Department for
Business, Energy
& Industrial Strategy

LAW COMMISSION REPORT ON CONSUMER PREPAYMENTS ON RETAILER INSOLVENCY

Government response

December 2018

Any enquiries regarding this publication should be sent to us at:
enquiries@beis.gov.uk

Contents

Introduction

Summary

In September 2014, the Department for Business, Innovation and Skills asked the Law Commission to examine the protections given to consumer prepayments and consider whether such protections should be strengthened. This followed a number of high-profile collapses over a number of years including the Farepak Christmas Savings Club and retailer insolvencies such as Jessops, HMV and MFI and the accompanying public concern about consumer protection in the case of insolvency.

The department asked the Law Commission:

1. to identify the existing protections given to prepaying consumers on the retailer's insolvency;
2. to consider whether such protection should be strengthened and, if so, what options are available for doing so;
3. to consult stakeholders; and
4. to make recommendations about which options, if any, should be pursued.

The Law Commission issued a consultation during the summer of 2015 and published its final report on 13 July 2016. This document is the government's response to the Law Commission's report.

In preparing its report the Law Commission considered a variety of prepayments made by consumers in advance of goods and services being provided. This included Christmas savings schemes, customer deposits for goods and the purchase of gift vouchers, as well as prepayments for furniture, funerals, or home improvement projects which require upfront payment for retailers to order from suppliers.

Since then, the government has launched a call for evidence on pre-paid funerals in order to help it design a more robust regulatory regime for the sector. (See www.gov.uk/government/consultations/pre-paid-funeral-plans/pre-paid-funeral-plans-call-for-evidence)

The government wants to thank the Law Commission for its thorough and objective contribution in this important area for consumers. The government welcomes the Law Commission's work and its report and sets out the government's consideration of the recommendations below. The government published a Consumer green paper[1] in April 2018 to examine markets which are not working fairly for consumers. It particularly looks at digital markets where there is continued strong growth in online shopping and payments are made before delivery. Whilst the timeframe for delivery is often quite short, recent insolvencies have seen online customers not receiving goods they have ordered. The Law Commission's work will therefore be further reflected upon in the light of that green paper work, particularly as regards possible legislative changes.

[1] www.gov.uk/government/consultations/consumer-green-paper-modernising-consumer-markets

Background

When a retailer becomes insolvent, consumers often stand to lose prepayments made in advance of receiving goods or services, such as for large furniture purchases, or a holiday. Aside from certain sectors where trade bodies take an active role (such as travel packages and funerals), consumers who have made prepayments do not have any special protections afforded to them, and most of the limited money available on insolvency will go to creditors towards the top of the hierarchy, such as employees and secured lenders.

There are several ways in which consumers can reclaim prepayments or the goods paid for, such as by refund from credit and debit card issuers, by commercial decisions taken by administrators or by protective arrangements put in place by individual businesses prior to the insolvency. As a last resort, consumers may receive a dividend for their unsecured claim, although this will often be negligible.

It is also possible for consumers to assert a claim over property itself, where it can be established that ownership of the goods has already passed to the consumer. Although the legal position is complex, a consumer can assert a right to goods where they can prove that a specific item is their own, even though it is still within the retailer's possession.

Administrators or purchasers of the new business are under no obligation to fulfil orders or honour gift vouchers, but it is reasonably common for them to do so, especially if they are attempting to retain value in the business name for example because there is the possibility of continuing or restarting the business as a going concern. However, any action taken by the administrator which indirectly favours consumers must be for the benefit of the creditors as a whole.

Where protections are unavailable, consumers may lose hundreds or in some cases thousands of pounds. In 2006, the collapse of the Christmas savings club Farepak, caused particular distress as thousands of consumers stood to lose nearly a year's worth of savings for Christmas. At the time of its collapse, Farepak held around £37 million in consumer prepayments, and most of those consumers could ill afford such losses. The government acted to assist those affected by Farepak and oversee the introduction of new voluntary protections but asked the Law Commission to look at the issue in the context of its work on prepayments because it was concerned to ensure that financially vulnerable consumers did not suffer such a situation again.

There are various ways in which consumer prepayments could be further protected in the event of insolvency, and the Law Commission has considered several of these in its report and made recommendations as to where the government and industry can make changes in order to better protect consumers.

The Law Commission also considered prepayments in the form of gift cards and vouchers. In this case it concluded that based on the evidence they received there was not a case for regulating gift vouchers.

