



RESEARCH PAPER 98/42  
2 APRIL 1998

# *Late Payment of Commercial Debts (Interest) Bill*

**[HL] 1997/98**

**Bill 132**

This Bill introduces a statutory right to claim interest on late payment of commercial debt. It stems from the Labour Government's Green Paper, *Improving the Payment Culture*, published in July 1997. The implementation of the Bill is to be phased in three stages. Initially, only small businesses with 50 or fewer employees will have the right to claim interest from large businesses and the public sector on late paid commercial debt. After two years, it is proposed to extend this right to enable small businesses to claim interest from other small businesses. Finally, after a further two years, it is proposed that all businesses and the public sector will have the statutory right to claim interest on trade debt from all other businesses and the public sector. Interest will probably be charged at base rate plus 8%. This Government Bill was introduced in the House of Lords by Lord Clinton-Davis, Minister for Trade. It completed its passage through the Lords on 26 February 1998 and is awaiting its Second Reading in the Commons.

This Paper should be read in conjunction with Research Paper 97/25. This outlines the background to the issue of late payment and the measures introduced to combat the problem from 1993 to the 1997 General Election. It also provides a comparison between the payment performance of businesses in the UK with that of other members of the European Community.

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## I Introduction

The *Late Payment of Commercial Debts (Interest) Bill* 1997/98 was introduced in the House of Lords on 10 December 1997 by Lord Clinton-Davis, Minister for Trade.<sup>1</sup> It is a Government Bill. The Small Firms Minister, Barbara Roche, announcing publication of the Bill on 11 December 1997, said:<sup>2</sup>

"The Government has kept its promise to Britain's businesses and today published legislation to help them to tackle the problem of late payment. The Bill is a key element in our comprehensive package of measures developed in partnership with businesses, their representative organisations and the public sector to improve Britain's payment culture.

Late payment hits small firms hardest; it stifles growth, disrupts cashflow and ultimately hits profits. I believe that small firms should be given every opportunity to benefit from the increased competitiveness that a healthy cashflow can bring. Surveys repeatedly show that small firms overwhelmingly support the introduction of a statutory right to interest on late paid commercial debt."

The Government originally set out its proposals in its Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, published on 28 July 1997.

The purpose of the Bill is to introduce a statutory right for businesses to claim interest on the late payment of commercial debt. To assist small businesses, the right to claim will be phased in three stages as follows:

- In the first stage, the right to claim interest will only be exercisable by small businesses against all large enterprises (including public sector organisations).
- In the second stage, the right will be extended, after a period of two years, for use by small businesses against all enterprises and the public sector.
- Finally, the right will be extended after a further period of two years, for use by all enterprises against all enterprises (including the public sector).

A small business is any business with 50 or fewer employees (or the part-time equivalent).

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<sup>1</sup> HL Bill 52

<sup>2</sup> DTI press notice, *Barbara Roche Announces Legislation on Late Payment: Late Payment of Commercial Debts (Interest) Bill Published*, 11 December 1997

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The Government does not support the imposition of a penal rate of statutory interest. Instead, it seeks to fairly recompense creditors for the cost of the delay and has proposed interest at base rate plus 8% per annum. In explaining how this statutory interest rate was decided upon, Barbara Roche, Minister for Small Firms said:<sup>3</sup>

"I am also keen to prevent the smallest of businesses suffering because they have to borrow overdraft finance to cover their late paid bills at a higher rate of interest than the base rate plus four percent initially proposed in the Green Paper. In the consultation a persuasive argument was made that the interest rate should reflect the rate at which small firms are charged for agreed overdrafts. The Government will follow the Bank of England's suggestion of eight percent".

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<sup>3</sup> Ibid

## II Background

The background to the issue of late payment of commercial debt and the measures introduced to combat the problem from 1993 to the 1997 General Election are discussed in detail in a Research Paper published in February last year.<sup>4</sup> The previous Paper sets out the divisions within the business community over the need (or otherwise) for a statutory right to interest. It also provides a statistical comparison between the payment performance of businesses in the UK with that of other members of the European Community.

The purpose of this section is simply to provide a summary of the background to the problem of late payment and provide an update on developments.

### A. Extent of the problem in the UK

It is difficult to quantify the effect of the late payment problem in the UK. The Cork Gully Report of 1991 for the Confederation of British Industry [CBI] found that almost 60% of businesses regarded late payment as a significant problem.<sup>5</sup> In 1995, the Forum of Private Business (an organisation that represents the interests of small businesses) estimated that 43.6% of small businesses surveyed were still concerned with late payment.<sup>6</sup> An Office World survey in 1996 found that 57% of small businesses said that late payment was a problem for them.<sup>7</sup>

A survey for Intrum Justitia found that a majority of UK companies surveyed said that late payment caused a serious problem for their cash flow, profit and survival.<sup>8</sup> The same survey found that in the UK commercial debts were paid on average 18 days late (i.e. 18 days after the contractual payment date). A more recent survey by Dun & Bradstreet in October 1997, showed that 67% of small businesses pay late by 1 to 29 days; for large businesses the figure was 86%.<sup>9</sup>

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<sup>4</sup> *Late Payment of Commercial Debt*, Research Paper 97/25, 12 February 1997

<sup>5</sup> *Late Payment of Trade Debts; a survey of small and medium-sized businesses*, Cork Gully Report, 1991

<sup>6</sup> *The 40<sup>th</sup> Quarterly Survey of Small Firms*, a survey by the Forum of Private Business, Quarter 4 1995, published January 1996

<sup>7</sup> DTI Regulatory Appraisal, *A Statutory Right to Claim Interest on the Late Payment of Commercial Debt*, URN 97/980

<sup>8</sup> *European Payment Habits*, survey by NOP Corporate and Financial, 1996

<sup>9</sup> DTI Regulatory Appraisal, *A Statutory Right to Claim Interest on the Late Payment of Commercial Debt*, URN 97/980

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It is accepted that late payment of commercial debt is a serious and continuing problem for businesses in the UK. According to the DTI, debtors may be late meeting credit payments for a number of reasons. These include:<sup>10</sup>

- deliberate unjustified delay for financial advantage;
- disputes over the provision of goods and services;
- temporary cash flow difficulties;
- administrative errors by either debtor or creditor;
- misunderstanding or uncertainty over the agreed credit period;
- 'pay when paid' contract terms;
- breakdown in payment systems;
- an inability to pay due to insolvency.

Delays in payment are generally more harmful to small businesses than to large businesses. This is because small businesses often rely on short-term loans and overdrafts for working capital. Consequently, cash flow problems caused by late payment can have a detrimental impact on the ability of many small businesses to trade. For this reason, the payment culture of commercial enterprises in the UK is a subject that has provoked a good deal of comment and parliamentary interest in recent years. In particular, the debate has focused on the complex arguments for and against introducing into UK law a statutory right to interest on overdue commercial bills. It is not surprising, therefore, that late payment has been the subject of a series of reviews and consultation exercises under both the previous Conservative Government and the new Labour Government.

### **B. The Conservative Government's approach**

On 30 November 1993, the DTI published a consultation paper on late payment of commercial debt.<sup>11</sup> The consultation paper examined the causes of late payment and sought views on possible solutions including legislating for a statutory right to interest. The results of this consultation exercise were incorporated into a Government White Paper, entitled "*Competitiveness: Helping Business to Win*".<sup>12</sup> The consultation had revealed a 'narrow

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<sup>10</sup> Ibid

<sup>11</sup> DTI press notice, *Government Announces Consultation on Late Payment of Commercial Debt*, 30 November 1993

<sup>12</sup> *Competitiveness: Helping Business to Win*, Cm 2563, May 1994

margin' in favour of a statutory right to interest on late payment, but the Government decided not to legislate. Instead, it announced a number of measures to help tackle late payment and agreed to keep the situation under review for the next two years if there was no significant improvement.

