



# TIED UP

## UNRAVELLING THE DISPUTE RESOLUTION PROCESS FOR SMALL FIRMS

Published: November 2016

 @fsb\_policy

[fsb.org.uk](http://fsb.org.uk)

**fsb**<sup>3</sup>  
Experts in Business

# ACKNOWLEDGMENTS

---

This report was authored by Richard Hyde, Policy Advisor for Regulation and Home Affairs, under the project leadership of Warren Smith and the close advice and input of Neil Sharpley and with the support from Richard Parlour, FSB member and Chairman of FSB's Home Affairs Policy Committee. Important contributions were also made by FSB members Martyn Weller and Ben Francis. Special thanks go to FSB's media, public affairs and policy teams, in particular the project team responsible for delivering the report: Anne Mannion, Natasha Smith, Jessica Smith and Andy Poole. The research was carried out by Verve – the market research agency responsible for administering the survey. The report was designed by Cactus Design Limited – a small business based in Wales.

This project would not have been possible without all FSB members who participated in this research, generously taking the time out of running their small businesses. Special thanks go to the myriad of external experts who also gave up their time to provide a variety of insights into this project: Dame Hazel Genn, Dean of Laws and Co-Director at UCL Judicial Institute; Martin Partington, Emeritus Professor at University of Bristol Law School; Neil H Andrews, Director of Studies in Law and Professor of Civil Justice and Private Law at Clare College, University of Cambridge; Andrea Knox, Partner at Knox Commercial Solicitors; Beth Silver, Business Member of the Civil Justice Council; Richard Thompson, Vice Chair of Civil Courts Users Association and Partner (Litigation and Recoveries) at Brachers Solicitors; Sarah Jane-Bennett, Head of Policy (Legal Affairs, Practice and Ethics) at the Bar Council; Averil Sessions, Policy Analyst at the Bar Council; Andrew Parsons, Barrister, Mediator and Arbitrator; Colin Manning, Barrister, Mediator and Arbitrator; Peter Causton, Solicitor, Deputy District Judge, Mediator and member of the Civil Justice Council's Cost Committee; Chris Hodges, Professor of Justice and Systems at the Centre for Socio-Legal Studies, University of Oxford; Dr Sue Prince, Associate Professor in Law at the Law School, University of Exeter; Pascoe Pleasence, Professor of Empirical Legal Studies at University College London; Robert Cross, Project Manager (Research) at the Legal Services Board and Steve Brooker (Head of Research and Development); Mike Harris, Head of Insight and Content at the Financial Ombudsman Service; Darin Thompson, Legal Counsel, British Columbia Ministry of Justice and Adjunct Professor at Osgoode Hall Law School and the University of Victoria. Gratitude also goes to a number of civil servants in the Ministry of Justice and HM Courts and Tribunals Service and the office of the Master of the Rolls Office for the numerous discussions about justice policy and the ongoing reform programme which helped provide important background for this report.

# WHO WE ARE

---

FSB (Federation of Small Businesses) is the UK's leading business organisation. We are non-party political and exist to protect and promote the interests of the self-employed and all those who start-up and run their own businesses. Small and medium-sized businesses make up 99.9 per cent of all businesses in the UK; they account for 47 per cent of private sector turnover and employ 60 per cent of the private sector workforce.

# TIED UP:

## UNRAVELLING THE DISPUTE RESOLUTION PROCESS FOR SMALL FIRMS



the **cost** smaller firms face per year by having a **dispute**

**£18,000**



average amount under **dispute** for a small business

**70%**



of small businesses have at least **1 commercial dispute**

Figure relates to between 2010-2015

### Dispute type small businesses face

**72%**



of small businesses face **late** and **no payment** disputes

**17%**



of small businesses **can not resolve** a dispute

### Methods small businesses use to resolve disputes

**43%**



**Informal and semi-formal**

**8%**



**Alternative dispute resolution**

**19%**



**Civil courts**

# CONTENTS

---

Foreword . . . . .	5
Executive Summary . . . . .	6
Small businesses and commercial disputes . . . . .	9
Avoiding a dispute . . . . .	16
Tier one: Informal or semi-formal resolution of a dispute . . . . .	17
Tier two: Small business and ADR . . . . .	20
Tier three: The civil justice system and small business . . . . .	28
Improving dispute resolution: A comprehensive three tier system. . . . .	40
Appendix I: Rule of law . . . . .	48
Appendix II: Private property, contracts and english law . . . . .	49
Appendix III: Areas for reform – civil courts. . . . .	51
Methodology . . . . .	52

# FOREWORD

---

Access to justice for small businesses is a burning issue. The purpose of this research is to shine a light on the extent of the problem, to highlight the cost to individual businesses and understand the wider impact on productivity and the UK economy. Most businesses are involved in a commercial dispute at one time or another. This may be with a supplier, a customer or a competitor. In some cases, disputes happen between owners within a business. This report highlights the scale of commercial disputes across England and Wales, with over 70 per cent of FSB members reporting being involved with at least one dispute. 11.6 billion is the cost smaller firms face per year by having a dispute. So, it is imperative that disputes are prevented where possible and, if not, they must be resolved swiftly, fairly and at the lowest possible cost to those involved.

Compared to larger business, smaller businesses are significantly less well equipped for resolving disputes. They simply do not have the resource to deal with the associated processes on top of the day job of trying to sustain and grow their business. Disputes are complex and costs can quickly spiral out of control. Most importantly though is the damage to a commercial relationship with a third party on whom the business may depend for its survival. The consequences can be devastating for small businesses, ranging from short-term cash-flow difficulties right through to insolvency.

This situation also has consequences for the wider economy. Around three quarters of commercial disputes are as a result of late or non-payment, creating negative knock-on effects for small businesses. Their ability to invest, innovate, grow and take on employees can be significantly damaged. This report explores how best to reduce the considerable negative impacts associated with commercial disputes involving the wider small business community and on the economy as a whole.

FSB believes that the way to help small businesses with disputes is through the development of a comprehensive three-tier dispute resolution system. The first tier should be focused on encouraging and equipping small businesses to prevent disputes arising or, if that is not possible, resolving them as early and as informally as possible. When a dispute cannot be prevented or resolved informally, the second tier should provide businesses access to a vibrant, diverse and trusted alternative resolution system. Finally, the first two tiers must be underpinned by the third tier, an effective civil justice system providing cheap, fair and just outcomes.

It is worth noting that the systems for prevention, informal resolution and alternative dispute resolution (ADR) can provide a low cost dispute resolution framework for many businesses. However, these systems will only work in the context of the ultimate 'backstop' that the civil courts provide and the wider social norms and rules which facilitate commerce. Successive governments have underinvested in the civil justice system in England and Wales and the result has been a deterioration in the quality of the service it provides to small businesses. Recent announcements from the Ministry of Justice (MOJ) about plans to invest in and modernise the civil courts are a welcome step forward towards reversing the decline of the civil justice system. FSB has produced this report and has provided a suite of recommendations for rebalancing the access to the justice landscape, which will help small businesses resolve their disputes effectively and efficiently.



**Martin McTague**  
FSB Policy Director

# EXECUTIVE SUMMARY

---

## Small business and commercial disputes

A considerable proportion of small businesses are, at some point, involved in a commercial dispute. FSB research found that 70 per cent of our members experienced at least one commercial dispute between 2010 and 2015. This suggests there were at least 3.4 million commercial disputes involving small and medium-sized businesses across England and Wales over that period. Further, this is likely to be an underestimate of the total number of disputes, given that many businesses will no doubt experience more than one.

Of those small businesses reporting a dispute:

- Nearly three-quarters (72%) were in relation to late and non-payment, e.g. small businesses in supply chains experiencing late and non-payment from their customers.
- Just over a quarter (28%) had a dispute over non-payment related contractual issues.

Small businesses are, on the whole, not well equipped to deal with disputes. They often do not have the resources to dedicate to pursuing a problem, whether that be negotiating its resolution informally, robustly through ADR or through the courts. Another key disadvantage small businesses face is powerful economic pressure from the other party. This can result in an unsatisfactory outcome despite the merits of the case due to the significant difference in bargaining power. Even where the parties nominally are of equal size one party may be more important to the other which results in disparities of bargaining power.

## The value and cost of commercial disputes

FSB research found that the average value of the most recent dispute between 2010 and 2015 was over £18,000. That is a significant amount for many small businesses. This suggests that, between 2010 and 2015, around £62 billion was tied up in disputes involving small businesses. This equates to £12.4 billion per year during that period.

In attempting to resolve the dispute small businesses incur costs (such as legal representation, lost alternative business opportunities, time spent dealing with the dispute rather than on core business activity) of nearly £17,000. This represents a broader cost to the small business community of England and Wales of around £11.6 billion per year.

The costs to the overall economy go even further. Commercial disputes can create considerable financial difficulties for small businesses, which have knock-on effects on the economy:

- Resources are inefficiently allocated across the economy as they disrupt previously agreed and mutually beneficial commercial arrangements.
- Investment and growth is impacted and drags down the dynamism of the economy. Late payments, the issue most FSB members reported as the cause of a dispute, have a negative impact on small business profits, investment and hiring of new employees.<sup>1</sup>

The considerable costs that disputes give rise to indicate that preventing them or resolving them fairly, justly and efficiently could deliver a considerable boon for both the small business community and the wider economy.

---

<sup>1</sup> FSB. Time to act: The economic impact of late payment' 2016.



## Deficiencies in the dispute resolution landscape

Despite the wide-ranging economic consequences of commercial disputes for small businesses and the economy, the dispute resolution environment in England and Wales is not as effective as it could be.

Access to appropriate dispute resolution methods in England and Wales is limited, for a number of reasons:

- Knowledge and skills: effective relationship management and dispute resolution strategies are essential for resolving disputes, but many small businesses do not have access to the relevant knowledge and skills.
- The ADR sector is fragmented and small businesses remain unaware of its possibilities. This market failure partly explains the relative unpopularity of ADR among smaller businesses. Only eight per cent of FSB respondents used ADR to resolve their most recent dispute compared to 19 per cent who used the civil courts.
- The English and Welsh courts are inefficient i.e. slow and expensive. This is most vividly demonstrated by the civil justice systems poor international ranking. The civil courts in England and Wales have faced underinvestment, with the court infrastructure falling far behind other jurisdictions such as Singapore. They have also suffered from organisational and managerial problems which have also contributed to the low comparative ranking.

A new approach to dispute resolution must be put in place. One that is based on the understanding that investing in reducing disputes and speeding up their resolution fairly and justly will deliver long-term benefits for small businesses and the wider economy.

## Types of dispute resolution

FSB believes that the way to help small businesses with disputes is through the development of a comprehensive three-tier dispute resolution system accessible to all small and medium-sized businesses in England and Wales. The first tier should be focused on encouraging and equipping small businesses to prevent disputes arising or, if that is not possible, resolving them as early and as informally as possible. When a dispute cannot be prevented or resolved informally, the second tier should provide businesses with access to a vibrant, diverse and trusted alternative resolution system. Finally, the first two tiers must be underpinned by the third tier, an effective civil justice system providing cheap, fair and just outcomes. Crucially, the latter should also be accessible directly if the parties wish to take their dispute direct to court.

## KEY RECOMMENDATIONS

The Government must develop a holistic policy response in order to deliver the long-term gains that can be obtained from both reducing the number of disputes and speeding up their resolution. Policy should aim to establish a comprehensive, three-tier system to help and enable small businesses to avoid or resolve commercial disputes.

Each method of dispute resolution has its own advantages and disadvantages. The right approach to a particular dispute is likely to depend on the circumstances, i.e. the nature of the dispute, the characteristics (size, sector, risk appetite) and relative priorities of the parties involved, e.g. between time costs, financial impacts and a just outcome. The decision about the most appropriate solution should be made by the disputing parties based on their specific needs.

The three-tiers should be organised as follows:

### **Tier one: prevention, informal and semi-formal resolution**

The key focus for this tier should be to help small businesses prevent disputes or resolve disputes early. To achieve this:

- The new Small Business Commissioner (SBC) should take a central role in developing and making freely available guidance and support for small businesses to improve their awareness and understanding of commercial relationship management and dispute resolution strategies.

### **Tier two: ADR**

The primary aim of this tier should be a commercial ADR market that small businesses are able to access easily. This will require a number of policy measures:

- The SBC should provide guidance and undertake measures to help raise small business awareness about the availability and potential benefits of ADR.
- Building on the Ministry of Justice's 'Find a Mediator' platform, the SBC should establish an ADR hub which includes a platform through which small businesses can better navigate the commercial ADR market.
- A comprehensive review of the commercial ADR sector with a focus on both regulation and its competitiveness with the aim of finding additional ways to enhance its ability to meet the needs of the small business community.

### **Tier three: the civil courts**

The third tier is the civil courts and ensuring that ultimately, there is a reliable and accessible civil justice system underpinning commercial activity which can efficiently resolve disputes. In order to have such a system:

- The civil court system needs to be reformed to make it cheaper and quicker for small businesses by bringing it up to the performance levels of the civil court systems in comparable Common Law countries.



# SMALL BUSINESSES AND COMMERCIAL DISPUTES

---

Small businesses are particularly vulnerable in dispute situations. Small businesses have limited resources to deal optimally with disputes that arise. They are unlikely to have access to the required knowledge, adequate spare labour, time and finance (cash flow, reserves) which would enable them to implement the best dispute resolution. Such resource constraints make them vulnerable to imbalances in bargaining power in disputes. Imbalances are not just size related but also linked to differences in knowledge and experience, as well as the importance of one party to the other. A customer who accounts for only a small proportion of sales is much less likely to be able to wield bargaining power than if the customer is the business' only client.

It is critical that small businesses in England and Wales are able to minimise the cost of disputes and their negative impact. It is similarly important to the wider economy that the costs of disputes are reduced. To these two ends, this report makes a number of recommendations for Government which will help ensure a thriving small business sector in England and Wales by reducing some of the economic efficiency losses which follow from the prevalence of commercial disputes.

Commercial disputes arise as a result of a number of factors. The most prominent of these are:<sup>2</sup>

- Uncertainty or lack of clarity around obligations, responsibilities, objectives and outcomes or deliberate and outright failure to meet them.
- Lack of written agreement.
- Conduct of one or more parties in the pre-agreement or performance part of the relationship.
- Third party interference with the performance of the contract.

Between 2010 and 2015 (inclusive), around 70 per cent of FSB members surveyed about their experiences of commercial disputes reported being involved in at least one.<sup>3</sup> Using the 2015 BIS business population data, this suggests just over 3.4 million businesses in England and Wales experienced at least one dispute over the period.<sup>4</sup>

Data collected by FSB found that the customer/client was the most frequently reported source of the most recent dispute experienced by respondents. This was followed, some distance behind, by disputes as a result of issues with the supplier of a good or service to the respondent's business.

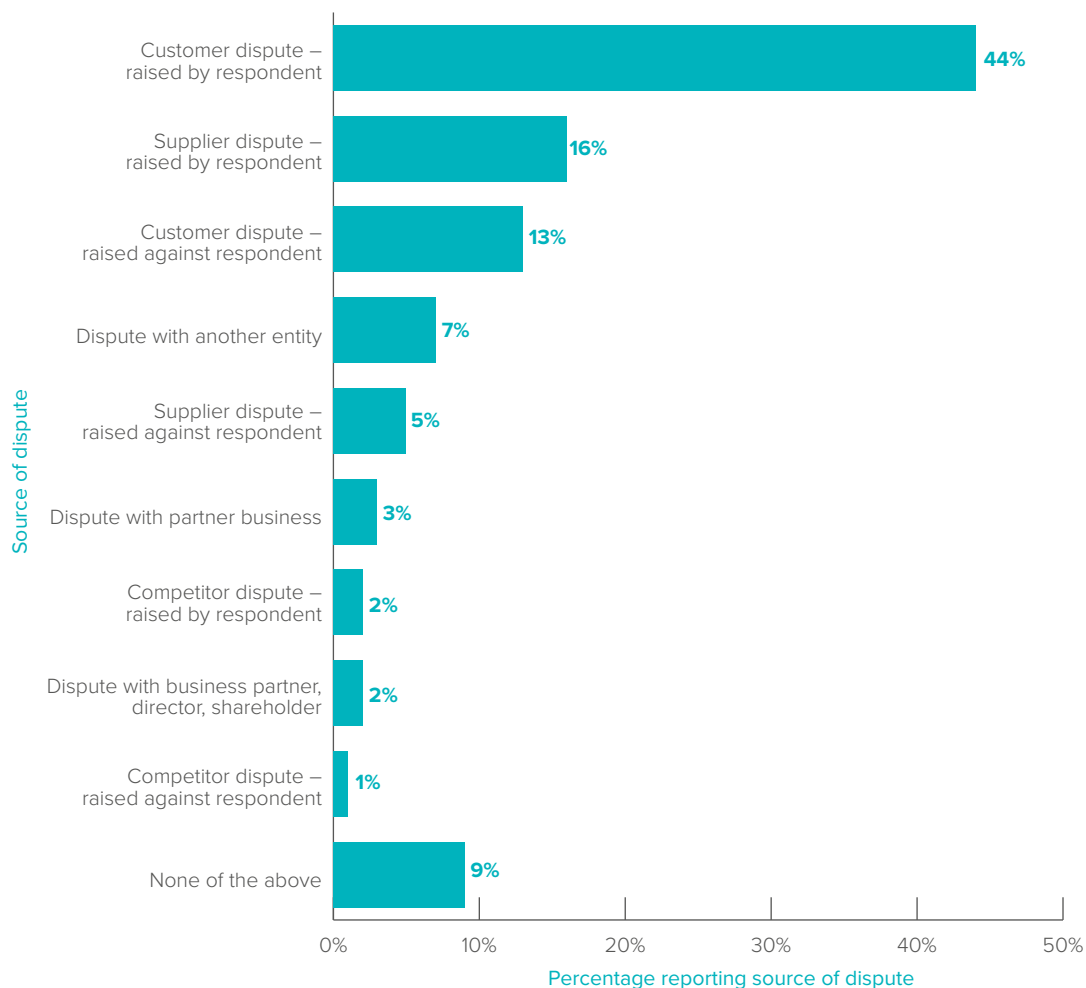
---

<sup>2</sup> Staugas, J., Strategies for dispute prevention and management in commercial arrangements. (2002).

