

late payment



The Late Payment of Commercial
Debts (Interest) Act 1998:
A User's Guide



COLLECT THE CASH

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THE BETTER PAYMENT PRACTICE GROUP



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Introduction

The importance of prompt payment

To maintain a successful business, a supplier must make an adequate profit. Late payment is a perennial problem for UK businesses and can lead to serious cash flow problems for the supplier, which can reduce profits and threaten commercial survival. If a business is continually paid late it will have to raise its prices, if it can, to reflect the costs of finance required, or go out of business.

The Government has introduced legislation to give businesses a statutory right to claim interest if another business pays its bills late.

The legislation is called the Late Payment of Commercial Debts (Interest) Act 1998. This guide explains how the Act works and how it affects businesses. It is written for the guidance of all traders, whether they are suppliers or purchasers of goods and services.

The statutory right to claim interest is not compulsory. It is for the supplier to decide whether or not to make a claim for interest.

Legal Warning

The User's Guide has been prepared to provide general guidance only. This guide does not constitute legal advice and reliance ought not to be placed on it. No liability can be accepted by the authors or publishers for its contents. The interpretation of the law on late payment is ultimately a matter for the courts, and users should take their own advice where appropriate.



Section 1:

Understanding the legislation

What is the legislation about?

Previously, businesses were only able to claim interest on late paid debts if it was included in the contract or if they pursued the debt through the courts and the courts awarded interest.

The Late Payment of Commercial Debts (Interest) Act was introduced on 1st November 1998 to encourage purchasers to pay on time by giving businesses the right to claim interest if another business pays its bills late.

The legislation also addresses the problems caused by persistent late payers, as suppliers are able to claim interest to compensate for not being able to make use of the money owed to them and to reflect the increased risk caused by late payment. The cost is no longer borne by the supplier but by the person who can control it - the purchaser. Paying late without good reason is wrong and this legislation is aimed at the wrongdoer.

When did the statutory right to interest start and who can claim it?

The legislation is phased as follows:



- From 1st November 1998 - small businesses have had a statutory right to claim interest from large businesses and the public sector on debts incurred under contracts agreed after that date.
- From 1st November 2000 - small businesses have a statutory right also to claim interest from other small businesses on debts incurred under contracts agreed after that date.
- From 1st November 2002 - all businesses and the public sector will have a statutory right to claim interest from all businesses and the public sector on debts incurred under contracts agreed after that date.

What is a public sector body?

A public sector body is any Government Department, local or public authority.

How is a 'small business' defined?

A small business is one with 50 or fewer employees, on average, over the financial year prior to the year the contract was made. The legal status of the business (i.e. whether it is a sole proprietor, partnership, limited liability company, etc) is irrelevant.

How is a 'large business' defined?

A large business is one with more than 50 employees.

How does a supplier or purchaser know whether the other party is large or small?

The simple answer is that they can ask. A purchaser who falsely claims to be small to avoid paying interest or a supplier who falsely claims to be small to obtain interest to which they are not entitled, may be guilty of fraud.

If the matter comes to court, and the size of a buyer or supplier business is in dispute, then it will be for the supplier to prove that it is small, and thus entitled to interest. Both suppliers and purchasers may find that the type of records which they already keep on employees (for example, payslips, PAYE and national insurance returns) are useful in proving size.

How are employees counted?

(Full time and part time employees)

An employee is counted as full time if they work 35 hours or more per week.

Part-time staff are counted as a proportion of a full-time employee. To calculate the equivalent number of full-time staff, divide the total number of hours worked by part-time staff by either:



- the number of hours worked by a full time employee who does the same kind of job as the part-time employee;
- or
- 35 hours per week, if there are no full-time employees doing a similar job.



How do I calculate the average number of employees?

In many businesses the number of employees changes significantly throughout the year. For example, many businesses in the tourism sector take on staff during the summer. For this reason, the number of employees is averaged over the previous financial year.

So, for businesses which were in operation for the whole of the previous financial year (that is, from 1st April to 31st March) the number of employees is calculated by adding up the number of employees on the last day of each month from April to March and dividing by 12.