The Law Commission's recommendations

While the Law Commission does not think that consumers should be protected from all loss, it has made five general recommendations designed to improve the chances in certain circumstances of consumers regaining prepayments they have made. The recommendations were that:

1. the Secretary of State should be granted a power to require protection of consumer prepayments in sectors which, in the opinion of the Secretary of State, pose a particular risk to consumers;
2. this legislation should be used to require that consumer payment schemes (such as paying for Christmas hampers in advance) marketed as a savings mechanism (or generally understood to be for that purpose) must adequately protect customer payments by way of a trust, insurance or by bond, subject to certain exclusions;
3. the Insolvency Service should provide early guidance to insolvency practitioners on giving advice to consumers regarding the use of chargeback (where payments are made by credit or debit card) to reclaim prepayments to businesses that enter insolvency, and that the UK Cards Association (now part of UK Finance) provide a code of best practice for card issuers;
4. the government should consider giving preferential status in insolvency proceedings to a limited number of consumer prepayments under six months old and of £250 or more and for which no alternative remedy (for example chargeback) is available. Such claims would still rank below claims from employees; and
5. new rules should be introduced to clarify at what stage in a transaction a buyer acquires ownership of goods.

The Law Commission makes it clear that these recommendations are made on the basis that they can be drawn on in whole or in part, depending on the impact of each change and the political appetite for further work in the area. It has suggested that some recommendations, such as the proposal to provide guidance on chargeback could be started immediately, whereas the granting of preferential status could be considered a solution of last resort.

Power to require sector-specific regulation

Summary of argument

When a business becomes insolvent, large amounts of money can be lost in consumer prepayments, from small amounts paid per individual for gift vouchers, to significant sums in advance of large purchases such as holidays or home refurbishment.

Industry led voluntary codes and mandatory protection play an important role in protecting prepaying consumers, but there are limits to the effectiveness of voluntary arrangements and existing legislation. Many businesses are reluctant to sign up to voluntary codes, which require protection of prepayments because it can be a major cost to businesses. Setting up a protection system can be difficult and expensive. The Law Commission makes the case that in some sectors, where there is a particular risk of consumer detriment, legislation may be required to compel the industry to protect consumer prepayments and provide the protections competition is not delivering.

Consumer markets develop rapidly, and the government has reaffirmed a commitment in the Industrial Strategy[2] to encourage competition and open up markets to new entrants. New competition can offer many benefits to consumers, but fledgling businesses are at greater risk of insolvency and new entrants may be less experienced, less well capitalised and may have lower levels of prepayment protection.

It is difficult to identify where or when another large insolvency might occur. A sector might pose particular risks to consumers, where the nature of the product means that consumer prepayments are held for a long period, or where the loss of the product or payment could cause particular hardship. The Law Commission makes the case that the government needs to be able to work quickly and flexibly when a sector-wide problem occurs, to minimise consumer harm in such circumstances, but it does not suggest in what sector that might occur in the future.

The Law Commission therefore recommends that the government take a power in primary legislation to enable the Secretary of State to make regulations requiring protection of consumer prepayments in any sector. It should be exercisable where, in the opinion of the Secretary of State, the sector poses particular risk to prepaying consumers.

The proposed legislation would set out the types of protection which would satisfy a requirement for protection of prepayments and the general remedies against a business in a relevant sector failing to protect the prepayments, and the manner of enforcement. The Law Commission recommends that a business be able to choose from a variety of protections to suit their own business model but a failure to protect the funds could constitute a criminal offence.

The Law Commission suggests that Trading Standards Services (TSS) should be responsible for most of the enforcement of this regulation but that a range of enforcers could have a role, depending on the sector in question. In practice, this means that TSS would most often be responsible for dealing with breaches as criminal prosecutions but that, for example, Ofgem should be responsible for enforcement should a problem be identified in the energy supply market, or Ofcom would take a role with cases in the broadband market. The details of

[2] www.gov.uk/government/publications/industrial-strategy-building-a-britain-fit-for-the-future

enforcement would be something for the government to consider if an insolvency risk in a particular market was identified and would need to be both flexible and proportionate. It is therefore too soon to make a judgment on the appropriate enforcement procedures.

The Law Commission has undertaken a thorough assessment of the impact of such powers and concluded that the main costs to business would be the legal and administrative costs of putting the protections in place. However, if industry bodies worked together to produce standard documentation for trusts, and if a number of scheme providers sought insurance, costs would be reduced in both areas.