In the 1995 Competitiveness White Paper, *Competitiveness Forging Ahead*,<sup>13</sup> the Government invited representatives of small businesses to contribute to a series of regional conferences to discuss the problems faced by small businesses. John Major, then Prime Minister, launched the "Your Business Matters" conferences on 26 September 1995, with the final conference taking place on 11 March 1996. Directors and proprietors were invited to discuss best practice, to identify barriers to growth and to highlight those areas where Government action could help.<sup>14</sup> A research project, which was led by the Forum of Private Business, was also carried out in conjunction with the conferences. The findings of the eleven regional conferences and the survey were presented in a report.<sup>15</sup>

According to this report, although there were strong arguments in favour of introducing a statutory right to interest, the weight of opinion was that this was not the best solution. A legally enforceable right to interest was seen as an additional burden which would be difficult to pursue in practice, damaging to established customer relations, and could legitimise late payment.

On 13 June 1996, the Conservative Government announced its decision not to legislate for a statutory right to interest on trade debt.<sup>16</sup> This decision followed a five-month review of late payment of commercial debt by Richard Page, then Minister for Small Businesses, which began in January 1996. Instead, the Government introduced a number of new measures to help tackle the problem. They included:

- Government Departments and their agencies to comply with the CBI's 'Prompt Payers Code', to publish their payment policies in their annual reports and to publicise their arrangements for handling complaints about late payment. On 13 June 1996, the Government also announced that it would be setting Government Departments prompt

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<sup>13</sup> *Competitiveness Forging Ahead*, Cm 2867, May 1995

<sup>14</sup> The conferences were organised by a steering committee representing the Institute of Directors, the Federation of Small Businesses, the Forum of Private Business, the TEC National Council, the Association of British Chambers of Commerce and the Confederation of British Industry. A series of one-day conferences were held across the country between October 1995 and February 1996. In total, 11 regional conferences were held and some 1,500 delegates, more than half of them small business people, attended the conferences.

<sup>15</sup> Institute of Directors, *Your Business Matters: Report from the Regional Conferences*, URN 96/765, June 1996; see also  
Institute of Directors, *Your Business Matters: Executive Summary - Key Problems and Possible Solutions*, 1996

<sup>16</sup> DTI press notice, *Government rejects statutory interest on late payment*, 13 June 1996

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payment targets and would publish a league table of performance figures. In fact, the first league table was published by the Treasury on 17 December 1996.

- Introduction on 1 February 1996, of the *Companies Act 1985 (Miscellaneous Accounting Amendments) Regulations 1996*. These Regulations require companies to state their payment policy in their annual reports. In addition, the *Companies Act 1985 (Directors' Report) (Statement of Payment Practice) Regulations 1997*, which came into force on 4 March 1997, require each public company (and each large private company within a group headed by a public company) to state its payment practice in its directors' report. This statement should give a figure indicating how many days, on average, it has taken the company to pay its bills. The aim is to provide suppliers with information about how they can expect to be treated by their major customers.
- A new British Standard on Payment Performance, BS 7890, was launched in September 1996. It requires companies to handle transactions fairly and promptly. Government Departments were required to sign up to the new British Standard.

### C. The Labour Government's approach

In its 1997 manifesto on small businesses, the Labour Party made a commitment to introduce a statutory right to interest on late payment of commercial debt.<sup>17</sup> In the Queen's Speech on 14 May 1997, the new Labour Government announced its intention to introduce this legislation during the 1997/98 session.

On 28 July 1997, the Department of Trade and Industry published a Green Paper, entitled "*Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*", outlining its proposals on the best way to implement such legislation. Over 5,300 copies of the consultation paper were distributed to a wide range of businesses, business representative organisations, interested parties and public sector bodies. The consultation period closed on 3 October 1997. In total, the DTI received 491 responses.

On 4 December 1997, in a written answer to a Parliamentary Question from Maria Eagle MP, the Small Firms Minister, Barbara Roche, said:<sup>18</sup>

"I am publishing today a summary of the responses<sup>19</sup> received to the Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*. The Paper shows that there is strong support for the Government's proposals on the

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<sup>17</sup> *Growing and Prospering Labour Party Manifesto on Small Businesses*, 1997, page 17

<sup>18</sup> DTI press notice, *Consultation shows strong support for Government's proposals on late payment law*, 11 December 1997

<sup>19</sup> DTI Summary of Responses to the Government's Green Paper, *Improving the Payment Culture - A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN 97/965, December 1997

best way to legislate to give small businesses the right to charge interest on late payment of commercial debt. In time, the new right will be extended to all businesses and the public sector.

It is clear that there is real support for a statutory right to claim interest. This bears out all that the Government had heard from small firms themselves. Late payment is a real problem for business. Firms are tired of having to carry the cost of their customers' late payment".

On 10 December 1997, the *Late Payment of Commercial Debts (Interest) Bill* was introduced in the House of Lords by Lord Clinton-Davis, Minister for Trade.<sup>20</sup> It completed its passage through the Lords on 26 February 1998 and was introduced in the Commons on the same day.<sup>21</sup>

The aim of the Bill is to introduce a statutory right to claim interest on late payment of commercial debt, exercisable, initially, only by small businesses against all large enterprises (including public sector organisations). The right will then be extended, after a period of two years, for use by small businesses against all enterprises. Finally, the right will be extended, again after a further period of two years, to all enterprises to use against all enterprises.

In a written answer to a PQ asked by Mr Jim Cunningham MP, requesting a list of the benefits of allowing small firms to charge interest on sums owed by late payers, Mrs Roche said:<sup>22</sup>

"The Regulatory Appraisal of the Late Payment of Commercial Debts (Interest) Bill details, among other things, the benefits of the legislation. The legislation:

- will allow a small business supplier to claim recompense for the cost of late payment;
- may reduce business risk caused by cash-flow uncertainty resulting from late payment;
- will make it uneconomic for debtors to withhold payment;
- will reduce the number of cases which need to go to court for settlement, as the right to interest will be statutory;
- will encourage creditors and debtors to agree credit periods and to resolve disputes quickly;
- will result in less valuable management time and resources being spent on chasing tardy debtors."

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<sup>20</sup> HL Bill 52

<sup>21</sup> Bill 132 1997/98

<sup>22</sup> HC Deb 4 February 1998 c. 665W

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The Government has stated that it does not view a statutory right to interest on trade debt as a panacea to the late payment problem.<sup>23</sup> This right will be one of a number of measures to help improve the payment culture of UK commerce. Other Government measures to combat late payment are set out in the Appendix.

### D. Extent of the problem in Europe

The problem of late payment of commercial debt is not confined to the UK. In Europe, late payment of commercial debt is acknowledged to be a serious problem, especially for small businesses that are least able to bear the additional cost arising from payment delays.

A statistical comparison between the payment performance of businesses in the UK with that of other members of the European Community is provided in last year's Research Paper on late payment.<sup>24</sup> As a brief illustration, a 1996 survey showed the average payment period in the UK was 50 days.<sup>25</sup> This compared to an average payment period of 73 days for Spain and 84 days for Italy. Germany's average payment period for 1996 was just 38 days. However, the Scandinavian countries were the best performers of all. The average payment periods in 1996 for Denmark, Finland and Sweden were 35 days, 24 days and 37 days respectively.<sup>26</sup>

The EU Commission is expected to bring forward a Directive to introduce a right to claim interest on late paid commercial debts. The aim of such a Directive would be to encourage a prompt payment culture across the whole of the European Community through a harmonised approach towards the problem of late payment.

The European Commission's proposal on late payment was originally intended to be presented on March 4 1998, but according to a recent report the Commission's Legal Service has asked for this to be done at a later date.<sup>27</sup> Officials now say that the matter will be added to the agenda for a Commission meeting at the end of March 1998.

Until the text of the draft Directive is published it is difficult to anticipate what measures will be proposed. It is possible, however, that the following measures may be put forward:<sup>28</sup>

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<sup>23</sup> Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN 97/781, July 1997

<sup>24</sup> *Late Payment of Commercial Debt*, Research Paper 97/25, 12 February 1997

<sup>25</sup> *Grant Thornton Good Payment Practice - A Question of Culture?*, Grant Thornton European Business Survey, 1996

<sup>26</sup> Ibid

<sup>27</sup> "Commission Defers Late Payments Proposal", *European Report* No. 2296, 4 March 1998

<sup>28</sup> Ibid

- A right to claim interest on late paid commercial debt exercisable by all businesses.
- Harmonisation of payment periods with them being set at 21 days for transactions in the private sector, as long as no date is referred to in the written contract.
- For transactions in the public sectors the payment period should not exceed 60 days and if no date were set in a written contract, the period would be shortened to 21 days.
- A penal rate of interest to be levied on late paid commercial debts. The aim is to make it more expensive to make late payments than to borrow from a bank. Interest on late payments would be calculated on repo rates (rate at which a country's Central Bank lends to commercial banks), plus a minimum 8%, so it is always higher than the rate applied by high street banks.
- No contracting-out of any legislation to enforce the Directive.

