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Insights

FAIR PAYMENT PRACTICES: RECENT DEVELOPMENTS

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SUMMARY

In this Insight, first published in PLC, Jennifer Badham discusses various attempts to address late payments and long payment terms that are a common problem in construction industry supply chains, including two recent developments, the British Property Federation Fair Payment Charter and the Department for Business and Trade Prompt Payment and Cash Flow Review Report.

Payment is one of the most important issues in a construction contract, and yet for several reasons late payment and long payment terms remain a key problem in construction and engineering projects. These payment practices have serious consequences for businesses, in particular the SMEs at the lower end of the supply chain.

Despite a number of initiatives to tackle this issue that are explored below, payment issues in the construction sector persist in posing a real risk to the viability of construction companies.

According to the Insolvency Service, the construction industry accounted for 16.8% of all insolvencies in England and Wales in November 2023, with the number of insolvencies in the sector rising by 7% in the year to November 2023 when compared to the number recorded in the year to 2022.

The insolvency of one contractor or supplier has knock on consequences for the delivery of multiple projects with the echoes felt throughout the supply chain.

This article takes a closer look at the latest developments on fair payment, the British Property Federation (BPF) Fair Payment Charter and the Department for Business and Trade Prompt Payment and Cash Flow Review Report.

BACKGROUND

As noted above, a number of attempts have been made in recent years to solve the problem of late payment. These have included:

- Statutory interventions: these include the Housing Grants Construction and Regeneration Act, Late Payment of Commercial Debts Act 1998, Small Business, Enterprise and Employment Act 2015 and most recently the Payment Practices and Performance Regulations 2017 (Payment Regulations 2017).

- Industry led voluntary codes: for example, the 2014 CLC Construction Supply Chain Payment Charter, Build UK's minimum standards to be applied when using retentions in the construction industry, as well as their roadmap to zero retentions by 2023 and "Trust and Productivity: the private sector construction playbook", published in November 2022, with its emphasis on fair payment.

- Construction standard form guidance on using retentions: most recently, the 2022 NEC and Construction Leadership Council joint guidance on how to reduce the use of retentions in NEC contracts. This guidance concluded that on well managed projects there was rarely a justification for the use of retentions.

- Government guidance and support: for example, the Construction Playbook and the 2008 Department for Business and Trade Prompt Payment Code (Code) whereby signatories undertook to pay suppliers on time, within agreed terms and to support good practice throughout their supply chain by encouraging adoption of the Code. In 2021, the Code was further strengthened requiring signatories to, among other measures, pay 95% of invoices from small businesses (with less than 50 employees) within 30 days and requiring small and medium sized signatories to report annually on their payment performance. The Payment Regulations 2017 bolstered these initiatives by increasing transparency around payment practices.

While there is some evidence that these initiatives have alleviated late payments to some extent, it remains an issue within the sector.

LATEST PROMPT PAYMENT INITIATIVES

BUILDING ON THE PROMPT PAYMENT CODE – BPF FAIR PAYMENT CHARTER

In Autumn 2023, the BPF published its Fair Payment Charter (BPF Charter), encouraging members to sign up to the Code and to promote the adoption and awareness of the Code across their supply chains. For more information, see BPF Fair Payment Charter.

The BPF Charter enshrines admirable principles, aiming to drive up payment standards across all parts of the construction supply chain. Key elements to achieve this are making 30 days the norm for making payments in line with the Code and, importantly, cascading the principle of fair payment throughout supply chains.

BPF members are encouraged to ensure that main contract payment terms (including those applying to retentions) are replicated in sub-contract terms. In addition, members are encouraged to foster transparency by publishing their own data on fair payment and including terms in their building contracts requiring contractors to pay their sub-contractors within a specified timescale and to provide evidence with their payment applications that sub-contractors are paid up to date.

Helpfully, the BPF Charter provides example drafting that can be incorporated into building contracts to reflect these principles but given that it operates on a voluntary basis it remains to be seen what the uptake will be across the BPF's membership.

PROMPT PAYMENT AND CASH FLOW REVIEW REPORT

The BPF are not alone in identifying that more can be done to address the ongoing issues late payment and long payment terms create.

In November last year the Department for Business and Trade reviewed its existing prompt payment policy and published its Prompt Payment and Cash Flow Review Report (DBT Report), setting out actions that the government will take to improve payment timelines across the UK.

The DBT Report confirms that the current Payment Regulations 2017 will continue to apply for up to seven years beyond the sunset clause date of 6 April 2024, with a review to take place after five years. Additional metrics will be implemented following consultation.

Historically, businesses within the remit of the Payment Regulations 2017 were required to report on the volume of payments made in the reporting period, which it was felt could encourage businesses to prioritise settling large numbers of low value invoices to improve their report. These businesses will now also be required to report on the total value of payments due that have not been paid within agreed terms as well as reporting on disputed invoices. The goal is to produce a balanced picture of payment practices so as to empower small businesses to make informed decisions when entering into contracts.

The Department for Business and Trade will also work with the Small Business Commissioner to utilise the reports to assess compliance with the Code. The stated aim of this joined up approach is to ensure that for those signatories who are caught by the Payment Regulations 2017, their membership of the Code is supported by data on their payment performance. In addition, businesses will be required to re-register for the Code every two years in order to sustain engagement with its principles.

While retention payments are not currently within the scope of the Payment Regulations 2017, the response to the consultation on extending them found that retentions can negatively impact on cash flow and are sometimes the subject of negative practices such as non-payment. Given the stated aim of government to increase transparency in payment practices, the DBT Report sets out the intention to extend the Payment Regulations 2017 to retention payment practices for those businesses caught by these regulations who use qualifying construction contracts. Interestingly, the draft Reporting on Payment Practices and Performance (Amendment) Regulations 2024 (draft Amendment Regulations 2024), published in January 2024, do not contain details of the retention provisions, although the accompanying Impact Assessment indicates that such provisions would come into effect in 2025. We await the detail of what these requirements will be.

FINAL THOUGHTS

Cash flow is critical for construction projects, particularly so in the current challenging economic climate. While it is positive to see new initiatives to tackle this perennial problem, the voluntary basis of the BPF Charter and the absence of reporting requirements for retention payments in construction contracts in the draft Amendment Regulations 2024 may mean that the well-known payment issues within construction supply chains continue for some time yet.

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RELATED CAPABILITIES

- Commercial Construction & Engineering

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