

Mr Phillip Collins
Chairman
Office of Fair Trading
Fleetbank House
2–6 Salisbury Square
London
EC4Y 8JX

24 September 2007

Dear Mr Collins,

The Forum of Private Business (FPB) is an organisation representing 26,000 UK-based small and medium-sized businesses, which in turn employ more than 600,000 people. We are submitting this complaint to the Office of Fair Trading (OFT) under Regulation 3 of Statutory Instrument 2002/1674, for investigation and action. It is our belief that our members and other smaller companies in a number of business sectors are suffering financial difficulties as a result of an increasing trend of predatory purchasing.

Supplier abuse/FPB Hall of Shame

Over the past few years, a growing number of companies have unilaterally extended their own credit periods with, or demanded discounts, free stock and marketing support from, their suppliers. The FPB has been gathering evidence of some of these changes and a sample of these is listed in the FPB 'Hall of Shame' enclosed. These show grossly unfair contract terms, which the FPB believes are 'supplier abuse'. Detailed below is the legal background governing this area, drawing upon the Late Payment of Commercial Debt (Interest) Act 1998, Statutory Instrument 2002/1674, and the European Union Directive 2000/35/EC on Late Payment.

A) Legal background

A1. The Late Payment of Commercial Debt (Interest) Act 1998

Clause 8 (1) of the above Act states: "Any contract terms are void to the extent that they purport to exclude the right to statutory interest in relation to the debt, unless there is a substantial contractual remedy for late payment of the debt."

Clause 8 (3) states: "The parties may not agree to vary the right to statutory interest in relation to the debt unless either the right to statutory interest as varied or the overall remedy for late payment of the debt is a substantial remedy."

Clause 8 (4) states: "Any contract terms are void to the extent that they purport to:

(a) confer a contractual right to interest that is not a substantial remedy for late payment of the debt,

(b) vary the right to statutory interest so as to provide for a right to statutory interest that is not a substantial remedy for late payment of the debt,

unless the overall remedy for late payment of the debt is a substantial remedy."

Clause 9 (1) states:

“A remedy for the late payment of the debt shall be regarded as a substantial remedy unless:

- (a) the remedy is insufficient either for the purpose of compensating the supplier for late payment or for deterring late payment;
- (b) it would not be fair or reasonable to allow the remedy to be relied on to oust or (as the case may be) to vary the right to statutory interest that would otherwise apply in relation to the debt.”

Clause 9 (2) states:

“In determining whether a remedy is not a substantial remedy, regard shall be had to all the relevant circumstances at the time the terms in question are agreed.”

Clause 9 (3) states: “In determining whether subsection (1)(b) applies, regard shall be had (without prejudice to the generality of subsection (2)) to the following matters:

- (a) the benefits of commercial certainty;
- (b) the strength of the bargaining positions of the parties relative to each other;
- (c) whether the term was imposed by one party to the detriment of the other (whether by the use of standard terms or otherwise); and
- (d) whether the supplier received an inducement to agree to the term.”

A2. Statutory Instrument 2002/1674

The Statutory Instrument (SI), as stated in its own explanatory notes¹, implements Directive 2000/35/EC.

Regulation 3 (3) states: “(3) If it appears to the High Court that in all or any circumstances the purported use of such a term in a relevant contract would be void under the Late Payment of Commercial Debts (Interest) Act 1998, the court on the application of a representative body may grant an injunction against that person restraining him in those circumstances from using the offending term, on such terms as the court may think fit.”

The FPB is such a representative body as described by this Regulation.

A3. Directive 2000/35/EC

The Act (and subsequent amend) that we cite above should, in an ideal case, provide on their own a sufficient legal basis on which to pursue action; the SI existed to implement the Directive to the extent that it was not already implemented by the 1998 Act. However, there is no clause in this Act that adequately represents recital 19 of the Directive. Given that the recitals express the intention of the Directive, and thus the effect that should be reached by the domestic law transposing the Directive, this is of crucial importance. Where there is no item of domestic law reflecting a specific Art of the Directive, we can refer directly to the Directive.

The 19th recital states:

“This Directive should prohibit abuse of freedom where an agreement mainly serves the purpose of procuring the debtor additional liquidity at the expense of the creditor, or where the main contractor imposes on his suppliers and subcontractors terms of payment which are not justified on the grounds of the terms granted to himself, these may be considered to be factors constituting such an abuse.”

