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BRIEFING

UPDATE TO THE LATE PAYMENT OF COMMERCIAL DEBTS (INTEREST) ACT 1998

A. Purpose of Act

1. The Act provides for interest to be paid by purchasers on the late payment of debt under commercial contracts. Paying late without good reason is wrong and the Act is aimed at the wrongdoer. It is important to note that so far as contracts are concerned, the Council will more often than not be a purchaser of services.
2. Before the Act was implemented the **common law** position was that interest was not payable on a debt where there had been no express agreement or custom to the contrary. Interest was not recoverable for late payment or non-payment of a debt for the time between when the money was payable until judgment (except when the claimant was charged interest by a third party as a result of the defendant's default and this loss was in the contemplation of the parties).
3. There was also a **statutory** entitlement to interest after judgment under a number of Acts of Parliament including:
 - Judgments Act 1838;
 - Bills of Exchange Act 1882;

- S35A Supreme Court Act 1981;
- S74 County Courts Act 1984; and
- S49 Arbitration Act 1996.

Also, there has been a statutory basis to claim interest where debts are paid after commencement of proceedings, but prior to judgment under:-

- Administration of Justice Act 1982; and
- S49 Arbitration Act 1996.

B. Which contracts does the Act apply to?

4. The Act applies to “**contracts for the supply of goods or services**” where the purchaser **and** supplier are each acting in the course of a “**business**”. Business includes a profession, a government department and a local authority.
5. A contract for the “**supply of goods or services**” includes:-
 - A contract for the sale of goods;
 - A contract for the performance of services;

- A hiring agreement.
6. **‘Excepted contracts’** are excluded. These are:-
- A consumer credit agreement;
 - A mortgage, charge or other security; or
 - A contract entered into before 7 August 2002 of a description in an order made by the Secretary of State.
7. The Act will not apply to employment contracts and apprenticeships. It may apply to works or construction contracts although standard industry construction contracts now routinely make express provision for interest on late payments.

C. How does the right to interest arise?

8. If the Act applies then:-
- A new implied term is created;
 - Any **“qualifying debt”** carries statutory interest.
9. A contractual obligation to pay the whole/part of the contract price is a **“qualifying debt”** unless:-
- Other legislation specifies a **right** to interest/a charge;
 - The debt relates to a contract entered into before 7 August 2002, and it is a debt of a description in an order made by the Secretary of State;
- or
- There is a right to demand interest on it and that right is exercised.

D. What is the rate of statutory interest?

10. The rate of interest is set by Order of the Secretary of State. In making the Order the Secretary of State has to consider the extent to which it may be desirable to set the rate so as to:-
- protect vulnerable suppliers;
 - deter late payment.
11. Currently the rate of interest is 8% per annum over the official dealing rate. The **“official dealing rate”** means the rate announced from time to time by the Monetary Policy Committee of the Bank of England as the official dealing rate. The rate to be used is that in force on 30 June or 31 December in any year, which will apply to debts arising in the following six month period (1 July to 31 December or 1 January to 30 June respectively). This is covered in the Late Payment of Commercial Debts (Rate of Interest) (No 3) Order 2002 SI 2002 No 1674).
12. The official dealing rate is published daily in the “Financial Times” (except on Sundays), together with the date on which the rate was last announced. It is referred to as the “UK clearing bank base lending rate” and can be found in the section entitled “London Money Rates.” The rate is also published at www.bankofengland.co.uk.
13. Alternatively, Treasury Management in Resources Directorate will quote the rate (303-2866).

E. What other compensation may be payable?

14. Suppliers under contracts entered into on or after 7 August 2002 will be entitled to a fixed compensatory sum (in addition to the statutory

interest on the debt and any other compensation or costs they may be entitled to or awarded) payable from the date on which statutory interest starts to run. The sum is intended to cover the supplier's costs and is £40 for debts of less than £1,000, £70 for debts of between £1,000 and £10,000 and £100 for debts over £10,000.

F. When is a payment late and due?

15. Statutory interest starts to run on the date on which payment is late.
16. Except where the debt relates to an **advance payment**, payment is late on:-
 - The day after the date agreed for the payment of the debt (i.e. the end of an agreed credit period) which may be:-
 - ◆ A fixed date; or
 - ◆ A date depending on the happening of an event or the failure of an event to happen; or
 - in the absence of an agreed credit period, the Act will imply a 30 day default period so that statutory interest will run from the 30th day beginning with:-
 - ◆ The day on which the supplier performed the obligation to which the debt relates (ie. delivery of goods or performance of the service); or
 - ◆ The day on which the purchaser had notice of the amount of the debt or the sum claimed by the supplier.
17. Statutory interest ceases to run where the interest would cease to run if it were carried under an

express contract term, generally when the debt has been repaid.

18. The Act sets out special provisions for statutory interest on advance payments (eg. a deposit). 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 has been performed.

