Late payment and dispute resolution for the self-employed

www.ipse.co.uk
Introduction

About IPSE
IPSE is the Association of Independent Professionals and the Self Employed. We represent anyone in the UK who works for themselves, with over 21,000 members. We campaign and lobby on behalf of independent professionals and the self-employed, and we also provide our members advice, support, insurances and networking opportunities.

About the self-employed and independent professionals:
One in seven UK workers is self-employed – about 4.5 million people in total. This has grown by almost 40% since the year 2000. The self-employed can be found across all industries working at all levels, from the boardroom down. What unites them is the way they work and the choice they have made to go it alone. They are neither employees nor employers, and they have their own unique set of needs.

A subset of the self-employed are independent professionals. These are workers who are self-employed but work in higher level professional and technical occupations, and primarily in a business to business way. Also known as consultants, contractors or freelancers, they are a key feature of the UK workforce. Businesses rely on these workers to provide expertise at short notice and on a flexible basis. The 1.7 million independent professionals in the UK play a vital role in encouraging innovation and entrepreneurship. They are the smallest of small businesses.

Our proposals
This document outlines our proposals on how to ensure the self-employed are paid on time, and how to ensure that disputes with their clients are resolved fairly. We believe that late payment has a disproportionately high impact on independent professionals and the self-employed. Paying day to day household bills can quickly become a struggle if you are not paid on time. Freelancers currently do not have the tools at their disposal to ensure that they are not abused by clients who fail to pay up. Sanctions are not tough enough for the worst offenders, and there are few incentives to encourage good practice. It is also very difficult for a self-employed person to chase late payment or address any other dispute without risking serious reputational damage. We therefore propose three main polices:

• Strengthening the legal sanctions for those who pay late, so that those who don’t play by the rules are punished with fines and high interest rates.

• Strengthening the voluntary ‘Prompt Payment Code’ so that signatories cannot escape their obligations. Signatories must commit to paying interest above the legal minimum.

• Introducing a ‘Small Business Conciliation Service’, which would provide businesses including the self-employed with a way of resolving disputes without costly court action or the risk of reputational damage.

These proposals are featured in our manifesto, ‘Britain’s Secret Weapon: Unlocking Independent Professionals and the Self Employed’, available at www.ipse.co.uk/manifesto

Late payment and dispute resolution for the self-employed The ipse Manifesto
Why is this a problem?

Late Payment:
No business should face having to be paid late. However, all too often, small businesses in the UK face major issues with late payment. According to BACS, six out of every ten SMEs experience late payment, with a national average of £38,000 per SME of outstanding payment. Chasing this payment also takes its toll on SMEs with businesses spending an average of 14 days every year chasing overdue payments, which are often more than six weeks late.4

For ‘nanobusinesses’ and the self-employed late payment is an especially fraught issue. Many self-employed workers will have a single client at any one time. Failure to be paid on time means they are denied their sole source of income for that particular period jeopardising their financial security and preventing them from meeting essential household and business bills such as mortgage repayments.

Independent professionals in a difficult position when it comes to negotiating with large and powerful client firms who may impose very long payment terms of up to 90 days. Often self-employed workers are not in a position to negotiate better terms without being seen as awkward or difficult, therefore damaging their reputations and reducing the likelihood that they will be engaged again.

This is a major issue when chasing late or missed payments from clients. Reputational damage is a major risk for the self-employed, who are only ever as good as their last contract. Court action is an option, as is engaging the services of a debt collection agency, but both of these options come with serious cost implications and no guarantee of recovering costs.

Dispute resolution:
Many of the issues outlined above apply to other disputes the self-employed are involved in. Small businesses and the self-employed have little power to resolve disputes with larger clients or customers. The balance of power in such disputes will always favour the larger party. Problems can often arise regarding unfair contract terms and disagreements over intellectual property. Particularly difficult clients can even create a dispute as a way of avoiding having to pay on time, for example querying the smallest expense.