¹ SI 2002/1674 is available at <http://www.opsi.gov.uk/si/si2002/20021674.htm#n4>, see the first explanatory note

The Directive provides that member states must ensure that means exist to limit the presence of or effect on creditors of grossly unfair contractual terms. In Article 3, paragraphs 3, 4, and 5, the Directive provides the following:

3. Member states shall provide that an agreement on the date for payment or on the consequences of late payment which is not in line with the provisions of paragraphs 1(b) to (d) and 2 either shall not be enforceable or shall give rise to a claim for damages if, when all circumstances of the case, including good commercial practice and the nature of the product, are considered, it is grossly unfair to the creditor. In determining whether an agreement is grossly unfair to the creditor, it will be taken, inter alia, into account whether the debtor has any objective reason to deviate from the provisions of paragraphs 1(b) to (d) and 2. If such an agreement is determined to be grossly unfair, the statutory terms will apply, unless the national courts determine different conditions which are fair.

4. Member states shall ensure that, in the interests of creditors and of competitors, adequate and effective means exist to prevent the continued use of terms which are grossly unfair within the meaning of paragraph 3.

5. The means referred to in paragraph 4 shall include provisions whereby organisations officially recognised as, or having a legitimate interest in, representing small and medium-sized enterprises may take action according to the national law concerned before the courts or before competent administrative bodies on the grounds that contractual terms drawn up for general use are grossly unfair within the meaning of paragraph 3, so that they can apply appropriate and effective means to prevent the continued use of such terms".

The aim of the Directive is to create rights to legal action. These are as follows:

- The right to seek damages in case a contract unreasonably extends payment periods or lowers interest rate percentages on late payments, or alternatively the right to claim that such contracts be unenforceable if the circumstances point to them being grossly unfair.
- The right to the benefit of statutory terms, unless otherwise decided by a court for reasons of fairness, in case a contract unreasonably extends payment periods or lowers interest rate percentages on late payments.
- The right of representative organisations to go before competent authorities and request the removal of grossly unfair terms.
- A right to a payment delay that cannot be extended, or alternatively to be entitled to an interest rate on late payments that is substantially higher than the statutory rate in cases of categories of contracts which by statute include payment periods of more than 30 days but less than 60 days.

B) Relevance of legal background to cases raised by the FPB

We have highlighted these items of law in detail because:

(i) The 1998 Act renders void any contract terms that seek to vary or exclude the right to statutory interest. The cases brought by the FPB involve the extension of payment terms: if a payment term is extended, then the period from which interest can be calculated is delayed.

(ii) SI 2002/1674 gives representative bodies the right to bring cases where contracts would be adjudged to be void under the terms of the 1998 Act.

(iii) Directive 2000/35/EC includes a provision, which cannot be found under the above Act, for grossly unfair contract terms, including those that exist solely to confer additional liquidity to the debtor at the expense of the creditor, should be rendered contracts void, and that representative bodies may bring cases under this provision. The cases brought by the FPB include cases where debtors have extended payment terms and, in some cases, demanded supplier contributions to their own capital expenditure projects, simply in order to confer additional liquidity upon themselves at the expense of their supplier-creditor.

C) Areas of investigation

The FPB requests that the OFT:

1. Determines the credit periods offered to suppliers, and those given to the companies' own customers.
2. Examines the use of suppliers' money in the companies' accounts to clarify the amount of extra profit gained from the supplier. For example, in a recent report for the European Commission on the impact of Directive 2000/35, Demolin, Brulard, Barthelemy-Hoche found that "the reported earnings of large distribution companies in Spain show that the earnings portion derived from financial operations surpasses that generated from these companies' core business, i.e. the retail business."²
3. Calculates the extra working capital required to finance the longer credit periods, and the restriction of competition that is so incurred by the erection of barriers to entry. This working capital is defined in the Demolin et al report as "Payment Period Working Capital Cost."³

D) Recommendations/decisions to be made

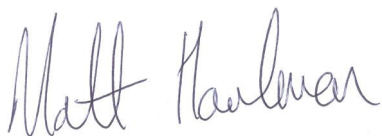
The FPB asks the OFT to:

1. Define which contracts have grossly unfair terms
2. Recommend the terms that should apply
3. Provide a 'substantial remedy' definition.
4. Suggest the formula on which damages should now be claimed in those cases where the right to statutory interest has been varied by the contract clauses, or where grossly unfair contract clauses have been used.

The FPB would be glad to help with any information that it can, however it is important that confidentiality is given to suppliers who provide information on the same basis as operating within DG Enterprise, where 'commercial in confidence' information is not disclosed to the putative claimant or offender.

We would welcome a reply giving the OFT's views on this complaint, a schedule of proposed enquiries and a timescale for implementation.

Yours sincerely,



Matt Hardman
Campaigns Manager

² Demolin, Brulard, Barthelemy, Hoche, *Review of the effectiveness of European Community legislation in combating late payments*, page 235, available at http://ec.europa.eu/enterprise/regulation/late_payments/doc/finalreport_en.pdf

³ Demolin, Brulard, Barthelemy, Hoche, *Review of the effectiveness of European Community legislation in combating late payments*, page 235, available at http://ec.europa.eu/enterprise/regulation/late_payments/doc/finalreport_en.pdf - page 74