ADDLESHAW GODDARD

PAYMENT LEGISLATION – A NEED FOR CHANGE

Cash is king……..

"Cash is King", as the old saying goes.

In a time where contractors and subcontractors (collectively "Contractors") are seeing prices challenged to a point where margins are low to non-existent, that old saying is truer than ever.

In this climate it is ever more important to move cash quickly through the supply chain. This starts with the payment terms offered by Owners, EPCs and Main Contractors ("Clients").

It is common for Contractors to agree to wait 90 days from invoice to payment. This is after the potential 30-day period from work commencing. This means waiting up to 120 days before receiving any cash.

In the time from supply to payment, Contractors have employees to pay, equipment to pay for, loans to repay and offices to maintain. Contractors are financing (sometimes multiple) projects on behalf of Clients who are usually better suited and able to carry that financing burden.

There was a time when Contractors were paid within 30 days of invoice…….so what changed?

Impact

There are very few Contractors that can withstand constant exposure to low margins and a four-month wait for cash. That is before factoring in the concurrent financing of multiple projects.

Contractors do not survive long on those terms, which leads to:

- Less competition in the market
- A monopoly for those big enough to survive
- Stagnant innovation
- A lack of a need to differentiate
- A lack of growth across industry

This ultimately results in higher prices, with no improvement or advancement in technique or solution.

Solution

In our opinion, it is time for the UK Government to improve legislation around payment terms in the private sector / B2B across a breadth of industries.

The Scheme for Construction Contracts (England and Wales) Regulations 1998 (The "Act") and the Late Payment of Commercial Debts Regulation 2002 (as amended by the 2013 and 2018 regs) (the "Regulations") go some way in trying to introduce payment terms. However, they are limited in application.

The Act only applies to 'Construction Contracts' and does not deal with the length of time Contractors must wait for their cash, only defining events that must occur. The parties are free to agree how long before payment is due.

The Regulations (modelled on EU Directive 2011/7/EU) only really impact those dealing with the Public Authorities. The Regulations grant a very easy opt out for those not selling to a Public Authority. In those instances, a payment period of up to 60 days is prescribed unless otherwise agreed and as long as the period is not "grossly unfair" to the supplier. "Grossly unfair" is not defined in the Regulations, which makes it difficult to pursue even with the 2018 amendment (the right to challenge grossly unfair payment periods).

Often, as a result of commercial pressures, Contractors accept payment terms well in excess of 60 days. Most Contractors would rather wait longer for their cash than not win the project at all or lose out to a competitor. This is more surviving than accepting.

The pressure of "not winning the work", or "not being on the list of approved suppliers", or "others in the industry accepted it" worsened by those Clients who refuse to negotiate a reduction in extended payment terms, must stop.

If the Regulations were amended to impose a strict 30-day period for payment, thus mirroring the regulations that apply when selling to a Public Authority, then this would ensure a fairer payment regime throughout the supply chain, from lenders and investors down to subcontractors and suppliers. Certain EU members have amended 2011/7/EU to ensure the 60 day period is made more strict. An example being Spain establishing no exceptions to the 60-day term.

Penalties, fines, mandatory interest, costs of debt recovery, liens on goods and automatic rights to suspend supply could be compliance incentives.

With the above changes to legislation, negotiations around payment terms would stop and efforts could be re-focussed on procuring the right solution for the project. More Contractors would remain solvent, competition would thrive, and the Client may ultimately receive a better solution at a better price.

Who to contact

Adrian McGuire

Group Head of Legal & Company Secretary

Abnormal Load Engineering Limited (ALE)