The main benefit would be to consumers making prepayments, who would face less risk of losing their savings. Business could also benefit from an increase in consumer confidence and custom, although they could potentially achieve something similar were they all to take their own measures to protect consumer savings.

Government view

This recommendation to require protection of consumer prepayments in particular sectors, requires primary legislation to give a specific power to the Secretary of State. The power could fill a potential gap in the government's ability to respond more speedily to emerging consumer problems but would need careful structuring in legislation to maintain a narrow scope whilst being flexible enough so that decisions could be made where necessary. Clear criteria for enacting the power would need to be set out in order to satisfy Parliament that the measure was proportionate. In view of the Law Commission's second recommendation the power should be crafted to enable the government to take action in the Christmas Savings Club market and bring long called for statutory protections to this vulnerable group of consumers.

This legislation would need to take account of the other potential solutions to these issues at the government's disposal that may be more appropriate, in certain sectors. For example, in energy, the government has also been working closely with Ofgem on concerns about the failure of energy suppliers. Ofgem has implemented a Supplier of Last Resort (SoLR) process or, where this is not feasible, the Secretary of State can use powers to seek a court order for the appointment of an energy supply company administrator to ensure continuity of supply for consumers. In addition, Ofgem has clarified how the existing SoLR powers can be used to give some protection to consumers' credit balances.

Through its work on launched by the consumer green paper 'Modernising Consumer Market[3]' the government is considering how best to ensure the whole system of consumer protection can provide a robust response to threats at both the national and local levels. It is important that a strong system of consumer protection is established to assess consumer risks and ensure the most appropriate and cost-effective intervention is used to protect consumers, including guidance, business advice, regulatory self-assurance and other tools. The enforcement of the proposed power will be considered in this context.

Next steps

We agree with the Law Commission that there is a gap in the ability of government to protect vulnerable prepayment customers that this proposal will fill. This power is key to protecting the customers of Christmas Savings Clubs, members of schemes outside the members of the

[3] www.gov.uk/government/consultations/consumer-green-paper-modernising-consumer-markets

Christmas Prepayment Association (CPA) where funds are unprotected. Government will engage with key stakeholders to develop the proposals and establish a practical route to implementation and formulate legislation as part of a suitable future legislative vehicle.

Legislation to ensure that ‘savings schemes’ provide adequate consumer protection

Summary of argument

Christmas savings clubs, such as the one previously run by Farepak, and similar savings schemes are not regulated as financial institutions by the Prudential Regulation Authority or the Financial Conduct Authority. A firm running such a scheme will only be regulated if it engages in other financial activities that are within the remit of regulators. As a result, there is no legal obligation on these businesses to take steps to protect consumer prepayments. However, the Law Commission considered that an average consumer perceives these schemes to be savings schemes and therefore expects the same protections as they would receive from a bank.

Typically, Christmas savings schemes are seen by consumers as a good way to ‘lock away’ money solely for Christmas, ensuring they do not spend it elsewhere. They tend to represent large amounts for the consumers involved, who are often struggling financially. The Law Commission therefore considered that these schemes represent a high risk for people who can ill afford it, and who are without effective protection if the worst occurs.

Voluntary protection schemes have been set up in the wake of the Farepak collapse in 2006, such as the CPA, which is a self-regulatory trade association. Members of the CPA must comply with the CPA’s Code of Conduct and are required to pay any consumer savings into a designated trust account. The trust account will be overseen by trustees, half of whom must be independent of the member. Currently only four schemes are covered by the CPA code. Even for them, the Law Commission identifies that a business can leave the association when they start to suffer financially, leaving them free to end the trust, use the money and leave consumers without protection again.

The Law Commission believes that the main “mischief” in this area is the offering of a scheme as a form of savings mechanism without the usual protections associated with saving which consumers expect. Respondents to its consultation agreed, arguing that additional measures of protection should be operated for such schemes which an ordinary person would understand to be a savings mechanism, or which have been advertised as such. The Law Commission recommends that powers be introduced to require such savings schemes to take steps to protect consumer savings by bond, trust or insurance. However, in order to maintain proportionality and recognise the role of smaller shops in the community, it recommends excluding schemes run by microbusinesses which do not take more than £100 from any individual consumer.