If the business has only been in operation for part of the previous financial year, the average is taken over the number of complete months in operation in that year. So, for example, if a business starts up on 15th July, the number of employees is calculated by adding up the number of employees on the last day of each month from August to March inclusive and dividing by 8.

If the business has been in operation for less than one month in the previous financial year, then the average is taken over the number of complete months in operation, ending at the month before the contract was made. So, for example, if the business starts up on 15th March and the contract is made on 22nd September, the number of employees is calculated by adding up the number of employees on the last day of each month from April to August and dividing by 5.

If the business has been in operation for less than one month, then the average is taken over the number of days it has been in operation, ending on the day before the contract was made. For example, if a business starts up on 3rd April and a contract is made on 26th April, the number of employees is calculated by adding up the number of employees on each day from 3rd April to 25th April and dividing by 23.

What if a business is part of a Group?

A business that belongs to a group of businesses is only considered small if the group as a whole fulfils the criterion of a small business - that is, the whole group has 50 or fewer employees. A group exists where one business has direct or indirect control of another, or where two or more businesses are directly or indirectly controlled by the same third person or business.

Is the legislation the only way I can remedy late payment?

No. A supplier and purchaser can make their own arrangements for a remedy to late payment. This is known as contractual interest. If they do so, the Act will not apply. However, if they do not, the remedy for late payment provided by the Act will apply.

To prevent purchasers abusing the right to agree their own arrangements with the supplier, any such contractual remedy for late payment must be “substantial” otherwise it will be void and the debtor will be unable to rely on it. It will be struck down by the courts and the terms of the Act will apply to the contract.

A remedy for late payment is substantial as long as it is:

- enough to compensate the supplier for the cost of late payment or to deter late payment;
- fair and reasonable in all the circumstances to allow the remedy to replace or vary the statutory right to interest provided by the Act.

In determining whether a remedy is substantial or not, the courts will consider all the circumstances, including the rate of interest that applies to late payments and the length of credit periods. Purchasers should not negotiate longer credit periods to avoid the possibility of late payment.



Where a credit period is considered to be excessive, the courts may strike it down and replace it with the 30 days default period provided by the Act.

How will the courts know whether a remedy is substantial or not?

It will be for the supplier to show that a remedy is not substantial (although the purchaser may have to provide evidence that it is fair and reasonable in the circumstances). The court will then have to judge whether, in all the circumstances (including what is usual for that sector of business), the remedy meets the criteria of a “substantial remedy” set out above.

Examples of contract terms which a court might declare void, to the extent that they relate to late payment, because they result in there being no substantial remedy for late payment, might include:

- a credit period that is significantly different from custom and practice in that industry;
- a credit period that is significantly different from other supply contracts operated by the purchaser;
- an interest rate on late payment, significantly lower than the statutory rate, that fails to act as a deterrent to the purchaser paying late because it is lower than the purchaser’s theoretical (or actual) cost of agreed borrowing;

- an interest rate on late payment, significantly lower than the statutory rate, that fails to recompense the supplier for being kept out of his money, because it is below the supplier's theoretical (or actual) cost of agreed borrowing;
- an interest rate on late payment, significantly lower than the rate used in other supply contracts operated by the purchaser or that is normal in that sector of the economy.

It is very unlikely that a rate of interest at or below the base rate would meet these criteria:

- a contract term that has the effect of reducing the amount of interest that can be claimed, such that the compensation for late payment is insufficient to recompense the supplier or to act as a deterrent to late payment;
- excessive information requirements which must be fulfilled under the contract before any credit period might start.

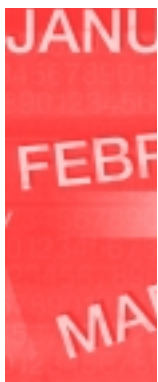
Whether the purchaser had given any benefit in return for the term in question would be relevant. However, it must be stressed that the courts will look at the issue of a substantial remedy for late payment on a case by case basis. The above list is not exhaustive and might not necessarily apply in every case.

How does the Act affect existing custom and practice?

