



Late Payment of Commercial Debts Legislation

Briefing Note

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Introduction

- 1 In August 2002 the Late Payment of Commercial Debts (Interest) Act 1998 (“the Act”) took the final step to provide a statutory right to interest on debts arising under contracts for the supply of goods or services between all commercial parties acting in the course of their business.
- 2 Prior to the Act interest on a debt had only been available in 3 limited circumstances.
- 3 At common law interest can be claimed as special damages¹. The interest is claimed as either ‘lost interest’ i.e. compensation to the creditor for interest the money would have earned in his bank account had the payment not been received late or reimbursement for ‘finance charges’ that a creditor has had to pay, for example, on an overdraft or loan repayment due to late funds. Judicial interpretation has developed the second limb of *Hadley v Baxendale*² to allow for a claim for lost interest in an action for breach of contract.³ This approach was approved in the case of *Amec Process and Energy Ltd v Stork Engineers & Contractors BV (No.2)*⁴. In a construction context the Court has interpreted certain contract terms⁵ to imply a right to reimbursement for interest paid as a ‘financial charge’ due to late payment.⁶

¹ *Wadsworth v Lydall* [1981] 2 All ER 401 CA.

² (1854) 9 Ex. 341 - ‘Where the contract is made under special circumstances which are communicated by one party to the other, the damages on breach are such as the parties might have reasonably contemplated as flowing from such breach in those circumstances.’

³ A creditor will need to satisfy the test for the second limb of *Hadley v Baxendale* that ‘the special circumstances were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.’

⁴ [2002] All ER (D) 42 (Apr)

⁵ For example, JCT 98 clause 26 and 34(3).

⁶ *F.G. Minter v WHTSO* (1980) 13 B.L.R. 1.

- 4 Interest on a debt sum can be claimed at judgment under s.35A Supreme Court Act 1981 or s.69 County Court Act 1984⁷ in the High Court and County Court respectively⁸ such a claim for interest is lost, however, if not included at first instance in the creditor's pleadings⁹.
- 5 Finally interest is payable on a debt if an express contractual term provides for it.¹⁰
- 6 With the exception of the express contractual remedy the main disadvantage in traditional methods of claiming interest is that the amount of interest and the period for which such interest can be claimed are at the discretion of the Court.¹¹ In the case of the common law remedy the award of the interest also depends on the strength of argument to prove the damages are special as opposed to general¹² (under which a claim for interest cannot be made¹³). The current situation under the Act, however, is that where interest is payable *per se* a creditor need not go through the courts to claim it. Yet whilst express contractual provision for an interest remedy may seem the answer such opportunity can be abused and/or an inadequate provision made by way of interest. The Act therefore protects a creditor if an insufficient interest term has been written into a contract.¹⁴
- 7 Since 1998 the Act has been implemented in 5 phases through various Statutory Instruments and the latest (SI 2002/1673, 2002/1674 and 2002/1675) have expanded and simplified a creditors rights against a defaulting debtor.¹⁵ Before these recent changes are looked at in more detail a brief background to the functions and application of the Act will be given.

Background

- 8 Main provisions of the Act:

Who is affected by the Act?

- The Act applies to all contracts for supply of goods or services between businesses and public authorities dated after 7 August 2002.¹⁶

⁷ As distinguished from interest available on a judgment from the High Court under Judgments Act 1838 s.17 and from a County Court under County Court Act 1984 s.74 (only judgments of £5,000 or more).

⁸ A similar interest provision exists in relation to arbitration and an arbitrator's power to award interest on an arbitration award under s.49 Arbitration Act 1996.

⁹ Subject to a limited opportunity to amend the pleadings to include a claim.

¹⁰ For example JCT 98 clause 30(1).

¹¹ See *Rees & Kirby Ltd v Swansea City Council* (1985) 30 B.L.R. 1 where the Court held that some financial charges were not recoverable as they were attributable to another cause. Cf. s.5 of the Act providing a limited scope for varying or reducing interest payable in the 'interests of justice'.

