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Insights

COMMERCIAL PAYMENTS BILL AND ITS IMPACT ON CONSTRUCTION CONTRACTS

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Summary

An article, first published in PLC Construction, considering the Commercial Payments Bill, in particular the provisions that ban the practice of deducting and withholding retention payments under a construction contract, and the implications for the construction industry.

This article contains links which are only accessible by PLC subscribers.

This article is the second of our two-part series, focusing on the government's proposed reforms to address late payment.

In our first article on this topic, we explored the government's *Late Payments Consultation Response* as the backdrop and precursor to the Commercial Payments Bill (Bill).

This article takes a detailed look at the Bill itself with a particular focus on the implications of the Bill for the construction industry.

For more information, see:

- *Practice note, Retention under a construction contract*.
- *Article, Late payments consultation response: significant changes coming for the construction industry*.
- *Construction tracker: Commercial Payments BillOpens in a new window*.

Backdrop to proposed legislation

Before we get into the detail of the Bill, it is worth taking a moment to consider why it was introduced.

The core objective of this legislation is to improve commercial payment practices and address practices that are considered to impede cash flow in the economy, in particular the imposition of long payment terms and lack of effective deterrent from late payment. Evidence given to the House of Commons Business and Trade Committee suggests that 44% of invoices from SMEs are paid late, and late payments are estimated to cost the UK economy £11bn per year, with 14,000 businesses closing each year due to late payments. For more information, see *House of Lords Library: Commercial Payments Bill [HL]: HL Bill 4 of 2026–27 (4 June 2026)*.

The Bill is intended to improve these statistics.

The longstanding challenges of cash flow in the construction industry are well known with historically disproportionate levels of inefficiency, disputes and widespread insolvency, notably among contractors and sub-contractors.

The Housing Grants, Construction and Regeneration Act 1996 (Construction Act 1996) responded to Sir Michael Latham's landmark report, *Constructing the Team* (published in July 1994) and introduced key measures such as mandatory payment provisions, the right of suspension for non-payment and adjudication to resolve construction disputes.

While the Construction Act 1996 has without doubt had a significant and positive impact on payment processes, roughly a quarter of a century later, the construction industry remains subject to poor cash flow and disproportionate levels of supply chain insolvency not least in today's economic and political climate.

Since the early 2000s, both government and industry have introduced successive measures in an attempt to further tackle these issues but with limited success. Although it extends to broader commercial contracts (especially those involving small businesses), the Bill is also intended specifically to address these features of the construction industry. When viewed in this context, it can perhaps be understood why government felt that the only way to resolve such issues was wide sweeping legislative reform.

For more information on previous attempts to tackle late payment, see:

- *Practice note, Retention under a construction contract: Initiatives and campaigns to improve payment in the construction industry*.
- *Practice note, Tackling late payment issues for smaller businesses*.
- *Article, Fair payment practices: recent developments*.

Timescales for implementation

The government has made clear that it wants the Bill to become law as soon as possible. In practical terms, this will mean, if all goes to plan, at some point during 2027.

The Bill has certainly been introduced at pace. In late March 2026, the government published its response to the consultation on late payment reforms which not only set out its legislative approach but also made clear that it would further consult on certain aspects of the planned reforms. The King's Speech followed on 13 May including a commitment to introduce legislation to tackle late payments to small businesses. Six days later, on 19 May, the Commercial Payments Bill was introduced to the House of Lords, a fast track method of speeding legislation through Parliament. A second reading was held on 9 June. On 21 July 2026 the Bill completed its Committee stage and a new version was published.

Despite over 100 amendments being tabled, the core tenets of the Bill remain unchanged, although amendments have been made to clarify drafting and ensure public sector payment rule consistency with the Bill's intent. For now, it appears that promises of further consultation have been superseded by events.

The next step is the Report stage, the date for which has yet to be announced as at the time of writing this article (mid-August 2026). Given where we are now, while it seems unlikely that the Bill will move to the House of Commons before early 2027, the government is on track to meet its intended deadline of Royal Assent during that year.

It will be interesting to see what the Bill looks like when it reaches that stage. Amendment is still possible. While the Bill has passed through the House of Lords relatively unscathed, the Commons is a markedly different forum to that of the Lords and amendment is more likely. As such, this article focuses on what is currently provided in the 21 July version of the Bill and, more specifically, its broader intent and approach.

For more information, see Legal updates:

- *Commercial Payments Bill introduced into Parliament*.
- *Commercial Payments Bill has second reading in House of Lords*.
- *Commercial Payments Bill completes House of Lords committee stage*.

Key features

Territorial reach

The Bill adopts the territorial reach of the Late Payment of Commercial Debts (Interest) Act (Late Payment Act), which it amends, namely imposing mandatory provisions affecting commercial contracts with a UK nexus. So, if an international commercial contract was entered into that, but for a choice of English law as its governing law, would be governed by the law of a non-UK territory, then these provisions would not apply.