The Act does not replace existing custom and practice. If the parties have undertaken business on the basis of usual industry practice, (for example, payment at the end of the month following the date of the invoice), then this practice will probably still apply. However, if any remedy for late payment is not "substantial" the terms of the Act will apply.

Are UK importers liable to claims for interest from overseas suppliers?

Yes. If the contract is made under the law of the UK, the terms of the Act apply; an overseas supplier may claim interest under the Act.



Are UK exporters able to claim interest from overseas purchasers?

Yes. If the contract is made under the law of the UK, the terms of the Act apply; a UK supplier may claim interest under the Act from an overseas purchaser.

What about contracts made under UK law between non-UK parties?

The Act applies to any contract made under the law of part of the UK except if there is no significant connection between the contract and that part of the UK.

What about contracts connected to the UK but made under a foreign law?

Where the choice of law is a foreign law, the Act applies if there is no significant connection between the contract and any country other than that part of the UK.

How does the Act apply to Scotland?

Scotland has its own legal system. Issues of contract law have been devolved to the Scottish Parliament. The Act applies to Scotland but the Scottish Parliament can amend or replace the Act. The Scottish Executive can change the rate of interest, the phasing of the right to claim interest, and the nature of contracts and debts covered by the Act. In changing any of these, the Scottish and Westminster Parliaments will consult closely with each other to ensure that there is a co-ordinated approach.

How does the Act apply to Northern Ireland?

The Act applies to Northern Ireland. Matters of contract law - of which the Act forms a part - have not been devolved to the Northern Ireland Assembly. In making any changes to the Act, the views of the people of Northern Ireland will be sought.

How does the Act apply to Wales?

England and Wales share the same system of law. Matters of contract law have not been devolved to the Welsh Assembly. The Act applies to Wales on the same terms as it applies in England. In making any changes to the Act, the views of the Welsh people will be sought.

How will European Law affect the right in future?

In 1998, the European Commission submitted a proposal for an EC Directive to ensure a common approach across Member States to the problem of late payment.

The EC Directive on combating late payment in commercial transactions (Directive 2000/35/EC) was formally adopted in 15th June 2000. It entered into force following publication in the Official Journal of the European Communities on 8th August 2000 and has to be implemented by all Member States by the 8th August 2002.

It is likely that the Directive will result in changes to the domestic legislation in due course, and the Small Business Service will be seeking ideas and suggestions from the business community regarding practical implementation of the Directive during this period.



Section 2: How to claim interest

When can I claim interest?

A claim for interest can be made once a payment is deemed late.

When is a payment late?

Where there is an agreed credit period, where a supplier has agreed, either in writing or orally, a credit period with the purchaser, the payment is late if it is made after the last day of the credit period.

If no credit period has been agreed, then the Act sets a default period of 30 days after which interest can run. This default period does not constitute a statutory credit period. Where no credit period is agreed in a contract, the principal debt will still become due from the moment the goods are delivered or the service performed.

The 30 day default period starts running from the later of the two actions:



- the delivery of the goods or the performance of the service by the supplier; or
- the day on which the purchaser has notice of the amount of the debt.

A payment is late once the agreed credit period or the default period has expired.

What happens if the contract requires advance payment(s)?

There are several ways in which a contract can require payment(s) to be made before the goods are delivered or the service is performed. The Act does not give a right to interest unless at least some of the goods have been delivered or part of the service performed unless contractually agreed. If the parties wish to agree otherwise, they will need to make provision in the contract for a substantial remedy instead of statutory interest.

Some contracts stipulate that the whole contract price should be paid before the goods are delivered or the service is performed. If payment has not been made before the goods are delivered or the service is performed then statutory interest starts to run from the day after the day on which all the goods are delivered or the whole service is performed.

Other contracts stipulate that payment should be made by instalments in relation to a delivery of any part of the goods or performance of any part of the service. Where payment of such an instalment is made late then statutory interest runs on the instalment from the day after the day on which the part of the goods are delivered or the part of the service is performed.

Finally, where an advance payment forms part of the contract price, but is not related to the delivery of some of the goods or performance of part of the service, then statutory interest runs from the day after the day on which all the goods are delivered or the whole service is performed.