The UK Government has already stated that it supports measures to improve the payment culture and plans to work closely with the EU Commission to ensure that the Directive and UK legislation in this area are consistent.<sup>29</sup>

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<sup>29</sup> Green Paper, *Improving the Payment culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN 97/781, July 1997

### **III The Existing Law**

#### **A. England and Wales**

In England and Wales the possibility of receiving interest on trade debt only exists where provision is specifically made in the contract, or where the creditor has resorted to litigation. Where the creditor takes the matter to court, the court has the power to award interest for the period from the final date for payment until it gives judgment. The rate of interest awarded is in the court's discretion but in commercial cases, the courts are generally prepared to adopt the rate at which the creditor could have borrowed the sum due. The courts recognise that this will often be greater for smaller businesses than for large ones.

In addition, for all commercial debt cases heard in the High Court, interest is payable as of right from the time the judgment order is made by the court in favour of the creditor. In the County Court, interest is payable as of right on all judgment debts for £5,000 or more. The rate of interest on judgment debts is currently 8% per annum.

Where late payments are never taken to court, or where payment is made before judgment is given, the creditor is obliged to accept payment in full and final settlement without interest.

#### **B. Northern Ireland**

In Northern Ireland, the legal position concerning claims to interest on trade debts is essentially the same as that which exists in England and Wales.

#### **C. Scotland**

In Scotland, the general rule, in the absence of express or implied agreement between the parties on the subject, is that interest does not run on a commercial debt merely because an account has been rendered. Interest will only begin to run where:

- the creditor intimates to the debtor that after a certain date interest will be charged; or
- a court action for payment is raised.

Where a creditor resorts to litigation, the civil courts in granting a decree may impose interest at the statutory rate from the date of service of the writ. However, the court is not restricted to the statutory rate and may fix a higher or lower rate appropriate in the circumstances. If the creditor has a right to claim interest on another basis it is for the creditor to decide whether to claim on that basis. The rate of interest on judgment debts is currently 8% per annum.

## IV The Bill

The *Late Payment of Commercial Debts (Interest) Bill* would provide businesses whose commercial creditors make late payment with the statutory right to charge interest, without going to court. Where a business goes to court to pursue non-payment of a commercial debt, the court would award interest as of right, as if it was enforcing an express contractual term which provided for interest. The courts would continue to exercise discretion to award interest, as at present, for late payment of debts other than commercial debts due to businesses.

Where a business does not claim the late payment in court, the commercial debtor's failure to include the statutory interest as part of the payment eventually tendered will mean that the tendered payment need only be accepted on account. A right of action in the courts would be available for the non-payment of the interest element alone, subject to the time limits imposed by the *Limitation Act 1980* or the *Prescription and Limitation (Scotland) Act 1973*. A limitation period of six years in contract from the date of breach is imposed under the *Limitation Act 1980* while the *Prescription and Limitation (Scotland) Act 1973* imposes a limitation period of five years in contract from the date of breach.

It should be pointed out, however, that as the Bill stands it is not mandatory for qualifying businesses to exercise their right to statutory interest. In other words, businesses do not have to demand interest on any late payment.

The main provisions of the Bill are summarised below. This exposition draws heavily on the Government's Consultation Paper.<sup>30</sup>

### A. Part I: Statutory interest on qualifying debts

Part I of the Bill provides for a statutory right to interest that will not depend on the existence of a contract term or the issue of a writ. It defines to which contracts and debts the right to claim interest will apply and from when interest will accrue. It also endows the Secretary of State with a power to set the rate of statutory interest by order.

Clause 1 deals with statutory interest. Subsections (1)-(3) state:

1.-(1) It is an implied term in a contract to which this Act applies that any qualifying debt created by the contract carries simple interest subject to and in accordance with this Part.

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<sup>30</sup> Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN 97/781, July 1997

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(2) Interest carried under that implied term (in this Act referred to as "statutory interest") shall be treated, for the purposes of any rule of law or enactment (other than this Act) relating to interest on debts, in the same way as interest carried under an express contract term.

(3) This Part has effect subject to Part II (which in certain circumstances permits contract terms to oust or vary the right to statutory interest that would be conferred by virtue of the term implied by subsection (1)).

Essentially, contracts are comprised of express and implied terms. In effect, this clause inserts an implied term in to all contracts covered by the Act to the effect that qualifying debts will attract a statutory rate of interest. Part I of the Bill is subject to Part II which deals with the contracting parties' limited freedom to make their own arrangements about the consequences of late payment.

Clause 2 identifies the commercial contracts to which the Bill applies. Subsections (1)-(3) state:

2.-(1) This Act applies to a contract for the supply of goods or services where the purchaser and the supplier are each acting in the course of a business, other than an excepted contract.

(2) In subsection (1) "contract for the supply of goods or services" means a contract of sale of goods, a contract for the transfer of goods, a contract for the hire of goods or a contract for the supply of a service.

(3) The following are excepted contracts-

- a) a contract where the consideration for the sale, transfer, hire or service is not, or does not include, a money consideration;
- b) a consumer credit agreement;
- c) a contract intended to operate by way of mortgage, pledge, charge or other security.

In other words, the Bill is only concerned with commercial debt. Commercial debt means any debt incurred by a business (for example, a company, body corporate, partnership, trust, sole trader or public organisation), in return for the provision of goods and/or services where both the creditor and the debtor are acting in the course of their business. The definition extends to public sector commercial debt, but not payments in pursuit of statutory functions (e.g. grants or benefits payments) made in the course of Government.

Clause 2 specifically identifies the commercial contracts to which the Bill applies: contracts for the sale or transfer of goods, contracts for the hire of goods and contracts for services.

Under Clause 2(3) certain contracts are specifically excluded from the Bill, while Clause 2(4) contains a power for the Secretary of State to make further exclusions should the need arise.

Clause 3 provides that statutory interest applies only to 'qualifying debts'. Subsection 1 states:

3. -(1) A debt created by virtue of an obligation under a contract to which this Act applies to pay the whole or any part of the contract price is a "qualifying debt" for the purposes of this Act, unless (when created) the whole of the debt is prevented from carrying statutory interest by this section.

This means that the Bill applies only to 'qualifying debt', that is, a debt under a contract for the supply of goods or services where the purchaser and the supplier are each acting in the course of a business. It applies to any commercial transaction entered into by a registered company, body corporate, partnership, trust, sole trader or public organisation.

Significantly, the Bill does not set a minimum monetary level of debt below which a claim for interest cannot be made. All commercial debts should, subject to the phasing in of the legislation and irrespective of monetary value, be covered by the legislation. In its Green Paper, the Government stated its view that to set a lower limit might disadvantage the smallest companies and, therefore, be contrary to the purpose of the proposed legislation. A lower limit might also encourage debtors to fragment their orders and creditors to aggregate unjustly their invoices. Ninety-two per cent of business respondents and eighty-eight per cent of all respondents to the Government's Green Paper, considered it was appropriate for the creditor to decide whether the interest due on any late paid debt was of sufficient value to be worth pursuing.

Subsection (2) and (3) of Clause 3 prevent certain debts from carrying statutory interest. Specifically, a debt does not carry statutory interest if or to the extent that it consists of a sum to which a right to interest or to charge interest applies by virtue of any other enactment. A debt does not carry (and shall be treated as never having carried) statutory interest if or to the extent that a right to demand interest on it, which exists by virtue of any rule of law, is exercised. Finally, subsection 4 contains a power for the Secretary of state to make further exceptions.

Clause 4 deals with the period for which statutory interest runs. Subsections (2)-(5) state:

4. (2) Statutory interest starts to run on the day after the relevant day for the debt, at the rate prevailing under Section 6 at the end of the relevant day.