G. Is there any relief from statutory interest?

19. The Act provides for relief from the accrual of statutory interest where, due to the conduct of the supplier (before or after the creation of the debt), the “**interests of justice**” require it.
20. This can mean that statutory interest will not be payable for a period or that will be payable at a reduced rate. Relief can be granted for part or the whole of the period during which statutory interest would otherwise have run on the debt.
21. The reasoning behind this is that in some circumstances awarding statutory interest for the full period could discourage businesses from pursuing legitimate disputes.

H. Can the parties contract out of the 1998 Act?

22. The general principle is that any contract term which purports to exclude the right to statutory interest is void unless there is a “**substantial remedy**” for late payment in the contract.
23. In practice this means that the overall remedy for late payment in any contract must be a substantial remedy or the Act and the right to statutory interest will still apply and any term purporting to exclude, vary or provide an alternative remedy to the Act will be void.

24. A remedy for late payment is a **substantial remedy** unless:-

- The remedy is insufficient to compensate the supplier or deter late payment; and
- It would not be fair or reasonable to allow the remedy to vary/oust the statutory right, having regard to all the relevant circumstances at the time the terms were agreed including:-
 - ◆ The benefits of commercial certainty;
 - ◆ The strength of each party's bargaining position;
 - ◆ Whether the term was imposed by one party to the detriment of the other (eg by the use of standard terms);
 - ◆ Whether the supplier received an inducement to agree to the terms.

25. Examples of contractual terms which a court may declare void are:

- 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 purchasers theoretical or actual cost of 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 suppliers theoretical or actual cost of borrowing;

- an interest rate on late payment that is significantly lower than the rate used in other supply contracts operated by the purchaser or that is normal in that sector of the economy;

[Accordingly, a rate of interest at or below the base rate could be declared void].

- 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 for late payment;

- Excessive information requirements which must be fulfilled under the contract before any credit period might start.

26. In addition, if a credit period is considered to be excessive, a court may strike it down and replace it with the 30 day default period provided by the Act.

27. However once the qualifying debt has arisen the parties are free to agree how to deal with the debt.

I. What is the effect of assignment/ novation?

28. The Act will continue to apply to a qualifying debt following an assignment or novation of the

contract or the debt. This means that the rights of supplier and purchaser under the Act will vest in the persons who are the creditor and the debtor for the time being. For example, a person to whom a debt has been assigned will be entitled to claim statutory interest provided the original supplier has notified the debtor.

J. Can a qualifying debt be postponed?

29. If a contract term purports to have the effect of postponing the time at which a qualifying debt would otherwise be created then section 3(2)(b) of the Unfair Contract Terms Act 1977 applies.

30. The effect of section 3 is that the purchaser cannot claim to be entitled:-

- To render a contractual performance substantially different from that which was reasonably expected of him; or
- In respect of the whole or any part of his contractual obligation, to render no performance at all;

except in so far as the contract term satisfies “**the requirement of reasonableness.**”

31. The requirement of reasonableness is that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

K. When did the Act come into force?

32. The Government has phased in the legislation as follows:-

- Since **1 November 1998** small business suppliers have been able to claim interest from large business suppliers and most United Kingdom Public Authorities (as defined below) on debts incurred under contracts entered into after 1 November 1998.

- The right to claim interest was extended from **1 November 2000** so that small business suppliers can claim from other small business suppliers on debts incurred under contracts entered into after 1 November 2000.

- **From 7 August 2002** all businesses and the public sector have been able to claim interest from all businesses and the public sector on debts incurred under contracts entered into after 7 August 2002.

33. A **United Kingdom Public Authority** includes:-

- A local authority;
- A Minister of the Crown;
- A department of Her Majesty's Government.

34. A **small business supplier** is a business with 50 or fewer full-time employees.

35. A **large business supplier** is a business with more than 50 full-time employees.

36. There is a detailed mechanism for determining the number of employees in a business which applies the following broad principles:-

- The number is the average number of full time employees during the period from 1 April

to 31 March immediately preceding the date of making the contract.

- Employees include partners.
- Full-time employees work for 35 hours or more per week.
- A part-time employee is counted as a fraction of a full-time employee.

37. A business is regarded as a large business where the average number of employees employed in that business when aggregated with the average number employed in all other businesses run by the same or any associated employer is more than 50.

38. If there is a dispute (before phasing in is completed) as to size then:-

- A supplier will need 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.

Payslips, PAYE and national insurance returns will be useful to prove size.

L. What action should be taken?

39. Identify if the Act applies to new contracts you are to enter with suppliers.

40. If the Act applies, you need to determine whether the statutory rate of interest should apply, or whether there is a sound basis for any other rate to apply.

41. You should ascertain that it is clear when the debt arises – are there any conditions, which should properly be conditions precedent

to payment? Ideally you should receive 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;
- by what method (cheque);
- VAT number, rate and amount.

42. You should determine how to effectively make part payment where part of an invoice is disputed. You should ensure that any computerised payment service allows you to do this without having to ask for a credit note or a fresh invoice.

43. You should ensure that payment of sums due can be made within the 30 day period.

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