What if there is no agreed credit period but the purchaser usually pays at the end of the month following the month in which the invoice is received?

Some purchasers and suppliers have a long-standing relationship in which this kind of payment arrangement has become standard practice. In these cases, the credit period is considered to end on the last day of the month following the month in which the invoice is received. Interest starts to run on the next day.

Where:

- the purchaser is dealing with a new supplier; or
- there is any other reason to doubt whether this kind of arrangement can be regarded as established practice between the supplier and purchaser.

the purchaser should ensure that there is an agreed credit period - otherwise the default period of 30 days might apply.



How do I make a claim for interest?

When the payment is late, a supplier should inform the purchaser that he or she is claiming interest on the late payment under the Late Payment of Commercial Debts (Interest) Act 1998. It may be helpful to indicate the daily rate of interest that will be claimed, although it is not necessary to do so.



For the purpose of claiming interest notification can be oral, but it is better to put it in writing, as this makes it easier to prove that notice has been given. It is necessary to provide all the information that should be carried on a standard invoice:

- how much is owed (it may be helpful to provide the total amount of interest owed at the date of the invoice for interest, and, if the principal has not been paid, the rate at which the interest will continue to accrue);
- what it is owed for (stating which principal debt it relates to, quoting the original number of the invoice which requested payment of the principal debt);
- to whom payment should be made;
- by what date;
- to what address; and
- by what method (cash, cheque, electronic transfer etc).

How should I inform purchasers that they will be charged interest if they pay late?

Rather than using it as a last resort when faced with an overdue invoice, the Act is designed as a deterrent against late payment to be used as part of standard business practices and credit management techniques. In much the same way as a supplier reminds purchasers that payment is due within a specified time limit, the supplier should also remind them that interest will be charged on overdue invoices under the Act.

In addition to informing purchasers verbally of the right to charge interest as part of standard payment terms, suppliers should state clearly on all written communications, credit application forms, order confirmations, invoices and all contracts:

" We understand and will exercise our statutory right to interest under the Late Payment of Commercial Debts (Interest) Act 1998 if we are not paid according to agreed credit terms."



Do I have to charge interest to all late payers?

No. The statutory right to claim interest is not compulsory. A supplier is free to decide whether or not to make a claim for interest.

Don't I risk antagonising my customers if I use the legislation?

Using the legislation is your statutory right and is not designed to jeopardise existing customer relationships. Rather than seeking to encourage claims for interest the legislation's primary aim is to deter companies from paying their bills late. By treating it as an integral part of your payment terms customers will become educated that this is part of the way that you like to do business.

Section 3:

How to calculate interest claims

What interest can be charged?

The rate of interest is the official dealing rate of the Bank of England (the base rate) + 8%, using the base rate at the end of the day on which the contract says that payment is to be made.

If the contract does not stipulate a date for payment, then the base rate to be used is the one at the end of last day of the default period, even if the base rate changes between then and the time the principal is eventually paid.

How do I find the correct base rate to use?

The base rate is the official dealing rate of the Bank of England. This is the interest rate that is announced by the Monetary Policy Committee of the Bank of England. It is always given a lot of press attention when it is changed.

The base rate is published in every edition of The Financial Times, with the date on which it was last changed. It can be found under the heading "UK Interest Rates" in the section on "London Money Rates". There is a sentence that reads "UK clearing bank base lending rate x per cent from DD/MM/YY". An example is given below:

Example

UK INTEREST RATES						
LONDON MONEY RATES						
Jul 8	Over-night	7 days notice	One month	Three months	Six months	One year
Interbank Sterling	7 1/8 - 8	7 1/8 - 7	7 1/8 - 7 1/4	7 1/8 - 7 1/4	7 1/8 - 7 1/4	8 - 7 1/8
Sterling CDs	-	-	7 1/8 - 7 1/4	7 1/8 - 7 1/4	7 1/8 - 7 1/4	7 1/8 - 7 1/8
Treasury Bills	-	-	7 1/8 - 7 1/4	7 1/8 - 7 1/4	-	-
Bank Bills	-	-	7 1/8 - 7 1/4	7 1/8 - 7 1/4	7 1/8 - 7 1/4	-
Local authority depts	7 1/8 - 8	7 1/8 - 7 1/4	7 1/8 - 7 1/4	7 1/8 - 7 1/4	7 1/8 - 7 1/4	7 1/8 - 7 1/8
Discount Market depts	7 1/8 - 7 1/8	7 1/8 - 7 1/8	-	-	-	-

