

23 January 2017

Dear Lord Justice Jackson

## **REVIEW OF FIXED RECOVERABLE COSTS**

The Federation of Small Businesses (FSB) welcomes this opportunity to submit comments to the review of fixed recoverable costs. FSB is the UK's leading business organisation. It exists to protect and promote the interests of the self-employed and all those who run their own business. FSB is non-party political and is also the largest organisation representing small and medium sized businesses in the UK.

Small businesses make up 99.3 per cent of all businesses in the UK, and make a huge contribution to the UK economy. They contribute 51 per cent of the GDP and employ 58 per cent of the private sector workforce.

### **Importance of the civil legal framework to small businesses**

The rule of law and the structures that support it are essential for a thriving commercial sector.<sup>1</sup> In order to do business small businesses rely on a deeply embedded culture of fair and honest dealing which is, in turn, founded upon being able to enforce commercial arrangements where necessary. Consequently, the civil courts and access to them by smaller businesses play a vitally important role in business success.<sup>2</sup> Yet the importance of legal institutions and their essential role in facilitating economic development has been a somewhat neglected aspect in the debates over civil justice reform and economic policy. We believe that it is time the needs of small business became a central issue in the legal reform agenda.

### **Costs of commercial disputes to small businesses**

Small businesses in England and Wales are labouring under £11.6 billion in annual Total Resolution Costs (TRC) as a result of commercial disputes.<sup>3</sup> This is a significant drain on their ability to invest and grow and subsequently the performance of the UK economy. This cumulative cost takes a significant toll on smaller businesses because small businesses are much more exposed to the negative consequences of high costs of doing business, due to a

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<sup>1</sup> FSB. 'Tied Up: unravelling the dispute resolution process for small firms'. (2016).

<sup>2</sup> Routine court activity such as ensuring parties to a contract uphold their obligations or pay compensation, ensuring debts owed are paid and disputes are adjudicated fairly and predictably are the foundations on which small businesses rely in order to undertake commerce. The absence of an institution to carry out such activities would be a severe impediment to production and exchange.

<sup>3</sup> FSB. 'Tied Up: unravelling the dispute resolution process for small firms'. (2016).

host of vulnerabilities that are inherent to smaller businesses.<sup>4</sup> The drag on the competitiveness of the small business community, as a result of these costs, needs to be reduced.<sup>5</sup>

FSB research, described in our report '*Tied Up: unravelling the dispute resolution process for small firms*', found that 19% of small business commercial disputes end up in a court.<sup>6</sup> While over a fifth of that 19% end up in the higher ('Fast' and 'Multi') tracks where cost recovery issues are most salient.<sup>7</sup> The small businesses involved in cases in the 'Fast' and 'Multi' tracks are likely to be incurring considerable costs. Consequently a proportion of the £11.6 billion of TCR is made-up of litigation costs.

Therefore, one important way of reducing the TRC bearing down on the small business community is to cut the direct costs of litigation for smaller businesses through more extensive use of fixed recoverable costs. The latter will reduce the costs incurred by some of those small businesses already ending up in the courts to resolve a commercial dispute.

Another aspect of the TCR are the costs associated with detriment incurred by a business because they are unable to defend their legitimate interests through the courts. Therefore, a second but closely linked way that fixed recoverable costs can reduce the £11.6 billion cost of commercial disputes to small business is through creating more certainty over the final costs of litigation. This will give more confidence to smaller businesses to defend their interests through the courts when necessary. Over time this will likely lead to more small businesses obtaining justice and a consequent more efficient allocation of economic resources across the economy. In the very long-term England and Wales could see (economy wide) improvements in the behaviour of parties to commercial arrangements and lower levels of litigation overall. This would mean substantial savings for the small businesses of England and Wales and a more efficient economy.

A final way that fixed recoverable cost could help reduce the costs of litigation is through the role they can play in incentivising greater efficiency among litigation services providers through more extensive investment in and deployment of technology and more efficient methods of working. Over time this should help reduce the cost of 'going to law' across the whole sector making formal legal advice more accessible for small firms.

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<sup>4</sup> Fletcher, A et al. 'Small Businesses as Consumers: Are They Sufficiently Well Protected?'. (2014).

<sup>5</sup> FSB. 'Tied Up: unravelling the dispute resolution process for small firms'. (2016).

<sup>6</sup> FSB. 'Tied Up: unravelling the dispute resolution process for small firms'. (2016).

<sup>7</sup> FSB. 'Tied Up: unravelling the dispute resolution process for small firms'. (2016).

## The implementation of fixed recoverable costs

FSB has argued for a significant increase in the limit for small claims to match the limit proposed for the planned online court. This would resolve some of the legal costs issues for many smaller businesses. However, raising the threshold to £25,000 would not impact cases which currently fall into the 'Multi' track. Therefore, for these businesses the risks around legal costs can be substantial and will remain. So too will the wider uncertainty deterrents to a small business fully protecting their legitimate interests that high litigation costs create. Therefore, FSB agrees with Jackson, LJ that fixed recoverable costs should apply to a wide range of cases. FSB believes all commercial disputes in the higher tiers of the civil courts likely to involve small businesses should be subject to fixed recoverable costs. This can be achieved by having a high threshold for applying fixed cost to commercial cases. The level should be fixed at least at £150,000. However, we think that the threshold proposed by Jackson, LJ of £250,000 is reasonable and would support this was the threshold implemented.<sup>8</sup>

While the rule for cases with a value below the relevant threshold should be for fixed costs to apply, the inevitable complexity of some commercial disputes means that a clear and robust regime of fixed recoverable costs should allow for those occasional difficult cases where a fixed cost regime may not be appropriate.<sup>9</sup> Therefore a narrow and strictly policed exemption should be put in place for any regime that is established.

