Department
for Business
Innovation & Skills

DIRECTIVE 2011/7/EU ON COMBATING LATE PAYMENT IN COMMERCIAL TRANSACTIONS

A Users Guide to the recast Late Payment Directive

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Summary

The United Kingdom was one of the first countries in the European Union to implement late payment legislation to help promote the culture of prompt payment. There has been late payment legislation since 1998 that saw a statutory right to interest for late payment for small business since 1998 from large firms and the public sector, and from small firms since 2002.

Amended late payment legislation comes into force on 16 March 2013[1], implementing *European Directive 2011/7/EU on combating late payment in commercial transactions;* that aims to make pursuing payment a simpler process across the European Union, reducing the culture of paying late and making paying on time the norm.

Many of the measures contained in the recast Directive are already in place within UK legislation but for ease, we have identified them in the next section below.

The new rules are simple – debtors will be forced to pay interest and reimburse the reasonable recovery costs of the creditor, if they do not pay for goods and services on time (60 days for business and 30 days for public authorities).

This guide has been prepared taking into account the responses to the transposition consultation that was held in autumn 2012.

[1] Statutory Instrument 2013 No. 395 The Late Payment of Commercial Debts Regulations 2013

Summary of new measures

Business to business payment terms	The period for payment fixed in the contract does not exceed 60 calendar days, unless otherwise expressly agreed in the contract and provided it is not grossly unfair to the creditor. It should therefore remain possible for parties to agree on payment periods longer than 60 calendar days provided such extension if not grossly unfair to the creditor.
Public sector payment terms	That in commercial transactions, where the debtor is a public authority, the payment period does not exceed 30 calendar days following receipt by the debtor of the invoice.
Statutory interest rate	Simple interest is calculated as equal to the sum of the Bank of England reference rate plus at least eight percentage points.
Compensation for recovery costs	The creditor is entitled to obtain from the debtor, a fixed charge of £40, £70 or £100 depending on the size of the debt (under £1,000, under £10,000, and higher), plus additional reasonable costs incurred.
Application	Contracts concluded before 16 March 2013 will be excluded from the amended provisions.
Verification periods	The maximum duration of a procedure of acceptance or verification does not exceed, as a general rule, 30 calendar days. Nevertheless, it should be possible for a verification procedure to exceed 30 days where agreed and not grossly unfair to the creditor.

What is meant by Late Payment Legislation?

The term Late Payment legislation refers to the Late Payments of Commercial Debts (Interest) Act 1998, the Late Payment of Commercial Debts Regulations 2002 and the Late Payment of Commercial Debts Regulations 2013.

The statutory right to claim interest and other compensation recovery costs and entitlements being made from 16 March 2013, are not compulsory and it is for the supplier to decide whether or not to use rights made available.

Part of maintaining any successful business is good cash flow management and the late payment legislation can help you with your credit management.

Legal warning

This Guide has been prepared to provide general guidance only. This Guide does not constitute legal advice and reliance ought not to be placed on it. No liability can be accepted by the Department for Business, Innovation and Skills for its contents. The interpretation of the law on late payment is ultimately a matter for the courts and users of this Guide should seek their own legal advice where appropriate.

Introduction

Late payments constitute a major obstacle to the free movement of goods and services and can substantially distort competition. The resulting administrative and financial burdens impede trade and increases costs. Small and medium-sized enterprises (SMEs) are most vulnerable. The revised Directive is a strengthening of the current Directive that essentially extends the protections already enjoyed by UK businesses across the Union.

The legislation is aimed at creating an environment where paying on time is the norm and late payment is seen to be unacceptable across the business community - it can never be a substitute for effective customer relationships and cash flow management and will always be the option of last resort for suppliers (many of which are in established and mutually beneficial relationships with their customers). The European Commission believes that, once introduced by all EU member states, the new rules could mean an extra £150 billion being made available to businesses across Europe, helping to relieve cash flow problems.