¹² See *Ogilvie Builders Ltd v Glasgow DC* (1995) S.L.T. 15, a Scottish case discussing the application of *Hadley v Baxendale* for claiming interest.

¹³ *London, Chatham and Dover Rly Co v South Eastern Rly Co.* [1893] AC 429 held no interest could be recovered as there was no contractual term providing such interest, affirmed in modern case of *President of India v La Pintada Compania Navegacion SA* [1984] 2 All ER 773.

¹⁴ See s.9 of the Act and meaning of substantial remedy.

¹⁵ The Act ensures the UK's partial compliance with EC law and, more specifically, the EC Directive 2000/35/EC on combating late payment in commercial transactions.

¹⁶ There are limited exceptions i.e. employment contracts.

- The parties must be ‘each acting in the course of a business’ i.e. a commercial transaction.
- The Act applies in the absence of any express contractual term¹⁷ or statutory provision providing interest for late payment of debts.
- A contract need not refer expressly to the Act for it to apply, however, it is advisable, for businesses intending to enforce their right to statutory interest, to state this intention on all invoices and debt letters.
- The Act does not preclude contracting parties from agreeing their own method of compensation for late payment, however, parties may not attempt to vary or exclude the right to statutory interest, particularly if there is no suitable alternative provision in its place.
- If parties do agree an alternative contractual interest provision and it is challenged in court it must be a ‘substantial remedy’¹⁸ and not amount to a ‘penalty’¹⁹.
- The Act does not apply to ‘excepted contracts’, defined as consumer credit agreements or contracts intended to operate by way of mortgage, pledge, charge or other security.
- Only small businesses (50 or fewer employees) can claim interest retrospectively under the Act and only from large businesses and most of the public sector for contracts dated after 1 November 1998 and, additionally, other small businesses from 1 November 2000.

How much interest may be due and how does it accrue?

- The interest payable is 8% ‘over the official dealing rate’.²⁰ Currently the official dealing rate has been fixed at 5.25%, which was the Bank of England base rate as at 11 January 2007. Therefore, an interest rate of 13.25% applies to any late payment until 30 June 2007.²¹
- Statutory interest starts to accrue the day after the final day for payment.²² In the event that no due date has been agreed, specified or is identifiable then the Act

¹⁷ JCT 98 clause 30(1), ICE 7 clause 60(7).

¹⁸ According to s.9 of the Act a term will be considered a ‘substantial remedy’ if it is sufficient to be a deterrent to making late payment, it compensates a creditor for losses due to late payment (i.e. Bank interest) and it is reasonable to allow the contractual compensation to replace the statutory right to interest.

¹⁹ *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* (1915) AC 79 HL. *Jeancharm Ltd v Barnet Football Club Ltd* [2003] EWCA Civ 58.

²⁰ The ‘official dealing rate’ means the Bank of England base rate - SI 2002/1675 s.3.

²¹ For international contracts the recommended EC statutory interest rate for late payment is around 7% above a base rate of 5.0%.

²² s.4 of the Act.

provides for a 30 day interest free period after which interest will accrue on a daily basis.²³

- The statutory 30 day credit period begins to run from date of delivery or the invoice, whichever is the later.
- The 30 day credit free period does not mean in the absence of a proper credit agreement that a debtor can assume he has 30 days grace in which to pay. If payment is due on delivery or performance of a service and no payment is made, a supplier can sue for that debt on the next day. The 30 days is simply interest free.
- If payment is to be in instalments then interest will accrue on each instalment the day after each instalment is due.
- Interest continues to accrue until judgment.
- The sum on which interest is calculated is inclusive VAT, but the interest sum itself is exclusive VAT.
- Any part payments of a debt will pay off the interest already accumulated before the principal sum reduces.
- There is no minimum sum for which interest can be claimed.