<sup>3</sup> All data from the FSB Dispute Resolution survey presented in this report are rounded to the nearest whole number.

<sup>4</sup> Totals are calculated using official data published by BIS in 2015. BIS. Business Population Estimates for the UK and Regions 2015. (2015). Accessible at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/467443/bpe\\_2015\\_statistical\\_release.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/467443/bpe_2015_statistical_release.pdf)

**Figure one: Source of most recent commercial dispute.**  
**Source: FSB commercial dispute resolution survey 2015.**



- Disputes with customers/clients accounted for over half (nearly 57%) of the most recent disputes in which respondents had been involved.<sup>5</sup>
- Disputes with suppliers accounted for just over a fifth (21%) of commercial disputes, whether that be the respondent raising the dispute or it being raised against them.<sup>6</sup>
- Problems with competitors, e.g. for anti-competitive behaviour or with businesses with which the respondent was undertaking a joint-venture, were not common. These two categories only accounted for just over two per cent of responses.
- Similarly, internal issues to a business which resulted in a dispute were only reported by two per cent of respondents, suggesting such problems are rare.

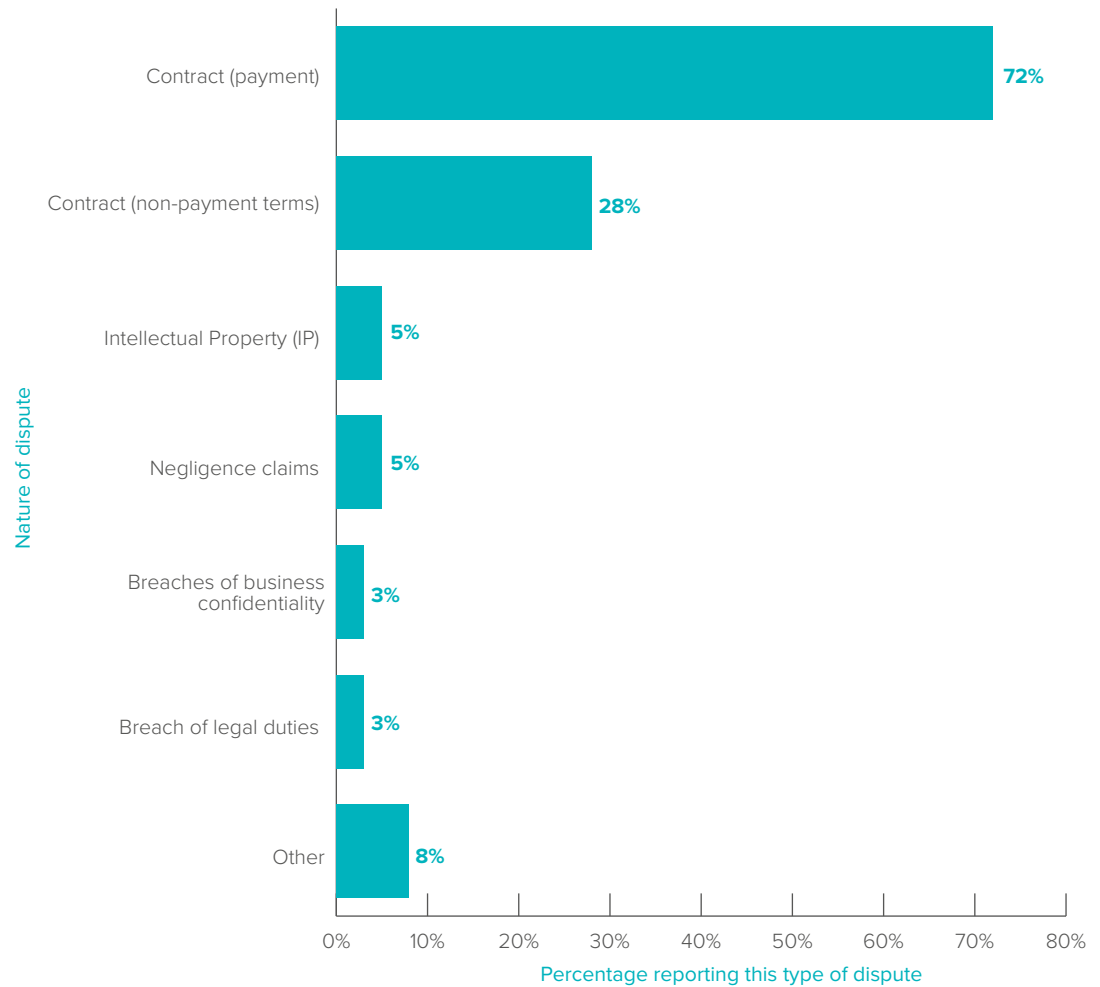
FSB research suggests that disputes arise overwhelmingly between businesses in customer–supplier relationships. Disputes outside this core business relationship area, while not insignificant, are much rarer. This pattern is confirmed by the data captured from FSB members on the nature of their most recent dispute illustrated in Figure one.

<sup>5</sup> Customers in the survey encompasses both other businesses, these could be larger, smaller or of equal size to the respondent business, as well as private consumers.

<sup>6</sup> The term suppliers in the FSB survey covers businesses of any size, larger, smaller or of equal size to the respondent business.

**Figure two:** Types of commercial dispute in which you have been involved.<sup>7</sup>

**Source:** FSB commercial dispute resolution survey 2015.



- Payment issues (debts) are by far the most frequently experienced type of dispute. Seventy-two per cent of respondents had a dispute about late payment or non-payment. The category of payment-related disputes includes both late payment (42%) and non-payment (30%) of debts, the latter likely having to be written off by many small businesses. This equates to over 2.4 million small and medium-sized businesses experiencing a payment related dispute.
- Payment problems were followed by other (i.e. non-payment-related) contractual issues, such as disputes over aspects of the sale or supply of a good or a service. This includes quality and conformity issues, breaches of other contractual terms and obligations and misrepresentation about the nature of the good, service or the price. Cumulatively, disputes in these areas were reported by over a quarter of respondents (28%). This equates to around 1.4 million English and Welsh businesses experiencing a non-payment contractual dispute issue at least once over the five year period 2010 to 2015.

<sup>7</sup> Respondents were asked to list the types of dispute they had experienced over the years 2010 to 2015. Respondents could choose more than one option.

While the commercial dispute landscape is dominated by various types of contractual issues, there were a range of other types of commercial dispute experienced at least once by respondents. FSB found that:

- Five per cent of respondents had a dispute over Intellectual Property.
- Five per cent were involved in negligence claims (i.e. tortious claims) by or against the respondent.
- Three per cent experienced a dispute over a breach of commercial confidentiality.
- Three per cent reported experiencing a dispute between business owners and directors.

Extrapolating the FSB survey data across the English and Welsh small business population suggests that over 700,000 small and medium-sized businesses experienced a dispute in one of the four categories above, over the period 2010 to 2015.<sup>8</sup>

### Disputes underestimate the extent of small business detriment

While 70 per cent of respondents experienced at least one dispute in the period 2010 to 2015, this is not a complete figure as many small businesses decided not to pursue a dispute. A recent survey by FSB found that a large proportion of smaller businesses suffer detriment (as a result of a contract term or terms) face significant barriers to challenging more powerful counter parties. This research found:<sup>9</sup>

- 40 per cent of respondents put up with unfair contract terms because they felt that the supplier was too important to their business or too powerful to challenge.
- 34 per cent replied that they would like to have challenged the supplier because of an unfair term in a contract and that they had a strong case, but did not have the resources or the knowledge to know how to challenge the other party.
- The proportions finding it difficult to challenge unfair contract terms are consistent with other available survey data, which found that just under a third (30%) of respondents to a survey of decision makers in small and medium-sized businesses did not pursue a case, despite there being grounds for pursuing one.<sup>10</sup>

### Value of small business disputes

FSB research suggests that the average value of the most recent dispute in which small businesses were involved was over £18,000. Extrapolating the FSB data across all small and medium-sized businesses in England and Wales suggests that:

- The total amount under dispute over the period 2010 to 2015 was at least £62.07 billion.
- There is, on average, £12.4 billion a year tied up in some sort of dispute. This figure is a likely underestimate as respondents were only asked about their most recent dispute.

<sup>8</sup> The figure, calculated using the 2015 England and Wales business population statistics is: 773,000.

<sup>9</sup> FSB. Protections or Micro-businesses in non-regulated markets. (2016). Accessible at: <http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-response---small-businesses-as-consumers---consultation---june-2016.pdf?sfvrsn=0>

<sup>10</sup> Annecto Legal Ltd and Opinion Matters. British SMEs missing out on billions of pounds in damages because they can't afford their day in court. (2014). Accessible at: [http://www.annectolegal.co.uk/download/2014\\_10\\_06\\_Annecto\\_SME\\_research\\_for\\_website\\_FINAL.pdf](http://www.annectolegal.co.uk/download/2014_10_06_Annecto_SME_research_for_website_FINAL.pdf)

## Costs of commercial disputes to small businesses: components of cost

The costs to small businesses of a dispute can be numerous. Whatever the reason for and the source of the dispute, it can result in a range of costs for small businesses. This can have a negative impact on business and its ability to invest and expand. Gibson and Gebken have described the range of costs that can be incurred by a business involved in a dispute as the ‘Transactional Resolution Costs’ (TRC).<sup>11</sup> There are three categories of costs:

- Direct costs, i.e. the fees and other charges paid to solicitors, barristers, the court or consultants, any amounts lost or written off to another party and any additional damages that end up being paid as a result of having a dispute.
- Indirect costs, i.e. the wages and time costs of owners and staff having to dedicate time and resources to dealing with the dispute.
- Hidden costs, i.e. the opportunity cost of the dispute, such as the inefficiencies and delays caused in the business, the lost business opportunities and the costs of the disrupted business relations between the parties involved.

The nature of smaller businesses means that any costs arising from a dispute are going to have bigger negative impacts than similar costs incurred by a larger business. Disruption to normal activity for a small business which does not have the resources to easily absorb unexpected costs can be significant. Smaller businesses operate under structural disadvantages, which consequently makes them vulnerable to ‘shocks’, such as a commercial dispute. They do not have the resources (time, knowledge, labour, finance and bargaining power) to dedicate to dealing with a dispute. Typically, in a small business, all resources are focused on sustaining and growing the business and, in particular, maintaining cash-flow and a reasonable level of working capital. Spare resource is targeted at meeting key legal requirements, such as paying tax, regulatory compliance, etc. Regulatory compliance alone costs a typical small business at least £6,000 a year on average.<sup>12</sup> Therefore it is unsurprising that, FSB research found late payment (the most frequently reported reason for a dispute) can have significant consequences for small businesses. The impact of late payments includes:<sup>13</sup>

- Increases the business death rate.
- Create cash-flow problems.
- Results in lower profits, delays in investment and the hiring of new employees.

## The costs of unresolved disputes and their impact on smaller businesses

It is not possible to discover from FSB survey data what proportion of an amount under dispute a small business loses out on and how much they are able to retain or get repaid to them when the dispute has been resolved. However, FSB survey results do show that 17 per cent of respondents’ most recent dispute went unresolved. This survey data suggest that over half a million businesses experienced an unresolved dispute in the period 2010 to 2015.<sup>14</sup> In many cases, this would involve the small business having to write off money. This equates in value terms to at least £10.5bn (£2.1 billion a year) worth of disputes that remain unresolved, much of which was likely a direct loss to those impacted small businesses.<sup>15</sup>

<sup>11</sup> Gibson, G E and Gebken, R J. Decision Making, Transactional Costs and Dispute Resolution: Is There a Better Way?.(2006).

<sup>12</sup> The FSB surveyed 1,685 smaller business owners online between 17-28 February 2016. Sixty-nine per cent of respondents were in the category of 0-4 employees; 16 per cent had 5-9 employees; 9 per cent had 10-19 employees; and 5 per cent had 20 or more employees.

The calculations were based made assuming a typical 227 working days per year and a 40-hour working week. This figure was calculated by multiplying the 840 hours annual hourly burden by the £7.20 National Living Wage. It suggests an annual burden equivalent to £6,048.

<sup>13</sup> FSB. Time to act: The economic impact of late payment. (2016).

<sup>14</sup> The figure, calculated using the 2015 England and Wales business population statistics is: 584,480.

<sup>15</sup> Quantum calculated by multiplying £18,058 (average value of a dispute)\*584,480.

Further, FSB data suggests that the prevalence of unresolved disputes and, consequently, the likelihood of having to write off the whole amount under dispute was much greater among smaller businesses than those at the medium-sized end of the SME range. The FSB survey revealed the breakdown of unresolved disputes among the different employee firm sizes in the small business community:<sup>16</sup>

- No employees- 28 per cent.
- One to 10 employees -17 per cent.
- 11 to 20 employees - 13 per cent.
- 21 to 50 employees - eight per cent.

No medium-sized businesses responding to the survey reported having any unresolved disputes.

Consequently, the burden of unresolved disputes is largely borne by smaller businesses. As previously discussed, a key reason for this is the resource constraints and bargaining power of small businesses. Therefore, in order to help smaller businesses avoid the damage of unresolved disputes, measures need to be identified and developed which mitigate some of the imbalances in resource and power which are accessible to and usable by those with limited resources.

### **The wider costs to small businesses**

The average additional cost of the most recent dispute reported by respondents to FSB survey was just under £17,000.<sup>17</sup> This estimate includes some of the direct costs captured by the TRCs, such as legal and court fees, but, additionally, also the 'indirect' and 'hidden' costs incurred by a small businesses involved in a dispute. Extrapolated across the English and Welsh small business population:

- The total additional TRC amounts to £57.9 billion over the five years of the survey.
- The cost averages out at around £11.58 billion each year.

Both figures are likely an underestimate, as FSB's survey only asked respondents about their most recent dispute. For those who had more than one, they would have incurred wider costs as many times as they had disputes.

### **The wider cost to the economy of small business disputes**

The wider costs to the economy of the prevalence of commercial disputes are both allocative<sup>18</sup> and dynamic.<sup>19</sup> Disputes not only result in desirable and economically efficient transactions being disrupted, but there are knock-on effects on the ability of small businesses to play their invaluable role in driving market dynamics.

#### **Impact on economic efficiency**

The quantum of value tied-up in disputes represents a considerable amount of misallocated resource. For example, where money or goods or services are subject to a dispute, a welfare-enhancing commercial arrangement bringing benefits to all parties is disrupted, taking time to resolve and consequently unable to be deployed elsewhere more productively. Therefore, the annual amount tied up in disputes (£12.4 billion) can be seen as a misallocation of resources, with previously desirable transactions either not taking place, being undone or taking place but at different prices with at least one of the parties gaining less surplus than they had planned for.

In addition to the mis-allocation of resources of the amount tied-up in the dispute, the additional costs (TRCs) associated with having a dispute, estimated to be at least £11.58 billion a year, are similarly inefficiently deployed resources as a result of commercial disputes.

<sup>16</sup> The sample sizes for the 'No employee', 21-50 employee and 51+ size categories were small and data should only be seen as offering an indication of a pattern, not as clear evidence.

<sup>17</sup> The precise mean figure is: £16,842

<sup>18</sup> A position where resources are allocated between alternative uses in the most efficient way possible. Allocatively efficient transactions maximise the welfare of all parties.

<sup>19</sup> The improvement of both allocative and productive efficiency over time. R Dolamore. Dynamic efficiency – the key to lifting Australia's productivity performance. (2014). Accessible at: [http://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/FlagPost/2014/March/Dynamic-Efficiency](http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/FlagPost/2014/March/Dynamic-Efficiency)

Therefore, a reasonable estimate of the annual total impact on the economic efficiency of the English and Welsh economy of commercial disputes is that they generate around £24 billion, at least, of economic inefficiency across England Wales a year.<sup>20</sup> This figure should be treated as offering an indication of the scale of the negative impact that commercial disputes and costly dispute resolution have on small businesses and the efficiency of the economy.

### **Impact on economic dynamism**

In addition to the static inefficiencies which arise as a result of the misallocation of resources. There are losses in the dynamism of the economy too. The financial consequences of resource misallocation directly impact the future plans of small businesses and, in turn, the markets in which they operate, buy from and supply to.

The dynamic impact on the economy results from reduced revenues for small businesses to invest than there otherwise would have been. This means lower levels of innovation, a reduced capital stock and less employment. It may also lead to the failure of some small businesses.<sup>21</sup> In turn, this will lead to less competitive pressure from small businesses in their respective sectors which will mean less efficient markets as competitor businesses feel less compelled to be efficient and inefficient businesses are not driven out of the market.

The impact on employment could be particularly pronounced. Between 1998 and 2010, 67 per cent of new jobs were created by small businesses.<sup>22</sup> 34 per cent of new jobs were created by existing firms in that period,<sup>23</sup> while start-ups created 33 per cent of new jobs.<sup>24</sup> With less to pay for additional employees, employment growth will inevitably be lower than it would otherwise.

### **Implications for policy**

Policymakers should factor in these static and dynamic costs of commercial disputes when formulating economic as well as justice policy. The possible scale of the costs of commercial disputes, provide an idea of the benefits to be gained from:

- Reducing the total number of commercial disputes.
- Increasing speed at which disputes are resolved.
- Ensuring fair outcomes with the wronged party achieving a satisfactory outcome with detriment redressed.

Investment in measures which will achieve the three objectives outlined are likely to deliver significant economic gains for both the small business community and economy in the long run.

The remainder of the report looks in more detail at various aspects of commercial disputes and how smaller businesses and the Government might implement measures which could reduce their negative impact on smaller businesses and, in turn, the wider economy.

20 This figure is a qualified one. A proportion of the annual total amount under dispute (£12.4 billion) will not necessarily have been misallocated, e.g. a business may be unfairly claimed against. However, from the data collected from FSB members, it is not possible to know what proportion of the total disputes involving small businesses in England and Wales that might be.