Problems can often arise for those small businesses which work exclusively online within the ‘sharing economy’. Individuals who use services such as Uber, Air BnB, etsy or similar may have limited protections in a dispute and this service could provide a way of addressing any issues which may arise.

Small businesses, and especially the self-employed, need a way of solving disputes which does not require resorting to the courts. Court action is expensive, lengthy, and not a guaranteed route to success. It can damage relationships and make the small business look like a ‘difficult’ customer. This can jeopardise existing working relationships or ruin the reputation of a small business or self-employed person.
The solution

A) STRONGER LEGAL SANCTIONS

Summary of proposal:
Not all disputes can be resolved amicably. In these situations, it is vital that small businesses and the self-employed are able to resort to simple, effective legal measures to reclaim debts that are owed to them. There is already legislation on the “Late Payment of Commercial Debts”, but it does not go far enough. The self-employed need to be able to set time limits on when they are paid, unreasonable time periods for payment should be banned, and fines should be issued for those who fail to pay on time.

We believe the Government should introduce fines and enhanced interest payments for those who pay their suppliers more than 30 days beyond the last possible date the invoice must be paid. This is known as the “30+30” principle.

How would it work?

- A client would have 30 days to pay an invoice from the date it was raised- longer payment terms would be banned.

- Every additional day the payment is late would accrue interest at the Bank of England Base Rate +8%, up to a maximum of 30 days of interest.

- Small businesses would also have the opportunity to use a small business conciliation service in this time to chase payment or establish whether a dispute exists which is preventing the client from making a payment. (see page 5)

- If there has still been no payment 60 days from the point at which the invoice was raised, fines of 10% of the value of the contract would be levied against the party at fault. (up to a maximum fine of £10,000)

- This would mean no more 60 or 90 day payment terms being the norm- they would be outlawed.

How would stronger legal sanctions help?

This approach would ensure that businesses have simple, effective legal sanctions to threaten those who pay late. Unlike the current system, fines would apply providing an extra incentive for firms to pay on time. The outlawing of 90 day payment terms would also make doing business easier. Such an approach would only require minor changes to the Late Payments of Commercial Debts Act and could be implemented relatively swiftly by the Government.
B) IMPROVING THE PROMPT PAYMENT CODE

Summary of Proposal:
We believe the voluntary ‘prompt payment code’ has the potential to achieve much more to ensure the problems of late payment are eradicated from the British business landscape. We propose that signatories to the code must agree to the following additional measures:

• Committing to pay enhanced interest, above the legal minimum, when they pay late. Currently there is little incentive for signatories to follow the rules. Agreeing to pay interest on late payment at say, Bank of England Base Rate +10%, as opposed to the legal minimum of +8%, would provide additional financial incentive for businesses to stick to the code.

• Committing to publishing an annual report on their payment performance, so that the best and worst performers are known to businesses.

• Committing to all Government suppliers and their subcontractors to sign up to the code.

How would these changes help?

To better encourage payment on time, prevention is better than cure. Although stronger legal protection for small business and the self-employed will undoubtedly act as a deterrent, there needs to be greater voluntary commitment from the biggest businesses, and from the Government itself, to set a good example in the marketplace.

To this end, the Prompt Payment Code exists as a voluntary code of practice for big businesses. The code is administered by the Institute for Credit Management on behalf of BIS. Currently signatories must pay their suppliers on time and provide them with clear guidance on payment terms.

Unfortunately, signatories can still impose unreasonably long payment terms and they have no strong incentive to stick to the rules. Introducing a financial penalty in the form of an enhanced interest payment will change this. Adding reporting requirements will also go some way to improving transparency.

Clearly a balance must be struck to ensure that businesses are not subject to excessive administrative burden. However we believe the above measures do not impose undue burden on signatories and the reporting requirements would be easy to comply with. They would make the PPC more transparent, more effective, and more respected, improving the business landscape in the UK.
C) A SMALL BUSINESS CONCILIATION SERVICE

Summary of Proposal:
We believe the Government should create a "Small Business Conciliation Service" to resolve disputes.

