

<b>Title:</b> Enacting EU Directive 2011/7/EU: Challenging 'grossly unfair' terms and practices <b>IA No:</b> BEIS002(F)-18-CCP <b>RPC Reference No:</b> N/A <b>Lead department or agency:</b> Department for Business, Energy and Industrial Strategy <b>Other departments or agencies:</b>	<b>Impact Assessment (IA)</b>			
	<b>Date:</b> 12/01/2018			
	<b>Stage:</b> Final			
	<b>Source of intervention:</b> EU			
	<b>Type of measure:</b> Secondary legislation			
	<b>Contact for enquiries:</b> Alex Shirvani alex.shirvani@beis.gov.uk			
<b>RPC Opinion:</b> Not Applicable				

**Summary: Intervention and Options**

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANDCB in 2014 prices)	One-In, Three-Out	Business Impact Target Status
-£0.66m	-£0.66m	£0.1m	In scope	Qualifying provision

**What is the problem under consideration? Why is government intervention necessary?**  
 Late payment causes cash flow problems for businesses. Sometimes when purchasers draw up contracts that set out the terms of payment to their suppliers, the purchasers are in a position of greater power in the negotiation (eg due to having more market power) and can insert terms related to timing of payment that are unfair to the supplier. This can cause particular difficulties if the supplier is a small business and has limited options of buyers in the market, and can feel pressured in to accepting unfair terms. A legal framework already exists to enable suppliers to challenge unfair payment terms in the courts, however smaller businesses may lack the confidence, funds or expertise to make legal challenges.

**What are the policy objectives and the intended effects?**  
 The policy enables representative bodies to bring legal cases with respect to unfair terms related to late payment on behalf of their members. This opens up a new route for member businesses to use the courts to challenge unfair terms and should act as a restraint on purchasers from attempting to impose unfair terms on suppliers.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**  
 This policy is part of the transposition of the Late Payment Directive 2011/7/EU. The Directive was transposed in the UK through the Late Payment of Commercial Debts Regulations 2013, however this did not explicitly transpose the requirement to enable representative bodies to bring legal cases on behalf of their members. Not introducing this policy option would leave the UK at risk of infraction for failing to effectively transpose the Directive, so no alternative policy options have been chosen.

<b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 04/2022				
Does implementation go beyond minimum EU requirements?			No	
Are any of these organisations in scope?			<b>Micro</b> Yes	<b>Small</b> Yes
			<b>Medium</b> Yes	<b>Large</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			<b>Traded:</b>	
			<b>Non-traded:</b>	

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.***

Signed by the responsible  
 SELECT SIGNATORY: Andrew Griffiths Date: 23/01/2018

# Summary: Analysis & Evidence

# Policy Option 1

## Description:

### FULL ECONOMIC ASSESSMENT

Price Base Year 2017	PV Base Year 2017	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -0.83	High: -0.50	Best Estimate: -0.66

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)	
Low	0.5	10	0.0	0.5
High	0.8	10	0.0	0.8
Best Estimate	0.7	10	0.0	0.7

#### Description and scale of key monetised costs by 'main affected groups'

Familiarisation costs for representative bodies that will gain the powers to pursue cases on behalf of their members: £300k to £1.4m (midpoint estimate £800k). These are one-off costs.

#### Other key non-monetised costs by 'main affected groups'

None. The policy does not place any new regulatory burden on any party, it just enables legal cases to be brought by representative bodies on behalf of their members. There is no change in the definition of non-compliant contractual behaviour so firms that were already compliant in their contractual practices will still be compliant following the change. However, there may be a greater likelihood that non-compliant firms will be challenged in the courts.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)	
Low	0.0	10	0.0	0.0
High	0.0	10	0.0	0.0
Best Estimate	0.0	10	0.0	0.0

#### Description and scale of key monetised benefits by 'main affected groups'

The benefits from this change are indirect and not directly quantifiable.