Enforcing a claim to statutory interest

- The interest sum can be pursued of its own right as a separate debt from the principal sum.

Recent changes

- 9 The **four** most recent amendments to the Act were introduced through SI 2002/1673, SI 2002/1674 and SI 2002/1675 on 7 August 2002.
- 10 In summary they are:
- a) The Act now regulates all contracts for supply of goods or services between commercial entities regardless of the size of parties involved i.e. large businesses supplying smaller businesses - SI 2002/1673, s.2;
 - b) Section 5 of the Act has been amended to provide a fixed compensation sum for recovery costs, in addition to the statutory interest sum - SI 2002/1674, s5A;
 - c) The Act provides certain representative bodies with the power to challenge unfair debt interest provisions contained in a purchaser's standard terms and conditions on behalf of small and medium sized businesses - SI 2002/1674; and

²³ In the construction context this section of the Act shall only have relevance to debts under contracts falling outside the scope of the Housing Grants, Construction and Regeneration Act 1996, which specifies the due date for payments.

- d) The Act provides a fixed 'official dealing rate' for 6 monthly periods - SI 2002/1675, s4.

The following is a more detailed look at these changes.

- a) The Act now regulates **all contracts for supply of goods or services** between commercial entities **regardless of the size of parties** involved i.e. large businesses supplying smaller businesses.

Previously the Act had only applied to contracts executed between small businesses (as supplier) and UK public authorities, large businesses and other small businesses. From 7 August 2002 the Act applies regardless of size of the contractual parties.

- b) Compensation arising out of late payment under s.5A.

The new s.5A provides additional compensation for late payment and is a fixed sum linked to the level of debt:

- Debt of less than £1,000 - £40.
- Debt of £1,000 or more but less than £10,000 - £70.
- Debt of more than £10,000 - £100.

There has been some misreporting and confusion in the construction press recently apropos additional compensation and it should be understood that this compensation is only available as part of a claim for statutory interest. Where parties include an express debt interest remedy/clause in their contract then a fixed sum compensation claim is lost - for instance if interest is payable under clause 30 of JCT 98. If a creditor pursues a statutory debt claim to court and wins, then the compensation sum is payable in addition to legal costs as awarded.

The right to compensation does not apply to statutory interest claims arising under contracts dated prior to 7 August 2002.

- c) Proceedings restraining use of grossly unfair terms.

This piece of delegated legislation provides that where a purchaser's standard terms of contract purport to exclude or vary the right to statutory interest then an appropriate representative body²⁴ may challenge such terms in the High Court. The High Court, if it sees fit to do so, may then grant an injunction restraining the purchaser using the term. The Court will generally look to whether use of the term would be void as under the Act.

This is only applicable for contracts made after 7 August 2002.

- d) Rate of statutory interest.

²⁴ " 'Representative body' means an organisation established to represent the collective interests of small and medium-sized enterprises in general or in a particular sector or geographical area." s.3 SI 2002/1674.

Previously the Act specified only that the interest rate payable be set at 8% above the official dealing rate.²⁵ By this latest SI, however, for ease of reference the official dealing rate has been fixed for 6 months -. The Act allows for the base rate to be fixed bi-annually for 6 month periods, i.e. the base rate at 31 December applies until 30 June and the base rate as at 30 June applies until the following 31 December each year. The base rate as of 31 December was 5.0%. A supplier can therefore claim 13% interest on a late payment.

Commentary

- 11 The fact that express contract interest clauses may specify payable rates of less than 8% above the official dealing rate does not mean that they are impeachable for being an inadequate or insubstantial remedy. The fact that most of the construction industry works on 5% above the base rate of the Bank of England is witness to this by practice and now near convention. However the point is yet to be tested. It goes without saying that commercially rates nearer 8% over base will be more robust and 5-8% above base is the range to be in.

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²⁵ See 13 *supra*.