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THE BETTER PAYMENT PRACTICE GROUP

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Introduction

What is the statutory right to claim interest?

The Government has introduced legislation to give businesses a statutory right to claim interest if another business pays its bills late. Until now, businesses have only been able to claim interest on late paid debts if it is included in the contract or if they pursue the debt through the courts and the courts decide to award interest.

The legislation is called the Late Payment of Commercial Debts (Interest) Act 1998. These guidance notes explains how the Act works and how it affects businesses.

It is written for the guidance of all traders, whether they are suppliers or purchasers of goods and services.

Why has the Government provided a statutory right to claim interest?

To maintain a succesful business, a supplier must make an adequate profit. Late payment can lead to serious cash flow problems for the supplier, which can reduce profits and threaten its survival. If a business is continually paid late, it will have to raise its prices, if it can, to reflect the cost of finance required, or go out of business. This is likely to result in less competition and increased costs to the purchaser. Quite simply, late payment is not good business practice. It costs money and affects competitiveness. Paying late without good reason is wrong and this legislation is aimed at the wrongdoer.

The Department of Trade and Industry publishes a guide to effective credit management - "Better Payment Practice: A Guide to Credit Management" - which describes the many things a business can do to reduce the risk of being paid late. The guide can be obtained by telephoning 0870 150 2500. This Act provides another tool which businesses can use if those measures fail.

The Government expects that a statutory right to claim interest will encourage purchasers to pay on time, and will reduce the late payment problem. However, if late payment persists in individual cases, suppliers will be able to claim interest to compensate for not being able to make use of the money owed to them, and to reflect the increased risk caused by late payment. The cost will no longer be borne by the supplier but by the person who can control it - the purchaser.

When does the statutory right to claim interest start?

The Government intends to phase the legislation as follows:

- for the first two years - 1 November 1998 to 31 October 2000 - small businesses will be able to claim interest from large businesses and the public sector on debts incurred under contracts agreed after that date;
- the right to claim interest will be extended, from 1 November 2000 to 31 October 2002, so that small businesses will also be able to claim from other small businesses on debts incurred under contracts agreed after that date;
- from 1 November 2002, all businesses and the public sector will be able to claim interest from all businesses and the public sector on debts incurred under contracts agreed after that date.

These dates are those that have been proposed by the Government. However, the Act does allow the Government to amend the phasing arrangements if the desired improvements in payment culture have not come about. The Government will publicise these changes widely as they happen.

Legal Warning

The Users' Guide has been prepared to provide general guidance only. The Guide is not legal advice and reliance ought not to be placed on it. No liability can be accepted by the authors or publishers for its contents. The interpretation of the law on late payment is ultimately a matter for the courts, and users should take their own advice where appropriate.

Part I: How the statutory right to claim interest works

Who can claim statutory interest?

From the commencement of the Late Payment of Commercial Debts (Interest) Act 1998, any small business can claim statutory interest against a large business or public sector body. A small business is one with 50 or fewer employees on average over the previous financial year prior to the year the contract was made. The legal status of the business (ie whether it is a sole proprietor, partnership, limited liability company, etc) is irrelevant.

An employee is anyone who works for a business for payment. This includes temporary staff, partners, owners or directors who work in the business. It does not include people for whom the business is a client or purchaser (so, for example, it excludes window cleaners, solicitors, most types of consultant, etc). Casual staff who are not required by contract to turn up for work are not employees.

How are employees counted?

Full time and part time employees

An employee is counted as full time if they work 35 hours or more per week.

Part-time staff are counted as a proportion of a full-time employee. To calculate the equivalent number of full-time staff, divide the total number of hours worked by part-time staff by either:

- the number of hours worked by a full time employee who does the same kind of job as the part time employee;
  or
- 35 hours per week, if there are no full-time employees doing a similar job.

Calculating the average number of employees

In many businesses the number of employees changes significantly throughout the year. (For example, many businesses in the tourism sector take on staff during the summer.) For this reason, the number of employees is averaged over the previous financial year.

So, for all businesses which were in operation for the whole of the previous financial year (that is, from 1 April to 31 March) the number of employees is calculated by adding up the number of employees on the last day of each month from April to March and dividing by 12.

If the business has only been in operation for part of the previous financial year, the average is taken over the number of complete months of operation in that year. So, for example, if a business starts up on 15 July, the number of employees is calculated by adding up the number of employees on the last day of each month from August to March inclusive and dividing by 8.