For more information, see *Practice note, Interest under the Late Payment of Commercial Debts (Interest) Act 1998: Applicability of Late Payment Act*.

Core reforms

In summary, the Bill introduces several key reforms.

It proposes amendments to the Late Payments Act that:

- Set payment terms in commercial contracts at a maximum of 30 days for public authorities (where the contract is not covered by the Procurement Act 2023) and 60 days for non-public authorities, subject to limited exemptions.
- Removes the ability of parties to contract out of the statutory interest rate for late payment by providing an alternative "substantial remedy". Paying parties will now be subject to the full statutory rate (8% above the Bank of England base rate) in the event of late payment.
- Implies a term into contracts that allows a supplier to recover a fixed sum from a purchaser where a dispute is raised late or without sufficient information.

It also introduces powers for the Small Business Commissioner to:

- Investigate larger businesses suspected of persistently engaging in poor payment practices and breaching payments legislation, make recommendations and take enforcement action where appropriate (including the power to give directions and impose financial penalties).
- Adjudicate contractual payment disputes between small and larger businesses outside of the court process and making binding interim decisions.
- Take enforcement action against larger businesses that are in breach of their statutory publication requirements set out in regulations made under section 3 of the Small Business, Enterprise and Employment Act 2015.

Further, it proposes various reforms that are specific to construction contracts. This article focuses in particular on these proposed changes and the impact that they are likely to have in practice.

For more information, see Practice notes:

- *Interest under the Late Payment of Commercial Debts (Interest) Act 1998: Proposed reform of Late Payment Act*.
- *Practice note, Tackling late payment issues for smaller businesses: Small Business Commissioner*.
- *Retention under a construction contract: Commercial Payments Bill*.

Key reforms specific to construction contracts

The most striking (and controversial) feature of the Bill is to effectively pick up where Latham left off, most obviously in its proposed outright ban on retention clauses, a reform Latham signalled as desirable over 30 years ago. It is in this sense a continuation of the reform trajectory that began with the Latham Report, addressing the unfinished business of the 1994 review.

In addition to attracting the minimum statutory interest under the Late Payment Act, the key changes to the Construction Act 1996 introduced by the Bill:

- Align the late payment provisions with existing payment and dispute resolution legislation for construction contracts:
  - where a payer fails to serve a payment notice, the payee may serve a default payment notice (if it hasn't already served a payment notice under the contract), and the final date for payment is currently extended by the number of days' delay in serving the default notice. The Bill caps this extension so that the final date for payment cannot be pushed beyond the permitted 30 or 60-day period;
  - a requirement for pay less notices to be issued no later than seven days before the final date for payment;

There is a potential lacuna here: if the default payment notice is served close to or after the 30 or 60-day limit, factoring in the new seven-day minimum period for pay less notices, the final date for payment may already have passed or not allow sufficient time for a pay less notice to be given. The legislation does not currently cater for this scenario.

  - Amending payment reckoning periods of time so bank holidays no longer extend the payment period.

- Moves to abolish retentions. It:
  - creates a ban on contractual provisions which permit the deduction and withholding of retention sums under a construction contract;
  - introduces a transition period for retention clauses agreed or varied in the two-year period leading up to the coming into force of the retentions ban;
  - creates a new requirement for any remaining retention sums withheld under these contractual clauses to be returned in accordance with the procedure, and by the dates, set out in the Construction Act 1996; and
  - establishes an implied clause in construction contracts for a fixed sum payable to the supplier for any unauthorised deduction of a retention sum, in addition to any entitlement

to statutory interest and compensation arising.

For more information, see Practice notes:

- *Payment in construction contracts: Construction Act 1996: Amendments to the Act introduced by the Commercial Payments Bill*.
- *Retention under a construction contract: Commercial Payments Bill*.

Abolition of retention: impact on cash flow and security

This is, without doubt, the headline measure, and the one that will require the most fundamental rethinking of standard practice. The Bill proposes that new clauses 113A to 113F are inserted into the Construction Act 1996, prohibiting contractual provisions that permit the deduction and withholding of retention sums under construction contracts. It is important to note that this does not necessarily just cover "defects" retentions in the traditional construction sense, but is potentially wide enough to capture any provision that would entitle a party to withhold a payment which has become due until certain conditions have been satisfied.

The ban is introduced in phases. During years one and two, the "transition period", parties may still agree or vary retention clauses in new or existing contracts. But those clauses are on borrowed time: they will automatically become ineffective at the end of year three regardless of what the contract says, and retention sums may continue to be withheld only during this period in reliance on such clauses.