21 FSB. Time to act: The economic impact of late payment. (2016).

22 BIS. SMEs: the Key Enablers of Business Success and the Economic Rationale for Government Intervention. (2013).

23 BIS. SMEs: the Key Enablers of Business Success and the Economic Rationale for Government Intervention. (2013).

24 BIS. SMEs: the Key Enablers of Business Success and the Economic Rationale for Government Intervention. (2013).



# AVOIDING A DISPUTE

---

Avoiding a dispute results in no loss to a business or the wider economy. It is the best outcome for all. Avoiding disputes is about good management of commercial arrangements with strategies for dispute prevention built into the contractual process.

## Managing commercial arrangements

Key elements that small businesses should have in place for the successful management of commercial arrangements include:<sup>25</sup>

- Thorough preparation (where the counter party is another commercial entity this should include due diligence about their reliability, reputation and credit rating) and a negotiation plan.
- Mutually agreed objectives between the parties, which are evident to all and leave little room for ambiguity.
- A clear and accurately written contract that states explicitly the obligations of all sides.
- Reasonable behaviour and good faith between all parties.

Best negotiation practice is a vital component of good commercial relationship management. For example, when entering into a contractual negotiation:

- The objectives and parameters of the negotiations should be clear to the negotiators.
- Appropriate advice should be taken. However, the cost of advice, especially legal advice, often prevents small businesses from being able to follow this approach.<sup>26</sup>
- The negotiations should be documented with notes of discussions so that there is an evidential record. Ensuring there is a record of the negotiations ensures greater certainty for all parties.

The position for small businesses can be a difficult one. The resource constraints suffered by small businesses and their limited economic bargaining power impinges on the ability of many to manage commercial relationships (including negotiating and contracting) as optimally as, for example, a larger business can. Further, standard form contracts are not uncommon in business relationships.<sup>27</sup> As a result of the same constraints these can be particularly challenging for smaller businesses.<sup>28</sup>

However, there are gains to be made for small businesses from good relationship management and effective negotiation despite their vulnerabilities. The Centre for Economic and Business Research (CEBR) identified that the UK lost £9 million per hour from poor negotiating.<sup>29</sup> A typical UK small company could improve its profits by seven per cent a year through better negotiation. This suggests better prepared and planned negotiation strategies could deliver real benefits for the UK's small business population.

## Implications for policy

There is a public policy imperative in helping to upskill small business owners and managers in their negotiation skills and dispute resolution strategies. This should be as part of a wider agenda of supporting small businesses to develop their commercial relationship management capacity. Not only is there a likely gain of around seven per cent to the bottom line for the many small businesses that do develop better negotiation skills, but there will be a reduction in the costs of commercial disputes to both individual businesses and the wider economy.

---

<sup>25</sup> Staugas J Strategies for dispute prevention and management in commercial arrangements. ( 2002).

<sup>26</sup> Blackburn, R. Kitching, J and Saridakis, G. The legal needs of small businesses. (2015). Accessible at: <https://research.legalservicesboard.org.uk/wp-content/media/PUBLISH-The-legal-needs-of-small-businesses-19-October-2015.pdf>

<sup>27</sup> The Law Commission and The Scottish Law Commission. Unfair Terms in Contracts: A Joint Consultation Paper. (2002).

<sup>28</sup> The Law Commission and The Scottish Law Commission. Unfair Terms in Contracts: A Joint Consultation Paper. (2002).

<sup>29</sup> Business Matters. Driving the deal – how SMEs' negotiation skills can boost Britain's bottom line. (2013). Accessible at: <http://www.bmmagazine.co.uk/in-business/advice/driving-deal-smes-negotiation-skills-can-boost-britains-bottom-line/>

# INFORMAL OR SEMI-FORMAL RESOLUTION OF A DISPUTE

When commercial disputes cannot or have not been prevented, a second-best solution may be to resolve the dispute informally or semi-formally as quickly as possible.

## Informal and semi-formal resolution

Quick informal resolution will, in many cases, minimise the costs of a dispute to the relevant parties and to the economy. Semi-formal resolution, while more costly than informal resolution, is frequently likely to be cheaper and quicker than having to get an external independent third party to help resolve it.

**Box one:** Definitions of informal and semi-formal resolution.

**Informal resolution:** describes resolutions achieved privately between the parties, e.g. through talking directly to the other parties.

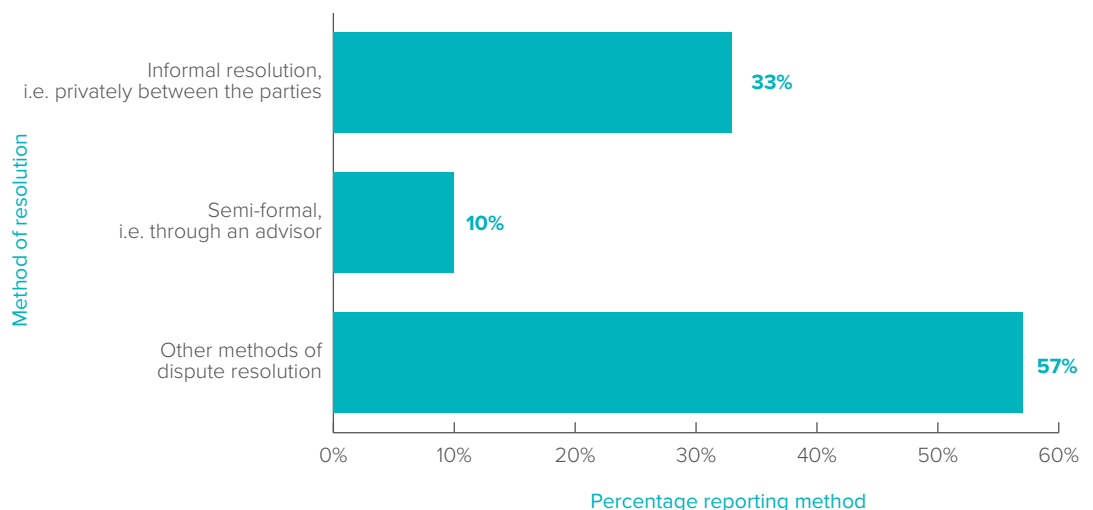
**Semi-formal resolution:** methods using formal channels of communication, but without the involvement of independent third parties. An example of semi-formal resolution is the use of advisors, such as a solicitor or an accountant, to formally represent one or more of the parties to the others over the dispute and reach a resolution.

A trend towards early resolution of disputes by businesses was noticed by practitioners as far back as the early 2000s.<sup>30</sup> That trend is clear in the popularity of informal or semi-formal resolution reported by FSB members.

43 per cent of FSB members surveyed resolved their most recent dispute through either informal or semi-formal means.

**Figure three:** Use of informal or semi-formal methods of dispute resolution.

**Source:** FSB commercial dispute resolution survey 2015.



A third (33%) of FSB members who had experienced a dispute in the last five years resolved their most recent dispute informally.

10 per cent of respondents resolved their most recent dispute semi-formally. However, it should be noted that semi-formal resolution was less popular than using the civil courts to resolve the respondent's most recent dispute.

<sup>30</sup> Staugas, J. Strategies for dispute prevention and management in commercial arrangements. (2002).

Kingston University found broadly similar proportions among respondents, with 37 per cent of small business reporting an informal resolution to their legal problem.<sup>31</sup> This suggests it is a consistently preferred method of dispute resolution among businesses. This is unsurprising. The virtue of informal or semi-formal resolution is that it can avoid a lot of the cost for all parties to the dispute, which will inevitably be incurred if the dispute escalates to ADR or the courts.

## Achieving early resolution

Early informal or semi-formal dispute resolution requires small businesses to have good dispute management strategies in place and to utilise them. Effective strategies need to be based upon:<sup>32</sup>

- Ongoing communication between parties to the dispute and the maintenance of the relationship.
- Clarity over the specific issue(s) under dispute.
- Strategies for minimising escalation.
- Ideas for resolving it.

The box below lists the main components that small businesses need in place for developing a successful dispute management strategy.

### Box two: Components of an effective dispute management strategy.

- Making sure the facts are clear and any contractual terms (ie a contract dispute) are clear and those not under dispute are adhered to as much as possible.
- Identify potential disputes as early as practicable and take swift action to head them off where possible or, if unable, to trigger dispute resolution clauses swiftly.
- Ensure reasonable behaviour and good faith is maintained with an open mind to the exchange of information between parties where appropriate.
- Be flexible and create opportunities for meetings and discussions.
- Avoiding behaviours that create tensions and unreasonable behaviour.

## Satisfactory outcomes as a result of informal or semi-formal resolution

However desirable from a speed perspective, informal and semi-formal dispute resolution is not always the answer. It is unclear how many of the issues resolved informally or semi-formally were resolved truly satisfactorily. Nevertheless, there is sufficient evidence which suggests that neither informal nor semi-formal resolution is satisfactory for all smaller businesses. 18 per cent of FSB members noted that informal resolution led to an unsatisfactory outcome.<sup>33</sup> In contrast, the same survey found that only 11 per cent of respondents felt that informal resolution led to an explicitly satisfactory outcome.<sup>34</sup> Furthermore, Kingston University research discovered that around 18 per cent of legal problems were resolved, but to the dissatisfaction of the survey respondents.<sup>35</sup>

This research indicates a pattern that just below one in five of the 43 per cent of small businesses resolving their most recent dispute (informally or semi-formally) are reaching agreements that they might be able to live with, but which fall short of being satisfactory. This aspect of dispute resolution would benefit from further research.

31 Blackburn, R, Kitching, J and Saridakis, G. The legal needs of small businesses. (2015). Accessible at: <https://research.legalservicesboard.org.uk/wp-content/media/PUBLISH-The-legal-needs-of-small-businesses-19-October-2015.pdf>

32 Staugas, J. Strategies for dispute prevention and management in commercial arrangements. (2002).

33 FSB. Protections for Micro-businesses in Non-Regulated Markets. (2016). Accessible at: <http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-response---small-businesses-as-consumers---consultation---june-2016.pdf?sfvrsn=0>

34 FSB. Protections for Micro-businesses in Non-Regulated Markets. (2016). Accessible at: <http://www.fsb.org.uk/docs/default-source/fsb-org-uk/fsb-response---small-businesses-as-consumers---consultation---june-2016.pdf?sfvrsn=0>

35 Blackburn, R, Kitching, J and Saridakis, G. The legal needs of small businesses. (2015). Accessible at: <https://research.legalservicesboard.org.uk/wp-content/media/PUBLISH-The-legal-needs-of-small-businesses-19-October-2015.pdf>

## Business size and informal and semi-formal resolution

Breaking down FSB survey data by business size paints a picture of the distribution of informal and semi-formal resolution that suggests a positive relationship between business size and the ability to resolve a dispute informally. The data showed that:

- Medium-sized businesses were nearly twice as likely to resolve a dispute informally, with 60 per cent of respondents who had experienced a dispute reporting that they resolved their most recent one in this way.
- 33 per cent for those businesses in the 11 to 20 employee size category resolved it informally.
- 32 per cent of businesses with between 1 and 10 employees brought their most recent dispute to a conclusion informally.
- 25 per cent of businesses with no employees resolved their dispute informally.

A similar pattern, albeit not quite as clear, can be observed in the proportion of businesses in the different size categories which utilised semi-formal means in resolving their dispute. 40 per cent of medium-sized businesses with a dispute resolved their most recent dispute using semi-formal means. This was more than twice the proportion in the 11 to 20 employee category for example, which had the second highest proportion of respondents reporting that they used semi-formal methods to resolve their most recent dispute.

While sample sizes for the different categories of business size are not large enough to offer more than an indication of a likely relationship, the picture painted by the breakdown of the data on methods of resolution by business size is consistent with the fact that smaller businesses are more vulnerable because of the range of constraints under which they operate. Those constraints make them less able to informally or semi-formally resolve disputes satisfactorily, or at all, because they do not have the resources to deploy or the leverage that a larger, i.e. medium-sized business, would have.

## Implications for policy

While informal and semi-formal resolutions can be desirable ways of resolving disputes, in some instances such methods are unlikely to deliver satisfactory outcomes for small businesses. This, in part, is down to the vulnerabilities of small businesses, which are a result of their limited resources and negotiating power. The bigger the business, the more likely informal or semi-formal resolution is likely to occur. The implications for policy are two-fold:

- Smaller businesses need to be supported in building up their capacity to resolve disputes at an early stage, utilising informal or semi-formal methods. This can be done by increasing their awareness, knowledge and use of dispute resolution strategies to increase the chances of more satisfactory early resolution. This suggests a role for Government and in particular the SBC, in addition to trade associations and business representative bodies, in building up such capability. For example, FSB provide an extensive legal advice to small businesses as part of its membership. This includes 24/7 legal advice over the phone and a wealth of essential online legal documents.
- Those businesses who are unable to resolve their disputes informally or semi-formally satisfactorily or at all need to be able to pursue their disputes through other means in order to be able to reach a fair conclusion.

# TIER TWO: SMALL BUSINESS AND ADR

Some disputes cannot be prevented and others are unable to be resolved early either informally or semi-formally. FSB members surveyed suggest that around 57 per cent of disputes are not resolved informally or semi-formally. These instances require different strategies for resolution. Many of these disputes proceed to court. Others are dealt with outside of the courts through a form of ADR.

## What is ADR?

ADR is a term that captures a multitude of different non-court based methods of resolving disputes. The common factor to all methods of ADR are that they are not court-based and they involve a neutral third-party in some capacity. The most widely recognised types are set out in Box three.

### Box three: Main types of ADR.<sup>36</sup>

**Adjudication:** the form of ADR that most closely resembles a court process. It involves the presentation of arguments and evidence followed by a ruling by an adjudicator to resolve the dispute. It can be binding or voluntary. Costs are unable to be awarded. There are usually strict time limits controlling adjudications.

**Arbitration:** a third party, often an expert in the problem under dispute, reviews the evidence surrounding the issue under contention and makes a ruling to resolve it. It can be voluntary or mandatory and is private.

**Conciliation:** an independent conciliator will help the parties to a dispute negotiate a settlement. The key difference with mediation is that the conciliator will make a settlement proposal for the parties to agree.

**Mediation:** a third party mediator assists the disputing parties to negotiate and come to a settlement. It is the most widely used form of ADR.

**Med-Arb:** a hybrid system mixing mediation and arbitration. The independent mediator/ arbitrator will try to mediate a settlement to the dispute initially but has the flexibility to arbitrate a resolution if mediation fails.

**Ombudsman:** an independent third party empowered to investigate a dispute, is both presented with and can gather additional evidence and is endowed with considerable discretion in how a resolution is achieved e.g. they can try and mediate a resolution or make a ruling based on broad principles of fairness.

Professor Christopher Hodges has mapped dozens of different ADR schemes in the UK.<sup>37</sup> Further, there are thousands of private providers of ADR. These private providers are often members of bodies such as the Chartered Institute of Arbitrators (CIArb) or the Civil Mediation Council (CMC). Although many providers are not members of such bodies. There are no requirements, for example, to be a member of the CMC in order to establish a mediation service and practice mediation. The same approach applies across much of ADR. This is in contrast to providers of other types of legal services. If an individual wants to set up a solicitor's firm or become a barrister in order to practice law for example, then there are educational and regulatory requirements that need to be fulfilled in order to do so.

<sup>36</sup> Belden. Brief comparison between Mediation, Adjudication, Arbitration and Litigation. (2007). Accessible at: <http://www.beldenlex.com/pdf/Brief%20Comparison%20Between%20Mediation,%20Adjudication,%20Arbitration%20and%20Litigation%20-%20ADR.pdf>

Med/ Arb in some Canadian provinces for example has statutory backing and is able to make binding decisions recognised by the courts despite it being a private process. Levison, J. Med/arb – could this alternative Canadian concept work for us?. (2013). Accessible at: <http://blogs.lexisnexis.co.uk/family/medarb-could-this-alternative-canadian-concept-work-for-us/>

Roth, B J. Med-arb, Arb-med, Binding Mediation, Mediator's Proposal, and other Hybrid Processes. (2009).

<sup>37</sup> Hodges, C and Tulibacka, M. Civil Justice in England and Wales – beyond the courts. (2009). Accessible at: [https://www.law.ox.ac.uk/sites/files/oxlaw/civil\\_justice\\_in\\_england\\_and\\_wales\\_-\\_beyond\\_courts\\_mapping\\_out\\_non-judicial\\_civil\\_justice\\_mechanisms.pdf](https://www.law.ox.ac.uk/sites/files/oxlaw/civil_justice_in_england_and_wales_-_beyond_courts_mapping_out_non-judicial_civil_justice_mechanisms.pdf)

**Box four: Online dispute resolution.<sup>38</sup>**

Online Dispute Resolution (ODR): it is often listed as a method of dispute resolution. ODR does not describe the method used to resolve the dispute. Rather, it describes the medium through which the dispute resolution takes place, namely internet based technology.

ODR is growing in popularity among those looking at ways of increasing access to justice at low cost. There are a number of high profile examples around the world:

- In the Netherlands there is the Dutch Rechtwijzer 2.0 system, which provides a wide-ranging online resolution service for divorce, employment and housing disputes;
- In British Columbia a new online platform has been established for resolving small claims and housing disputes. It is called the Civil Resolution Tribunal.

In England and Wales, Lord Justice Briggs in his recent report on structural reforms to the English and Welsh civil court system, recommended the establishment of an online court system for low value claims.

**The advantages of ADR for small businesses**

A decision on which type of dispute resolution to choose is based on a mixture of salient factors, which include:

- The nature of the dispute, including its value i.e. how much is at stake, and the degree to which the issue under dispute is specialist or generic.
- The circumstances of the disputing parties, including relative economic bargaining power and access to expertise, support and advice.
- The financial and time costs associated with each of the available resolution options relative to alternatives.
- The extent of the damage to the commercial relationship of different methods of resolution.