#### Other key non-monetised benefits by 'main affected groups'

By enabling representative bodies to take action on behalf of their members, it increases the potential for accessing legal redress against unfair contract terms with respect to late payment, for businesses that would otherwise have been deterred from pursuing legal action themselves either due to cost or complexity of the legal system. This will act as a restraint on purchasers from being tempted to include unfair clauses in contracts that set the terms of payment for their suppliers.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
Familiarisation costs assumed to be incurred in the first year of the policy only. Although new representative bodies may enter the market and will also incur some form of costs of training and familiarisation, these are assumed to be rolled up in general business-as-usual training and not included in this assessment.		

### BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: 0.1	Benefits: 0.0	Net: -0.1	
			0.5

# Evidence Base

## Problem under consideration

### Late payment

1. UK companies often supply goods and services on credit, agreeing to defer payment for a period after delivery rather than requiring immediate payment. This form of payment, known as ‘trade credit’ is a common part of business practice in the UK.
2. Late payment occurs when a business has been supplied goods or services on credit but fails to pay within the agreed term. Legally, if no explicit payment terms have been agreed, payment is assumed to be due after 30 days for the purposes of charging statutory interest<sup>1</sup>.
3. Late payment causes problems for businesses that are not paid on time as it adversely affects their liquidity. This can constrain the ability of a business to invest for future growth, and in the worst cases it can force businesses to exit the market. Small businesses are especially exposed to liquidity problems when they do not receive payment on time.

### Contracting and unfair terms

4. Payment terms are generally agreed in a contract between a purchaser and a supplier. Sometimes there is an imbalance in power between the purchaser and supplier, for instance the purchaser being in a position of greater market power due to its size and the supplier having relatively few options in being able to shop around for other buyers. Large purchasers can be an important or in some cases the only route to market for a supplier’s products. In this case, the purchaser is in a powerful position and potentially able to dictate the terms of the contract in a way that favours the purchaser and disadvantages the supplier.

## Policy background

### Legislative history

5. The UK statutory framework for tackling late payment was established through the Late Payment of Commercial Debts (Interest) Act 1998<sup>2</sup>. This gave businesses the right to charge other business customers interest on overdue accounts.
6. Legislation to address late payment was introduced at EU level through the Late Payment Directive 2000/35/EC<sup>3</sup>. This was transposed in to UK law through The Late Payment of Commercial Debts Regulations 2002<sup>4</sup>. This included provision for “representative bodies<sup>5</sup>” to challenge terms “purporting to oust or vary the right to statutory interest in relation to qualifying debts created by those contracts”.
7. The EU Directive was recast in 2011 through the Late Payment Directive, 2011/7/EU<sup>6</sup>, which was transposed in to UK law through the Late Payment of Commercial Debts Regulations 2013<sup>7</sup>. The recast Directive extended the powers to allow representative bodies to challenge all contractual terms or practices with regards to late payment considered “grossly unfair” on behalf of businesses. At the time of transposition, the Government felt that the existing provision for representative bodies

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<sup>1</sup> Section 4(2A) of the Late Payment of Commercial Debts (Interest) Act 1998

<sup>2</sup> <https://www.legislation.gov.uk/ukpga/1998/20/contents>

<sup>3</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:200:0035:0038:EN:PDF>

<sup>4</sup> <http://www.legislation.gov.uk/ukxi/2002/1674/contents/made>

<sup>5</sup> Defined as organisations “established to represent the collective interests of small and medium-sized enterprises in general or in a particular sector or area”.

<sup>6</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:048:0001:0010:EN:PDF>

<sup>7</sup> <https://www.legislation.gov.uk/ukxi/2013/395/contents/made> [note that an Impact Assessment was completed for this legislation: [https://www.legislation.gov.uk/ukia/2013/1116/pdfs/ukia\\_20131116\\_en.pdf](https://www.legislation.gov.uk/ukia/2013/1116/pdfs/ukia_20131116_en.pdf)]

to challenge on behalf of small or medium-sized enterprises (SMEs) was sufficient to reflect the requirements of the Directive.

8. Subsequently, the Department for Business, Innovation and Skills<sup>8</sup> (the Department) reviewed its transposition and felt it was necessary to clarify the legislation to make clear that representative bodies can challenge any grossly unfair term. This was both to reflect the views of stakeholders that it would be beneficial to provide greater legal clarity, and to ensure there were no gaps in the completeness of transposition of the Directive. The Department published a discussion paper<sup>9</sup> in February 2015 and followed this with a consultation in October 2015<sup>10</sup> on the proposals to expand the powers representative bodies have to challenge contract terms and practices.