• In Australia, businesses can turn to an independent body to help settle disputes, whether the dispute is with Government or with another business. It provides conciliation, arbitration, advice and other ADR (alternative dispute resolution) services.

• This solution avoids the need for lengthy court action, preserves business relationships, and is self-funding by charging a small fee to its users for advice.

• We believe Britain should do the same. BIS should administer a Small Business Conciliation Service for England and Wales to help the smallest businesses get a fair deal, as should the devolved Governments in Scotland and Northern Ireland.

How would a small business conciliation service help?

• It would provide advice: Often businesses and sole traders are unaware of the rights they have to pursue issues such as late payment. They may also not know where they can turn to for support. A small business conciliation service would be both a provider of advice and a ‘signposting’ service to other agencies that may be able to help.

• It would stop issues from escalating, preserving relationships: A key function of the small business conciliation service would be to preserve business relationships and prevent escalation to an overburdened judicial system. By facilitating conciliation and mediation services, much like ACAS does in employment relationships, issues would stop going to court as action that both sides agree on can occur. One potential benefit of this is late payment cases in the small claims court would become far less common.

• It would ensure the balance of power is fair: A small business conciliation service would independently criticise a business which is behaving unfairly, adding extra clout in a dispute by reminding them of their legal obligations and ways of fulfilling them. In cases where the conciliation service is unable to come up with a solution and a dispute does go to the courts, the fact that a complainant sought to resolve the situation first through the conciliation service would be seen as evidence of positive intentions.

• It would be able to suggest ways forward which benefit both sides in a dispute, by acting as an ‘honest broker’: A small business conciliation service would be able to suggest a way forward for both parties in dispute, as it has nothing to gain and is acting independently. Its determinations would therefore be trusted.
How would it work?

- There are a number of ways such a service could work. We envisage a service modelled closely on that of the Australian Small Business Commissioner. In Australia the commission provides a range of services from providing advice to full conciliation and mediation services.

- The Australian conciliation service has been a great success. Established in 2003, it consistently achieves over 90% satisfaction rates with both the client and the respondent in disputes. It is a statutory role, with the state providing a full suite of alternative dispute resolution services. It began in Victoria and was rolled out nationwide after its success became apparent.

- However, whereas in Australia such services are devolved to each state Government, we envisage a service in the UK being more centralised, although each devolved administration would be responsible for their own part of the conciliation service.

- The service would be administered as an agency of the Department for Business, Innovation and Skills. It would have no formal judicial role; however it could issue a determination or an opinion of what course of action those in a dispute should take. This means less legislation and cost would be required to set it up. Alternatively, the service could be run at a regional level by Local Enterprise Partnerships, or form part of a new “Small Business Administration”.

- The service would provide initial advice for free on what to do in a dispute. Comprehensive advice and a helpline would be available as the first ports of call for a business in difficulty.

- The service could also refer business and sole traders to other agencies or bodies for advice or help, such as Local Enterprise Partnerships or Trading Standards, who may be better placed to assist. Existing Government advice on business dispute resolution would be brought under the umbrella of the service.

- For more involved help, the service would charge a fee for formal mediation or conciliation services, or it would refer users to private sector providers charging a fixed fee for their services. This would ensure the service is largely self-funding or requires minimal funding if it refers users to the private sector. It would also prevent frivolous or time wasting cases from being considered.

- If the Government provides mediation directly: this would be at a fixed low fee and for a limited number of sessions to reduce costs to both Government and the parties in dispute. By limiting the number of sessions available, this would encourage resolution within a set time-frame.

- We estimate implementing this model would cost the Government £4.8 million. This is based on the assumption that 25% of those cases which proceed to the
small claims court at the earliest stage (known as ‘Track 1’) would opt to use the conciliation service instead, and assumes a 15% administrative burden.