If the business has been in operation for less than one complete month in the previous financial year, then the average is taken over the number of complete months of operation, ending at the month before the contract was made. So, for example, if the business starts up on 15 March and the contract is made on 22 September, the number of employees is calculated by adding up the number of employees on the last day of each month from April to August and dividing by 5.

If the business has been in operation for less than one month, then the average is taken over the number of days it has been in operation, ending on the day before the contract is made. So, for example, if a business starts up on 3 April and a contract is made on 26 April, the number of employees is calculated by adding up the number of employees on each day from 3 April to 25 April and dividing by 23.

If a business is a member of a group

A business that belongs to a group of businesses is only considered small if the group as a whole fulfils the criterion of a small business - that is, the whole group has 50 or fewer employees. A group exists where one business has direct or indirect control of another, or where two or more businesses are directly or indirectly controlled by the same third person or business.

Against whom can a claim be made?

A small business can claim interest against any large business or public sector organisation. A large business is any business that falls outside the definition of a small business - that is, any business with more than 50 employees. A public sector body is any Government Department, local or public authority.

How will a supplier or purchaser know whether the other party is large or small?

The simple answer is they can ask. A purchaser who falsely claims to be small to avoid paying interest, or a supplier who falsely claims to be small to obtain interest to which they are not entitled, might be guilty of fraud.

If the matter comes to court, and the size of a buyer or supplier business is in dispute, then it will be for the supplier to prove that it is small, and thus entitled to interest. A purchaser will have to prove that it is small to avoid a claim for interest. Both suppliers and purchasers may find that the type of records which they already keep on employees (for example, payslips, PAYE and national insurance returns) are useful in proving size.

Is a supplier obliged to exercise the right to claim statutory interest?

No. The statutory right to claim interest is not compulsory. A supplier is free to decide whether or not to make a claim for interest.

When is a payment "late"?

Where there is an agreed credit period

Where a supplier has agreed, either in writing or orally, a credit period with the purchaser, the payment is late if it is made after the last day of the credit period.

Where there is no agreed credit period

If no credit period has been agreed, then the Act sets a default period of 30 days after which interest can run. Please note, this default period does not constitute a statutory credit period. Where no credit period is agreed in a contract, the principal debt will still become due from the moment the goods are delivered or the service performed

The 30 day default period starts running from the later of two actions:

(i) the delivery of the goods or the performance of the service by the supplier; or
(ii) the day on which the purchaser has notice of the amount of the debt.

Ideally, the supplier should give notice by means of an invoice that sets out:

- how much is owed;
- what it is owed for;
- to whom payment should be made;
- by what date;
- to what address; and
- by what method (cash, cheque, direct credit etc);
- VAT number, rate and amount.

However, for the purpose of claiming interest under the Act, a simple telephone call would be enough, although this would make it harder to prove that notice had been given.

A payment is late once the agreed credit period or the default period has expired.

Where the contract requires advance payment(s)

There are several ways in which a contract can require payment(s) to be made before the goods are delivered or the service is performed. This section explains under what circumstances statutory interest can be claimed if advance payments are made late. The principle is that the Act does not give a right to claim interest unless at least some of the goods have been delivered or part of the service performed - although the supplier and purchaser are free to agree otherwise in the contract.

(a) Some contracts stipulate that the whole contract price should be paid before the goods are delivered or the service is performed. If payment has not been paid before the goods are delivered or the service is provided and the contract does not provide a substantial remedy for late payment, then the Act allows statutory interest to be claimed after a default period of 30 days. The default period runs from the day all the goods are delivered or the whole service is performed.

(b) Some contracts stipulate that the goods will be delivered, or the service performed, over a period of time and that separate payments should be made every time this happens. If the contract does not provide a substantial remedy where these payments are made late, then the Act allows statutory interest to be claimed after a default period of 30 days.

The default period runs from the day that some of the goods are delivered or part of the service is performed.

(c) Some contracts stipulate that payment should be made by instalments which do not relate to delivery of some of the goods or performance of part of the service. If the contract does not provide a substantial remedy where these payments are made late, then the Act allows statutory interest to be claimed after a default period of 30 days.

The default period runs from the day all the goods have been delivered or the whole of the service performed.

In all cases, a payment is late if it is made after the expiry of the default credit period.