(3) Where the supplier and the purchaser agree a date for payment of the debt (that is, the day on which the debt is to be created by the contract), that is the relevant day unless the debt relates to an obligation to make an advance payment.

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A date so agreed may be a fixed one or may depend on the happening of an event or the failure of an event to happen.

(4) Where the debt relates to an obligation to make an advance payment, the relevant day is the day on which the debt is treated by Section 11 as having been created.

(5) In any other case, the relevant day is the last day of the period of 30 days beginning with-

(a) the day on which the obligation of the supplier to which the debt relates is performed; or

(b) the day on which the purchaser has notice of the amount of the debt,

whichever is the later.

In effect, the Bill defines a payment as late when it is received after the contractually agreed credit period. The Bill gives precedence to contractually agreed terms giving a right to interest if bills are paid late. The statutory rate of interest will apply from the payment date specified in the contract or, in the absence of a specified date, 30 days from the date of the invoice or delivery of the goods or the performance of the service, whichever is the later. In the case of a sum required to be paid in advance of the performance of the supplier's obligation, interest will not start to run until it is performed. If the purchaser does not have notice of the amount of the debt when the supplier's obligation is performed, the 30-day period starts when the purchaser has notice of that amount.

95% of business respondents to the Green Paper and 88% of all respondents agreed with the proposed date from which the credit period should run.

Clause 5 provides for statutory interest to be remitted, in whole or in part, in cases where the conduct of the supplier makes it unjust for the purchaser to pay the full amount of statutory interest.

Finally, Clause 6 requires the Secretary of State to set the rate of statutory interest by order. An order will either prescribe a formula or specify a figure. Clause 6 states:

6. -(1) The Secretary of State shall by order made with the consent of the Treasury set the rate of statutory interest by prescribing-

(a) a formula for calculating the rate of statutory interest; or

(b) the rate of statutory interest.

(2) Before making such an order the Secretary of State shall, among other things, consider the extent to which it may be desirable to set the rate so as to-

(a) protect suppliers whose financial position makes them particularly vulnerable if their qualifying debts are paid late; and

(b) deter generally the late payment of qualifying debts.

The rate of interest will not be stated on the face of the Bill, being instead set through a statutory instrument. Subsection (2) ensures that the Secretary of State considers the extent to which it is desirable to set the rate so as to compensate more financially vulnerable businesses that are paid late and also to deter late payment generally.

In its Green Paper, the Government stated that it does not support the imposition of a penal rate of interest because penalties should be consistent with the perceived offence.<sup>31</sup> It argued that any penal rate of interest would be out of proportion to the offending cause of late payment. It might also increase the likelihood of expensive court action as debtors challenge the right to interest by, for example, citing inferior goods, in an attempt to avoid paying penal rates of interest. Instead, the Government recommended a commercial rate of interest linked to the average cost of borrowing for small businesses and proposed that the statutory rate be set at 4% per annum above the prevailing base rate. However, following responses to the Green Paper, the Government increased the proposed interest rate to 8% above the prevailing base rate per annum. In explaining how this interest rate was arrived at, Barbara Roche, Minister for Small Firms, said:<sup>32</sup>

"I am also keen to prevent the smallest of businesses suffering because they have to borrow overdraft finance to cover their late paid bills at a higher rate of interest than the base rate plus four percent initially proposed in the Green Paper. In the consultation a persuasive argument was made that the interest rate should reflect the rate at which small firms are charged for agreed overdrafts. The Government will follow the Bank of England's suggestion of eight percent".

## **B. Part II: Contract terms relating to late payment of qualifying debts**

In its Green Paper, the Government stated that its overriding intention is to encourage businesses to agree their own contractual terms giving a right to interest if bills are paid late. Part II of the Bill therefore gives precedence to contractually agreed credit provisions. However, Part II also contains clauses to restrict the freedom of the contracting parties to make any provision that has the effect of ousting or varying the right to statutory interest. Specifically, Clause 8 states:

8. -(1) Any contract terms are void to the extent that they purport to exclude the right to statutory interest in relation to the debt, unless there is a substantial contractual remedy for late payment of the debt.

(2) Where the parties agree a contractual remedy for late payment of the debt that is a substantial remedy, statutory interest is not carried by the debt (unless they agree otherwise).

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<sup>31</sup> Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN 97/781, July 1997

<sup>32</sup> DTI press notice, *Barbara Roche Announces Legislation On Late Payment: Late Payment of Commercial Debts (Interest) Bill published*, 11 December 1997

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(3) The parties may not agree to vary the right to statutory interest in relation to the debt unless either the right to statutory interest as varied or the overall remedy for late payment of the debt is a substantial remedy.

(4) Any contract terms are void to the extent that they purport to-

(a) confer a contractual right to interest that is not a substantial remedy for late payment of the debt, or

(b) vary the right to statutory interest so as to provide for a right to statutory interest that is not a substantial remedy for late payment of the debt,

unless the overall remedy for late payment of the debt is a substantial remedy.

(5) Subject to this section, the parties are free to agree contract terms which deal with the consequences of late payment of the debt.

In effect, Clause 8 outlines detailed rules about the extent to which parties may make their own contractual provision about the consequences of late payment. The aim of Clause 8(1) is to prevent parties to a trade agreement "contracting out" of the legislation. The objective of this provision is to preclude a dominant customer circumventing the legislation by setting excessively low rates of interest on late payments or by extending credit terms excessively with the result that there is no substantial remedy for late payment for the small business. It will still remain for any for any business to decide whether it wishes to exercise the right to statutory interest or not, but this decision will be voluntary not coerced.

Under Clauses 8(2) and 8(3), a statutory right to claim interest under Clause 8(3) may be excluded by a contract but only where the parties have agreed a substantial contractual remedy for the late payment of a qualifying debt.

Parties may also vary the right to statutory interest provided, again, that the overall remedy for late payment remains a substantial remedy. Clause 8(4) renders void contract terms which purport to confer a contractual right to interest, or to vary the right to statutory interest, where the overall remedy for late payment is not a substantial remedy.

Clause 9 sets out the test for deciding whether a remedy is substantial:

9. -(1) A remedy for the late payment of the debt shall be regarded as a substantial remedy unless-

(a) the remedy is insufficient either for the purpose of compensating the supplier for late payment or for deterring late payment; and

(b) it would not be fair or reasonable to allow the remedy to be relied on to oust or (as the case may be) to vary the right to statutory interest that would otherwise apply in relation to the debt.

In determining whether a remedy is not a substantial remedy, Clause (9)(2) states that regard shall be had to all the relevant circumstances at the time the terms in question are agreed. Clause 9(3) lists some of the circumstances which should be considered:

9. -(3) In determining whether subsection (1)(b) applies, regard shall be had (without prejudice to the generality of subsection (2)) to the following matters-

- (a) the benefits of commercial certainty;
- (b) the strength of the bargaining positions of the parties relative to each other;
- (c) whether the term was imposed by one party to the detriment of the other (whether by the use of standard terms or otherwise); and
- (d) whether the supplier received an inducement to agree to the term.

Clause 10 simply defines certain terms used in Part II.

### **C. Part III: General and supplementary**

Part III deals with: the treatment of advance payments of the contract price; the jurisdictional scope of the Bill; assignment and separation of the right to interest; and the definition of terms in the Bill.

Clause 11 deals with payments of all or part of the contract price, which are due before the supplier has fully performed his obligations under the contract. It ensures that statutory interest does not run immediately in relation to a sum due before the relevant obligation of the supplier has been performed. Clause 11 states:

11.-(1) This section applies to a qualifying debt created by virtue of an obligation to make an advance payment, that is, a payment falling due before the obligation of the supplier to which the whole contract price relates ("the supplier's obligation") is performed.

(2) A debt relating to an advance payment falling within subsection (3), (4) or (5) shall be treated for the purposes of this Act as if it was not created until the day mentioned in that subsection.

(3) Where the advance payment is the whole contract price, the debt shall be treated as created on the day on which the supplier's obligation is performed.

(4) Where the advance payment is a part of the contract price, but the sum is not due in respect of any part performance of the supplier's obligation, the debt shall be treated as created on the day on which the supplier's obligation is performed.