## Policy objective

9. The objective is to expand the existing ability for representative bodies to challenge contractual terms on behalf of SMEs. This would help address the imbalance of power between SMEs and larger firms when entering in to a contract by making it more likely that unfair contracts will result in a challenge.

## The 2016 EU referendum and transposing EU legislation

10. Another policy objective is to ensure that the UK fully complies with the requirements of transposing the Late Payment Directive, 2011/7/EU.
11. On 23 June 2016, the EU referendum took place and the people of the UK voted to leave the EU. Until exit negotiations are concluded, the UK remains a full member of the EU and all rights and obligations of EU membership remain in force. During this period the UK Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.

## Policy options for appraisal

*Transpose the power in EU Directive 2011/7/EU for representative bodies to challenge grossly unfair contractual terms in the courts on behalf of their members.*

12. The Government will introduce a new regulation that will substitute for Regulation 3 of the Late Payment of Commercial Debts Regulations 2002. The new provision will clarify that representative bodies are able to challenge the use of certain grossly unfair contractual terms and practices in or on relation to contracts to which the Late Payment of Commercial Debts (interest) Act 1998 applies. This would expand existing powers for representative bodies to challenge unfair terms relating to late payment on behalf of SMEs.
13. The proposal would allow any business to approach representative bodies for assistance. Representative bodies will have the flexibility to decide whether or not to take forward a case. A challenge can be taken on behalf of a group as well as individual companies. Action taken at a group level would create confidence for the businesses involved rather than taking an action and associated risk on a single organisation.

### *Do nothing*

14. In this case the powers to challenge would remain as they are currently defined under The Late Payment of Commercial Debts Regulations 2002. This option would bring a legal risk of the Government being challenged around the transposition of EU Directive 2011/7/EU.

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<sup>8</sup> Subsequently merged with the Department of Energy and Climate Change in to the Department for Business, Energy and Industrial Strategy in July 2016.

<sup>9</sup> Department for Business, Innovation and Skills *Late Payment: Challenging grossly unfair terms and practices* (February 2015) [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/400351/bis-15-68-late-payment-challenging-grossly-unfair-terms-and-practices.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/400351/bis-15-68-late-payment-challenging-grossly-unfair-terms-and-practices.pdf)

<sup>10</sup> Department for Business, Innovation and Skills *Late Payment: Challenging 'grossly unfair' terms: Consultation paper* (October 2015) [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/471068/BIS-15-616-challenging-grossly-unfair-terms-and-practices.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/471068/BIS-15-616-challenging-grossly-unfair-terms-and-practices.pdf)

## Cost-benefit analysis

### Proportionality and evidence gathering

15. The regulatory change proposed here is small so this impact assessment used a relatively light touch appraisal in order to be consistent with good practice around proportionality of assessment and use of government analytical resources.
16. In order to assess the impact of proposals and inform development of the policy proposal, the Department has gathered evidence from: face to face meetings with representative bodies and businesses; data from representative bodies; responses to the February 2015 discussion paper and October 2015 consultation.

### Scope of the regulations

17. The regulatory change directly affects “representative bodies”, as defined in The Late Payment of Commercial Debts Regulations 2002. These are organisations “established to represent the collective interests of small and medium-sized enterprises in general or in a particular sector or area”.
18. The change will indirectly affect all firms who enter into contracts which contain terms relating to late payment.
19. There is no official list of bodies that would meet this definition. The Trade Association Forum represents 300 trade associations which represents around a 7.5 per cent market share. This would imply an overall population of around 4,000 trade associations in the UK.
20. According to the FAME database<sup>11</sup>, there are around 2,400 companies listed under the Standard Industrial Classification of economic activity “activities of business and employers membership organisations”.
21. The estimate listed in table 1 below considers a “low” business population of representative bodies that would be required to familiarise to be 2,400 and a “high” business population to be 4,000.