UK clearing bank base lending rate 7 1/8 per cent from Jun 4, 1988

	Up to 1 month	1-3 months	3-6 months	6-9 months	9-12 months
Certs of Tax dep: (£100,000)	4	6.5	6.5	6.25	6.25

Certs of Tax dep: under £100,000 to 4pc. Deposits withdrawn for cash 2pc.
Ann. tender rate of discount on Jun 29, 7:30/29pc. ECU: fixed rate 5 1/2pc. Export Finance: Wake up day Jun 30, 1988. Agreed rate for period Jul 29, 1988 to Aug 29, 1988, Scheme B 8.8/2pc. Reference rate for period May 30, 1988 to Jun 30, 1988, Scheme V A V 7.7/13pc. Finance House Base Rate 8pc from Jul 1, 1988.

How do I calculate the interest charge?

The interest owed on a late payment is simple, not compound, interest. It is calculated like this:

Debt x interest rate x the number of days late

365

Do I calculate inclusive or exclusive of VAT?

You charge interest on the gross amount of the debt (including any element of VAT) but you do not pay VAT on the interest.

Example

If the base rate is 5%, then the statutory interest rate is 13% (5% base rate plus 8%)

Debt is £851.06 plus £148.94 VAT = total £1,000

If this debt is 30 days late, then the interest owed is:

$£1,000 \times 13\% = £130$ (the annual rate)

$£130 \div 365 = 35.6\text{p}$ (the daily rate)

$35.6 \text{ pence} \times 30 \text{ days} = £10.68$ (the interest owed to date)



When does the interest stop running?

Interest stops running on a debt once the principal has been paid.

If the purchaser owes the principal and interest, unless payment is accepted on other terms, any part payment of the debt will go to reduce the amount of the interest first.

Do I have to claim immediately?

There is no doubt that the older the debt the less likely it will be paid; however a claim for interest does not need to be made straightaway.

A supplier has six years in England, Wales and Northern Ireland, and five years in Scotland, in which to make the claim. Receivers or liquidators of a business may pursue its purchasers for interest on late payment going back over this period. Businesses may also claim interest after they have stopped supplying a purchaser. Purchasers who wish to avoid future claims for interest should pay their bills on time.

Can I charge retrospectively on my existing debtors' lists?

Yes. If the interest is being claimed some time after the contract has been completed, old copies of The Financial Times can be consulted in local libraries.

Alternatively, telephone the Bank of England's Public Enquiries Unit on 020 7601 4878. They can provide the current base rate and past base rates.

Section 4:

Collecting the interest

How do I collect the interest?

The interest is payable by law. It is up to the supplier to decide whether or not to enforce this right. It is good business practice to agree payment terms "up-front", either verbally or preferably in writing.

If the purchaser pays late, then the supplier should make a written demand for the interest as described earlier in Section 2.

Can my right to interest be sold or transferred to another party such as factors or collection agencies?

Yes. If any part of the debt - i.e. the interest or the principal or both - is assigned to a third party, the original supplier should inform the purchaser in writing, saying to whom the debt has been assigned.

The third party, regardless of its size, can then pursue the debtor through the courts for the interest.

Sometimes a supplier sells a debt without notifying the debtor. When this happens, the transfer is effective as far as the original supplier and the third party are concerned. However, as far as the debtor is concerned, the debt is still owed to the original supplier, and it is only the original supplier who can pursue the debtor through the courts.

The person entitled to receive the money can employ an agent to chase it for them. For example, a supplier might employ a debt collector to act as its agent in seeking to collect from the debtor, without actually transferring the debt. Similarly, a factor might expect a supplier to act as its agent by continuing to press debtors for payment of debts they have sold to him. Someone who is acting as an agent in this way can calculate and claim interest and invoice for it. Some agencies offer a legal service, enabling them to issue court proceedings.