ADR can bring several real benefits to the process and practice of resolving a dispute<sup>39</sup> As a result of these benefits, many businesses see it as offering a value-for-money way of resolving disputes.<sup>40</sup>

Benefits of ADR:

- Private and confidential: It can be conducive to dealing with sensitive commercial issues such as IP.<sup>41</sup>
- Speed: It is often considered to be speedier than using the courts.<sup>42</sup> This is in part because ADR tends to be less formal than the courts. Two American studies found that ADR could save at least one month and perhaps up to four months of time compared to using a court.<sup>43</sup> Data collected by the EU on use of ADR across the EU found 51 per cent of users of ADR were satisfied with the swiftness of the ADR process they had used<sup>44</sup>. National Audit Office (NAO) research found that mediated cases could be completed in about a quarter of the time that non-mediated cases took to be resolved albeit this latter research focussed upon family issues.<sup>45</sup>

38 Rechtwijzer. 2016. Accessible at: <http://rechtwijzer.nl> Civil Resolution Tribunal. (2016). Accessible at: <https://www.civilresolutionbc.ca/> Briggs, LJ. Civil Courts Structure Review (CCSR): Final Report. (2016). Accessible at: <https://www.judiciary.gov.uk/wp-content/uploads/2016/07/civil-courts-structure-review-final-report-jul-16-final-1.pdf>

39 Love, I. Settling Out Of Court: How Effective Is Alternative Dispute Resolution?. (2011). Accessible at: <http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1307652042357/VP329-Setting-out-of-court.pdf>

40 A survey commissioned by the Australian Government (Department for Innovation, Industry, Science and Research) found that 70% were satisfied with the range of ADR available, 77% were satisfied with the quality of it. Orima Research. Small Business Dispute Resolution: summary report. (2010). Accessible at: <http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2010/Small%20Business%20Dispute%20Resolution%20Research/downloads/pdf/DisputeResolutionSurveyReport.ashx>

41 Commercial confidentiality was identified by practitioners interviewed for this report as an important advantage over the courts. Victorian Law Reform Commission. Civil Justice Review: Report. (2008). Accessible at: <http://www.lawreform.vic.gov.au/sites/default/files/VLRC%2BCivil%2BJustice%2BReview%2B-%2BReport.pdf>

42 Victorian Law Reform Commission. Civil Justice Review: Report. (2008). Accessible at: <http://www.lawreform.vic.gov.au/sites/default/files/VLRC%2BCivil%2BJustice%2BReview%2B-%2BReport.pdf>

43 Love, I. Settling Out Of Court: How Effective Is Alternative Dispute Resolution?. (2011). Accessible at: <http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1307652042357/VP329-Setting-out-of-court.pdf>

44 EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)

45 NAO, Legal aid and mediation for people involved in family breakdown, (2007) cited in Scottish Government. Making Justice Work: Enabling Access to Justice Project - International literature review of Alternative Dispute Resolution. (2014).

- Price: It can be cheaper than using a court process and consequently more accessible to businesses.<sup>46</sup> A Canadian study found that around CAN\$6000 was saved by using ADR rather than a court.<sup>47</sup> Significant proportions of businesses that use ADR for business-to-business disputes profess satisfaction with its cost.<sup>48</sup>
- Expertise: It can more easily leverage in expertise than the courts, where expert testimony has to be organised and presented and the opportunity to challenge it also has to be allowed. Whereas, ADR can be conducted by sectoral experts negating the need for expert witnesses
- Relationship saving: There can be a greater chance of 'saving' the commercial relationship because it is less confrontational than the courts and can encourage participants to work together to resolve the issue.<sup>49</sup> Sometimes saving the commercial relationship is possible because ADR leaves room for innovative solutions to disputes.<sup>50</sup>
- Flexibility: Participants can have more control over the method, pace and scope of the process.<sup>51</sup> The ability to be more involved in the process and the informality of the methods help increase satisfaction with ADR. A study commissioned by the EU found that 58 per cent of those who used ADR rated the easiness of the process satisfactory while 54 per cent described as satisfactory the amount of personal effort required to use the process.<sup>52</sup>
- Success rate: Settlement rates for ADR are often high. One Australian study identified ADR settlement rates of between 50 per cent and 85 per cent.<sup>53</sup> High settlement rates are accompanied by high levels of satisfaction.<sup>54</sup>

---

46 Victorian Law Reform Commission. Civil Justice Review: Report. (2008). Accessible at: <http://www.lawreform.vic.gov.au/sites/default/files/VLRC%2BCivil%2BJustice%2BReview%2B-%2BReport.pdf> <http://www.lawreform.vic.gov.au/sites/default/files/Chapter%2B4,%2BChapter%2B5.pdf>

47 Love, I. Settling Out Of Court: How Effective Is Alternative Dispute Resolution?. (2011). Accessible at: <http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/282044-1307652042357/VP329-Setting-out-of-court.pdf>

48 EU commissioned (Flash Eurobarometer 347) research found half of respondents who had used ADR were satisfied with its cost. EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)  
An Australian survey by the Australian Government (Department for Innovation, Industry, Science and Research) found that 60% of respondents were satisfied with the cost of the ADR. Source: Orima Research. Small Business Dispute Resolution: summary report. (2010). Accessible at: <http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2010/Small%20Business%20Dispute%20Resolution%20Research/downloads/pdf/DisputeResolutionSurveyReport.ashx>

49 Practitioners interviewed for this report suggested that ADR offers more opportunity for saving a commercial relationship than the more confrontational courts. This was considered by those same practitioners to be a unique benefit to ADR, especially methods such as mediation and conciliation. Victorian Law Reform Commission. Civil Justice Review: Report. (2008). Accessible at: <http://www.lawreform.vic.gov.au/sites/default/files/VLRC%2BCivil%2BJustice%2BReview%2B-%2BReport.pdf>

50 The freedom to innovate solutions was raised by practitioners interviewed for this report as a key benefit of using ADR.

51 Victorian Law Reform Commission. Civil Justice Review: Report. (2008). Accessible at: <http://www.lawreform.vic.gov.au/sites/default/files/VLRC%2BCivil%2BJustice%2BReview%2B-%2BReport.pdf>

52 EU Commission. Business-to-Business Dispute Resolution in the EU. 2012. Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)

53 Mack, K. Court Referral to ADR: Criteria and Research. (2003).

54 Victorian Law Reform Commission. Civil Justice Review: Report. 2008. Accessible at: <http://www.lawreform.vic.gov.au/sites/default/files/VLRC%2BCivil%2BJustice%2BReview%2B-%2BReport.pdf> A survey commissioned by the Australian Government (Department for Innovation, Industry, Science and Research) found that 70% were satisfied with the range of ADR available, 60% were satisfied with the cost of the ADR service they utilised and 77% were satisfied with the quality of it. Source: Orima Research, Small Business Dispute Resolution: summary report, 2010. Accessible at: <http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2010/Small%20Business%20Dispute%20Resolution%20Research/downloads/pdf/DisputeResolutionSurveyReport.ashx>



## ADR in the English and Welsh civil justice system

As a result of the advantages that ADR can offer, it has come to play an ever more central role in the English and Welsh civil justice system.<sup>55</sup> The Woolf reforms of the late 90's explicitly looked to encourage greater use of ADR.<sup>56</sup> Its usage has been heavily promoted through the Pre-action protocols and Civil Procedure Rules (CPR) of the civil justice system and a developing body of case law.<sup>57</sup> Part of that trend has seen the growth of court-based ADR. This has proved successful where the circumstances are favourable e.g. parties are of roughly equal bargaining power and capability and all are sufficiently willing to compromise sufficiently.<sup>58</sup>

*'In the three years since April 2013...[to]...a substantial increase in the use of ADR...Courts have more readily granted orders in support of ADR. They have more frequently made costs orders against parties who unreasonably refused to mediate.'*<sup>59</sup>

Jackson, LJ. Lecture to the Chartered Institute of Arbitrators, 2016.

## Use of ADR by small businesses

While there does not appear to be a shortage of supply of ADR services in England and Wales, use of ADR by small businesses is relatively low. Despite the significant increase identified by Lord Justice Jackson in use of ADR this trend does not seem to have permeated down to the small business community to the degree that many would like. FSB research found that only eight per cent of English and Welsh small businesses used ADR to resolve their most recent dispute.

**Table one:** Use of ADR to resolve most recent dispute.

**Source:** FSB commercial dispute resolution survey 2015.

Method of ADR resolution	Percentage reporting use of method
Mediation	3%
Arbitration/ adjudication	1%
Trade/ sector dispute resolution scheme	2%
Ombudsman	2%
Other methods of dispute resolution	92%

## Comparative usage: courts and ADR

Despite the potential advantages, ADR is not widely used by small businesses in England and Wales, compared to the numbers using the courts. As already referenced, eight per cent of FSB members use ADR to resolve a dispute. Similar studies have discovered the same trend with EU research quoting nine per cent of businesses<sup>60</sup> and Kingston University quoting even lower at three per cent.<sup>61</sup> ADR is not the go to method for dispute resolution regardless of its benefits.

<sup>55</sup> Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. (2013).

<sup>56</sup> Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. (2013).

<sup>57</sup> Halsey v Milton Keynes General NHS Trust [2004] EWCA Civ 576. *Dunnett v Railtrack* [2002] 1 WLR 2434 and *PGF II SA v OMFS Co 1 Ltd* [2013] EWCA Civ 1288; [2014] 1 WLR 1386. Ministry of Justice. CPR – Rules and Directions. (2016). Accessible at: <https://www.justice.gov.uk/courts/procedure-rules/civil/rules>

<sup>58</sup> Genn, H. The Central London County Court pilot mediation scheme, cited in Jackson, LJ. Civil Justice Reform and Alternative Dispute Resolution, lecture to the Chartered Institute of Arbitrators. 2016. Accessible at: <https://www.judiciary.gov.uk/wp-content/uploads/2013/03/lj-jackson-cjreform-adr.pdf>

<sup>59</sup> Jackson, LJ. Civil Justice Reform and Alternative Dispute Resolution, lecture to the Chartered Institute of Arbitrators. (2016). Accessible at: <https://www.judiciary.gov.uk/wp-content/uploads/2013/03/lj-jackson-cjreform-adr.pdf>

<sup>60</sup> EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)

<sup>61</sup> Blackburn, R. Kitching, J and Saridakis, G. Legal needs of small businesses: An analysis of small business' experience of legal problems, capacity and issues. (2015). Accessible at: <https://research.legalservicesboard.org.uk/wp-content/media/PUBLISH-The-legal-needs-of-small-businesses-19-October-2015.pdf>

#### Box five: Ratio of court to ADR usage for resolving disputes.<sup>62</sup>

- **FSB research:** a ratio of court to ADR usage of 2.9 to 1 was identified. For every dispute that went to ADR, 2.9 went to the civil courts.
- **EU research:** a ratio of court to ADR usage of 2.6 to 1 was discovered. For each dispute that was resolved through ADR, 2.6 were resolved in the courts.

The gap between the proportion of smaller businesses utilising ADR and the proportion taking a dispute to the courts is substantial. As Box five illustrates the ratio of court use by businesses compared to ADR is nearly three to one. The similarity in the ratio between FSB research and the EU commissioned research suggests a persistent preference for the courts among businesses.

#### Reasons for weak demand for ADR among small businesses

- A 'knowledge gap' among both small businesses and market intermediaries, such as trusted advisors e.g. accountants and solicitors. These actors may influence the method with which a small business uses to resolve a dispute, including ADR.
- A fragmented supply-side and a consequently difficult market to navigate by resource constrained small businesses.

Together the demand-side and supply-side problems result in a market for ADR that does not work effectively. The market for ADR appears to suffer from some of the same problems as the wider commercial legal services sector, where there is around £100bn of unmet legal need.<sup>63</sup> The failures in the ADR market make it difficult for small businesses that may want to use ADR to access (i.e. identify and utilise) available value-for-money ADR services. Consequently, the uncertainty and risk created by the failures in the ADR market, small businesses utilise the option they feel more confident about; the civil courts.

#### The 'knowledge gap'

There is a substantial 'knowledge gap' among small businesses about ADR. The 'knowledge gap' has three elements:<sup>64</sup>

- Some small businesses do not know ADR exists at all with between a quarter and a third of UK businesses reporting that a 'lack of awareness' was a key reason for not using ADR to resolve their most recent dispute.<sup>65</sup>
- Some perceive ADR as unsuitable for resolving commercial legal disputes when in fact it can be a method for resolving them.
- Others may not understand which type of ADR is best suited to their particular dispute, despite knowing that ADR exists and can be used to resolve some disputes of a legal nature.<sup>66</sup>

62 FSB ration was based on FSB's own calculations using data from FSB's Commercial dispute resolution survey. EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)

63 Pleasence, P and Balmer, N J. In Need of Advice? Findings of a Small Business Legal Needs Benchmarking Survey. (2013). Accessible at: <https://research.legalservicesboard.org.uk/wp-content/media/In-Need-of-Advice-report.pdf>

64 Pleasence and Balmer identified a 'knowledge' gap about the relevance and usefulness of legal advice and support to help resolve business problems. Pleasence, P and Balmer, N J. In Need of Advice? Findings of a Small Business Legal Needs Benchmarking Survey. (2013). Accessible at: <https://research.legalservicesboard.org.uk/wp-content/media/In-Need-of-Advice-report.pdf>

65 Around 30 per cent of UK based businesses said a lack of awareness was a reason they did not use a non-binding ADR scheme. 27 per cent said that a lack of awareness was the reason why they didn't use a binding ADR scheme. EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf) file:///C:/Users/User/AppData/Local/Temp/adr\_brochure\_final\_4125-1.pdf

66 7 per cent and 8 per cent of respondents cited not knowing how to begin to use an ADR procedure, whether binding or non-binding respectively, as a reason for not using ADR to resolve their most recent dispute. EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)

The ‘knowledge gap’ exists for a range of reasons. The most salient include:

- The limited resources (time, knowledge, labour, finance etc) available to a small business constrain significantly how much can be dedicated to optimising their dispute resolution strategy. With resources primarily focussed on sustaining the business there is little left to invest in increasing awareness about ADR except in reaction to a dispute arising.
- Insufficient planning for managing commercial relationships, ahead of entering into commercial arrangements. Issues that aren’t ‘core’ tend to be dealt with on a reactive basis by small businesses. In such circumstances, when a dispute arises the possible purchase of external services to help resolve it become a distress purchase. Urgency can mitigate against extensive searches of available options especially where is unfamiliar. The use of ADR is also likely to be an occasional purchase, reducing the scope of incremental improvements in knowledge about the sector.
- Low levels of awareness among trusted sources used by small businesses when confronted with significant challenges like a commercial dispute. Trusted sources include accountants, solicitors and other businesses and friends. These sources are only as good as their own knowledge and if value-for-money ADR providers are not known to them, then the small business with the dispute is not going to be directed towards ADR through a trusted channel.
- The fragmented structure of the supply-side of the ADR market, which offers little to help overcome the ‘knowledge gap.’

#### **Fragmented supply-side**

The fragmented supply of ADR makes it difficult for small businesses with limited resources to navigate the sector.<sup>67</sup> The fragmentation is the result of a number of factors:

- The multiple methods of ADR available which are further complicated by the similarities between some of them.
- The range of different accreditation and standards bodies operating in the ADR sector. In addition the fact that many small businesses may not have a clear understanding of what membership of these types of bodies mean and what quality standards to expect.
- The large number and range of providers of each type of ADR and consequent difficulties in identifying and selecting the right provider from a large number of similar appearing offers.
- Difficulty in identifying before the purchase whether the service chosen is going to deliver a service of satisfactory quality. The return on the purchase comes at the end of a process.

For a small business with little experience or knowledge of ADR the sector and limited resource, to dedicate to negotiating it, it is a complex market where the supply-side frequently compounds the ‘knowledge gap’ on the demand-side. There are few signalling mechanisms such as proxies for quality which can be relied upon and that small businesses can use to help aid their decision making. These difficulties are often compounded because the purchase is likely to be a distress purchase.

<sup>67</sup> European Commission. Business disputes keep businesses from doing business: But business dispute resolution need not be costly or time consuming. (No date given). Accessible at: [ec.europa.eu/DocsRoom/documents/1952/attachments/1/translations/en/.../native](https://ec.europa.eu/DocsRoom/documents/1952/attachments/1/translations/en/.../native)

## The disadvantages of ADR

Regardless of the problems with the market for commercial ADR services, for some disputes ADR is not the most suitable method for resolving the issue. The best method of resolution is dependent on a range of circumstantial factors.<sup>68</sup> While ADR offers advantages, it also comes with disadvantages.

The types of ADR disadvantages that small businesses should be aware of include:<sup>69</sup>

- Lack of court protections.
- Binding ADR can result in the loss of the right of the parties to the ultimate protection offered by a court e.g. the right to appeal.
- ADR resolutions are difficult to enforce and largely rely on the good will of both sides.
- ADR resolutions may not have the lasting impact of a court judgment with innovative solutions not necessarily that common.<sup>70</sup>
- Failure to resolve disputes consistently faster than the courts.<sup>71</sup> Notably, ADR can delay a resolution and increase the time it takes to resolve a dispute by requiring additional stages in the resolution process.
- ADR procedures tend not to be as procedurally fair as those of a court (although the extent of this can vary by type of ADR). The lack of procedural and other protections (which the courts offer) can exacerbate power imbalances.<sup>72</sup> The insertion of a contractual clause requiring some form of ADR to be used to resolve a dispute can be a benefit. On the other hand, the more powerful party in the agreement can dictate the form of dispute resolution that could be chosen. Consequently, ADR can exacerbate the ability of one party to impose its will on the other.<sup>73</sup>
- ADR is not always cheaper than court, especially small claims procedures.<sup>74</sup> Despite perceived cost advantages in many cases a considerable proportion of businesses choose not to use ADR because of cost.<sup>75</sup> Practitioners interviewed for this report identified third-party adjudication as one method of ADR that can be particularly costly. The economics of ADR will prevent the costs being reduced beyond a certain point and there will be an inevitable trade-off between quality and cost the lower the prices are pushed. A further cost consequence of using ADR comes from likelihood that the value of the claim may have to be significantly compromised upon to reach a resolution.<sup>76</sup>

---

68 Genn, H. Fenn, P. Mason, M. Lane, A. Bechai, N. Gray, L. and Vencappa, D. Twisting arms: court referred and court linked mediation under judicial pressure, Ministry of Justice Research Series, (2007) cited in Scottish Government. Making Justice Work: Enabling Access to Justice Project - International literature review of Alternative Dispute Resolution. (2014).