Government view

The government welcomes this proposal and acknowledges there are several arguments in favour of implementing the recommendation. A move to require protection would increase consistency across the sector and increase protection for those who are just about managing but seeking to safeguard Christmas for their families. Requirements to protect such money would also improve the transparency of marketing of these schemes, ensuring that consumers know exactly what sort of protections they are afforded if they choose to put their money into such an organisation.

Requiring these schemes to take steps to protect consumer savings could improve the consumer experience of prepayments and could reduce the risk for some of the more vulnerable consumers who might be most affected by business insolvency.

It could be argued that requiring the protection of consumer prepayments in such schemes is unnecessary when voluntary schemes designed to protect consumers by requiring protections for prepayments of its members, such as the CPA, exist. However, in addition to the risk highlighted by the Law Commission that a company in financial difficulty might withdraw from the scheme before reimbursing consumers, the government notes that membership of these schemes is not widespread and has declined since the Law Commission first reported. Large supermarket savings schemes and the many local retailers and microbusinesses are not members of the CPA, and could attract considerable sums in “savings” from consumers.

Evidence suggests that for a variety of reasons vulnerable consumers are not always capable of making informed choices and this differential between schemes that adhere to a code and protect customer funds is not acting as a real incentive for consumers to choose certain companies which offer these protections. Factors such as convenience and familiarity may draw consumers to savings schemes that are not protected.

One of the risks of this proposal is that protecting consumer prepayments deprives what can be very small businesses of working capital required to secure the goods promised. Also, setting up methods for protecting consumer payments could be costly for business in terms of management time and expert advice. It could erode profit margins and push more businesses toward insolvency more quickly.

These risks could be reduced by excluding schemes which do not take more than £100 from any individual consumer and focussing on schemes marketed to consumers as savings schemes when they do not contain equivalent protections. Given the cyclical nature of these schemes (many are focused around helping families pay for Christmas) the government considers it might be practical to apply any cap on an annual basis.

Next steps

The evidence presented by the Law Commission suggests that users of Christmas savings schemes are much more likely to be vulnerable than those of other, fully regulated, schemes. There is a case that these types of consumer need more protection others.

The government considers that this is an important issue. It believes that all consumers have the right to expect reasonable outcomes. In the case of a product promoted as a savings vehicle that should, as a minimum, protect those savings. The consumer green paper is particularly focused on protections for more economically vulnerable consumers so that markets are working for all consumers not just the economically engaged and active.
The government notes that this measure is dependent on the power to legislate referred to above being in place. We therefore propose to take action on this measure once the necessary legislative capability has been established by the new power.

Guidance to insolvency practitioners on chargeback

Summary of argument

When a consumer pays for a product by credit card they are protected by s.75 of the Consumer Credit Act 1974 (CCA) which allows a consumer who has not received the goods paid for, and where the goods cost between £100 and £30,000, to claim back the total value of their prepayment (regardless of whether they paid the full amount of the prepayment on the card).

However, the same protection does not apply to other payments. For those made by debit cards, there is a voluntary protection scheme, to which the merchant acquirer (WorldPay, Barclaycard Merchant Services, and Elavon, for example) that processes credit and debit card transactions signs up.

Through this type of protection scheme (known as chargeback), and within a certain time period, the consumer can ask their card issuer to reclaim the amount they paid on their debit or credit card from the merchant acquirer in the event of insolvency. Merchant acquirers can hold back payments (or parts thereof) to businesses depending on the terms of their contracts with the individual business.

For example, a card holder's payment to a restaurant is likely to be instantaneous because the consumer is likely to have already received the goods and service when making a payment. However, a furniture store which takes payments some weeks in advance of providing and fitting kitchens may pose a higher risk and the merchant acquirer could hold back some funds for a short time, to protect against the risk of potential chargeback claims.

These protections are an important way to underpin consumer confidence and form the key way in which consumers were reimbursed in a number of high-profile insolvencies which the Law Commission considered. However, the Law Commission believes that the chargeback scheme needs to be better known and understood by all and made several recommendations to that end. These were that:

a) the Insolvency Service should produce best practice guidance for insolvency practitioners on their procedures. This would include:
    i. advising consumer creditors who have paid by card to contact their card issuer to raise a chargeback,
    ii. advising consumers that further information on chargeback can be found in the UK Cards Association (UKCA)[4] guide to chargeback, on the UK Finance website
    iii. providing on the retailer's website a confirmation that the company is in administration or liquidation in a form which consumers can provide to their card issuer as evidence of the same, and
    iv. making available to consumers other evidence or information which a card issuer may reasonably require;

[4] The UK Cards Association is now integrated into UK Finance (www.ukfinance.org.uk) www.theukcardsassociation.org.uk/welcome/

b) insolvency practitioners and card issuers should agree between them the form and content of the document which the insolvency practitioner should place on the insolvent retailer's website;

c) the UKCA should prepare a code of best practice for card issuers on the provision of information to consumers on chargeback; and

d) the UKCA should prepare chargeback guidance for consumers, including greater information on time limits and complaints.