(5) Where the advance payment is a part of the contract price due in respect of any part performance of the supplier's obligation, but the obligation to pay it arises before that part performance is completed, the debt shall be treated as created on the day on which the relevant part performance is completed.

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(6) Where the debt is created by virtue of an obligation to pay a sum under a contract for the hire of goods which is due in respect of a period of hire, this section has effect as if-

- (a) references to the day on which the supplier's obligation is performed were references to the last day of that period; and
- (b) references to part performance of that obligation were references to part of that period.

(7) For the purposes of this section an obligation to pay the whole outstanding balance of the contract price shall be regarded as an obligation to pay the whole contract price and not as an obligation to pay a part of the contract price.

Subsections 11(3) to 11(5) treat advance payments as not being due until the relevant obligation of the supplier is performed.

Clause 12 deals with the application of the Bill to contracts with a foreign element. Where the law governing a contract is the law of England and Wales, Scotland or Northern Ireland by the choice of the contracting parties, the Bill will apply unless there is no significant connection between the contract and that part of the United Kingdom. Conversely, the Bill will apply to contracts governed by a foreign law if, but for the choice of the parties, the law applicable to the contract would be that of part of the United Kingdom and there is no significant connection between the contract and any country other than that part of the United Kingdom.

The Bill permits the separation of interest and the assignment of the interest on the debt. Clause 13 states:

13.-(1) The operation of this Act in relation to a qualifying debt is not affected by-

- (a) any change in the identity of the parties to the contract creating the debt; or
- (b) the passing of the right to be paid the debt, or the duty to pay it (in whole or in part) to a person other than the person who is the original creditor or the original debtor when the debt is created.

(2) Any reference in this Act to the supplier or the purchaser is a reference to the person who is for the time being the supplier or the purchaser or, in relation to a time after the debt in question has been created, the person who is for the time being the creditor or the debtor, as the case may be.

(3) Where the right to be paid part of a debt passes to a person other than the person who is the original creditor when the debt is created, any reference in this Act to a debt shall be construed as (or, if the context so requires, as including) a reference to part of a debt.

(4) a reference in this section to the identity of the parties to a contract changing, or to a right or duty passing, is a reference to it changing or passing by assignment or assignation, by operation of law or otherwise.

In effect, this Clause provides for the continued operation of the Bill where there is a change in the identity of the parties to a contract or where the identity of the creditor or debtor changes. The situation envisaged is where there has been assignment of the debt and interest. The Bill therefore allows the statutory right of interest to extend to debts assigned to a third party, such as a factoring agent or a debt collector. Factoring is the selling of debts owed to the business in return for a proportion of their face value. The factor will normally also charge a fee to reflect the cost of collecting the debts. It is a form of credit management open to all businesses but is particularly useful for small businesses.

In its Green Paper, the Government stated its belief that this provision will help encourage the change in payment culture sought by the Bill in that a factoring agent or debt collector will be able to aggregate small debts making the pursuance of statutory interest owed more economical.<sup>33</sup>

Clause 14 ensures that contract terms which seek to delay the creation of a qualifying debt are subject to the controls in Sections 3(2)(b) and 17(1)(b) of the *Unfair Contract Terms Act 1977*, whether or not they are included in standard terms of business.

Clause 15 simply makes provision as to the making of subordinate legislation under the Bill and provides for the negative resolution procedure to apply (except for commencement orders).

Clause 16 defines certain terms used in the Bill.

Clause 17 includes a commencement power to permit the phased implementation of the statutory right to claim interest. Clause 17(2) states:

17.-(2) This Act (apart from this section) shall come into force on such day as the Secretary of State may by order appoint; and different days may be appointed for different descriptions of contract or for other different purposes.

An order under this subsection may specify a description of contract by reference to any feature of the contract (including the parties).

In its Green Paper, the Government set out its proposal that small firms should initially be granted the right to claim interest against large firms.<sup>34</sup> This right should then be extended to

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<sup>33</sup> Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN97/781, July 1997

<sup>34</sup> Ibid

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enable small firms to also claim interest against other small firms. Finally, the right to claim interest should be granted to all businesses for use against all businesses, including the public sector. The Government proposed the following time scale:

<b>Claimant</b>	<b>Timing</b>
(1) <b>Small</b> businesses against <b>large</b> businesses and the public sector	-from enactment of legislation
(2) <b>Small</b> businesses against <b>all</b> businesses and the public sector	-two years after enactment
(3) <b>All</b> businesses against <b>all</b> businesses and the public sector	- four years after enactment

In setting out this timetable in its Green Paper, the Government argued that many small businesses would take time to adjust to the legislation. The interim stage will allow them to test their credit management systems before they face claims on possibly their largest bills. As the phasing proposals are transitional stages they are not set out on the face of the Bill. They will be brought in by an Order under the Bill, when enacted.

The Government's proposal for the phased implementation of the legislation was supported by a large majority of the responses to its Green Paper.<sup>35</sup>

- 87 % of business respondents and 82% of all respondents supported the concept of phasing;
- 85% of business respondents and 79% of all respondents supported the proposed timetable for phasing.

Of the minority that did not support the phasing proposals, most comments received tended to support full application of the right to claim interest from commencement of the legislation or after shorter phases. There was concern that businesses would not take action to improve their systems until they were themselves faced with claims for interest. Some respondents also felt that it might be difficult for small businesses to know against whom they could claim and that they might, therefore, not use their new right until phasing had been completed. There was also a suggestion that the commencement of the legislation should be delayed by 6

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<sup>35</sup> DTI Summary of Responses to the Government's Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late payment of Commercial Debt*, URN 97/965, December 1997

months from enactment to give small businesses the time to 'gear up' their credit management systems before full implementation of the right to claim interest.<sup>36</sup>

It is clear that until full application of the statutory right to claim interest, both creditors and debtors will need to be aware of their respective sizes in order to judge whether a legitimate claim for interest can be made. A small business is any business with 50 or fewer employees (or the part-time equivalent). However, this definition will appear in a statutory order, not on the face of the Bill, as it is linked to the phased implementation of the legislation and is, therefore, a transitional arrangement.

Irrespective of their size, subsidiaries of large businesses will not be treated as small businesses.

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<sup>36</sup> Ibid

## **V The Debate in the Lords**

The Bill was debated at some length in the Lords where a number of Members made substantial contributions including: Lord Home, the Opposition Front Bench Spokesman on Trade, Lord Ezra the Liberal Democrat spokesman on Economic Affairs, and Lord Meston QC another Liberal Democrat peer. The Government's position was explained both by Lord Clinton-Davis, the Minister for Trade, and by Lord Haskel, a Government Whip in the House of Lords.

The stages were:

Second Reading - 12 January 1998

Committee consideration - 28 January 1998

Report Stage - 19 February 1998

Third Reading - 26 February 1998

Topics that provoked some of the liveliest discussions included:

- Phasing the introduction of a statutory right to claim interest.
- Excluded contracts
- The statutory rate of interest
- The treatment of excessive credit periods
- The application of the Bill in Scotland
- The Bill's compatibility with the European Commission's proposed directive on late payment
- Qualifying debt.

### **A. Phasing in provisions of the Bill**

The phasing in provisions of the Bill were among the most important areas of debate covered at Second Reading. In particular, Lord Meston expressed concern that phasing may be a source of considerable uncertainty and that if phasing is applied, it is vital that the subsequent phases are not conditional but are followed through automatically. He also suggested that accelerating the transitional period and reducing each phase to a year had the merit of

decreasing the period during which businesses would face additional complexity in identifying which, if any, of their trading partners are subject to the provisions.<sup>37</sup>

Lord Ezra asked during both the Second Reading and Committee stages, whether it was necessary to have two preliminary phases of two years each before the Act came into force as a whole.<sup>38</sup> He was concerned that small firms, which alone would have the right in the first phase to claim interest, would be too worried to do so. He suggested that either there should be a preliminary phase of only two years, or that during the first phase large firms should be able to make claims against other large firms. A wider use could then be made of the facility and the legislation could gain greater credibility.