From the start of year three, no new retention clauses may be agreed. Existing transition-period clauses cannot be varied adversely to the payee. At the end of year three, the "last retention day", any retention money still held becomes a "transitional retained sum". It falls due for payment within 30 days of the last retention day, with the final date for payment a further 30 days after that (public authorities) or 60 days (private sector).

A retention debt arises where the paying party deducts or retains all or part of a notified sum, which would otherwise be due and payable under the contract, after the end of the transition period. In these circumstances, a term is implied into the contract that the paying party must pay the higher of £40 or 50% of the retention debt as a fixed sum. This is on top of the debt itself and statutory interest. Any attempt to contract out of that obligation is void.

Proposed new section 113E(7) provides that the implied term also applies in relation to construction contracts entered into before the transition period began. In other words, the ban on retentions applies to an existing construction contract if the payer retains sums under the retention provisions after the end of the transition period. It does not mean that the fixed sum penalty will automatically apply to any retention being withheld pursuant to a valid retention clause prior to the end of the transition period. Nevertheless, there may be some ambiguity here and clarification from the government on this point would be helpful.

The abolition of retentions is controversial: it has been the standard and accepted primary form of security in respect of the contractor completing the works and remediating defects notified in the rectification period. It has served a role in incentivising the supply chain to "get across the line" on these key milestones for a project and providing some degree of recourse to the employer in case of default.

Impact on cash flow

The prohibition on retentions, combined with the 60-day payment cap, compresses the cashflow cycle significantly. The ban will have implications for contract drafting, cash flow planning and the procurement of alternative surety products in place of retentions.The 60-day maximum payment term (30 days for public authorities) constrains the ability of developers to defer payment to contractors beyond those periods. Developers who previously relied on longer payment periods to manage their own drawdown schedules and interest costs will need to restructure their payment profiles accordingly. The removal of retentions will impact cash flow projections and financial models for both developers and funders. Financial teams should update their models to reflect the changed payment profiles.

As we explore further below, the removal of the ability to withhold retention sums will require developers to consider alternative arrangements to manage the risk of defective work and ensure contractor performance.

Impact on security

As to alternative forms of surety products, we expect that the market will need to respond to these changes. However, whatever alternative solution is adopted, it feels inevitable that it will result in increased project costs relative to the current position.

Those who expressed concern with these changes believe retentions are a cost-effective mechanism, incentivising contractual performance and defect rectification. Developers and their funders will need to assess whether alternative instruments provide equivalent protection.

The government recognises that if retentions are no longer available as a means of mitigating risk, this will require a larger and more sophisticated surety market to support the construction sector and its clients. Employers are unlikely to accept the security risk posed by the abolition of retentions without exploring alternative ways to achieve a similar end. Bonds and escrow arrangements will require careful consideration. However:

- Retention bonds can be expensive, particularly for smaller contractors and sub-contractors, and they will no doubt seek to pass the cost of these up the supply chain so that this is ultimately borne by the employer. Employers will need to consider whether it is cost effective to procure such a bond on smaller projects. Employers will also expect such bonds to be provided on an "on-demand" basis and it remains to be seen whether the surety market will be willing to offer this. There is also the possibility that sureties may not even be willing to offer such bonds to smaller contractors and sub-contractors if there are concerns about those parties' covenant strength.

- Performance bonds are widely used in the construction industry, but are commonly used in addition to retentions rather than as an alternative. In the UK, such bonds are also only available on a "default" basis which introduces a further hurdle for employers to overcome before they are able to recover monies under the bond, which typically only provide a "right to sue" once the work has been completed and the final account assessed. This invariably requires an employer to incur additional costs when enforcing their rights under the bond.

- Project bank accounts can help achieve fairer and more prompt payment practices, but can increase a project's costs because of the training, set up and administration costs. They also generally benefit the supply chain rather than employers so do not provide the same protection to the employer as a retention.

- Trust accounts are rare but could be utilised across the construction industry as an alternative to cash retentions provided the money is placed in a separate account. However, it remains to be seen if such an arrangement will be permitted by the new legislation.

Employers will no doubt also explore potential contractual solutions or alternatives to retention. However, until tested by the courts or explicitly addressed in legislation, this carries the risk of a 50% penalty payment in the event that the solution is found to amount to an unlawful retention.

The most obvious alternative to "retention" deductions is to structure the contractual payment mechanism as milestone payments. This is already adopted (at least in part) in some contracting structures, often alongside retention provisions, in a genuine attempt to measure and structure the release of portions of the contract sum relative to accepted milestone events. This includes (not least) the completion of defined portions (or all) of the work and the correction of defects. Rather than apply a percentage deduction to all interim payments of the contract sum, a proportion of the contract sum could be prescribed to fall due upon these defined milestone events.

We will need to see whether this is the subject of debate and elaboration as the Bill progresses through Parliament. At present, the proposed new section 113A of the Construction Act 1996 includes in the definition of retention:

"the practice by which one party to a construction contract deducts or retains sums of money equating to a percentage of … the total of the construction contract, until any condition for release or partial release of the sums … is met."