These could all be taken forward by insolvency practitioners and could form a cost-effective tool for increasing consumer awareness of the protections already available.

Government view

We welcome these recommendations and consider that the push to clarify guidance on chargeback is likely to bring positive results. Stakeholder responses have been generally receptive, from consumers to insolvency practitioners. This proposal does not require changing existing rules or regulations or require new legislation.

We have worked with the card payment industry, insolvency practitioners, business and consumer groups to act upon the Law Commission's recommendations and publish guidance for insolvency practitioners on the information to be made available to consumers about chargeback when a retailer becomes insolvent. The guidance was published in June 2017 edition of 'Dear IP', a quarterly publication sent to insolvency practitioners providing updates on sector news[5]. The government also assisted the UK Cards Association (UKCA) in their production of an industry code of best practice and guidance which is hosted on their website[6].

The UKCA was able to put the Law Commission recommendations into practice when the holiday group, Lowcostholidays (Lowcost), went into administration in July 2016. The UKCA immediately began to implement the new procedures recommended in the Law Commission report and has provided the department with a review of how these procedures affected the overall running of the insolvency event, and so far, the UKCA considers the results to be positive.

Some of the actions taken early on by UKCA included:

a) clarifying whether and what chargeback and s.75 claims could be made by UK customers who had paid a Lowcost company by credit, charge and/or debit card;

b) approaching key stakeholders to seek clarity on some of the issues facing card issuers in assessing chargeback claims and ensuring consistent messages were given to all consumers;

c) placing guidance to consumers on the UKCA website of what Lowcost claims they could make with their card issue (this page was viewed 15,800 times in the first week it was published);

d) offering assistance to the Pan Nordic Cards Association as there were many consumers affected in Scandinavia; and

[5] https://content.govdelivery.com/attachments/UKIS/2017/06/28/file_attachments/838421/Dear%2BIP%2BIssue%2B77%252C%2BJune%2B2017.pdf

[6] www.theukcardsassociation.org.uk/wm_documents/Credit%20and%20debit%20cards%20-%20A%20consumer%20guide%20June%202016%20FINAL.pdf

e) working hard to build and maintain contact with the administrator appointed to oversee the Lowcost case to help them assist the card industry on several aspects of the failure, such as which elements of consumer holidays had already been paid for and arranging for data to be provided to the UKCA to disseminate to card issuers and acquirers to track / validate consumer claims.

By following the approach set out in the guidance, insolvency practitioners should help to increase consumer awareness of the availability of the chargeback procedure when a retailer becomes insolvent. It allays concerns expressed by some insolvency practitioners to the Law Commission that they felt unable to alert consumers to the existence of chargeback claims for fear that they would be favouring one group of creditors over another. Monarch's insolvency in 2017 which occurred shortly after the guidance was published, saw the possibility of refund through debit or charge card highlighted to customers on the insolvency practitioner's details page. More recent insolvencies, such as House of Fraser, and Maplin have seen the relevant insolvency practitioners flagging early on to consumers this option for obtaining refunds through their website and FAQs.

Next steps

The government will continue to work with UK Finance and industry stakeholders to monitor the code of best practice and guidance for making consumers aware of chargeback and how to request it of their card issuers. This guidance should ensure that consumers know what to do when seeking a refund through their card issuer, and to clarify the process for the card issuer.

Consumers' status in the insolvency hierarchy

Summary of argument

When a retail business becomes insolvent a consumer who has made a prepayment but not received their goods or service can be protected in several ways. They may seek refunds from their card issuer; the administrators or purchasers of the business may decide to honour the transaction; or the business may have taken steps to safeguard the payments.

If none of these protections apply, consumers are left with an (often small) claim under insolvency law to receive a share of whatever assets the business still owns. Consumers are unsecured creditors and, in common with other creditors in that class, often receive negligible amounts if they receive anything at all. Moreover, those who pay by cash or cheque, rather than by card, are much more likely to be vulnerable or suffering hardship than those who pay by card or other protected means.