Where there is no agreed credit period but the purchaser usually pays at the end of the month following the month in which the invoice is received

Some purchasers and suppliers have a long-standing relationship in which this kind of payment arrangement has become standard practice. In these cases, the credit period is considered to end on the last day of the month following the month in which the invoice is received. Interest starts to run on the next day.

Where:

- the purchaser is dealing with a new supplier; or
- there is any other reason to doubt whether this kind of arrangement can be regarded as established practice between the supplier and purchaser

the purchaser should ensure that there is an agreed credit period - otherwise the default period of 30 days might apply.

What is the rate of interest?

The rate of interest is the official dealing rate of the Bank of England (the base rate) + 8%, using the base rate at the end of the day on which the contract says that payment is to be made.

If the contract does not stipulate a date for payment, then the base rate to be used is the one at the end of the last day of the default period, even if the base rate changes between then and the time the principal is eventually paid.

How is the interest rate found and calculated?

The base rate is the official dealing rate of the Bank of England. This is the interest rate that is announced by the Monetary Policy Committee of the Bank of England. It is always given a lot of press attention when it is changed.

The base rate is published in every edition of the Financial Times, with the date on which it was last changed. It can be found under the heading “UK Interest Rates” in the section on “London Money Rates”. There is a sentence that reads “UK clearing bank base lending rate x per cent from DD/MM/YY” An example is given below.

UK INTEREST RATES

LONDON MONEY RATES

Jul 6	Over-night	7 days notice	One month	Three months	Six months	One year
Interbank Sterling	7¼ - 6	7 5/16 - 7	7⅝ - 7½	7⅞ - 7¾	7 15/16 - 7 13/16	8 - 7⅞
Sterling CDs	-	-	7 19/32 - 7 17/32	7⅝ - 7 9/16	7⅝ - 7 9/16	7 9/16 - 7½
Treasury Bills	-	-	7½ - 7 7/16	7½ - 7 7/16	-	-
Bank Bills	-	-	7½ - 7 13/32	7½ - 7 13/32	7½ - 7 13/32	-
Local authority deps.	7 5/16 - 5	7⅜ - 7 5/16	7 9/16 - 7 7/16	7 9/16 - 7 7/16	7 9/16 - 7 7/16	7 17/32 - 7 15/32
Discount Market deps	7 17/32 - 7½	7 17/32 - 7½	-	-	-	-

UK clearing bank base lending rate 7½ per cent from Jun 4, 1998

	Up to 1 month	1-3 month	3-6 months	6-9 months	9-12 months
Certs of Tax dep: (£100,000)	4	6.5	6.5	6.25	6.25

Certs of Tax dep. under £100,000 is 4pc. Deposits withdrawn for cash 2pc.
Ave. tender rate of discount on Jun 26. 7.3602pc. ECGD fixed rate Stlg. Export Finance. Make up day Jun 30, 1998. Agreed rate for period Jul 26, 1998 to Aug 25, 1998, Scheme III 8.97pc. Reference rate for period May 30, 1998 to Jun 30, 1998, Schemes IV & V 7.741pc. Finance House Base Rate 8pc from Jul 1, 1998.

If the interest is being claimed some time after the contract has been completed, old copies of the Financial Times can be consulted in local libraries.

Alternatively, telephone the Bank of England’s Public Enquiries Unit on 0171-601 4878. They can provide the current base rate and past base rates.

The interest owed on a late payment is simple, not compound, interest. It is calculated like this:

$$\text{debt} \times \text{interest rate} \times \frac{\text{the number of days late}}{365}$$

Example

If the base rate is 7%, then the statutory rate of interest is 15% (7% + 8%).

If the debt is £1,000 and it is paid 30 days late, then the interest owed is:

£1,000 x 15%	=	£150	(the annual rate)
£150 ÷ 365	=	41.09p	(the daily rate)
41.09p x 30 days	=	£12.33	

When does the interest stop running?

Interest stops running on a debt once the principal has been paid.

If the purchaser owes the principal and interest, unless payment is accepted on other terms, any part payment of the debt will go to reduce the amount of the interest first.

How is a claim for interest made?

When a payment is late, a supplier should inform the purchaser that he or she is claiming interest on the late payment. It may be helpful to indicate the daily rate of interest that will be claimed, although it is not necessary to do so. Notification can be oral, but it is better to put it in writing.

