related claims can be dealt with cost-effectively by the courts system, if the earlier measures proposed in this paper do not achieve a resolution.