Lord Home commented during Committee that the phasing in process of the Bill had led to much debate in industry.<sup>39</sup> Whilst acknowledging that there had been a certain amount of support for phasing during the consultation process, he doubted whether any of those consulted realised what an extremely complicated procedure this would turn out to be. To illustrate his point, he asked how a supplier who wants to claim interest from a purchaser employing about 50 people, can know whether that purchaser is, in fact, a big or small business. In his amendment, Lord Home suggested a phasing in period of four months as adequate time for small companies to adjust to the new legislation. In his view, "a great amount of complicated, time-consuming and possibly expensive work could be avoided by bringing this Act in its entirety into operation on the same day."<sup>40</sup>

In reply, Lord Clinton-Davis said:<sup>41</sup>

"I say again that I will certainly read very carefully what has been said, and I am always prepared to consult further with noble Lords who have raised this point, and others, but unless there is a very good reason for changing our position on this matter we would be reluctant to do so. It would be inconsistent of the Government to recognise that small businesses need credit management help if we were not to allow them sufficient time for the measures to take effect before requiring them to pay interest themselves on overdue debts.

Phasing will put businesses on notice that they should take action if their systems are inadequate. That is an important part of this debate. We simply cannot expect small businesses to develop these systems in just four months, as the noble Earl, Lord Home, has suggested. These are technical matters. There are training matters that need to be addressed, and, in addition, those with IT systems are already under pressure to ensure their systems are compatible with the year 2000. So they need time, and the Government feel that, despite the arguments we have heard so far and as I stressed, before this Committee stage, we should

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<sup>37</sup> HL Deb 12 January 1998, c. 876

<sup>38</sup> HL Deb 12 January 1998, c. 856 and HL Deb. 28 January 1998, CWH c. 31

<sup>39</sup> HL Deb 28 January 1998, CWH c. 28-29

<sup>40</sup> Ibid

<sup>41</sup> HL Deb 28 January 1998, CWH c.29-30

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give that time to them so that they can prepare themselves more effectively for the legislation coming into effect.

The noble Lords, Lord Meston and Lord Ezra, suggested that two years would be an appropriate period. We feel that it is not only a question of developing systems, but also allowing businesses sufficient time to make sure those systems are viable. That is why we have suggested two phases before commencement of the Act."

Lord Home tabled a probing amendment in Committee asking that large companies should be able to make claims on other large companies including the public sector from day one.<sup>42</sup> Lord Ezra supported the amendment when it was discussed again during the Report stage. He could see no reason why the public sector (including local authorities) should not subject itself to claims being made under the terms of the Bill.<sup>43</sup> However, after consideration Lord Clinton-Davis rejected the amendment:<sup>44</sup>

"I believe that, having regard to the consultations which we entered into on the proposals, we ought to wait and see. I remind the House that they received widespread support for phasing, with 87 per cent of business respondents to the Green Paper expressing support for phasing and 85 per cent supporting the proposed timetable. Those factors are rather compelling. Therefore, we do not intend to extend the initial commencement period of the Bill to include claims by large businesses or the public sector. But I believe that one ought to wait and see. We shall be very flexible about this, but we want to see how the Bill operates in practice."

He pointed out that local authorities are already required to pay all invoices promptly. The Audit Commission has set a performance indicator for the current year that local authorities in England and Wales must monitor and publish details of the percentage of their bills paid on time.

Lord Home remained dissatisfied.<sup>45</sup> He could not see how experience would make the situation any clearer and asked the Minister to reconsider the matter. At Report stage, however, he did not wish to divide the House on the amendment, and withdrew it.

### **B. Excluded contracts**

Debate during the Second Reading and in Committee also centred on why conditional sale and hire purchase agreements were excluded from the Bill. Lord Clinton-Davis explained that it was never the Government's intention to give a right to claim interest on authorised credit. For that reason conditional sale and hire purchase agreements were excluded because they are used to grant authorised credit and usually provide for interest payments on default of the

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<sup>42</sup> HL Deb 28 January 1998, CWH c. 29

<sup>43</sup> HL Deb 19 February 1998, c. 391

<sup>44</sup> HL Deb 19 February 1998, c. 390-391

<sup>45</sup> HL Deb 19 February 1998, c. 392-394

periodic payments being made on time. In these types of agreements the supplier is normally more powerful than the customer and can insist on interest.<sup>46</sup>

In Committee, Lord Home tabled an amendment with the aim of bringing into the scope of the Bill conditional sale and hire purchase agreements on the ground that they should be treated in the same way as leasing agreements.<sup>47</sup> Again, Lord Clinton-Davis stated the Government's position that conditional sale and hire purchase agreements were excluded because they are used to grant authorised credit:<sup>48</sup>

"They usually provide for interest payments if the periodic payments are not made in a timely way. They do not fall within the mischief which the Bill seeks to address; that is, the use of one's suppliers as a source of unauthorised trade credit by the debtor".

In contrast, leases fall within the legislation because they do not necessarily contain provision for late payment. The lease term ends and money may still be owed.<sup>49</sup>

Significantly, during Report, Lord Clinton-Davis announced that the Government was persuaded that some conditional sale and hire purchase agreements might not include provision for a remedy in the event of late payment of an instalment and repossession of the goods might not be a practical remedy in many instances. The Government has therefore accepted that such agreements should be subject to the legislation. However, where the agreement includes a remedy for late payment Part II will apply, thereby ensuring that statutory interest cannot be claimed on top of that contractual remedy.<sup>50</sup>

In Committee, Lord Barrie and Lord Home also referred to the question of conditional sale agreements which consisted of Romalpa clauses (otherwise known as retention of title clauses).<sup>51</sup> It was argued that these agreements should not be excluded from the Bill.<sup>52</sup> In Report, Lord Clinton-Davis stated that the Government had looked again at the definition of conditional sale agreements in the Bill which came from the *Consumer Credit Act 1974*. According to this definition ROMALPA agreements were never excluded from the Bill but, nevertheless, he moved an amendment to clarify the position beyond doubt.<sup>53</sup>

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<sup>46</sup> HL Deb 12 January 1998, c. 861 and HL Deb 28 January 1998 CWH c. 5

<sup>47</sup> HL Deb 28 January 1998, CWH c. 5

<sup>48</sup> HL Deb 28 January 1998, CWH c. 6-7

<sup>49</sup> Ibid

<sup>50</sup> HL Deb 19 February 1998, c. 385

<sup>51</sup> Retention of title clauses have become known as Romalpa clauses after the case which established their validity: *Aluminium Industrie Vaassen B.V. -V- Romalpa Aluminium Ltd 1976* [1 WLR 676]

<sup>52</sup> HL Deb 28 January 1998 CWH c. 5

<sup>53</sup> HL Deb. 19 February 1998 c. 384-5 and Clause 2 of the Bill

### C. Statutory rate of interest

#### 1. Separate right of action

During the debate in Committee, Lord Home moved an amendment to clarify that the Bill provides a separate right of action in respect of interest at the statutory rate.<sup>54</sup> He also moved other amendments to ensure that statutory interest is assignable, notwithstanding that the original qualifying debt no longer exists by virtue of having been paid.

Lord Clinton-Davis agreed that the Bill should provide a separate right of action in respect of statutory interest but thought it unnecessary to state this explicitly in the Bill. He explained that the Bill creates a right to interest. Once that right has been created, then a supplier will be able to pursue an action in pursuit of that right. Such an action may be pursued regardless of whether the principal debt, from which the right arose, remains outstanding:<sup>55</sup>

"If the debtor tenders the principal alone, the creditor can accept it on account and then pursue the interest separately- there is no doubt about that. This right is an important addition to the current law."

He also assured the Lords that the Bill had been framed in such a way as to allow the separated claim for interest to be assigned to a third party, for example, to a factor who can then claim the interest alone.

#### 2. Power of the Secretary of State

A number of important technical amendments were also made to the Bill in respect of the statutory rate of interest.

