Claiming statutory interest in construction contracts

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The Late Payment of Commercial Debts (Interest) Act 1998 ("the 1998 Act") is 8% above the Bank of England's base rate - currently at 5%, i.e. 13% in total.

It is important to remember that interest in accordance with the 1998 Act applies to "qualifying debts" which are defined in s.3(1) of the same:

"*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*."

Therefore, the statutory interest applies to a "debt" that arises from an obligation to pay the whole or part of a contract price but not in respect of damages, e.g. damages for breach of contract. The latter can, however, become a debt following a judgement or award, whereon the statutory rate can apply.

What if there is already a contractual rate?

According to s.8 of the 1998 Act, if there is a "substantial" contractual remedy for late payment of the debt, then statutory interest may be ousted; but if the remedy (i.e. the contractual interest for late payment) is not "substantial", then the relevant provisions are void and statutory interest applies.

When is the remedy substantial?

In accordance with s.9 of the 1998 Act; a remedy would be regarded as substantial <u>unless</u> (s.9(1)):

(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.

According to s.9(2), in determining whether a remedy is <u>not</u> substantial regard should be had to all the relevant circumstances at the time the terms in question were agreed. Further, in relation to the test of fairness and reasonableness (see 9(1)(b) above) the following matters should be considered (s.9(3)):

(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.

As shown below, these matters were considered in the recent TCC case where it was decided that the contractual rate for late payment was not sufficient and, consequently, the statutory interest applied.

A &V Building Solution Ltd v J & B Hopkins Ltd[1]

The judgement, which was handed down on 6 September 2024, concerned the issues of adjudicators' fees and interest following a series of five previous judgements where the issues between the parties on the merits had been determined.

In regard to interest, A &V Building Solution Ltd ("A&V") sought statutory interest on the sums awarded against J & B Hopkins Ltd ("J&BH"). J&BH contended that the contractual rate should apply instead.

The judge concluded that the contractual rate did not provide a substantial remedy and, consequently, the statutory rate applied. In reaching his decision on the matter, the judge took into consideration, among other things, the factors set out in s.9(3) of the 1998 Act and concluded that:

- J&BH's bargaining power was substantially greater than A&V's (factor (b));

- the relevant clause was imposed by J&BH, as in practical terms A&V was probably faced with a "take it or leave it" situation (factor (c));

- although the relevant clause stated that it was acknowledged by A&V that the rate was a "*substantial remedy for late payment (as defined in the Late Payment of Commercial Debts (Interest Act) 1998*", this represented competent drafting on the part of J&BH's lawyers, rather than a reflection of both parties' consideration of the pros and cons of including an interest provision in the contract which purports to oust the 1998 Act;

- the contractual provision worked in only one direction, i.e. it applied only if J&BH failed to pay, but if A & V failed to pay J&BH there was no limit on the interest rate that the latter could seek to recover; and

- the contract provided for interest at 2% over the Bank of England's base rate current at the date of the default, thereby remaining fixed even if interest rates rose during the subsequent period of non-payment; in a period of rising interest rates – as the judge observed – this was massively in favour of J&BH and against A & V.

Conclusion

Claiming parties should be alert to the fact that although their contract sets out interest for late payments, there are cases (such as the one referred to above) that such interest could be found not to be a "substantial remedy", and the statutory interest (8% above the Bank of England's base rate) could apply instead.

For assistance in related matters, you can contact us at info@pronea.co.uk

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[1] [2024] EWHC 2295 (TCC)