When making prepayments, consumers are effectively lending the business money, but without being in a position to assess the credit risk, unlike other lenders. For example, some trade creditors are able to gain varying levels of protection by using retention of title clauses, credit insurance or changed payment terms.

It has also been argued that the current statutory hierarchy creates a perverse incentive for lenders with both secured and floating charges. Often a business will attempt to trade its way out of difficulty by taking further unprotected prepayments, even when their chances of delivering to the consumer are minimal. The lender has little reason to prevent or discourage a business doing this as further unprotected prepayments could increase the return to the lender if the business eventually becomes insolvent.

Businesses which take large cash payments from consumers without providing any form of protection before insolvency can cause significant bad publicity, public disquiet and risk undermining confidence in their sector and the law in this area.

The Law Commission has proposed that the government should consider, as a solution of last resort, a change in the hierarchy of creditors on insolvency, to the benefit of consumers. It has made clear that this recommendation is made only if further protection is required and considers the ultimate decision to act to be a political one.

The change proposed by the Law Commission is to require a limited group of consumer claims to be paid in advance of floating charge holders. These floating charge holders are often banks or other financiers – businesses perceived to be able to assess risk more accurately and bear losses more easily than consumers or individuals.

The consumer claims which the Law Commission argue should be prioritised are those which meet the following:

a) the claimant is a consumer as defined in the Consumer Rights Act 2015;
b) the claim relates to a prepayment;
c) the payment is made during the six months leading up to insolvency;
d) the payment is £250 or larger; and

e) the consumer is not protected by other means, such as where s.75 of the Consumer Credit Act 1974 or chargeback remedies are available on card payments, or where insurance or bonds have been taken out, or a trust put in place to protect the payment.

Government view

Some stakeholders have expressed support for this recommendation, including Citizen's Advice, although it had reservations about imposing the five requirements recommended by the Law Commission before a consumer prepayment would qualify for prioritisation in the list of creditors.

R3, the industry body for insolvency practitioners, in its response to the Law Commission's report said it was not in favour of the proposal, arguing it would increase the complexity and cost of administering retail insolvencies and delay the time it would take to resolve such cases, to the detriment of all creditors.

The categories of preferential debts were reduced significantly by the Enterprise Act 2002, which removed the Crown's preferential status for tax and social security contribution debts. At the same time, a share of floating charge assets (known as the prescribed part) was made available to unsecured creditors. At the same time a "prescribed part" of the floating charge recoveries would be made available to unsecured creditors. The aim of this was to bolster the opportunities for a business to be rescued from trouble and provide additional funds to unsecured creditors[7].

Insolvency practitioners have suggested that one impact of this proposal is that it could decrease further the sums available to other unsecured creditors, including employees for the non-preferential part of their claims and small businesses. There is also the risk that the proposal might have a chilling effect on business lending, increase the cost of capital and harm enterprise, though this is hard to quantify.

When making this proposal the Law Commission recognised that there are legitimate wider political issues for government to consider. The question of how far losses should fall on consumers, suppliers, other creditors (including HMRC), banks or other institutional lenders and whether to extend the class of creditor paid ahead of other unsecured creditors has been considered on a number of occasions including:

a) by the Coalition government, in response to the joint House of Commons committees' report on the impact of the closure of City Link on employment (the government rejected the Committees' call for all of a company's workers, regardless of whether they were directly employed by the company, to be afforded preferential status); and

b) in a 2016 Westminster Hall debate on small shops regulation in which the government rejected a call for money recovered in an insolvency from 'head clients' to be ring-fenced and shared down the supply chain to particular suppliers.

c) through a 2018 consultation[8] on insolvency and corporate governance including looking at how to best protect SMEs in a supply chain in the event of a large customer's insolvency.

[7] In his Autumn 2018 Budget statement the Chancellor announced proposals for some Crown debts such as VAT, PAYE, and employees' national insurance contributions to be afforded higher priority than unsecured creditors from April 2020.

[8] www.gov.uk/government/consultations/insolvency-and-corporate-governance

The government is aware that implementation could have unintended effects on other areas of the market.

Next steps

The government recognises the concerns when individual consumers may lose money in an insolvency situation. However, in its view this recommendation could increase the cost of capital, harm enterprise and lead to calls for preferential status for other groups of creditors which would adversely affect the amount available to other unsecured creditors, which would lead to far greater losses to the wider economy. The Law Commission suggest that there are value judgments to made when considering the insolvency hierarchy and set the measure out as an option should the government feel the need to act. The government has decided not to pursue this measure.