The Directive is based upon UK legislation and the UK is recognised as an exemplar across Member States, including for the measures it has introduced to drive a culture of paying according to agreed terms (the Prompt Payment Code[2], improved guidance for suppliers[3] and speedy public sector payment).

Evidence suggests that the best way of securing timely payment is to agree terms in advance of the transaction and to invoice timely and accurately - effort therefore needs to be focussed upon managing customer relationships and managing cash flow.

The UK will transpose (implement) the EU Directive 2011/7/EU by 16 March 2013.

[2] http://www.promptpaymentcode.org.uk/
[3] https://www.gov.uk/doing-business-with-government-a-guide-for-smes

Business to business payment terms

If you are a business involved in a commercial transaction with another business, you need to know that:

- Businesses must pay their invoice within 60 days, unless expressly agreed otherwise and provided it is not unfair to the creditor.
- Statutory interest rate applies (at least 8 percentage points above the Bank of England's reference rate) to the debt unless an agreement has been reached which amounts to a substantial remedy for the late payment of the debt.

Substantial remedy examples	
It must be stressed that these are examples and that the courts will look at the issue of substantial remedy for late payment on a case-by-case basis.	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 purchases;
	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 from being kept from their money, because it is below the supplier's theoretical [or actual] cost of agreed borrowing;
	An interest rate on late payment, significantly lower than the rate used in other supply contracts operated by the purchaser or than is normal in that sector of the economy;
	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

Substantial remedy examples	
	payment;
	Excessive information requirements that must be fulfilled under the contract before any credit period might start.

If you are a creditor:

In cases of late payment, you are entitled to claim interest for the late payment without a reminder. You can also claim reimbursement of the reasonable recovery costs for the late payment. To stop any abuse of negotiation power, you have further opportunities under the Directive to challenge grossly unfair contractual terms and practices.

You are not obliged to, but you have the right to take these actions against your debtor.

Statutory interest rate

In the case of late payment, you are entitled to claim interest for the late payment without a reminder.

How to calculate late payment interest

At the start of a six-month-month period the official dealing rate of the Bank of England (the base rate) will be made a fixed "reference rate" for the subsequent six months. The table below shows how this works:

	The sixth month period
The Bank of England base rate on 31 December will be the "reference rate" for	1 January to 30 June
The Bank of England base rate on 30 June will be the "reference rate" for	1 July to 31 December

What rate of interest can be charged?

To determine what interest rate you should use when calculating interest in late payment, you need to **add 8%** to the "reference rate" that covers the six-month period in which your debt becomes late. You can find the correct base rate by looking in the financial pages of the national press of the appropriate date or by visiting the Bank of England website[4]. Calculating the (simple, not compound) interest is as follows:

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

Compensation for recovery costs

As well as being entitled to claim interest arising from late payment, suppliers will also be able to claim a fixed amount, depending on the size of the unpaid debt. The table below shows how much you are entitled to:

Size of the unpaid debt	To be paid to the creditor
Up to £999.99	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

Suppliers can also claim compensation for reasonable costs in recovering the incurred debt.

Public authority payment terms

If you are a business involved in a commercial transaction with a public authority, you need to know that:

- A public authority must pay your invoice within 30 days.
- That the late payment interest rate will be a minimum of 8 percentage points above the Bank of England's reference rate (see section above). This rate cannot be negotiated.
- That the contract cannot exclude interest for late payment or compensation for recovery of costs if paid late.
- Verification and acceptance procedures should be expressly mentioned in the tender documents and in the contract and, as a rule, cannot exceed 30 calendar days unless otherwise expressly agreed and provided it is not unfair to the supplier.

[4] http://www.bankofengland.co.uk/Pages/home.aspx

- If payment is late, suppliers are entitled to receive the outstanding amount that includes daily interest for every day payment is late based on 8 percentage points above the Bank of England's reference rate (see section above) plus the fixed amount, depending on the size of the unpaid debt (see section above).