During the Committee stage, concern was expressed that the Bill gave the Secretary of State the choice of whether to set a statutory rate of interest. In answering this point, Lord Haskel drew the Lords attention to a draft order, made under the Bill, setting the rate of statutory interest.<sup>56</sup> A copy of the draft order is deposited in the Library of the House of Lords.<sup>57</sup> He explained that the legislation would simply not work if no rate of interest or its formulation were announced:<sup>58</sup>

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<sup>54</sup> HL Deb 28 January 1998, CWH c. 1-2

<sup>55</sup> HL Deb. 28 January 1998 CWH c. 2-4

<sup>56</sup> HL Deb 28 January 1998 CWH c. 16

<sup>57</sup> *The Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No.1) Order 1998*, Dep. Paper HINF 98/163

<sup>58</sup> Ibid

"As the Government are bringing forward the Bill, clearly it would be our intention to announce an interest rate. That is why we have published a draft order which sets a rate of the Bank of England's official dealing rate plus 8 per cent."

In Committee, Members were also concerned that the Bill empowered the Secretary of State to set the rate of statutory interest without reference to any other authority. Lord Home expressed the view that industry should know on what basis the rate of statutory interest is calculated. In particular, overseas purchasers would find it hard to accept a rate of interest that is not fixed in accordance with an explicable formula.<sup>59</sup>

Lord Haskel assured the Lords that in setting a rate of interest the Government would wish to consult parties both within and outside government:<sup>60</sup>

"This is how we arrived at the rate that has been set in the draft order, and I can assure the Committee that if any change is made it will not be made by the Secretary of State acting on a whim."

Lord Clinton-Davis also explained:<sup>61</sup>

"I think the noble Earl [Lord Home] conceded that it will not always be possible to state on the face of the Bill the rate of statutory interest. It is our desire to link the rate to the official dealing rate of the Bank of England as announced by the Monetary Policy Committee. But, as the noble Earl rightly said, it may not be incumbent on the Bank to announce the rate in the future if the committee decides to use a macroeconomic tool other than interest rates to give effect to monetary policy.

For that reason the Bill provides a power exercisable by the Secretary of State to prescribe the rate of statutory interest instead of a particular formula."

Significantly, during the Report stage, two amendments were agreed which have the effect of ensuring that the Secretary of State shall by Order, made with the consent of the Treasury, set the rate of statutory interest by prescribing:

- a formula for calculating the rate of statutory interest or
- the rate of statutory interest.

In other words, as a consequence of the amendments the Secretary of State is obliged to set a rate of statutory interest and the Treasury must approve this rate. This requirement is now contained in Clause 6(1).

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<sup>59</sup> HL Deb 28 January 1998, CWH c. 16

<sup>60</sup> HL Deb 28 January 1998, CHW c. 17

<sup>61</sup> HL Deb 28 January 1998, CWH c. 18

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During Report, an additional amendment was also agreed, which has the effect of ensuring that before prescribing the rate of statutory interest, the Secretary of State is obliged to consider the extent to which it may be desirable to set the rate so as to:

- protect suppliers whose financial position makes them particularly vulnerable if their qualifying debts are paid late; and
- deter generally the late payment of qualifying debts.

However, the amendment makes it clear that the Secretary of State is free to also consider other factors while deliberating upon changes to the interest rates.<sup>62</sup> This provision is now contained in Clause 6(2).

### 3. Tax treatment of the earned interest

During Committee, Lord Clinton-Davis also answered very specific questions on the Bill's tax treatment of statutory interest. He explained that the full price of the good or service including VAT would bear interest. The interest will be paid wholly to the creditor, who will have paid the VAT up front to the Customs and Excise. Interest should be treated for tax purposes in the same way as interest charged under a contractual provision for interest; in effect, it would be a non-tax item and its treatment would be tax neutral. On the question of legal costs, Lord Clinton-Davis explained that the successful party in any action to secure payment of a debt (plus interest at the statutory rate) would be entitled to the costs.<sup>63</sup>

### D. Excessive Credit Periods

During the Committee stage there was extensive discussion on the effect of the Bill on excessive credit periods. Lord Home stated that the Bill specifies that, when no credit period is agreed, the relevant day is in effect 30 days from the date of the invoice. While this period is appropriate for most sectors, in some industries, especially in the manufacturing industry, accepted practice is 30 days from the month end following the date of invoice. He argued that it was desirable not to cause a great upheaval and change existing accepted and well tried methods of trade and moved an amendment to this effect.<sup>64</sup>

Lord Clinton-Davis confirmed that the Government was aware that the CBI has expressed concern about this. Its desire is to ensure that trade custom and practice are recognised in the Bill and that where they exist there is no requirement for an express contract term for

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<sup>62</sup> HL Deb 19 February 1997 c. 387

<sup>63</sup> HL Deb 28 January 1998, CWH c. 24

<sup>64</sup> HL Deb 28 January 1998, CWH c. 9

deferment of the day that the debt is created. However, the Government believes that the Bill deals with this matter.<sup>65</sup>

The Bill as originally drafted dealt with excessive credit periods in the following way. The *Unfair Contract Terms Act 1977* prevents parties agreeing contractual terms which unreasonably postpone the obligation to pay the contract price. The Bill provides that variations of the right to interest are valid only if the right, as varied, or the overall remedy for late payment is substantial. However, in Committee, concern was expressed that legislation on this point should be made as clear as possible and Lord Clinton-Davis gave a commitment to review the question of excessive credit periods in commercial contracts and how the Bill deals with them.

At Report stage, Lord Clinton-Davis moved a group of amendments which sought to clarify the position. In particular, a new clause extends the operation of the *Unfair Contract Terms Act 1977* for the purposes of this legislation to contract terms that are not contained in the standard written terms of the purchase.<sup>66</sup> This is now Clause 14(2) of the Bill.

## **E. The application of the Bill in Scotland**

During the debate in Committee, Lord Fraser of Carmyllie, Opposition Spokesman on Trade and Industry, posed a number of important questions regarding this Bill and its application in Scotland on enactment, and in the future, when the *Scotland Bill* is enacted.<sup>67</sup> In particular, he asked whether the late payment legislation would be devolved to the Scottish Parliament on enactment of the *Scotland Bill*. If this legislation were to be devolved, he asked why the Government was legislating for Scotland now.

Lord Clinton-Davis wrote to Lord Fraser of Carmyllie to answer each question in turn; a copy of the letter has been placed in the Library of the House of Commons.<sup>68</sup> First, Lord Clinton-Davis confirmed that the powers conferred on the Secretary of State in relation to Scotland by the late payment legislation would pass to Scottish Ministers when the *Scotland Bill* is enacted. This will include powers for the Scottish Executive to set rates of interest as part of the law of Scotland independently of the UK administration. He explained that it is appropriate for this matter to be devolved alongside all other aspects of contract law.

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<sup>65</sup> Ibid

<sup>66</sup> HL Deb 19 February 1998 c. 385

<sup>67</sup> HL Deb 28 January 1998, CWH c. 12-15

<sup>68</sup> Letter by Lord Clinton-Davis, Minister for Trade, to Lord Fraser of Carmyllie QC, *Re: Late Payment of Commercial Debts (Interest) Bill*, 9 February 1998, Deposited Paper 3/6219

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Secondly, Lord Clinton-Davis stated that the Government was persuaded by the arguments for bringing forward late payment legislation, which covers Scotland as well as the rest of the UK, now rather than later. In explaining the Government's position, he said:<sup>69</sup>

"Late payment has been a serious problem for business for many years and we have made a commitment to legislate to provide a right to claim interest on late paid debts. The Scottish Parliament will not be in full operation until the millennium. Subject to the views of Parliament, late payment legislation will be enacted and commenced in the latter half of 1998. If the Government declined to include Scotland in this Bill, the rights accorded to the rest of UK business would be denied to the Scots for at least a year, possibly two. This would be an entirely untenable position for the Government to take."

Lord Clinton-Davis also underlined the point made by Lord Haskel when speaking on Lord Fraser of Carmyllie's amendment in Committee.<sup>70</sup> Lord Haskel argued that if this Bill were not to cover Scotland the effect would be that no statutory rate of interest would be operable in Scotland. As a consequence of there being no power to prescribe a rate of interest for Scotland, there would be no power of a Minister of the Crown which could transfer to the Scottish Ministers by virtue of Clause 49 of the *Scotland Act*, when enacted. Accordingly, not even the Scottish Ministers, when there was a Scottish Parliament, would be able to prescribe a rate of statutory interest under this legislation.