69 Victorian Law Reform Commission. Civil Justice Review: Report. (2008). Accessible at: <http://www.lawreform.vic.gov.au/sites/default/files/VLRC%2BCivil%2BJustice%2BReview%2B-%2BReport.pdf>

70 Genn, H. Fenn, P. Mason, M. Lane, A. Bechai, N. Gray, L. and Vencappa, D. Twisting arms: court referred and court linked mediation under judicial pressure, Ministry of Justice Research Series, (2007), cited in Scottish Civil Justice Council. Access to Justice Literature Review: Alternative Dispute Resolution in Scotland and other jurisdictions. (2014).

71 Genn, H. Civil mediation: a measured approach? in Journal of Social Welfare & Family Law, Vol. 32 (2). (2010) cited in Scottish Government. Making Justice Work: Enabling Access to Justice Project - International literature review of Alternative Dispute Resolution. (2014). Genn, H. ADR and Civil Justice: what's justice got to do with it? in Judging Civil Justice (2009) cited in Scottish Civil Justice Council. Access to Justice Literature Review: Alternative Dispute Resolution in Scotland and other jurisdictions. (2014).

72 Abadi, S H. The role of dispute resolution mechanisms in redressing power imbalances - a comparison between negotiation, litigation and arbitration. (2011). Genn, H. ADR and Civil Justice: what's justice got to do with it? in Judging Civil Justice (2009).

73 Abadi, S H. The role of dispute resolution mechanisms in redressing power imbalances - a comparison between negotiation, litigation and arbitration. (2011).

74 Genn et al suggested that unsuccessful mediation for example could increase the costs for the parties involved by between £1500 and £2000. Genn, H. Civil mediation: a measured approach? in Journal of Social Welfare & Family Law, Vol. 32 (2). (2010) cited in Scottish Government. Making Justice Work: Enabling Access to Justice Project - International literature review of Alternative Dispute Resolution. (2014). Genn, H. ADR and Civil Justice: what's justice got to do with it? in Judging Civil Justice (2009) cited in Scottish Civil Justice Council. Access to Justice Literature Review: Alternative Dispute Resolution in Scotland and other jurisdictions. (2014).

75 EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)

76 Genn, H. Fenn, P. Mason, M. Lane, A. Bechai, N. Gray, L. and Vencappa, D. Twisting arms: court referred and court linked mediation under judicial pressure, Ministry of Justice Research Series, (2007) cited in Scottish Civil Justice Council. Access to Justice Literature Review: Alternative Dispute Resolution in Scotland and other jurisdictions. (2014).

An indicator of why many small businesses choose to use the courts can be found in the considerable differences in satisfaction between larger businesses and smaller businesses about the use of ADR<sup>77</sup>. For some small businesses, the preference for the court, is a reasonable choice in the face of the numerous possible downsides and the ‘gap’ in satisfaction with ADR. Therefore, a balanced judgment about the effectiveness of ADR for small businesses would be that, while ADR delivers positive outcomes for many, its achievements should not be over-sold.<sup>78</sup>

### **Implications for policy**

The disadvantages of ADR suggest a menu of reasons as to why its not used as much as many would like. Therefore, while ADR is an important tool which should have a central place in the dispute resolution landscape, it should not be the primary focus of policy. Rather, the focus of policy should be helping to create the right suite of dispute resolution options for small businesses and providing them access to the right information and tools needed.

Ensuring the adequate availability of ADR requires the problems on both the demand and supply-side of the ADR market to be tackled. The benefits of reforms bridge the ‘knowledge gap’ and help the supply-side overcome some of the problems caused by its fragmentation could be significant for both the small business sector and the wider economy. Helping the ADR market work better for smaller businesses will require making it much easier for small businesses to navigate through more effective signalling mechanisms.

The data highlighting the current preference among small businesses for the civil courts over ADR is a clear indication of the need for a comprehensive dispute resolution system to have a third tier i.e. the civil courts, and for the courts to be effective resolvers of disputes. Small businesses should not be unreasonably penalised with an inefficient court system for either choosing or having to take the court route to resolve their disputes.

<sup>77</sup> Large companies (72%) were more likely to be satisfied with the cost of an ADR procedure than small and medium-sized businesses (49%), while small enterprises are more likely to be satisfied with the cost of an ADR procedure than micro businesses suggesting a positive relationship between ‘satisfaction’ and size even at the smaller end of the size spectrum. EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)

<sup>78</sup> Genn, H. ADR and Civil Justice: what's justice got to do with it? in Judging Civil Justice (2009).

# TIER THREE: THE CIVIL JUSTICE SYSTEM AND SMALL BUSINESS

## The importance of a civil justice system to small businesses

The civil court system plays two vital roles for small businesses:<sup>79</sup>

*'The [civil] justice system has both dispute resolution and behaviour modification functions. Essentially, the civil courts in a common law system provide much of the legal structure for the economy to operate effectively and for peaceful, authoritative and coercive termination of disputes between... companies'.*

Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. 2013.

The importance of both good quality rules and their efficient enforcement through effective impartial judicial institutions to a vibrant economic environment cannot be overstated.<sup>80</sup> The enabling role of the civil justice system provides the vital foundation on which all commercial activity is based.<sup>81</sup> Impartial courts (ensuring the rule of law) and the law (the Common Law in England and Wales) together set the parameters of acceptable behaviour and establish important social norms ensuring obligations and expectations are honoured and where these are not there is redress.<sup>82</sup> The result is a high level of trust in economic activity which encourages more of it in the long-run. The English Common Law is an indispensable ingredient in this mix as a result of its widely recognised commerce promoting characteristics.<sup>83</sup>

Two of the most important reasons to have an effective civil justice system (based upon impartial courts and Common law) so a small business can resolve a dispute are:

- They establish norms which businesses, investors and consumers can rely upon which shape expectations and behaviour which aids dispute prevention.
- They underpin and enable the other non-court methods of dispute resolution (whether they be some form of ADR or informal or semi-formal resolution) to work.

The strong focus in recent years on moving disputes out of the courts has risked losing sight of the:<sup>84</sup>

*'...extent to which the civil courts support social order and economic activity; and...[have a]... protective function....in relation to the rights of citizens and business vis-a-vis other citizens and businesses'.*

Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. 2013.

<sup>79</sup> Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. (2013).

<sup>80</sup> La Porta, R., Lopez-de-Silanes, F and Andrei Shleifer, A. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, Vol 46 (2). (2008). Lorzio, M. and Gurrieri, A.R. Efficiency of Justice and Economic Systems in *Procedia Economics and Finance*. Vol 17. (2014). Lorenzani, D and Lucidi, F. European Economy: the Economic Impact of Civil Justice Reforms. (2014). Chemin, M. Does Court Speed Shape Economic Activity? Evidence from a Court Reform in India, in *Journal of Law, Economics, & Organisation*. Vol 28 (3), (2013), cited in Palumbo, G., Giupponi, G., Nunziata, L and Mora-Sanguinetti J S. *The Economics of Civil Justice: new cross-country data and empirics*. (2013). Johnson, S., McMillan, J and C. Woodroof, C. Courts and Relational Contracts, in *Journal of Law, Economics and Organisation*, Vol 18. (2002), cited in Palumbo, G., Giupponi, G., Nunziata, L and Mora-Sanguinetti J S. *The Economics of Civil Justice: new cross-country data and empirics*. (2013).

<sup>81</sup> Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. (2013).

<sup>82</sup> See Appendices I and II for more on the importance of the rule of law (including impartial judicial institutions) and the specific advantages of the Common law for facilitating commerce.

<sup>83</sup> See Appendix II for more detail on the characteristics and benefits of the Common Law for commerce.

<sup>84</sup> Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. 2013.

The importance and influence of the civil justice system and Common Law on long-term prosperity is dependent on the short-term performance i.e. efficacy of the system.<sup>85</sup> The civil courts are vital as an independent forum where individual small businesses can go directly, to get a dispute resolved in a procedurally fair way, a public finality to it. The indispensable foundations that the rule of Common Law establishes are eroded over time if the courts and the law continually fall short of providing an efficient and cost effective solution to users such as small businesses who have commercial disputes.

As a result of this risk of erosion, it is the first duty of Government to maintain public goods such as the rule of law and retain the benefits of the Common Law because without which there could not be a thriving commercial sector in the long-run.<sup>86</sup>

### Use of the courts by small businesses

The courts remain a much more popular method of resolving disputes among small businesses than ADR. Just under a fifth of respondents who had experienced a dispute resolved their most recent one through the courts. As Table five below shows, the large majority (79%) of the cases that went to court went to the Small Claims Court (SCC).

**Table two:** Used civil courts to resolve most recent dispute.  
**Source:** FSB commercial dispute resolution survey 2015.

Method of resolution	% reporting as method of resolution
Small Claims Court (claims under £10,000)	15%
Fast Track (claims between £10,000 and £25,000)	2%
Multi Track (claims over £25,000)	2%
Other methods	81%

Breaking the survey data down by business size illustrates a consistent pattern of usage of the SCC across most of the size categories. It also shows the positive relationship between business size and use of the 'Fast' and 'Multi' tracks.

- Among the respondents with no employees, 17 per cent had their most recent dispute resolved in the SCC, while three per cent got it resolved through the 'Fast Track' and a similar percentage through the 'Multi Track'.
- For businesses in the one to 10 employee category who experienced a dispute, 16 per cent got their most recent one resolved in the SCC, while two per cent got it resolved in the 'Fast Track'. Less than one per cent went through the 'Multi Track' for resolution.
- For respondents in the 11 to 20 employee size category only eight per cent got their most recent dispute resolved in the SCC while six per cent reported it being resolved in the 'Multi Track'.
- Finally, 17 per cent of respondents in the 21 to 50 employee size bracket stated that their most recent dispute was resolved through the SCC, four per cent in the 'Fast Track' and 13 per cent in the 'Multi Track'.
- No medium-sized businesses reported using the courts to resolve their most recent dispute.

<sup>85</sup> Lorenzani, D and Lucidi, F. European Economy: the Economic Impact of Civil Justice Reforms. (2014). Chemin, M. Does Court Speed Shape Economic Activity? Evidence from a Court Reform in India, in Journal of Law, Economics, & Organisation, Vol 28 (3), (2013), cited in Palumbo, G., Giupponi, G., Nunziata, L and Mora-Sanguinetti J S. The Economics of Civil Justice: new cross-country data and empirics. (2013). Johnson, S., McMillan, J and C. Woodroof, C. Courts and Relational Contracts, in Journal of Law, Economics and Organisation, Vol 18. (2002), cited in Palumbo, G., Giupponi, G., Nunziata, L and Mora-Sanguinetti J S. The Economics of Civil Justice: new cross-country data and empirics. (2013).

<sup>86</sup> As noted by Professor Dame Hazel Genn: "...the civil justice system is a public good...The civil courts contribute quietly and significantly to social and economic well-being...an orderly society where there are rights and protections...". Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. (2013).



The exception to the fairly even distribution of the use of the SCC to resolve disputes was the 11 to 20 employee business size category, where there was a considerable difference in the proportion reporting using the SCC.<sup>87</sup>

The proportion of respondents in the 21 to 50 employee size category resolving their most recent dispute using the 'Multi Track' was significantly greater than in the other business size categories. This suggests that a significant number of disputes for businesses in the 21 to 50 category experience disputes in excess of £25,000 in value when they have them.

Equally noteworthy was the absence of any medium-sized businesses who reported using the courts to resolve their dispute. As previously noted they resolved their disputes informally or semi-formally. The greater access to resources and the significant economic bargaining power available in comparison to smaller businesses is likely to be a key reason why they can resolve a dispute without going to the court.

The relatively high degree of usage of the civil courts among small businesses compared to ADR, despite a concerted effort to push potential disputing small business towards ADR, suggests a preference for using the courts by some smaller businesses. The advantages of courts include:

- The prospect of clearer and fairer procedures than for example ADR, which can protect the weaker (usually smaller) party.
- Less compromise on the amount under dispute.
- A perception that the court's decision will be definitive and rigorously enforced.
- The total cost of court (including time and money) can be cheaper or similar to the cost of ADR depending on the circumstance.

## The deficiencies in the English and Welsh civil justice system

The English and Welsh civil justice system is fair and impartial.<sup>88</sup> However, many aspects of the system have been allowed to stagnate leading to a slow deterioration in the quality of the service to small business users. This has resulted in significant barriers to accessing justice and the efficient resolution of disputes:

*'The single, most pervasive and intractable weakness of our civil courts is that they simply do not provide reasonable access to justice for any but the most wealthy individuals, for that tiny minority still in receipt of Legal Aid, for those (mainly with personal injury claims) able to obtain no win no fee agreements with their lawyers ('CFAs'), for the few who obtain free advice and representation, and for substantial business entities. In short, most...small businesses struggle to benefit from...our civil justice system...'*

Briggs, LJ. Civil Courts Structure Review: Interim Report, 2015.

Within the term 'reasonable access to justice' are a number of failings. A number of key academics and practitioners interviewed for the purposes of this report have set out four key criteria the civil justice system should reach. The English and Welsh civil justice system fails to perform well enough on three out of four of these key criteria. These include:

- Speed (efficiency) in dealing with a case i.e. filing, processing and reaching a conclusion
- Accessibility i.e. open and useable to all who may need it to obtain redress
- Fairness with impartial decision-making
- Efficient enforcement of judgments

<sup>87</sup> It should be noted that the sample sizes for the categories of business 'No employees', 21 to 50 employees and Medium-sized are small and the data therefore offers at best an indication of a trend, nothing more.

<sup>88</sup> The Lord Chancellor: states in 2015 'We are fortunate that the reputation of our independent judiciary...and the total absence of corruption in our courts...have all made England and Wales the best place in the world when it comes to resolving matters by law'. Source: Gove, M (2015). 'What does a one nation justice policy look like?'

These four criteria need to be met if the civil justice system is to deliver for individual small business users and continue to provide the overall benefit to the wider economy identified above. Currently, the English and Welsh civil justice system is underperforming on three of the four criteria. The numerous 'archaic systems' and 'cumbersome processes' of the civil justice system as 'bewildering' small businesses.<sup>89</sup>

*'...The level of service currently received at a court or tribunal is at best inconsistent and, at worse, frustrating...[there is]...delay, inefficiency and failure in the system...[the]...user experience is inconsistent and unnecessarily confusing...'*<sup>90</sup>

HM Courts and Tribunals Service. Annual Report. 2015, cited in Santo, M. House of Lords Library Note: Resourcing and Staffing of the Courts. (2016).

*'Despite all the efforts made over the last fifteen years, the cost of...[going to law in England and Wales]...make the conduct...of small and medium-sized civil cases...disproportionately expensive and therefore unaffordable...'*

Briggs, LJ. Civil Courts Structure Review: Interim Report. (2015).

The deterrent impact of the financial, time and complexity costs of accessing justice through the civil courts on business highlighted by Lord Justice Briggs and implied by the World Bank comparative data (see below) is considerable. Research for the EU found that:<sup>91</sup>

- 28 per cent of UK respondents who had experienced a dispute did not resolve their most recent dispute in the courts because the cost was too high compared to the value of the dispute.
- 12 per cent were deterred because the process would take too long.
- 17 per cent were fatalistic about the courts and thought nothing would come of trying to resolve their dispute using the courts.
- Only just over half of UK based respondents said they would consider using the courts to resolve a future dispute.

While the EU data covered UK businesses of all sizes, a 2014 survey found that 30 per cent of small and medium-sized businesses who had a legitimate legal claim did not pursue it.<sup>92</sup> A number of reasons were given for this reluctance.

- Half were deterred by the cost.
- Just under half were put off by the time it would take.
- A quarter said the complexity of the process helped deter them.
- One in five raised the lack of information about how to take a case forward.

The significant proportion of businesses declining to use the civil courts because of these reasons suggests that the ratio of businesses taking cases to court relative to using ADR could be greater if the cost, time and complexity barriers were reduced.

<sup>89</sup> Ministry of Justice. What Does a One Nation Justice Policy Look Like?. (2015), cited in Santo, M. House of Lords Library Note: Resourcing and Staffing of the Courts. (2016). HoL HMCTS report

<sup>90</sup> HM Courts and Tribunals Service. Annual Report and Accounts 2014-15, cited in Santo, M. House of Lords Library Note: Resourcing and Staffing of the Courts. (2016).

<sup>91</sup> EU Commission. Business-to-Business Dispute Resolution in the EU. (2012). Accessible at: [http://ec.europa.eu/public\\_opinion/flash/fl\\_347\\_en.pdf](http://ec.europa.eu/public_opinion/flash/fl_347_en.pdf)

<sup>92</sup> Annecto Legal Ltd and Opinion Matters. British SMEs missing out on billions of pounds in damages because they can't afford their day in court. (2014). Accessible at: [http://www.annectolegal.co.uk/download/2014\\_10\\_06\\_Annecto\\_SME\\_research\\_for\\_website\\_FINAL.pdf](http://www.annectolegal.co.uk/download/2014_10_06_Annecto_SME_research_for_website_FINAL.pdf)

### International comparisons: England and Wales and other Common Law systems

Comparing the civil courts of England and Wales against three similar Common Law jurisdictions the former is outperformed comfortably on key indicators, fairness and enforcement. Overall, England and Wales's civil courts ranked 31<sup>st</sup> out of 189 countries for their overall effectiveness. As illustrated in Table six below, in each of the categories used by the World Bank to measure the performance of civil justice systems, England and Wales falls significantly short of best international practice.

**Table three: Enforcing a contract comparative performance.**<sup>93</sup>

**Source:** World Bank. Doing Business 2017. (2017).

	Enforcing contract ranking	Distance to Frontier score*	Time to resolution (days)	Cost (% of claim)	Quality of judicial processes (18 max rating)
England and Wales	31	69.36	437	43.9	15
Singapore	2	83.61	164	25.8	15
Australia	3	79.72	395	21.8	15.5
New Zealand	13	74.25	216	27.2	11

\* Distance to Frontier "...measures the distance of each economy to the "frontier," which represents the best performance observed on each of the indicators across all economies in the Doing Business sample since 2005... An economy's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier. For example, a score of 75 in 2016 means an economy was 25 percentage points away from the frontier constructed from the best performances across all economies and across time'. World Bank. Distance to Frontier. (No date given). Accessible at: <http://www.doingbusiness.org/data/distance-to-frontier>

England and Wales trails both Singapore and Australia on all criteria analysed by the World Bank. England and Wales is behind New Zealand on all criteria except the quality of judicial processes.