Transfer of ownership

Summary of argument

There are some cases where a consumer will have paid for goods which are still in the retailer's possession when the retailer enters administration or becomes insolvent. Questions can arise as to whether the ownership of the goods has been transferred, i.e. whether it is the property of the consumer. As the use of internet sales increases the volume of goods potentially affected grows.

The current legal position is that where there is a sale of specific goods in a deliverable state, ownership passes when the contract is made. Specific goods are those 'identified and agreed upon at the time a contract of sale is made'. However, how this works in practice is not always clear, especially when the goods need to be 'put into a deliverable state', which could include amending the product to the consumer's requirements or taking down a display item.

It is usually administrators who interpret the law where there are questions on the ownership of goods. Administrators are more likely to advise staff not to hand over goods to consumers, as they owe duties to all creditors not just the individual customer claiming the good.

Unascertained goods (i.e. goods which are yet to be identified at the warehouse at the time of contract and may not have been in existence) are in an even more uncertain state. Most internet sales will establish contracts for unascertained goods. Goods must be unconditionally appropriated before ownership passes from the supplier to the consumer. This means they must be assigned to a consumer and put in such a state for delivery that they cannot be re-appropriated by the retailer (e.g. passed to a delivery courier), but the application of this in practice is not clear.

Both of these scenarios leave uncertainty for consumers and administrators and can leave consumers significantly out of pocket, particularly where they have paid in full for an expensive item, but it has not yet been assigned to them specifically or delivered.

The Law Commission recommends several changes to the law on the transfer of ownership, which would require primary legislation to amend the Sale of Goods Act 1979. The new rules it recommends include:

a) ownership of specific goods identified at the time of the contract should pass at the time the contract is made, even if the retailer has agreed to alter the goods in some way. If the property needs to be put into a deliverable state, the consumer should bear the costs;

b) ownership of unascertained or future goods should be transferred when goods are identified for the fulfilment of the contract;

c) the legislation should include a non-exhaustive list of events which would be sufficient to identify goods for the contract;

d) the rules should be mandatory and any contract term putting the consumer in a worse position could have no effect; and

e) the seller should have a right to retain the goods until the whole of the price has been paid.

The Law Commission is particularly keen that the law on transfer of ownership be rewritten in plain language and brought together in one place, to make it more readily accessible not only to consumers but also to administrators and retailers attempting to interpret the law.

Government view

The government agrees with the Law Commission that the law on transfer of ownership is not as clear and understandable as it could be. However, due to the technical nature of this area of law, we have concerns about the practicalities and wider impacts of amending legislation at present, particularly in relation to drawing up an agreed list of events that would be sufficient to identify the goods for the contract, and what other impacts there might be.

Next steps

The government believes the recommendations are sensible and will be increasingly important as internet sales grow but the government is keen to ascertain what effects these could have on other areas if implemented. We will therefore explore this area further with the Law Commission and other interested parties with a view to changing the law on transfer of ownership at a suitable moment.

Overall next steps

The government has already taken action on some, such as the chargeback proposals.

The government will explore options for taking forward the proposals to grant the Secretary of State a power to require protection of consumer prepayments in sectors which, in the opinion of the Secretary of State, pose a significant risk to consumers and to mandate protection for consumer prepayments in schemes such as Christmas savings clubs and others where it becomes apparent that there are significant risks to consumers. This includes further consultation on the detail of the proposals and in particular exploring the technicalities of how we would implement the proposals to transfer of ownership of goods in advance of any legislation.

On the proposal to amend the hierarchy of creditors on insolvency to promote the interests of a certain group of consumers, the government is aware that implementation of the proposals could have unintended consequences. It is therefore not intending to bring forward changes to the creditor hierarchy in insolvency. However, following the March 2018 consultation on insolvency and corporate governance the government announced in August that it intends to increase the cap on the proportion of funds that can be ring-fenced and paid over to unsecured creditors in the event of insolvency.

Finally, the government wants to emphasise it is grateful for the Law Commission’s thorough and objective contribution in this important area for consumers.

This publication is available from: www.gov.uk/beis

If you need a version of this document in a more accessible format, please email enquiries@beis.gov.uk. Please tell us what format you need. It will help us if you say what assistive technology you use.