Suppliers are advised, though it is not necessary that they should do so, to provide the following information when making a claim for interest:

- how much is owed. (It may be helpful to provide the total amount of interest owed at the date of the invoice for interest, and, if the principal has not been paid, the daily rate at which the interest will continue to accrue);
- what it is owed for. (It is for late payment of such and such a principal debt. If available, quote the original number of the invoice which requested payment of the principal);
- to whom payment should be made;
- to what address; and
- by what method (cash, cheque, direct credit etc).

A claim for interest does not need to be made straight away. A supplier has six years in England, Wales and Northern Ireland, and five years in Scotland, in which to make the claim. Receivers or liquidators of a business may pursue its purchasers for interest on late payment going back over this period. Businesses may also claim interest after they have stopped supplying a purchaser. Purchasers who wish to avoid future claims for interest should pay their bills on time.

What happens if a purchaser does not agree with the interest charged?

A purchaser may not agree with an interest charge (for example, if the goods delivered were faulty and had to be repaired). If this happens, the purchaser may negotiate with the supplier to reduce or amend the interest charge.

Sometimes the purchaser might not agree with the interest charged and may be unable to reach any agreement with the supplier. The purchaser might tender the principal and refuse to pay the interest. If this happens, and the supplier considers that his claim for interest is a proper one, he can go to court. The purchaser may ask the court to be excused from paying part or all of the interest, either as a defence to a claim by the supplier or by applying to the court himself. This might happen, for example, if the supplier did not give the purchaser enough information about the amount owed, where payment should be sent or by what method it should be made (cash, cheque etc).

What happens if the purchaser simply does not pay the interest?

If the purchaser simply does not pay the interest, the supplier can pursue the claim through the courts. Taking someone to court can be a very effective method of debt recovery. The procedures are designed to be quick and easy to operate. County court offices can provide information about court procedures, copies of the forms and help with filling them in. The addresses and telephone numbers of county courts are listed in the telephone directory under "Courts".

If the court makes an award against the purchaser, the purchaser may find that their credit rating is affected.

Can the interest be sold or transferred to a third party?

Yes. If any part of the debt - i.e. the interest or the principal or both - is assigned to a third party, the original supplier should inform the purchaser in writing, saying to whom the debt has been assigned.

The third party, regardless of its size, can then pursue the debtor through the courts for the interest.

Sometimes a supplier sells a debt without notifying the debtor. When this happens, the transfer is effective as far as the original supplier and the third party are concerned. However, as far as the debtor is concerned, the debt is still owed to the original supplier, and it is only the original supplier who can pursue the debtor through the courts.

The person entitled to receive the money can employ an agent to chase it for them. For example, a supplier might employ a debt collector to act as its agent in seeking to collect from the debtor, without actually transferring the debt. Similarly, a factor might expect a supplier to act as its agent by continuing to press debtors for payment of debts they have sold to him. Someone who is acting as an agent in this way can calculate and claim interest and invoice for it. Some agencies offer a legal service, enabling them to issue court proceedings.

The supplier can transfer the whole debt (that is, both the principal sum and the interest) or the principal sum alone, or the interest alone. Where only part of the debt has been transferred, the supplier can act as agent for the third party in respect of the transferred part, and the third party for the supplier for the part which has not been transferred.

Whatever the arrangements between the supplier and third party, the purchaser will never be required to pay interest twice on the same debt.

Part II: Contractual interest on late payment

What about contractual rights to interest on late payment?

A supplier and purchaser can make their own arrangements for a remedy for late payment. If they do so, the Act will not apply. However, if they do not, the remedy for late payment provided by the Act will apply.

To prevent purchasers abusing the right to agree their own arrangements with the supplier, any contractual remedy for late payment must be "substantial". If it is not, it will be void and the debtor will be unable to rely on it. It will be struck down by the courts and the terms of the Act, described in Part I of this guidance, will apply to the contract.

What is a "substantial remedy" for late payment?

A contract must include a substantial remedy for late payment, otherwise the Act will apply.

A remedy for late payment is substantial as long as it is:

a) enough to compensate the supplier for the cost of late payment or to deter late payment;

b) fair and reasonable in all the circumstances to allow the remedy to replace or vary the statutory right to interest provided by the Act.

In determining whether a remedy is substantial or not, the courts will consider all the circumstances, including the rate of interest that applies to late payments and the length of credit periods. Purchasers should not negotiate longer credit periods to avoid the possibility of late payment. Where a credit period is considered to be excessive, the courts may strike it down and replace it with the 30 days default credit period provided by the Act.