- Legal costs are high in England and Wales. A claim of nearly £54,336 incurs costs of around 35 per cent of the value. The fees to make the claim and use the courts cost around account 7.7 per cent of the value of a typical claim.
- It takes 30 days to file and service the claim.
- To get from tried to judgment it takes the English and Welsh courts 345 days.
- To get a judgment enforced it is likely to take an additional 62 days costing the equivalent of 1.2 per cent of the value of the claim.

The performance of three similar Common Law countries: Singapore, Australia and New Zealand is set out briefly in in boxes six, seven and eight below.

**Box six: Singaporean civil court system.<sup>94</sup>**

To enforce a contract worth SG\$ 138,343 in the Singaporean civil courts:

- Legal costs are equivalent to only 25.8 per cent of the value of a typical claim. Court fees are considerably less at only 2.8 per cent of the value of the claim.
- Filing and service takes only six days in Singapore.
- Trial and judgment is finished in 118 days.
- Enforcement typically takes 40 days.
- Compared to England and Wales, Singapore is equal in the quality of its judicial processes.
- Singapore outscores England and Wales on the effectiveness of its court structure and on automation of court processes.

Singapore introduced a new electronic litigation system in 2014. The system allows litigants to file cases online — and it enables courts to keep litigants and lawyers informed about their cases through e-mail, text alerts and text messages; to manage hearing dates; and even to hold certain hearings by videoconference.

**Box seven: Australian civil court system.<sup>95</sup>**

Australia outperforms England and Wales on all the comparative metrics. To enforce a contract worth AU\$ 131,697 in the Australian civil courts:

- Legal costs are considerably lower with lawyer's fees only accounting for an equivalent cost of 18.5 per cent of the value of the claim, court fees only 3.1 per cent and enforcement costs of 0.2 per cent of the claim. Additionally, Australia outperforms the UK on case management, helping it keep it ahead of England and Wales in the quality of its judicial processes.
- Filing and service takes only seven days in Australia.
- It takes 328 days for trial and judgement.
- Australia is also marginally ahead (by 0.5) of England and Wales on the quality of its judicial processes.

**Box eight: New Zealand civil court system.<sup>96</sup>**

New Zealand is not as far up the rankings as Singapore and Australia. However, it is still considerably higher than the UK. The New Zealand system is considerably better than the English and Welsh courts at keeping costs relatively low and a tight rein on the length of time a claim takes to get to resolution. To enforce a contract worth NZ\$ 105,687 in the New Zealand civil courts:

- Legal costs are the equivalent of 22 per cent of the claim including fees, which are only 2 per cent of the value of the claim.
- Filing and service only takes seven days in New Zealand.
- Trial and judgment takes 167 days.
- Enforcement requires 42 days.
- New Zealand falls behind England and Wales however in relation to the cost of enforcement. In New Zealand it costs two per cent more of the value of the claim to get the judgment enforced than in England and Wales.

<sup>94</sup> World Bank. Doing Business 2017: Singapore. (2017).

<sup>95</sup> World Bank. Doing Business 2017: Australia. (2017).

<sup>96</sup> World Bank Doing Business 2016: New Zealand 2017

The Singapore, Australia and New Zealand experiences offers both:

- Possible models that the Government and HMCTS should look to learn from.
- A set of benchmarks that the English and Welsh system should aim to achieve.

While the exemplar is Singapore, even improving the English and Welsh system to a level comparable with New Zealand's in the international rankings (through reducing usage costs, the time taken to resolve a dispute through the courts and the effectiveness of judgment enforcement) would deliver substantial cost savings to those small businesses who use the courts to resolve a dispute.

Lord Justice Briggs highlighted '*...a number of interlocking reasons for...[the civil justice system's failings]...*'<sup>97</sup> Many of the problems identified by Briggs were echoed by academics and practitioners interviewed for this report. The key reasons for the English and Welsh civil justice system's underperformance were identified as:

- Complex civil procedure (despite attempts to make it simpler) which make using the courts for Litigants in Persons very difficult.<sup>98</sup> Those who '*...choose, or are forced, to litigate in person suffer crippling disadvantages...*'<sup>99</sup> For a number of the academics and practitioners interviewed ahead of the drafting of this report the complicated paperwork that claimants and defendants have to comply with created additional complexity for those inexperienced users of the courts.
- The disproportionate cost of 'going to law'. The many procedures, complexities and need for expertise to guide and support a user through the civil courts plus the risk of costs being awarded against the losing party are significant barriers to access to justice. Lord Justice Briggs suggested that:

*'...almost all consultees recognised that it would be an unusual civil claim in which, assuming that it went all the way to trial, costs would be proportionate if the VaR...[Value at Risk]...was below £25,000. Most consultees...put the line much higher...between £50,000 and £100,000.'*<sup>100</sup>

Briggs, LJ. Civil Courts Structure Review: Interim Report. (2015).

- The cost barriers have worsened in recent years with significant increases in court fees that were introduced in the last three years in particular. When the price of something goes up the demand for it falls. There are clear indications that this is what is happening following the series of fee increases across the civil courts.<sup>101</sup> The policy driving the significant fee increases is the ambition to make the courts largely self-funding.<sup>102</sup> For some of the academics and practitioners interviewed for this report the costs of using the law was the most important factor impacting access.
- Deficits in the numbers of adequately trained and resourced staff. The quantity and skills 'gap' has knock-on impacts on the efficiency of the courts because it makes planning and management more difficult. JUSTICE has similarly highlighted the negative impact of reduced staffing, arguing that the role of HMCTS staff should be expanded not reduced.<sup>103</sup> Currently work which could be carried out by others is mis-allocated to District Judges rather than other court staff.

<sup>97</sup> Briggs, LJ. Civil Courts Structure Review: Interim Report. (2015).

<sup>98</sup> *...that it was a founding principle of the reform that produced the CPR that they should be couched in plain English: see section 1(3)(b) of the Civil Procedure Act 1997 which requires that the power to make Civil Procedure Rules is to be exercised with a view to securing that: 'the rules are both simple and simply expressed'.* Section 1(3)(a) imposes the additional purpose that: "the system of civil justice is accessible, fair and efficient". Briggs, LJ. Civil Courts Structure Review: Interim Report. (2015). Practitioners and academics interviewed for this report highlighted similar concerns about the complexity of using the civil court system especially for Litigants in Person (LiPs).

<sup>99</sup> Briggs, LJ. Civil Courts Structure Review: Interim Report. (2015).

<sup>100</sup> The Value-at-Risk describes '*...the value, expressed in monetary terms, which is really at issue between the parties' and is evaluated against the potential and actual costs that may be incurred by going to law'.* Briggs, LJ. Civil Courts Structure Review: Interim Report. 2015.

<sup>101</sup> The Registry Trust Limited (RTL) maintains the statutory public Register of Judgments, Orders and Fines for England and Wales. The RTL released data for the first half of 2016 on the quantity of County Court Judgements (CCJs) against businesses. The figures were down 19 per cent compared with the first half of 2015. This was an indication of the impact of the multiple court fee increases on the use of the civil courts in England and Wales by businesses. Croft J. Barristers warn of business impact from new court fees. (2016). Available at: <https://www.ft.com/content/ec731566-687e-11e6-a0b1-d87a9fea034f>

<sup>102</sup> Bowcott, O. Top UK judges denounce 'dangerous' increase in court fees. (2016). Available at: <https://www.theguardian.com/law/2016/jan/26/top-uk-judges-denounce-dangerous-increase-in-court-fees>

<sup>103</sup> Marks, A. What is a Court?: a report by JUSTICE. (2016), cited in Santo, M. House of Lords Library Note: Resourcing and Staffing of the Courts. (2016). Between 2014/15 and 2015/16 HMCTS lost around 1000 further staff. Santo, M. House of Lords Library Note: Resourcing and Staffing of the Courts. (2016).

- Inconsistencies in the quality and approach of judges and the wider navigability of the system. Practitioners interviewed for this report raised the issue of the lack of understanding among some about business and commercial law leading to poorer outcomes for business litigants and defendants. Also raised by practitioners and some academics interviewed was the absence of effective support for Litigants in Person (LiPs). These are a growing proportion of the court using population and do not have access to the expertise that those employing professional representation have and face having to deal with a complicated system without enough knowledge and experience.<sup>104</sup>
- Deficiencies in the operational management of civil cases, a lack of resources and investment in civil expertise and an absence of strictly regulated timeframes for completing claims. There has been a failure to implement fully Lord Woolf's recommendation for a Head of Civil Justice to deliver clear authority and management to the administration of civil justice in England and Wales. There are considerable inconsistencies in the quality of the service provided by the courts to users.<sup>105</sup> Systems have not been designed to work holistically and technology being used is decades old.<sup>106</sup>
- Insufficient performance management hindered by a lack of useful data collection about the effectiveness of the system. This is in part a symptom of a lack of investment in modern court infrastructure which can collect and store and use data more easily and effectively.
- Poor enforcement. Enforcement was raised by a number of the practitioners interviewed for this report. Alongside fees it was raised as the aspect of the court system in most urgent need of reform. The inefficiency and the ineffectiveness of the enforcement process was a frustration to many of the practitioners spoken to. Poor enforcement enables those who have been found against to avoid accountability, which can result in long-run damaging effects on the credibility of the system. There is also some evidence of a direct link between the effectiveness of enforcement in the courts and with business productivity and access to credit for businesses.<sup>107</sup>

*'Enforcement is the Achilles heel, of the civil court...[it is]...heavily localised, paper based, prone to error in form filling, and perceived to be slow, ineffective and expensive'.*

Briggs, LJ. Civil Courts Structure Review: Interim Report. (2015).

<sup>104</sup> Civil Justice Council. Access to Justice for Litigants in Person (or self-represented litigants). (2011), cited in Garton Grimwood, G. Litigants in Person: the rise of the self-represented litigant in the civil and family cases. (2016).

<sup>105</sup> HM Courts and Tribunals Service. Annual Report and Accounts 2014-15, cited in Santo, M. House of Lords Library Note: Resourcing and Staffing of the Courts. (2016).

<sup>106</sup> HM Courts and Tribunals Service. Annual Report and Accounts 2014-15, cited in Santo, M. House of Lords Library Note: Resourcing and Staffing of the Courts. (2016).

<sup>107</sup> Ponticelli, J. Court Enforcement and Firm Productivity: Evidence from a Bankruptcy Reform in Brazil. (2014). Accessible at: [https://bfi.uchicago.edu/sites/default/files/research/bankruptcy\\_brazil.pdf](https://bfi.uchicago.edu/sites/default/files/research/bankruptcy_brazil.pdf)

## The Small Claims Court

The existence of a SCC can make a big difference to the effectiveness of a judicial system.<sup>108</sup> The relative informality and flexibility of the SCC help small businesses with very low value claims by enabling them to avoid some of the crippling financial and time costs of the main court system.<sup>109</sup> However, the English and Welsh SCC is a track within the civil court system and consequently suffers from many of the same problems as the other tracks dealing with the higher value cases.<sup>110</sup> The problem of disproportionate costs acting as a barrier to accessing justice are as pertinent to the SCC as the rest of the civil court system. In a number of the interviews with leading academics and practitioners undertaken for this report a range of concerns were raised in relation to the effectiveness of the enforcement system, speed of the SCC and quality and consistency of the service were raised.

Some representative summary descriptions of the experiences of using the SCC by FSB members are briefly set out in Box nine below.

### Box nine: Member experiences of the SCC.

#### Issue: Non-payment contract issue.

Counter-party: with supplier.

*'The experience was tortuous, with many delays... it was all too detailed for a judge to read in just an hour...Ultimately an award was made to me but the company took no notice.'*

**FSB member, Kent England.**

#### Issue: Outstanding debt.

Counter-party: with customer.

*'Hard going & long winded - always seemed to favour the debtor. Eventually got the money just prior to bailiffs going in.'*

**FSB member, Warwickshire, England.**

#### Issue: Non-payment contractual dispute. Counter-party: with supplier.

*'Extremely time consuming and a cloud over our business from the day we received the Court papers until the decision was made by the Judge.'*

**FSB member, Kent, England.**

<sup>108</sup> World Bank. Access to justice: the English experience with small claims. (2000).

<sup>109</sup> Djankov, S., La Porta, R., Lopezde-Silanes, F and Shleifer, A. Courts. Quarterly Journal of Economics. Vol 118 (2). (2003).

<sup>110</sup> Christie, S. Small claims courts 'failing the public'. (2014). Available at: <http://www.telegraph.co.uk/finance/personalfinance/10757159/Small-claims-courts-failing-the-public.html>

Practitioners and legal academics interviewed for this report similarly identified costs and delays, among other things, as key ways in which the SCC is not delivering effectively enough for users.

A key element of Lord Justice Briggs's recent review into the structures of the civil court highlighted the failure of the civil justice system to provide adequately options for those with low value claims to utilise the courts without incurring disproportionate costs at best and at worst preventing small businesses using the courts because the costs are prohibitive. One of the most visible problems with the SCC is the time it takes a claim to get from its submission to the end of the trial. In the most recent data available it took, on average, 31 weeks for a small claim to reach the trial.<sup>111</sup> For the system to take over seven months to deal with a low value claim is too long for small businesses. In contrast, many Ombudsman services look to deal with a case from start to finish within three months.

Academics and practitioners interviewed for this report highlighted a number of reasons why the SCC offering to small business is costly and inefficient. The key ones included:

- An absence of adequate advice and other support for small business users in general, and LiPs in particular at the pre-claim and pre-hearing parts of the process.<sup>112</sup> In addition, the process can be intimidating for LiPs with paperwork associated with a claim or defending a claim more complicated than necessary and procedure rules which are not easy for LiPs to understand. Briggs identified that the elements of the CPRs and associated Practice Directions applicable to the SCC could be significantly improved in order to help LiPs.<sup>113</sup>
- Inconsistency in the approaches to cases taken by judges.<sup>114</sup> Small businesses are unable to rely on a clear and consistent approach from judges e.g. some judges are more flexible with the length of hearings, others are rigid, some judges take an informal approach encouraging resolution while others take a less interventionist role. In addition, there is variable quality in case management nor much accountability for inadequate management.
- An absence of specialist knowledge in commercial issues in the lower civil courts, in contrast to the higher courts where there are specialist courts dealing with commercial disputes.<sup>115</sup>
- Lawyers have an unclear and ill-defined role in the SCC.<sup>116</sup> The SCC is meant to be easily navigable by LiPs, less intimidating than the higher courts and a fair and equitable all parties. However, lawyers are able to represent litigants in the SCC. The result can be disparities in 'arms' when the other party is not represented by a professional.
- Increasing fees which are making the costs of using the courts ever more disproportionate to the value of many small claims especially when added to the inevitable wider costs that will be incurred when pursuing a claim through the courts.
- Poor enforcement of judgments, which add to the length and cost of the whole process.<sup>117</sup>

<sup>111</sup> Between April and June 2016 there were 8,367 small claims trials which took 31.7 weeks after the claim was originally made. This is similar to the average time taken in the comparable period in 2015, where the average time it took to get to trial was 31.8 weeks. Ministry of Justice and ONS. Civil Justice Statistics Quarterly, England and Wales, April to June 2016. (2016). Accessible at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/549424/civil-justice-statistics-april-june-2016.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/549424/civil-justice-statistics-april-june-2016.pdf)

<sup>112</sup> Christie, S. Small claims courts 'failing the public'. (2014). Available at: <http://www.telegraph.co.uk/finance/personalfinance/10757159/Small-claims-courts-failing-the-public.html> Williams, K. Litigants in person: a literature review. (2011). Accessible at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/217374/litigants-in-person-literature-review.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/217374/litigants-in-person-literature-review.pdf)

<sup>113</sup> Briggs, L.J. Civil Courts Structure Review: Interim Report. 2015.

<sup>114</sup> Christie, S. Small claims courts 'failing the public'. (2014). Available at: <http://www.telegraph.co.uk/finance/personalfinance/10757159/Small-claims-courts-failing-the-public.html>

<sup>115</sup> Tucker, A. Making a Case for Business Courts: A Survey of the Proposed Framework to Evaluate Business Courts. Vol 24 (2). (2007).

<sup>116</sup> Christie, S. Small claims courts 'failing the public'. (2014). Available at: <http://www.telegraph.co.uk/finance/personalfinance/10757159/Small-claims-courts-failing-the-public.html>

<sup>117</sup> Christie, S. Small claims courts 'failing the public'. (2014). Available at: <http://www.telegraph.co.uk/finance/personalfinance/10757159/Small-claims-courts-failing-the-public.html>



## Factors influencing the effectiveness of the court system: where to target reform

In order to understand how the civil justice system might maximise its positive impact on the small business community and the economy and minimise its negative impact i.e. be speedy, accessible and enforce judgments effectively, it is vital to understand what factors influence the effectiveness of the courts. The key factors that influence that include:<sup>118</sup>

- The organizational structures.
- The level of formality of procedures.<sup>119</sup>
- The method of work within the judicial offices.
- The incentives of the parties engaged in service provision, especially judges and lawyers.

Table seven in Appendix III illustrates what type of reform is needed, whether that be in relation to procedures, the organisation of the courts, working methods or incentives to tackle a specific problem identified by Lord Justice Briggs.

However, the drivers of efficiency are not confined to the four factors outlined. Funding is also key. The court infrastructure must be invested in and modernised whenever necessary. Better technology can be an important driver of greater efficiency and effectiveness. The recent announcement of over £700 million of investment in HMCTS to modernise the courts infrastructure is very welcome it is an important step on the road to bringing the English and Welsh civil courts up the level of Australia and Singapore.<sup>120</sup>

Further, while accessibility is in part driven by the efficiency of the courts including their ease of use, there is also a demand-side aspect to the accessibility equation which is equally important.<sup>121</sup> The demand to use the courts is a function, to a large degree, of cost. Action to reduce the costs borne by those wanting to use the courts is needed in order to increase accessibility. That means action on fees, but also on minimising the other costs associated with pursuing a dispute through the courts such as legal costs. Without action to tackle the problems on both the court side and cost to the users side the court will remain inaccessible to many small businesses, depriving them of justice.