Turning to Lord Fraser of Carmyllie's third question, Lord Clinton-Davis argued that the fact that the Government's late payment legislation has, for reasons of equity, included Scotland now is not an argument for retaining those powers when the Scottish Parliament comes into being:<sup>71</sup>

"We see no compelling reason why policy responsibility should be retained by Westminster for late payment legislation, particularly since, as noted above, all other aspects of contract law are to be devolved; hence, this area has not been included in Schedule 5 of the Scotland Bill (which defines reserved matters)."

### F. EC Directive

The issue of how the Bill would link up with the long-awaited European Directive on the right to claim interest on late payments of commercial debt, was referred to in a number of speeches at Second Reading.

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<sup>69</sup> Ibid

<sup>70</sup> HL Deb 28 January 1998, CWH c. 15

<sup>71</sup> Letter by Lord Clinton-Davis, Minister for Trade, to Lord Fraser of Carmyllie, Re: Late Payment of Commercial Debts (Interest) Bill, 9 February 1998, Deposited Paper 3/6219

Lord Ezra was aware that the Government wished to work closely with the Commission to ensure that the Directive and UK legislation are consistent. However, he asked how the Government would deal with any inconsistencies if the directive were still delayed after the present Bill was enacted.

Lord Borrie stated that in its Green Paper the Government had envisaged that, unlike its own proposals, the EU would propose a penal rate of interest on late payment. The Government has stated that it does not support a penal rate because it would not be proportionate to the perceived wrong and might increase the likelihood of debtors challenging in court the right to interest, for example, by alleging that the goods or services supplied were defective or deficient. Lord Borrie asked how the Government intended to ensure that their proposals in the Bill were compatible with the EU proposals.

At Committee stage, Lord Clinton-Davis assured the Lords:<sup>72</sup>

".. that officials of the DTI and my colleague, Barbara Roche, the Minister for Small Firms, have indeed had meetings with the Commission on the legislation which we are currently considering. In July, she briefed Commissioner Papoutsis, the Commissioner with this responsibility, on the proposals we were advancing. We understand very well the point that has been made by a number of your Lordships that it would be unfortunate if we were required by the directive to amend the Bill or the Act after it had gone on the statute book. The present state of play is far removed from that. We have not seen the draft directive because it is not yet before the Commission. It is, I understand, hoped by the Commission that it will have a draft before it next month for consideration. We think, from the discussions that have taken place with the Commission, the directive will set a minimum rate of interest less than that which we are proposing under the Bill.

I also understand that in setting the rate the Commission have taken a view, such as we have, of protecting the most vulnerable suppliers and deterring late payment. The fact is that the directive is unlikely to be in force at the earliest for another four years, and there is a great deal of terrain to be covered before that. And even if the draft directive is approved by the Commission, it then has to be considered by the Council of Permanent Representatives, the European Parliament and the Council of Ministers, and it is by no means certain that the directive will be supported by all the member states."

He stated the Government's view that it is better to proceed with this Bill and ensure that the UK Government plays a positive part in the Commission's thinking:<sup>73</sup>

"The important thing is whether our legislation would be in contradiction to that proposed by the Commission. I see no evidence of that situation being a possibility, and certainly not a probability."

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<sup>72</sup> HL Deb. 28 January 1998 CWH c. 22

<sup>73</sup> Ibid

### G. Qualifying debt

Finally it should be pointed out that the Government thought it necessary to lay two groups of drafting amendments at Third Reading. Lord Clinton-Davis, Minister for Trade, wrote separately to Lords Ezra and Home to outline why the amendments were necessary; copies of both letters are deposited in the Library of the House of Commons.<sup>74</sup> In brief, a query from one of the business representative organisations prompted Parliamentary Counsel to reconsider how the Bill uses terms such as "qualifying debt", "the debt" and so on. This exercise revealed that the Bill did not deal as clearly as it should with the possibility of a single contract debt owed partly for a sum which carries interest under the Bill and partly for a sum which is excepted under the Bill. The first group of amendments clarified the position and ensured that terms are used consistently throughout the Bill.<sup>75</sup> As a result any part of a debt which qualifies for statutory interest will be subject to the Bill, regardless of whether some other part of the debt is excluded from the Bill.<sup>76</sup>

The second group of amendments simply tidied up the Bill, none were substantial.

It was decided to lay these amendments at Third Reading so that the Bill was in as good a shape as possible before introducing it in the Commons.

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<sup>74</sup> Letters from Lord Clinton-Davis, Minister for Trade, to Lord Ezra and the Earl of Home, *Re: Late Payment of Commercial Debts (Interest) Bill*, both dated 25 February 1998, deposited Papers 3/6100 and 3/6101 respectively

<sup>75</sup> See Clause 3(1) of the Bill

<sup>76</sup> The substantial amendment was to Clause 3

## Appendix: Government measures to combat late payment of commercial debt

The new Labour Government has announced that it is bringing forward a package of measures to tackle the late payment problem and change the payment culture in the UK.<sup>77</sup> As outlined in its Green paper, this package of measures include:<sup>78</sup>

### Prompt payment by central and local government

Government departments must pay 100% of their undisputed invoices for commercial debts within 30 days or other agreed contract terms. All departments and agencies have now adopted the British Standard for Achieving Good Payment Performance in Commercial Transactions, BS7890.

NHS Trusts must settle all invoices for commercial debt within 30 days or other agreed credit terms.

Local Authorities are required to pay all invoices promptly. The Audit Commission has set a performance indicator for the current year that all Local Authorities must monitor and publish details of the percentage of their bills paid on time.

### Improve the payment performance of public limited companies and their private subsidiaries

The Government has stated its intention to enhance the existing requirement for public limited companies and their large private subsidiaries to disclose the average time taken to pay suppliers by producing league tables for the private sector.<sup>79</sup> The first league tables are expected in the spring of 1998. This measure will provide small suppliers with useful information on how quickly they can expect to be paid when dealing with a larger company.

### British Standard BS 7890 for achieving good payment performance in commercial transactions

The Government intends to continue to promote BS7890 and to encourage the public sector to adopt the Standard.<sup>80</sup> The aim of the Standard is to bring greater transparency to payment procedures and to encourage the adoption of best practice procedures.

### Factoring and invoice discounting

Factoring and invoice discounting provide businesses with finance secured against their unpaid invoices. The Government's aim is to encourage businesses to use factoring and invoice discounting as a means of credit management.

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<sup>77</sup> DTI press notice, *Helping Businesses Beat Late Payment: Better Payment Practice Guide published*, 10 March 1998

<sup>78</sup> Green Paper, *Improving the Payment Culture: A Statutory Right to Claim Interest on Late Payment of Commercial Debt*, URN 97/781, July 1997

<sup>79</sup> DTI Regulatory Appraisal, *A Statutory Right to Claim Interest on the Late Payment of Commercial Debt*, URN 97/980, undated

<sup>80</sup> Ibid

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### Trade credit insurance

To encourage small businesses to take out and use trade credit insurance as an important tool in credit management.

Supporting the development of an NVQ in credit management to ensure that the UK workforce has appropriate and relevant skills.

### Court procedures

In June 1997, the Lord Chancellor announced a review of the existing proposals for the reform of the civil justice system. In addition, the Lord Chancellor has announced that consultation will proceed on the proposed 'Fast Track' and 'Multi Track' court procedures.<sup>81</sup>

Encouraging trade associations, representative organisations, Business Links and other business advisers across the UK to provide businesses with credit management guidance

Ensuring that credit management information is readily available on the Enterprise Zone on the Internet.

Working with the Credit Management Research Group at the University of Bradford into identifying and disseminating best practice in credit management amongst SME's.

Setting up the "Better Payment Practice Group".

The group includes the main small firm organisations and representatives from the credit management, factoring and trade credit insurance sectors, Government and other interested bodies. Its aim is to help propose and develop measures to bring about a better payment culture.

Producing a free guide to credit management and debt recovery in conjunction with the Institute of Credit Management

This guide, entitled "*Better Payment Practice: a guide to credit management*", was published by the DTI on 10 March 1998 on behalf of the Better Payment Practice Group. It is for use by businesses and provides advice to both buyers and suppliers on credit management and the prompt settlement of debts.

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<sup>81</sup> Ibid