Payment between public authorities and business

If you are a public authority:

- You must pay for the goods and services that you procure within 30 days.

- *If you do not pay within the deadline, you are obliged to pay the outstanding amount. In addition, a liability for interest on the outstanding amount accrues for every day payment is late. This can be claimed by a supplier* ***<u>automatically</u>*** *and without reminder. The rate of this interest will be based on 8 percentage points above the Bank of England's reference rate (see section above) plus the fixed amount, depending on the size of the unpaid debt (see section above). You are responsible for ensuring that you pay your supplier on time. The supplier is not obliged to remind you that payment is outstanding in order to allow them to claim interest on the outstanding amount.*

- Public authorities are not allowed to fix a lower interest rate.

- Verification or acceptance of goods and services should not exceed, as a general rule, 30 days. Nevertheless, it should be possible for a verification procedure to exceed 30 days where agreed by both parties and not grossly unfair to the supplier.

The UK Government recognises that the public sector should set a strong example by paying promptly. Over time it has been improving its payment times to assist the cash flow of businesses and especially small businesses.

The Directive proposes that Member States shall ensure that in commercial transactions where the debtor is a public authority, the payment period does not exceed 30 calendar days following receipt by the debtor of the invoice. <u>This matches Government's current best practice for the public sector.</u>

In 2010, UK Government introduced a far more onerous target that goes beyond this and previous versions of the Late Payment Directive, in committing Whitehall Government Departments to aim to pay 80% of undisputed invoices within 5 days. By adopting this measure, it seeks to ensure that the benefits of prompt payment to main contractors are felt through the supply chain and benefit smaller businesses.

It has also looked to improve payment times within the supply chain. All Whitehall Departments are required to include a clause in their contracts that requires prime contractors to pay their suppliers within 30 days. In its procurement of construction works UK Government continues to increase its use of Project Bank Accounts, which provide both certainty and speed of payment to suppliers down to tier 3 of supply chains. The Cabinet Office has introduced a "Mystery Shopper" service that investigates issues of poor procurement practices, including prompt payment both from public bodies and in public procurement supply chains. Suppliers can use this service anonymously to escalate issues about problems in Government supply chains to the Cabinet Office[5].

The devolved administrations of Scotland, Wales and Northern Ireland set their own prompt payment terms, within the limits of the Late Payment legislation.

Application

Contracts concluded before 16 March 2013 will be excluded from the amended provisions.

Verification periods

Where a verification and acceptance procedure is provided for, the period of time to carry out that procedure cannot exceed 30 days unless otherwise expressly agreed and provided it is not grossly unfair to the supplier.

Voluntary code of Practice – the Prompt Payment Code

Prompt payment is critical to the cash flow of every business, and especially to smaller businesses. But it is not just the timeliness of payment, but rather the certainty of getting paid, enabling businesses to plan.

The Prompt Payment Code[6] is about encouraging and promoting best practice between organisations and their suppliers. Signatories to the Code commit to paying their suppliers within clearly defined terms, and commit also to ensuring there is a proper process for dealing with any issues that may arise. This means that suppliers can build stronger relationships with their customers, safe in the knowledge that they will be paid, and confident that they are working with a business that values the service they deliver. Visit the prompt payment website for details on how to sign up[7].

Further information:

As a European business that may have dealings with businesses or public authorities in another Member State, this Directive should make your life easier. For further information on the European Commission's Late Payment Information Campaign visit their website[8].

[5] https://www.gov.uk/doing-business-with-government-a-guide-for-smes
[6] http://www.promptpaymentcode.org.uk/benefits.htm
[7] Sign up to the prompt payment code - http://212.36.97.6/ppc/apply.a4d
[8] http://ec.europa.eu/enterprise/policies/single-market-goods/fighting-late-payments/late-payment-campaign/

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