---

118 Palumbo, G., Giupponi, G., Nunziata, L and Mora-Sanguinetti J S. The Economics of Civil Justice: new cross-country data and empirics. (2013).

119 Djankov et al., 2003 found that the more complex and formalist the courts procedures the longer the duration of the dispute and the higher cost, without off-setting benefits in terms of the substantive decision. Djankov, S., La Porta, R., Lopezde-Silanes, F and Shleifer, A. Courts. Quarterly Journal of Economics. Vol 118 (2). (2003).

120 'In 2014 we...[HMCTS]...agreed gross funding of over £700 million that we will invest to radically transform and improve the service we deliver'. HMCTS. Annual Reports and Accounts: 2014-15. (2015).

121 alumbo, G., Giupponi, G., Nunziata, L and Mora-Sanguinetti J S. The Economics of Civil Justice: new cross-country data and empirics. (2013).

## Implications for policy

An effective civil justice system is a necessity for a functioning economy. Efficient civil courts are strongly associated with a dynamic economy. The negative consequences for small businesses of not being able to resolve their disputes quickly, at minimal cost and fairly can be substantial. Despite their vital role, it is clear the English and Welsh civil courts have fallen behind the best performing Common Law systems around the world suggesting considerable room for improvement. First it is important that the parts of the system working well, such as the Common Law itself, are preserved and maintained. Secondly, to get the English and Welsh courts up to the standard of the best – Singapore – significant reform is needed in the areas of:

- Organisation.
- Procedure.
- Management.
- The incentives structure facing those operating and working with the system.
- Funding.
- Access. Change is needed to reduce the barriers to accessing dispute resolution on the demand-side to improve access.

There are plans for improvements in the pipeline. Not only for a significant investment in updating the important court infrastructure such as IT systems but plans for a new online court aimed at making access easier. These are welcome developments and need to be sustained over the long-term to ensure improvements are maintained. However, there is considerable room for further change in the six areas listed above, in order to bring about a step-change in the service the civil courts offer small businesses and deliver more of the benefits to small businesses and the economy that an effective civil justice system can.

# IMPROVING DISPUTE RESOLUTION: A COMPREHENSIVE THREE TIER SYSTEM

---

The evidence outlined in the preceding sections illustrates how important it is for small businesses to be able to efficiently and effectively resolve their commercial disputes. Small businesses are vulnerable and a dispute can have significant, in some cases existential, implications. Therefore, it is imperative that commercial disputes are avoided where possible and, if they arise, are resolved in the least costly way while delivering, as far as practicable, a fair, just and economically efficient outcome.

England and Wales has a mature commercial culture based on a similarly well-established adherence to the rule of law and Common Law legal framework with the latter's long history of enabling and facilitating commerce.<sup>122</sup> The existence of this institutional nexus in England and Wales helps create a benign environment for small businesses and small business investors to engage in commercial transactions and make investments. It is essential that these basic building blocks are maintained as the foundation on which the economy is built.<sup>123</sup> Beyond this 'defensive role' for Government protecting the enabling aspects of the English and Welsh legal system, there is much that can be done to improve the dispute resolution environment for small businesses, which would help small businesses to prosper. Measures should be focussed upon reducing the cost (in their widest sense) of disputes.

Devising the right policy mix requires policymakers to have an understanding of the vulnerability of small (and especially micro) businesses. A successful policy, based on a detailed understanding of the position of small businesses, and that delivers a significant improvement in the dispute resolution landscape for small businesses, needs to be conceived and developed holistically. The aim should be to establish a comprehensive dispute resolution system consisting of three tiers, which offer a menu of support to small businesses that will enable them to deal with their commercial disputes whatever their circumstances, ambitions and business characteristics in the most appropriate way.

---

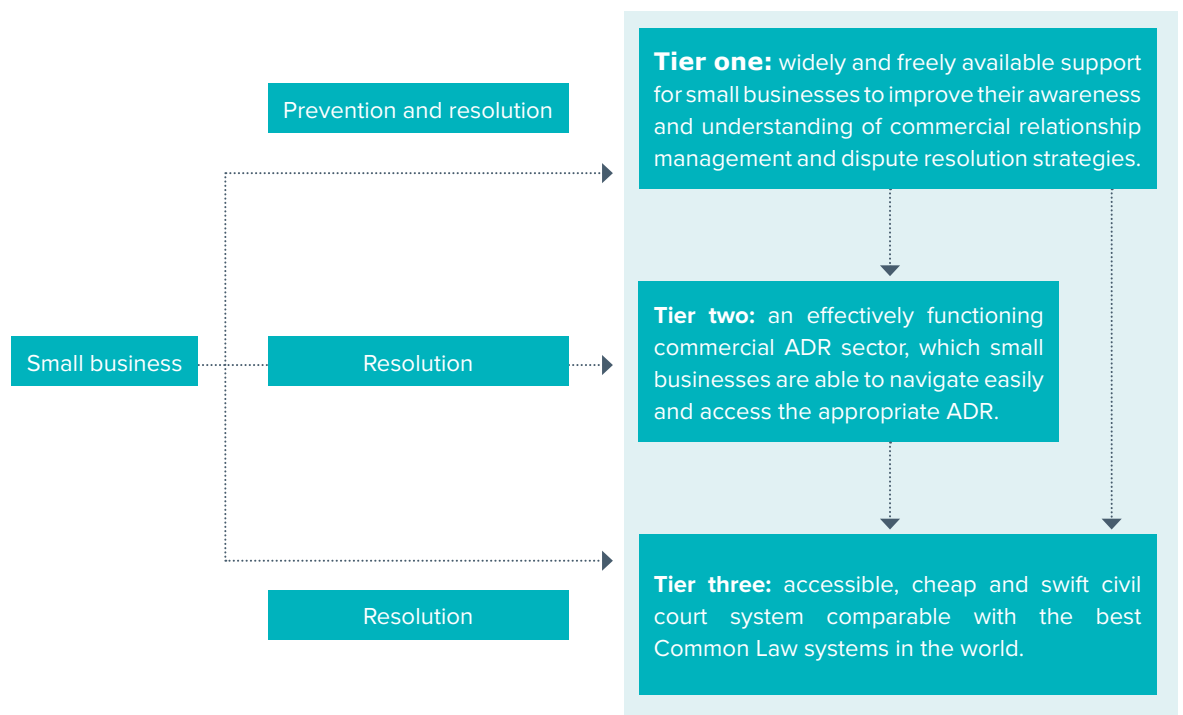
<sup>122</sup> 'In these islands we are fortunate that the rule of law is embedded in our way of life...The principles that contracts should be honoured, property rights respected and all are equal before the law are customary – the deep fabric of our culture'. Gove, M. What does a one nation justice policy look like? (2015).

<sup>123</sup> Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. (2013).

## A dispute resolution system for England and Wales

Each tier of the system should be accessible to all small businesses in England. Wales may, with many issues devolved, want to pursue its own separate policies in this space where it can. Diagram one below illustrates the basic outlines of the comprehensive dispute resolution system.

**Diagram one:** Components of a comprehensive dispute resolution system.



### Tier one: preventing disputes and informal/ semi-formal resolution

Preventing disputes, or ensuring problems and disagreements are resolved before they become disputes, is an effective method of minimising the costs of a dispute. However, smaller businesses suffer from a lack of resources, cash-flow and working capital that inhibit their ability to invest in and develop helpful specialist business ancillary skills, such as negotiating and contracting. Smaller businesses should take the opportunity to build up their skills where they can. As the CEBR suggested, there can be a bottom line benefit by doing so, and much to be gained from avoiding problems once a commercial arrangement has been entered into.

Government has a role to play in helping smaller businesses improve their negotiating and contracting knowledge and skills. The planned SBC could play a central role in this if supplied with the requisite resource and it can develop a high profile among the small business community. While the SBC should not be supplanting the private sector, where the latter is already delivering for small businesses, there is a role for it to help try and correct some of the market failures which have resulted in the large quantum of unmet legal needs identified by Pleasence and Balmer.<sup>124</sup> The SBC should try and go some way in filling the gap on basic legal advice and guidance, with a particular focus on commercial dispute resolution. The legal sector is currently not delivering for small businesses in this regard.

<sup>124</sup> Pleasence, P and Balmer, N J. In Need of Advice? Findings of a Small Business Legal Needs Benchmarking Survey. (2013). Accessible at: <https://research.legalservicesboard.org.uk/wp-content/media/In-Need-of-Advice-report.pdf>

The SBC should:

- Design and provide basic tool kits and advice on relationship management, negotiating and contracting for small businesses.
- Develop a hub for small businesses through which they can access training in key aspects of commercial relationship management, negotiation and contracting. Over time, the SBC, in partnership with relevant bodies and agencies, should create an accreditation system for such training courses. This would ensure small businesses can expect a minimum level of quality from training accessed through the SBC. The long-term aim should be that the SBC becomes the primary intermediating platform for accessing courses on relationship management, negotiating and contracting by small businesses in England. Offering access through one central portal is likely to help more small businesses to become aware of and take up opportunities for upskilling.

### **Tier two: the ADR sector**

Using ADR offers small businesses the opportunity to resolve a disagreement in a private and consensual way, which may save a commercial relationship. ADR offers numerous methods of dispute resolution for a small businesses, but few use it. This is due to an ADR knowledge gap, which needs to be closed if more small businesses are to utilise it.

Policymakers should:

- Help raise awareness of and increase the knowledge about the existence and possible uses of ADR among smaller businesses.
- Help small businesses find the most appropriate method of ADR to their circumstances. In turn this includes a better functioning commercial ADR market.

In a similar vein to the Australian Small Business Commissioner model, the SBC should play a central role in helping achieve these ends.

The SBC should:

- Be explicitly tasked with increasing the levels of awareness and understanding of ADR among smaller businesses and be held accountable for their performance in doing so.
- Raising the level of knowledge among the small business community by offering both basic general advice on the differences between types of ADR and more tailored advice and guidance on what might be most appropriate given the particularities of a specific dispute.
- Become the hub for signposting to different individual providers of commercial ADR services similar to the Ministry of Justice's 'Find a Civil Mediation' online directory service. In time, the SBC should take the MOJ model further. In addition to the helpful pricing guidelines that the 'Find a Civil Mediation' provider service offers, the SBC's signposting platform should be developed, over time, into an online user review and rating facility offering feedback on the quality and cost of the ADR providers listed. Providing a single place that small businesses are expected to grow ever increasingly aware of offers the best chance of helping small businesses navigate the fragmented ADR sector.

The single high profile portal role of the SBC will be a useful coordinating mechanism for the ADR market. It should help it work somewhat better than it currently appears by helping match supply with demand more appropriately. Also, by providing integrated assistance for potential demanders to better navigate the market.

To complement the central role of the SBC and further help increase familiarity with the use of ADR across markets and within supply-chains, the Government should require larger businesses applying for significant Government contracts (i.e. Tier one suppliers) to have ADR clauses in their contracts. This would help resolve disputes with Tier two and three sub-contractors and suppliers in their supply-chains.

However, given the continued fragmented nature of much of the ADR sector, the low levels of awareness among smaller businesses, the difficulty in evaluating quality standards and value-for-money offerings are likely to continue for a considerable period of time. As with legal services more generally, there are few proxies which small businesses can use to help them search the ADR market and make appropriate choices. While there are a number of professional bodies regulating some providers of ADR, more generally applicable standards across the sector would increase trust in ADR among small businesses. Therefore, the Ministry of Justice should:

- Undertake a fundamental and wide ranging review of the commercial legal services sector.<sup>125</sup> The review should encompass the current review by the Competition and Markets Authority (CMA) of the commercial legal services sector and the findings of the recent consultation into the regulation of the legal profession.
- A central element of the review should be to make Commercial ADR and its market more effective. This should explore the question as to whether there is a case for the existing ADR professional bodies to be brought within the remit of the Legal Services Board (LSB), putting them on the same footing as the Bar Standards Board (BSB), Solicitors Regulation Authority (SRA), etc.
- As a first step to helping build trust among small businesses in commercial ADR services across the board, ADR providers should come within the jurisdiction of one or more independent redress schemes.

### **Tier three: civil justice reform**

The third and final tier in the comprehensive dispute resolution system should be a reformed civil court system.

The civil courts must have a central role in a holistic system. The first step has to be a re-balancing at the strategic policy level, with an equal focus put on making sure the civil courts are significantly improved and that improvement is sustained over time.<sup>126</sup>

More detailed reforms should be focused on improving the civil courts' performance across the following five categories of factors which drive effective courts:<sup>127</sup>

1. Structural reform to improve the service for users.
2. The procedures in the courts.
3. Management practices and processes to improve efficiency.
4. The incentives faced by those who operate the system.
5. Investment.
6. Access.

In each of the six areas, a number of reforms need to be made with the aim of bringing the English and Welsh civil justice system up to the level of the effectiveness of comparator countries.

There are three policy prerequisites for the proposed reforms, which must be in place in order to deliver the world class civil justice system small businesses in England Wales need. These are:

- A sustained public investment in the civil courts. The proposed investment programme for the Courts and Tribunal System must go ahead. Further, the initial injection of money needs to be sustained so that, once improvements are in place, they are maintained and future improvements can be implemented where necessary.<sup>128</sup>

<sup>125</sup> FSB. FSB submission to CMA market study into the supply of legal services in England and Wales. (2016). Accessible at: <http://www.fsb.org.uk/docs/default-source/fsb-org-uk/cma-legal-services-market-study---fsb-submission---february-2016.pdf?sfvrsn=0>

<sup>126</sup> Genn, H. What is Civil Justice For? Reform, ADR and Access to Justice. (2013).

<sup>127</sup> See Appendix III for Table outlining in which areas reforms are needed to deal with the kinds of deficiencies identified by Lord Justice Briggs.

<sup>128</sup> The stated objectives of the £700 million funding for modernisation are the right, and unarguable, ones: a better service to users, fair and transparent justice, improved and modern access channels and a future-proofed infrastructure. HMCTS. Annual Reports and Accounts: 2014-15. (2015).

- Policy should not be focused on making the civil courts largely pay for themselves. General taxation should be the main source of funds supporting a public good like the court system.
- There should be a commitment by all Governments (current and future) to ensure the Common Law continues to be a commercially sensitive system of law by maintaining robust protection of property rights and supporting economic freedom. Measures, often more suited to different legal (i.e. Civil) traditions and which could dilute some of the long-standing commercial strengths of the Common Law, need to be avoided. The long-term consequences of such policies would be negative for the commercial environment in England and Wales.

With these three foundational pillars in place, the Government and HMCTS should implement a civil courts reform programme to deliver the effective civil court system small businesses need to resolve their disputes in a swift, fair, just and economically efficient way. Such a programme should build upon the positive plans already underway such as the investment in new IT infrastructure for the courts and structural changes like the online court that should help access by making use of the courts more convenient.<sup>129</sup> Recommendations set out below aim to build upon what is good in these plans and take them further where necessary and propose new ideas where these would deliver additional benefits for small business court users.

## Organisational reform

- The proposed online court, if it is established as a separate court, needs to be seamlessly inter-linked with the SCC and the fast and multi tracks to enable frictionless shifting of cases between them. In developing the online court one option the Government should consider very carefully, in the context of upper claim limits (see below), is to integrate the system into the SCC. This would then ensure users using the the online option can choose a menu of methods for taking their claim through the civil courts or defending a claim. This would reduce the inevitable frictions that will arise from having a separate online court to the SCC.
- There is a risk that the current proposals for an online court leave behind the traditional SCC, which is badly in need of its own modernisation. The Government should develop a specialist commercial track within the SCC. Specialist commercial (e.g. the Commercial and Mercantile Courts) courts operate at the higher value end of the civil court structure. These specialist courts offer many benefits to commercial parties, not least a more expert understanding of commercial practice and detailed knowledge of relevant commercial law. Courts can deliver more effective outcomes more swiftly as a result of that expertise. Therefore, the principle should be extended to commercial disputes in lower value cases. Smaller businesses should be able to benefit from these advantages and not be excluded from them because of the typically lower value of their case.
- Increase the value limit of the SCC to £25,000 to align it with the limit proposed for the new online court, along with similar appropriate upward revisions to the case value ranges for the 'Fast' and 'Multi' tracks. A regular review of the SCC limit should be put in place. One of its first tasks should be to explore the merits of increasing the limit significantly further. Perhaps as high as the upper end of the VaR highlighted by Lord Justice Briggs.
- Judges should be redeployed away from dealing with SCC cases to handle only appeals from the SCC alongside duties to manage the 'referees' and the courts and, additionally, concentrating on the higher value and complex cases in the fast and multi tracks.
- Instead of judges, the primary decision makers and case managers in small claims cases should be specialist 'referees'. These could be an adopted and expanded version of the 'primary dispute resolution officer' (registrar) model proposed by JUSTICE.<sup>130</sup> The 'referee' system should also replace separate court-based ADR offerings. All possible methods that might help resolve the dispute such as mediation/conciliation and adjudication should be integrated into a single stage in the dispute process, effectively creating a flexible 'hybrid' mediation-conciliation-adjudication system borrowing from the New Zealand Dispute Tribunal system model. While some judges

<sup>129</sup> Briggs, L.J. Civil Courts Structure Review: Final Report, (2016).

<sup>130</sup> Burnton, S. Delivering Justice in an Age of Austerity', (2015).

in the SCC currently exercise their discretion, such that they often try to find a compromise solution before a formal judgment akin to conducting a conciliation or mediation, an official ‘hybrid’ approach would regularise and formalise this pragmatic practice. By removing potential mediation or conciliation as a separate stage in the court process, and giving the ‘referee’ an integrated role, administration and other costs (such as time) of the dispute moving through additional stages or between different parts of the system can be avoided. Overall the system should move more quickly and be less costly.

- Establish a comprehensive ‘wrap around’ support service for small business users of the civil courts particularly focused on helping small business LiPs and those with low value claims. It should offer some basic ‘early neutral evaluation’ and legal advice, e.g. on the *prima facie* merits of a dispute.<sup>131</sup> The SBC and the SBC should signpost small businesses to the service when they are planning to take a dispute to the civil courts. The support service should be developed in partnership with the SBC and small business representative groups in addition to small businesses themselves so that it can be tailored to the needs of small business users of the courts.