### Costs

22. The regulatory change proposed here is small and does not impose a direct regulatory burden on businesses: it clarifies the grounds on which a representative body can challenge unfair terms in contracts on behalf of businesses, although it does not change the way in which unfair terms would be defined in law. Representative bodies will therefore likely want to become familiar with the change and decide on the implications for their organisation.
23. There is no change in the grounds on which an individual business can challenge unfair terms, so there is no need for individual businesses to take legal advice to review the implications of the regulatory change. If representative bodies become familiar with the regulations they can advise their individual member businesses on whether there is scope to take a challenge.
24. The changes represent a positive increase in the ability to make a legal challenge in the courts. There is no burden of ‘compliance’ that will force any organisation to take action in order to avoid being non-compliant with the law.
25. As the underlying law is not being changed, firms entering in to contract will not need to take new legal advice in order to ensure they are being compliant when drawing up contracts. Contractual clauses that were compliant before this change will still be compliant. The change increases the possibility that non-compliant contractual clauses will be challenged. In the analysis we have not treated this as a new regulatory burden.

#### *Familiarisation costs*

26. Consultation with two significant trade associations suggested that it would take around 2 hours to read and become familiar with the regulations. There were differing opinions on the number of people in a regulatory body that would need to read and familiarise with the regulations: one association felt familiarisation would be the responsibility of just one legal advisor, while another felt it would need to involve four legal advisors and a senior manager.

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<sup>11</sup> Produced by Bureau Van Dijk

27. Table 1 summarises the cost of familiarisation calculated in terms of the opportunity cost of time spent familiarising with new regulations. The underlying assumption is that this represents time diverted away from activity that would otherwise have delivered returns to the organisation equal to the cost to the representative body of employing the staff (ie the total labour cost to the body).
28. This gives two estimates for the level of staffing involved in familiarisation: a low estimate based on familiarising being the responsibility of one legal advisor, and a high estimate based on four legal advisors plus a senior manager.
29. Table 2 summarises the range of estimates. The estimates derived from a business population of 2,400 range from £168,000 to £822,000 (midpoint £495,000) and the estimates derived from a business population of 4,000 range from £280,000 to £1.37m (midpoint £825,000)<sup>12</sup>.
30. These two midpoint estimates form the basis for the impact assessment's overall Low and High estimates, ie a Low estimate of **£495,000** and a High estimate of **£825,000**. The "Best estimate" is a simple midpoint of the two, ie **£660,000**.

**Table 1: Cost of familiarisation**

Business population	Low	Low	High	High	
Level of staffing involved in familiarisation	Low	High	Low	High	<i>Hourly cost of labour</i>
Estimated number of representative bodies	2,400	2,400	4,000	4,000	
Staff required to familiarise					
<i>Legal advisors</i>	1	4	1	4	£34.99
<i>Senior managers</i>		1		1	£31.30
Time (hrs) per person familiarising	2	2	2	2	
Cost of familiarisation	£168,000	£822,000	£280,000	£1,370,000	

Cost of labour based on estimates of hourly pay taken from the Annual Survey of Hours and Earnings (ASHE)<sup>13</sup>. These are uprated by 19.7 per cent<sup>14</sup> to include non-wage labour costs based on Eurostat<sup>15</sup> data on wages and labour costs.

**Table 2: Cost of familiarisation: summary**

	Level of staffing involved in familiarisation		
	Low	High	Midpoint <sup>16</sup>
Business population			
<b>Low</b>	£168,000	£822,000	£495,000
<b>High</b>	£280,000	£1,370,000	£825,000

<sup>12</sup> Rounded to the nearest £100k.

<sup>13</sup> Annual Survey of Hours and Earnings: 2017 provisional and 2016 revised results (October 2017) Table 14.6a Hourly pay - Excluding overtime (£) - For all employee jobs: United Kingdom, 2017.

<sup>14</sup> Estimated hourly total labour cost in the UK (2016) estimated at €26.70 of which €22.30 (83.52 per cent) is made up of wages and salaries and €4.40 (16.48 per cent) is made up of other labour costs. Total labour cost therefore represents 26.70 / 22.30 = 1.197 of wages and salaries. We therefore uprate an estimate of hourly wages by a factor of 1.197 to derive an estimate of total hourly labour cost to businesses.