The supplier can transfer the whole debt (that is, both the principal sum and the interest) or the principal sum alone, or the interest alone. Where only part of the debt has been transferred, the supplier can act as an agent for the third party in respect of the transferred part, and the third party for the supplier for the part which has not been transferred.



Whatever the arrangements between the supplier and third party, the purchaser will never be required to pay interest twice on the same debt.

What happens if a purchaser does not agree with the interest charged?

A purchaser may not agree with an interest charge (for example, if the goods delivered were faulty and had to be repaired, or they were delivered late). If this happens, the purchaser may negotiate with the supplier to reduce or amend the interest charge.

Sometimes the purchaser may be unable to reach any agreement with the supplier.

If this happens, and the supplier considers that his/her claim for interest is a proper one, he/she can go to court or consider the following action:

- to withhold the supply of further goods or services until interest is paid;
- to refuse to trade on credit terms with the purchaser in the future;
- to negotiate with the purchaser to ensure that future invoices are paid on time.



How do I use the courts to collect payment?

If the purchaser does not pay the interest, the supplier can pursue the claim through the courts. Taking someone to court can be a very effective method of debt recovery. The procedures are designed to be quick and easy to operate. County court offices can provide information about court procedures, copies of the forms and help with filling them in. The addresses and telephone numbers of county courts are listed in the telephone directory under "Courts".

The supplier should, as a matter of best practice give notice to the purchaser of an intention to issue proceedings to recover the interest. If the legal proceedings are taken, the purchaser may set out the grounds of his dispute to contest the claim. It will then be for the court to decide the matter.

How will a county court judgment affect the purchaser?

If the court makes an award against the purchaser, the purchaser may find that their credit rating is detrimentally affected. This will make obtaining credit in the future much more difficult as the purchaser will be perceived as a poor payer.

Are there any valid grounds for disputing interest claims?

The purchaser may ask the court to be excused from paying part or all of the interest, either as a defence to a claim by the supplier or by applying to the court themselves. This might happen, for example, if the supplier did not give the purchaser enough information about the amount owed, where payment should be sent or by what method it should be made (cash, cheque etc).

Section 5:

Receiving and avoiding claims for interest

What do I do if I receive a claim for interest?

If the payment was made late (see Section 2 - HOW TO CLAIM INTEREST) then interest is due and payable under the Act. The supplier has a legal right to the interest and, if necessary, to seek enforcement through the courts for non-payment. To avoid litigation, if any interest is legally due, it should be paid.

If there is a genuine dispute, or the charge has been made incorrectly, then the claim should be queried at once.



How can I ensure that I don't receive a claim for interest?

- Purchasers must not enter into a contract that they realistically do not think they will be able to fulfil. A purchaser's reputation and credit rating will be damaged, notwithstanding the increased risk of having to pay significantly more than originally envisaged as interest accrues.
- Purchasers should ensure that agreed payment terms are complied with.
- Purchasers should reconcile invoices and statements of account promptly.
- Purchasers should raise any genuine complaints or disputes as soon as they arise, at the very latest on receipt of an invoice.
- If a dispute or complaint arises, purchasers should obtain (where possible) written confirmation from the supplier that a query exists.

As a supplier, how can I protect my right to claim interest?

- Suppliers should evaluate the purchaser's financial status to minimise the risk of providing goods or services to a company which cannot or will not pay.
- Suppliers should send invoices and statements of account promptly.
- Suppliers should ensure that genuine customer complaints or disputes are resolved as early as possible.
- Suppliers should have an effective collection system in place to ensure compliance with agreed terms.

Can purchasers and suppliers work together to promote a better payment culture?

Good communication between supplier and purchaser can help reduce the incidence of late payment.

Purchasers and suppliers should ensure that payment terms are agreed at the start of the trading relationship and that they are clear to all parties.

Section 6: Additional copies and further information

Free copies of this guide are available by telephoning **0870 150 2500**
or can be downloaded by visiting the Better Payment Practice Group's website
www.payontime.co.uk.



Notes:



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