### Procedural reform in the civil courts

- Simplification of the Civil Procedure Rules (CPRs) and the associated Practice Directions for LiPs across the SCC, the fast and multi tracks with a move away from too much prescription. Changes to the CPRs should be based on the following principles: flexibility of procedure with quality and fairness guaranteed through accountability, openness, and reporting, especially of the reasoning for key procedural decisions, performance metrics and rigorous professional training.
- The courts should have a high degree of flexibility over where complex cases end up being resolved. Keeping cases that might be considered relatively complex within the SCC more often would benefit smaller businesses. So too would consistency over what constitutes a complex case and what does not.
- If the online court is to be a separate court, subject to practical constraints, it should have procedure rules as closely aligned to a reformed set of SCC procedures as possible.
- Procedure related to the enforcement to be overhauled to speed them up. At the judgment stage, a Statement of Means form should automatically be issued to the debtor along with a court order to return it and payment within strict time frames. Further, small businesses should not have to pay extra to get judgements enforced and additional charges for enforcement should be repealed. The Government should review whether a more radical approach needs to be taken to improve the enforcement of judgments, e.g. setting up a system whereby the courts can directly retrieve costs from a losing party.
- The implementation of clear and robust overall time frames for the different stages of claims and cases in the SCC in particular. Many Ombudsmen services, for example, achieve resolution in the large majority of cases within two to three months. This should be the aim for all SCC claims, perhaps with flexibility for the various court stages within it. ‘Referees’ should have discretion over length of hearings, whether they be remote or face-to-face. Some cases may benefit from a single lengthier hearing but which reduce the overall amount of time the case takes. Currently, most SCC hearings are typically about an hour in length. However, where a three hour hearing may resolve the issue, there is no reason why the Judge or ‘referee’ should not be able to have that time.

<sup>131</sup> An independent third party, in this case a member of the civil court's wrap around support service, offers an initial view on the merits of the case.



### **Operational/ managerial reform**

- The new online court systems needs to be developed in a flexible and adaptive way with extensive and open user testing at every stage. The new digital systems must aim to provide seamless interconnection between the different tracks in the civil courts and differently located courts. It also needs to be cyber secure, with security built in by design. Beyond the online court, the improvement in the IT infrastructure of the rest of the civil court system needs to be developed in the same flexible and adaptive way, fully interoperable and secure.
- ‘Referees’ should be extensively trained across the range of disciplines they will need in their role. They will require a high degree of competence in mediation, conciliation, case management, law and procedure. Their training needs to ensure ‘referees’ can deliver a high quality and consistent service level across the County Courts of England and Wales for all small businesses, along with adequate transparency about performance and robust accountability.

### **Incentives**

- Implement Lord Woolf’s proposal for a Head of Civil Justice, with responsibility for the administration of civil justice across England and Wales with a clear process for ensuring accountability for the performance of the court system.
- Where currently there can be ambiguity the Government and HMCTS should ensure clear and direct case management responsibilities across the civil courts. In the SCC these need to be placed in the hands of the proposed ‘referees’ who can take a case from start to resolution. There needs to be robust performance and accountability mechanisms in place to ensure high quality and consistent case management at all levels of the civil courts but especially in the County Courts.
- Reform of the current system of enforcement with better incentives for more effective enforcement. Plans to centralise enforcement are important steps in the right direction and should be completed.<sup>132</sup> High Court Enforcement Officers should play the leading national role in enforcement. Practitioners interviewed for this report generally considered the High Court Enforcement Officers to perform more effectively in recovering debts than the County Court Bailiff.
- Fixed costs should be brought in as swiftly as possible to help reduce some of the legal costs incurred by smaller businesses.<sup>133</sup> An overall reduction in the cost of ‘going to law’ for small businesses, especially reducing some of the risk around damages for losing parties, would be a significant boon to those small businesses seeking access to justice but are deterred by concerns over costs.

---

<sup>132</sup> Briggs, L.J. Civil Courts Structure Review: Interim Report. 2015.

<sup>133</sup> Jackson L.J. Fixed Costs – The Time Has Come. (2016).

## Access

- There should be a restructuring of the current court fees system. Evidence suggests that continuing increases are having a deterrence effect. This is not surprising; increases in the price of something reduce the demand for it. However, the consequence in the case of court service, is reduced access to justice, fewer disputes resolved and knock-on negative consequences for small businesses and the economy. England and Wales should copy the Singaporean Small Claims Tribunal and New Zealand Dispute Tribunal examples of charging low, even nominal, fees. The international comparative data shows that low costs do not necessarily mean a slow and overloaded civil court system. Rather, both the Singaporean and the New Zealand systems outperform England and Wales despite lower fees. There should be a significant reduction in court fees to a much lower level accompanied by a rationalisation of the numerous fees a small business is liable to pay into a single fee.
- Accompanying the fee changes the Government should introduce a ‘costs fee’ to be paid by the losing party to a dispute after the judgment. While it should generally be quite low, the existence of this ‘fee’ should help deter anyone who wants to bring a vexatious claim or who wastes the court’s time, as it should be adjustable dependent on the behaviour of the party through the process.
- The online court fee system, if it is to be a separate track, should mirror the fee structure of the SCC. This will ensure that the choice by a small business user of whether to use the online court or the SCC is one based on their circumstances and what is most appropriate to the dispute not skewed by price decisions.
- The default hourly rate for LiPs should be a more accurate reflection of the cost, to a small business, of having to take time out of the business to deal with court, with a default assumption that time spent at court would otherwise be billable work hours.
- HMCTS should make the SBC a key partner, working with them, along with small businesses and their representative groups, to help develop the ‘wrap around’ support service offering advice and guidance to small businesses on navigating the courts early neutral evaluation and to continually improve the service once it is up and running.

# APPENDIX I: RULE OF LAW

---

The existence and effectiveness of the rule of law in a society has a clear and established link to economic performance.<sup>134</sup> Economies without the rule of law are demonstrably less successful. This is unsurprising. The rule of law is an essential institutional underpinning to commercial activity.<sup>135</sup> It ensures that the law, i.e. the nexus of private property rights, obligations and concomitant freedoms to conduct business, can be guaranteed and, consequently, generates trust among economic actors, reduces the costs associated with doing business (see Appendix II for more on what constitutes ‘the law’) and in-turn drives entrepreneurship and investment.<sup>136</sup>

The rule of law consists of a number of key elements, all of which have to be present in order to be able to say that there is the rule of law. The elements are:<sup>137</sup>

- Rules that are published and, consequently, readily accessible to all.
- Rules which are reasonably certain, clear and stable, which, as a result, excludes discretion which has no constraints.
- Mechanisms ensuring the application of rules without discrimination.
- Binding decisions by an independent judiciary.
- Limited delay in judicial proceedings.
- Effective judicial sanctions.
- Compliance by, and accountability of, the Government and its officials in relation to relevant rules.

The rule of law, in order to be effective, has to be applied, i.e. enforced. Those breaching the rules need to be held to account, otherwise the rules are meaningless. Businesses and consumers could not rely on them setting the parameters of behaviour if the rules were not, and commercial activity would suffer. A key part of the enforcement of the law is the impartiality of the institutions (the judicial institutions) which do the enforcement.<sup>138</sup>

---

<sup>134</sup> Braunerhjelm, P. and Henrekson, M. Entrepreneurship, institutions, and economic dynamism: lessons from a comparison of the United States and Sweden in *Industrial and Corporate Change*. Vol 22 (1), (2013). Rodrik, D., Subramanian, A. and Trebbi, F. Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development in *Journal of Economic Growth*. Vol 9 (2). (2004).

<sup>135</sup> Robert M. Sherwood, R M., Shepherd G. and De Souza, C M. Judicial Systems and Economic Performance in *Quarterly Review of Economics and Finance*. Vol 34 (1). (1994).

<sup>136</sup> Braunerhjelm, P. and Henrekson, M. Entrepreneurship, institutions, and economic dynamism: lessons from a comparison of the United States and Sweden in *Industrial and Corporate Change*. Vol 22 (1), (2013). Lorzio, M. and Gurrieri, A R. Efficiency of Justice and Economic Systems in *Procedia Economics and Finance*. Vol 17. (2014).

<sup>137</sup> World Bank. *Governance and Development*. (1992). World Bank. *World Development Report 1997: The State in a Changing World*. (1997). Posner, R.A. *Creating a Legal Framework for Economic Development in World Bank Research Observer*. Vol 13. (1998).

<sup>138</sup> Dakolias, M. Court Performance around the World: A Comparative Perspective in *Yale Human Rights and Development Journal*. Vol 2 (1). (2014). Accessible at: <http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=1009&context=yhrdj>

# APPENDIX II: PRIVATE PROPERTY, CONTRACTS AND ENGLISH LAW

---

The question naturally arises, having established what the rule of law is and why it is necessary, as to what law?

In England and Wales that law is the Common Law. It is law which:<sup>139</sup>

- Is strongly associated with judicial independence, that secures private property rights.
- Provides considerable freedom for a wide range of bespoke economic relationships (e.g. contracting) to develop and evolve.
- Ensures the accountability of those who breach their obligations.

Economic success is linked very closely with strong guarantees of private property rights and the freedom to exchange rights over property i.e. objects of economic value. Private property and freedom to enter into commercial arrangements create the incentives to invest, innovate and take risks in ways most appropriate to the parties involved in the commercial relationship. Private property rights for example, underpin economic activity in four ways:<sup>140</sup>

- Security - investment is expected to lead to a flow of income, which needs to be protected against expropriation through secure, well-defined property rights. Such protection provides incentive to invest. Conversely insecure property rights result in individuals and businesses unable to realise the fruits of their investment and efforts.
- Efficiency - enhancing the mobility of assets through transactions such that assets are transferred to those who can use them most productively.
- Reduced protection costs – secure property rights mean that individuals can devote fewer resources to protecting their property (which is an unproductive use of resources) and these resources can be put instead into productive activities.
- Transaction facilitation – formally defined property rights allow for the use of property in supporting other transactions by using it as collateral to obtain credit.

Consequently, the stronger the protection of property rights and the guarantee of substantial economic freedoms through the system of law, the greater the level of economic development in the long-run.

The Common Law of England and Wales is particularly good for encouraging economic growth because it is very effective at guaranteeing private property rights and a high degree of economic freedom.<sup>141</sup> Scholars have identified that Common Law:

- Is dispute resolving and supports private contracting, in contrast to Civil law which is frequently less 'sympathetic'.<sup>142</sup>
- Facilitates a high degree of discretion and flexibility in commercial relationships compared to Civil law countries.<sup>143</sup>
- Is highly protective of investors (shareholders) and lenders (creditors) compared to Civil legal traditions, which encourages the provision of credit and investment and the development of capital markets.<sup>144</sup>

---

<sup>139</sup> La Porta, R., Lopez-de-Silanes, F. and Shleifer, A., The Economic Consequences of Legal Origins, in *Journal of Economic Literature*. Vol 4 (2). (2008).

<sup>140</sup> Besley, T. and Ghatak, M. Property rights and economic development, in Rodrik, D and Rosenzweig, M. eds. *Handbook of Development Economics: 1st ed.* (2009).

<sup>141</sup> Mahoney, P G. The Common Law and Economic Growth: Hayek Might Be Right. in *Journal of Legal Studies*. Vol 30 (2). (2001).

<sup>142</sup> Damaška, M R. *The Faces of Justice and State Authority: A Comparative Approach to the Legal Process.* (1986), cited in La Porta, R., Lopez-de-Silanes, F and Andrei Shleifer, A. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, Vol 46 (2). (2008). Pistor, K. Legal Ground Rules in Coordinated and Liberal Market Economies, in *Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan, and the US*, ed. Klaus J. Hopt K J., Wymeersch, E and Kanda, H. and Baum, H. (2006), cited in La Porta, R., Lopez-de-Silanes, F and Andrei Shleifer, A. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, Vol 46 (2). (2008).

<sup>143</sup> Pistor, K. Legal Ground Rules in Coordinated and Liberal Market Economies, in *Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan, and the US*, ed. Klaus J. Hopt K J., Wymeersch, E and Kanda, H. and Baum, H. (2006), cited in La Porta, R., Lopez-de-Silanes, F and Andrei Shleifer, A. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, Vol 46 (2). (2008).

<sup>144</sup> Djankov, S, La Porta, R., Lopez-de-Silanes, F and Shleifer, A. Courts. *Quarterly Journal of Economics*. Vol 118 (2). (2003) cited in La Porta, R., Lopez-de-Silanes, F and Andrei Shleifer, A. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, Vol 46 (2). (2008).

- Is strongly associated with judicial independence and lower procedural formalism and faster judicial procedures than Civil law countries and consequently better at enforcing contracts.<sup>145</sup>

The key elements of the Common Law which make it, for example, dispute resolving, supportive of private contracting, tolerant of a wide range of commercial relationships, flexible, highly protective of investors and lenders, are:

- The clarity and certainty of the Common Law and, consequently, its predictability. These are a result of its long established principles and rules, high quality legal reasoning, use of precedent and fair procedures and processes.<sup>146</sup>
- The flexibility of the Common Law for property owners and contracting parties due to its lack of prescription, use of broad standards and evolutionary nature.<sup>147</sup>

---

<sup>145</sup> La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R.W. (1997). Legal Determinants of External Finance: Working Paper 5879. (1997). La Porta, R., Lopez-de-Silanes, F and Andrei Shleifer, A. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, Vol 46 (2). (2008). La Porta, R., Lopez-de-Silanes, F., Shleifer, A. and Vishny, R.W. (1998). Law and Finance in *The Journal of Political Economy*. Vol 106 (6). (1998).

<sup>146</sup> The Law Society of England and Wales. England and Wales: the jurisdiction of choice. (No date given). Accessible at: <http://www.eversheds.com/documents/LawSocietyEnglandAndWalesJurisdictionOfChoice.pdf>

<sup>147</sup> Johnson, S., La Porta, R., Lopez-de-Silanes, F and Shleifer, A. Tunneling in *American Economic Review*. Vol 90 (2). (2000), cited in La Porta, R., Lopez-de-Silanes, F and Andrei Shleifer, A. The Economic Consequences of Legal Origins. *Journal of Economic Literature*, Vol 46 (2). (2008).

# APPENDIX III: AREAS FOR REFORM – CIVIL COURTS

Table three below shows in which categories of factors needed for an efficient court system the problems identified by Lord Justice Briggs sit within and require action.

**Table three:** Identified problems in the E&W civil courts and the factors required for an efficient civil justice system.

**Source:** OECD and Briggs, LJ. Civil Courts Structure Review: Interim Report. (2015).

Problems with E&W civil justice system	The level of formality of procedures	The organisational structures	The method of work within the judicial offices	The incentives of the parties engaged in service provision, especially judges and lawyers	Investment
Complex civil procedure rules and complicated forms	X	X			
Lack of expertise in civil justice in many County Courts		X	X		X
Civil cases given low priority		X	X	X	X
Absence of robust case management			X	X	
Under-investment in staff with work misallocated between judges and other staff			X	X	
Absence of a senior responsible person for the administration of civil justice		X		X	
Gaps in data collection and use for improvement		X	X		X
Low levels of effective enforcement of judgements				X	X
Disproportionate costs of 'going to law', with a possible VaR as high as £100,000	X	X	X	X	X
Lack of utilisation of information technology and automation			X		X

# METHODOLOGY

---

This report draws from data collected from a survey of FSB's Big Voice panel, carried out by Verve. The survey took place in 2015. It asked five questions and received 905 responses from FSB members across England and Wales.

In addition, 17 face-to-face interviews were carried out between August and November 2015 with leading academics, practitioners, regulators and professional bodies in order to explore in greater depth a number of issues relating to civil justice and dispute resolution. Interviewed, face-to-face or on the telephone, for this report were:

- Dame Hazel Genn, Dean of Laws and Co-Director at UCL Judicial Institute.
- Martin Partington, Emeritus Professor at University of Bristol Law School
- Neil H Andrews, Director of Studies in Law and Professor of Civil Justice and Private Law at Clare College, University of Cambridge.
- Andrea Knox, Partner at Knox Commercial Solicitors.
- Beth Silver, Business Member of the Civil Justice Council.
- Richard Thompson, Vice Chair of Civil Courts Users Association and Partner (Litigation and Recoveries) at Brachers Solicitors.
- Sarah Jane-Bennett, Head of Policy (Legal Affairs, Practice and Ethics) at the Bar Council.
- Averil Sessions, Policy Analyst at the Bar Council.
- Andrew Parsons, Barrister, Mediator and Arbitrator.
- Colin Manning, Barrister, Mediator and Arbitrator.
- Peter Causton, Solicitor, Deputy District Judge, Mediator and member of the Civil Justice Council's Cost Committee.
- Chris Hodges, Professor of Justice and Systems at the Centre for Socio-Legal Studies, University of Oxford.
- Dr Sue Prince, Associate Professor in Law at the Law School, University of Exeter.
- Pascoe Pleasence, Professor of Empirical Legal Studies at University College London.
- Robert Cross, Project Manager (Research) at the Legal Services Board and Steve Brooker (Head of Research and Development) at the Legal Services Board.
- Mike Harris, Head of Insight and Content at the Financial Ombudsman Service.
- Darin Thompson, Legal Counsel, British Columbia Ministry of Justice and Adjunct Professor at Osgoode Hall Law School and the University of Victoria.

© Federation of Small Businesses

[fsb.org.uk](http://fsb.org.uk)

 [federationofsmallbusinesses](https://www.facebook.com/federationofsmallbusinesses)

 [@fsb\\_policy](https://twitter.com/fsb_policy)

If you require this document in an alternative format please email:

[accessability@fsb.org.uk](mailto:accessability@fsb.org.uk)

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission of FSB. While every effort has been made to ensure the accuracy of the facts and data contained in this publication, no responsibility can be accepted by FSB for errors or omissions or their consequences. Articles that appear in the report are written in general terms only. They are not intended to be a comprehensive statement of the issues raised and should not be relied upon for any specific purposes. Readers should seek appropriate professional advice regarding the application to their specific circumstances of the issues raised in any article.

This report can be downloaded from FSB website at [www.fsb.org.uk](http://www.fsb.org.uk)

  
Experts in Business