<sup>15</sup> Eurostat data extracted April 2017: [http://ec.europa.eu/eurostat/statistics-explained/index.php/Wages\\_and\\_labour\\_costs#Labour\\_costs\\_2](http://ec.europa.eu/eurostat/statistics-explained/index.php/Wages_and_labour_costs#Labour_costs_2)

<sup>16</sup> Simple midpoint of the low and high estimates of level of staffing involved in familiarisation.

### *Ongoing costs*

31. Once representative bodies are familiar with the new regulations, there should be no ongoing costs as a result of this legislative change. Whilst there will be court costs associated with bringing legal action, the decision to bring action will be down to representative bodies and the firms on whose behalf they are acting, and there will be no requirement to incur these costs unless a business decision has been taken that it would be advantageous overall to do so.

### **Benefits**

32. Enabling representative bodies to challenge grossly unfair contractual terms on behalf of businesses should increase the likelihood that unfair terms will be challenged in the courts. This is because suppliers who may otherwise not feel confident in acting alone in taking court action, may feel more able to make representations to a representative body who could act on their behalf. This should act as a restraint on parties intending to include unfair terms in their contracts as they will be more likely to be challenged.
33. The benefits of the policy are indirect, ie they do not happen automatically but as a result of some behavioural response from the parties involved. In order for the policy to deliver benefits, firms would need to improve the integrity of their contract proposals to eliminate instances of unfair terms being included in contract, due to the increased threat of legal action.
34. There does not need to be an increase in the amount of legal cases brought in order to have the desired effect, the increased potential for small firms to be able to act through their representative bodies can act as a restraint at the time contracts are drawn up.
35. The extent of these benefits is not possible to monetise and this impact assessment has not made a speculative attempt to quantify the benefits.

### *Benefits to suppliers*

36. Suppliers will benefit from increased ability to access legal redress against unfair contract terms through their representative bodies being able to take action on their behalf. A representative body can share the cost of action and may be more likely to have access to legal expertise than a supplier. Suppliers will also benefit if there is reduced incidence overall of use of unfair terms in their contracts.

### *Benefits to representative bodies*

37. By enhancing the status of representative bodies to enable them to challenge unfair terms on behalf of their members there is the potential for representative bodies to attract more members. This could offer the potential for new business models to be developed by representative bodies, for example offering a chargeable service to non-members as well as offering a low cost additional service to existing members or groups of members<sup>17</sup>.

### *Broader benefits of tackling late payment*

38. The Impact Assessment associated with the Payment Reporting Requirement regulations presents a discussion around the benefits of reducing the incidence of late payment in the economy<sup>18</sup>. This includes: reduced need to pay interest on external finance or forego alternative returns on cash reserves; reduced administrative costs by not having to chase payments or make contingency plans to find alternative liquidity when expected receipts are late; increased ability to finance hiring extra employees or increase capital investment due to not needing to use cash reserves to cover for late payments; lower likelihood of business exit.

### **Wider impacts**

#### *Equalities impact*

39. We have assessed these proposed reforms against the equality duty and do not consider them to have an adverse effect on any protected group.

#### *Small and micro business assessment*

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<sup>17</sup> This idea was suggested in evidence gathered from consultation with representative bodies.

<sup>18</sup> Payment Reporting Requirement Impact Assessment (2016) BEIS024(F)-1-CCP  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/586815/payment-reporting-requirements-final-impact-assessment-sig.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/586815/payment-reporting-requirements-final-impact-assessment-sig.pdf)

40. The policy is likely to disproportionately benefit small and micro businesses, because these are the businesses that are currently most likely to be deterred from bringing legal action against use of unfair terms in contract due to having lower experience, confidence and financial resources. By enabling representative bodies to take action on their behalf, it is more likely that they will feel confidence in being able to use the court system to challenge unfair terms. Whilst larger businesses will also be able to use representative bodies as a means to bring action on their behalf, they are more likely to have existing capability to bring legal action on their own.

*Justice impact*

41. A separate Justice Impact Test has been submitted to the Ministry of Justice to assess the impact of the policy on HM Courts and Tribunals Service.