On 16 March 2013, the Late Payment of Commercial Debts Regulations 2013 ("Regulations") came into force. The Regulations amend the Late Payments of Commercial Debts (Interest) Act 1998 ("Act") and introduce new rules relating to payment periods, and the dates from which statutory interest runs on commercial debts.

Who will be affected?

The Regulations apply to all commercial contracts for the supply of goods and services (other than excepted contracts) entered into on or after 16 March 2013. The Regulations will not have retrospective effect.

It is still possible for businesses to contract out of the application of the Act, as amended, and agree a "substantial contractual remedy" for the late payment of a commercial debt such that the statutory interest rate provided for by the Act will not apply. However, where contracts are silent, and no such remedy is provided, the rules introduced by the Regulations apply.

Rationale

The Regulations aim to promote a more supplier-friendly approach to payment and to tackle the EU-wide culture of late payments in commercial transactions. In particular, the Regulations are designed to benefit SMEs by combating the problems caused by late or unpaid invoices which can include financial difficulties, loss of jobs and, in extreme cases, insolvency.

The position prior to 16 March 2013

Unless the application of the Act was ousted by a contractual term, a business would have a statutory right to claim interest for the late payment of commercial debts. This statutory interest would generally start to run from the day after the agreed date for payment of the debt. Where no date was agreed, statutory interest would generally start to run from the date 30 days after the supplier performed its obligation (e.g. delivered the goods), or the customer received the invoice, whichever is later. In addition to claiming statutory interest, a supplier could also claim as compensation for the cost of recovering a debt, a fixed charge of between £40 and £100 depending on the size of the debt.ii

What has changed?

Payment periods / dates from which statutory interest will start to run

The Regulations effectively impose payment periods on commercial contracts for the supply of goods and services by providing that statutory interest on outstanding payments will start to run after certain time periods set out in the Regulations.

- **Public authorities.** Where a public authority purchases goods or services, statutory interest will start to run on outstanding payments from 30 days after the supplier's invoice is received, the goods or services are received, or the goods or services are verified and accepted (where provided for by statute or contract), whichever is the later.

- **Other organisations/businesses.** Where a payment period has not been agreed, statutory interest will start to run on outstanding payments from 30 days after the supplier's invoice is received, the goods or services are received, or the goods or services are verified and accepted (where provided for by statute or contract), whichever is the later.

Where a payment period is specified in the contract, statutory interest will start to run from that date. However, if that agreed payment period is more than 60 days after the events listed above, the Regulations state that statutory interest will begin to run from the date 60 days after the events listed above despite the express contractual term, unless the longer payment period agreed between the parties is not "grossly unfair" to the supplier.

- In this way, the Regulations seek to impose payment periods on businesses by stating that statutory interest will start to run from a defined date. However, if statutory interest has been ousted by the provision of a "substantial contractual remedy", statutory interest will not apply and these provisions will have no effect.
In determining what payment period is “grossly unfair” to a supplier, all the circumstances of the case will be considered, including in particular:

- the nature of goods or services supplied;
- whether the long payment period is a gross deviation from good commercial practice and contrary to good faith and fair dealing; and
- whether the purchaser has an objective reason for requiring the extension.

Interest rate

The statutory interest rate payable under the Act, as amended, has not changed and remains at 8.5% (8% above the current base rate).

Reasonable costs of recovering a debt

The existing fixed sum rates are retained but a supplier may also claim as compensation any “reasonable” costs of recovering the debt that exceed the fixed sum. Any attempt to exclude or limit this right is subject to the test of reasonableness set out in the Unfair Contract Terms Act 1977.

Next steps for those affected

1) **Consider providing a substantial remedy for late payment.** It is possible to contract out of these new rules by including an express term of the contract that provides for a substantial contractual remedy for late payment.

2) **Review payment periods.** Public authorities should ensure that their payment terms are 30 days maximum. All other businesses should also review their payment terms. These Regulations seek to encourage all businesses to include payment terms of 60 days maximum, but longer payment terms will still be permitted provided the payment period is not “grossly unfair” to the supplier. Any statutory interest would then not run until the expiry of the longer period. Where longer payment terms are included, parties should consider including a term in the contract acknowledging that the parties agree that the payment period is fair taking in account the commercial needs of both parties.

For more information about the issues detailed in this note please contact your usual Osborne Clarke contact or:

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1 Excepted contracts are consumer credit agreements and contracts intended to operate by way of mortgage, pledge, charge or other security.

2 The fixed sums are: £40 for a debt less than £1,000; £70 for a debt between £1,000 and £10,000; and £100 for a debt of £10,000 or more.