Further, the fixed costs must be reasonable and balance incentives to provide a litigation service and the need to reduce the costs of 'going to law' for small businesses. Their level should be set based upon rigorously collected evidence about the costs incurred by efficient legal service providers.

In addition, the costs and thresholds will need to be regularly reviewed to make sure that they remain a fair reflection of the balance between the incentives for providing legal services and the disincentives to using them.

Finally, it is vital that they should also be established in the context of wider reform (please see section below for more detail) which will help minimise any unintended consequences from the policy by assisting in the control costs within the court system and offering alternative ways to access justice.

## Additional reforms needed for fixed recoverable costs to work effectively

In order for fixed recoverable costs to be effective and to minimise any potential unintended consequences for some potential future users of litigation services, the Ministry of Justice

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<sup>8</sup> Jackson, LJ. 'Fixed costs: the time has come'. (2016). Available at: <https://www.judiciary.gov.uk/wp-content/uploads/2016/01/fixedcostslecture-1.pdf>

<sup>9</sup> The Law Society raised a number of reasonable points about how fixed recoverable costs might work in practice and impact the legal profession. Source: Hyde, J. 'Jackson: fixed costs needed for all claims up to £250k'. (2016). Available at: <https://www.lawgazette.co.uk/law/jackson-fixed-costs-needed-for-all-claims-up-to-250k/5053344.article>

(MoJ) and HM Courts and Tribunals Service (HMCTS) will need to make sure that there is a suite of substitute options to litigation which small businesses can utilise. These substitute options should include:

- Rigorous case management of court disputes to keep cases progressing. Reigning in the costs of professional advice through fixed recoverable costs could have some counter-productive consequences unless the length and amount of resource a court case takes up is also kept in check.<sup>10</sup> Case management needs to be accompanied by investment in modern IT systems to speed up the efficiency of court processes. Together such measures would reduce wider court operating costs and in turn lessen some of the costs legal representatives incur due to the inefficiencies in the court system.
- An increase the small claims court (SCC) limit substantially removing the need for legal advisors from more cases. The threshold should be aligned with that for the proposed online court.<sup>11</sup> This should be accompanied by commensurate increases in the 'Fast' and 'Multi' track thresholds. Further, more flexibility needs to be built into the civil court system and into case allocation and the SCC in particular, giving the court more discretion over where cases should be dealt with e.g. there should be a default presumption of keeping cases in the SCC where possible (i.e. where it is in the interests of justice and proportional to do so) rather than being moved up into the other 'tracks'.<sup>12</sup>
- Providing a high quality wrap around support service for small business users of the courts and Litigants in Person (LiPs) in particular, which can help small firms better navigate and utilise the courts more easily.<sup>13</sup>
- Measures which improve the availability of Alternative Dispute Resolution (ADR) to small businesses. ADR offers another route to resolving disputes if more small businesses are able to access ADR. FSB research highlighted that small businesses currently use courts nearly three times more than they use ADR.<sup>14</sup> A more effective commercial ADR sector could provide a useful alternative to litigation for small businesses by helping provide a substitute option should there be any unintended consequences resulting from the imposition of fixed recoverable costs. However, in order to be a more popular option the commercial ADR market will need to work better for smaller businesses. The sector is highly fragmented and it is difficult for small businesses to navigate.<sup>15</sup> FSB proposed a number of measures which would improve its functioning in our recent report '*Tied Up: unravelling the dispute resolution process for small firms*'.<sup>16</sup>

We intend to engage constructively with the remainder of the review, and to take up any further opportunities to input the small business perspective if and when any arise.

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<sup>10</sup> FSB. '*Tied Up: unravelling the dispute resolution process for small firms*'. (2016).

<sup>11</sup> FSB. '*Tied Up: unravelling the dispute resolution process for small firms*'. (2016).

<sup>12</sup> FSB. '*Tied Up: unravelling the dispute resolution process for small firms*'. (2016).

<sup>13</sup> FSB. '*Tied Up: unravelling the dispute resolution process for small firms*'. (2016).

<sup>14</sup> FSB. '*Tied Up: unravelling the dispute resolution process for small firms*'. (2016).

<sup>15</sup> FSB. '*Tied Up: unravelling the dispute resolution process for small firms*'. (2016).

<sup>16</sup> FSB. '*Tied Up: unravelling the dispute resolution process for small firms*'. (2016).



If you have any further questions regarding our views on this issue please do not hesitate to contact my colleague Richard Hyde on the following number: 020 7592 8127 or on his email address: [Richard.hyde@fsb.org.uk](mailto:Richard.hyde@fsb.org.uk)

Yours sincerely

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