As a matter of interpretation, one can readily see that as fitting the description of a milestone payment and so falling foul of the prohibition. However, the focus of the Bill has always been the deduction of retention, not the use of milestone payments. Where to draw the line is not clear cut. Provided that a contractor is entitled to be paid 100% of each interim payment when it falls due, the Bill does not appear to prohibit structuring the payment mechanism so that the final milestone payment becomes payable following issue of the notice of making good defects. However, if not clearly addressed in the legislation, we foresee such arrangements being tested in adjudication and litigation.

On a similar note, construction contracts commonly provide for a percentage of the contract sum (or interim payments) to be withheld pending the contractor's delivery or procurement of required security instruments (for example, collateral warranties, parent company guarantees or performance bonds). However, as noted above, these arrangements could also conceivably fall within the scope of the prohibition. Taking a step back, where the government has acknowledged the need for alternative security arrangements, removing a common safeguard and incentive for the contractor to deliver that security presents another practical and commercial challenge at the outset of a project.

Impact on project finance transactions

By extension, for funders involved in project finance transactions, the changes will have implications for the security package and conditions precedent as construction bonds, including retention bonds, are an important part of the security package in this type of transaction. Before advancing funds under a facility agreement for a construction project, lenders typically include the delivery of construction-related items and evidence of performance security as conditions precedent to financial close.

The removal of cash retentions and the need for alternative surety products will require lenders to consider the creditworthiness of the institutions providing bonds or guarantees and ensure these instruments form part of the security package. Facility agreements may need to be amended to address how amounts previously held as retentions are funded and treated.

Construction budgets and financial covenants may also need to be revised to account for the changed security arrangements. Lenders should also consider whether events of default provisions need to be updated to address the failure to maintain alternative security instruments.

Anticipated broader impact on construction projects

Beyond the immediate objectives and provisions of this Bill, we foresee broader consequences in respect of parties' expectations and behaviours brought about by these reforms.

As noted above, we anticipate that the need to obtain alternative forms of security will lead to an increase in the cost of delivery of projects, which will end up ultimately being borne by developers and funders.

It will also likely lead to more stringent provisions (and practice) in the measurement of progress and valuation of interim payments to be made to the contractor. Given the tightening of cash flow for employers, they will naturally require their project managers and quantity surveyors to scrutinise more rigorously reported progress and valuation of the works so that the contractor is compensated in line with its actual progress and continues to be suitably incentivised to reach completion.

This is no bad thing, and for more than payment reasons. In the recent decision of *Mace Construct Ltd v Baltic Investment Holdings Ltd [2026] EWHC 976 (TCC)*, the court indicated that (under an amended JCT Design and Build Contract, 2016 Edition) an adjudicator tasked with reviewing extension of time claims made during the course of the works is to place themselves in the shoes of the employer's agent in receipt of the contractor's particulars and undertake a prospective analysis of the impact of relevant events, ignoring what has happened since that date. Whether or not that approach is to be adopted in a blinkered fashion, it should serve as a reminder of the importance of a rigorous contemporaneous review of the contractor's reported (and actual) progress of the works and the records and programmes in which that is presented. For more information, see *Legal update, Court considers derogations from design responsibility, planning provisions and adjudicator's powers (TCC)*.

In a similar vein, depending on how the matter of security for performance is addressed, the changes brought about by this proposed legislation could prompt shifts in parties' behaviours as works progress to completion. Cash-flow driven incentives will likely shift in the absence of retention, possibly leading to employers more readily exercising their right to deduct and withhold liquidated damages prior to practical completion. Previously they may have decided not to do so immediately in the knowledge that they might be offset against retention later on in the final account process.

The combination of these factors may well result in an increase in the number of disputes being referred to adjudication during the course of the works. As we saw with the introduction of the 2011 amendments to the Construction Act 1996 (driven also by the fallout of the 2008 financial crisis), changes in construction contract payment provisions create a rich environment for payment disputes that are referred to adjudication. Similarly (and in addition), claims for extensions of time or liquidated damages being more actively pursued contemporaneously will inevitably result in more disputes being referred.

Given the objectives of the Bill and its amendments to the Late Payment Act and the Construction Act 1996, this may be a necessary consequence of the changes being introduced until both the construction and insurance market adapt to the change in risk management and parties receive guidance from the TCC about drafting solutions that are acceptable as regards alternative forms of contractual security for performance.

At a time when there is already significant investor concern with the viability of UK construction projects due to rising supply costs, increasing regulatory requirements, planning delays and sector insolvencies, this greater potential for disputes and the additional costs these would entail, risks further undermining investor confidence in the UK construction industry potentially leading to more projects being mothballed or even cancelled in the short to medium-term.

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