How will the courts know whether a remedy is substantial or not?

It will be for the the supplier to show that a remedy is not substantial (although the purchaser may have to provide evidence that it is fair and reasonable in the circumstances). The court will then have to judge whether, in all the circumstances (including what is usual for that sector of business), the remedy meets the criteria of a "substantial remedy" set out above.

Examples of contract terms which a court might declare void, to the extent that they relate to late payment, because they result in there being no substantial remedy for late payment might include:

- a credit period that is significantly different from custom and practice in that industry;
- a credit period that is significantly different from other supply contracts operated by the purchaser;
- an interest rate on late payment, significantly lower than the statutory rate, that fails to act as a deterrent to the purchaser paying late because it is lower than the purchaser's theoretical (or actual) cost of agreed borrowing;

- an interest rate on late payment, significantly lower than the statutory rate, that fails to recompense the supplier for being kept out of his money, because it is below the supplier's theoretical (or actual) cost of agreed borrowing;
- an interest rate on late payment that is significantly lower that the rate used in other supply contracts operated by the purchaser or that is normal in that sector of the economy;

  It is very unlikely that a rate of interest at or below the base rate would meet any of these criteria;
- a contract term that has the effect of reducing the amount of interest that can be claimed, such that the compensation for late payment is insufficient to recompense the supplier or to act as a deterrent to late payment;
- excessive information requirements which must be fulfilled under the contract before any credit period might start.

Whether the purchaser had given any benefit in return for the term in question would be relevant. However, it must be stressed that the courts will look at the issue of a substantial remedy for late payment on a case by case basis. The above list is not exhaustive and might not necessarily apply in every case.

What about existing custom and practice?

The Act does not replace existing custom and practice. If the parties have undertaken business on the basis of usual industry practice, (for example, payment at the end of the month following the date of the invoice), then this practice will probably still apply. However, if any remedy for late payment is not "substantial" the terms of the Act will apply.

Part III: Imports, exports and foreign contracts

Are UK importers liable to claims for interest from overseas suppliers?

Yes.

If the contract is made under a law of the UK, the terms of the Act apply. An overseas supplier may claim interest under the Act.

Are UK exporters able to claim statutory interest from overseas purchasers?

Yes.

If the contract is made under a law of the UK, the terms of the Act apply. A UK supplier may claim interest under the Act from an overseas purchaser.

What about contracts, made under UK law, between non-UK parties?

The Act applies to any contract made under the law of part of the UK except if there is no significant connection between the contract and that part of the UK.

What about contracts connected to the UK but made under a foreign law?

Where the choice of law is a foreign law, the Act applies if there is no significant connection between the contract and any other country other than that part of the UK.

Part IV: Devolution and Europe

How will the right apply to Scotland after devolution?

Scotland has its own legal system. Issues of contract law will be devolved to the Scottish Parliament. The Act will apply to Scotland but the Scottish Parliament will be able to amend or replace the legislation. The Scottish Executive will be able to change the rate of interest, the phasing of the right to claim interest, and the nature of contracts and debts covered by the Act. In changing any of these, the Scottish and Westminster Parliaments will consult closely with each other to ensure that there is a co-ordinated approach.

How will the right apply to Wales after devolution?

England and Wales share the same system of law. Matters of contract law will not be devolved to the Welsh Assembly. The Act will apply to Wales on the same terms as it will apply in England. In making any changes to the Act, the views of Welsh people will be sought.

How will the right apply to Northern Ireland after devolution?

The legislation applies to Northern Ireland. It is not expected that contract law - of which the legislation forms a part - will be devolved to the Northen Ireland Assembly. In making any changes to the Act, the views of the people of Northern Ireland will be sought.

How will European law affect the right in future?

The European Commission has introduced a draft Directive that seeks to ensure a common approach across Member States to the problem of late payment. It will, among other things, require Member States to introduce a statutory right to interest on the late payment of commercial debts. It is too early to say whether the Directive will require any amendments to the UK's regime of statutory interest. The Directive, provided it is agreed, is unlikely to require implementation until 2001 at the earliest.

Part V: Additional copies and information

Free copies of this guide are available by telephoning 0870 150 2500.

The Court Services have also produced a leaflet which explains how to make a claim for interest under the Late Payment of Commercial Debts (interest) Act. Copies are available from courts and Citizen's Advice Bureaux.