- If the Government refers users to private sector providers: providers of alternative dispute resolution services would register with the Conciliation service to appear on a localised listings service (similar to NHS Choices). The fee for mediation for the first session only would be set by Government – all providers would agree to charge no more than this fee in return for being listed and for meeting certain professional standards. Limited funding by the Government may be required to ensure this is viable - we estimate up to £150 a session would halve typical average mediation costs. Further meetings (if required) would be charged at the provider’s usual rate. This model reduces cost and risk for the Government, and would require less initial set up cost.

- We estimate implementing this model would cost Government £2.3 million. This is based on the assumption that 25% of those cases which proceed to the small claims court at the earliest stage (known as ‘Track 1’) would opt to use the conciliation service instead and that the Government would provide £150 of funding towards the first mediation session for each claimant. Administration costs have been assumed at 15%.

- The Government should immediately launch a consultation on the scope and nature of such a service, so that its precise structure can be determined following consultations with the UK’s self-employed and small business community.

What’s in it for the Government?

We believe the economic value of such a service could, on a conservative estimate, be worth over £29 million to the economy. We believe investing in the creation of a small business conciliation service would therefore provide a good return for the Government, with an excellent cost benefit ratio of up to 12:1 depending on the model used.

This figure is based on the savings in credit and financing costs, litigation costs, and working hours saved when dealing with disputes, on the assumption that at least 25% of those businesses who used the small claims court at the first stage would have found success with the proposed conciliation service instead.

The service would also provide other tangible benefits including:

- Less burden on the judicial system: The courts are clogged with cases regarding late payment or contractual disputes. Many of these need not have got as far as this and the service will reduce the burden on the courts.

- A better business environment: The self-employed and small businesses would be confident that they are working in a market with a level playing field. The economic benefits of such an environment, where serious disputes are less likely, would far
outweigh the modest costs of implementing this scheme.

• A self-funding scheme: Although initially this scheme would require the Government to meet its set-up costs, we envisage that it would eventually be largely self-funding. Not all of the scheme’s services would be free, and in particular the more involved conciliation and mediation services would charge a fee to their users, or would be provided at a fixed rate by private sector providers in partnership with the Government.

• Would complement and not replace existing commercial providers of such services: Although there are existing commercial providers of similar services, this scheme would complement and not replace them. Inevitably, there will be situations the service may not be able or well placed to resolve an issue and in these cases, it could refer businesses to commercial providers. In Australia, commercial providers and the Commissioner work side by side.

• Encourages local involvement: Although we envisage BIS being the core provider of this scheme, we believe Local Government and Local Enterprise Partnerships could also have a role in the service, for example by referring local businesses to the scheme, or providing localised advice where necessary (such as with regards to planning or trading standards disputes).

We believe the Australian model of a Small Business Commissioner, repurposed as a Small Business Conciliation Service, could bring a number of benefits to small businesses and especially independent professionals and the self-employed. It would restore the balance of power in business relationships and prevent disputes over late payment or contract terms from escalating to the courts. It would allow business in the UK to have the confidence to operate without the fear that they will be treated poorly or unfairly by larger businesses. Businesses would also have access to a service which would ensure they are well informed about their rights and obligations. This scheme has the potential to transform the way businesses solve their problems in the marketplace, preserving relationships.
Conclusion

Our proposals provide for an easily implementable roadmap to make doing business in the UK fairer for small businesses and the self-employed. Our plans are small changes with a big impact. They are:

- Easy to implement – with changes to the Prompt Payment Code and Late Payment of Commercial Debts Act in particular requiring only small changes to existing law.
- Easy to comply with – they do not require significant administrative burdens from larger businesses.
- Demonstrably successful – our proposal for a small business conciliation service has worked well in Australia to improve the business landscape.
- Tough on bad practice – our proposals stop unreasonable 90 day payment terms and prevent businesses from treating the self-employed badly.

These plans would deliver tangible benefits across the economy, and not just for the individual businesses affected by late payment and disputes. For more information on IPSE’s policies, see our manifesto at www.ipse.co.uk/manifesto.

References

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