Fair Payment Practices

A Presentation to the LGA 6th National Construction Conference

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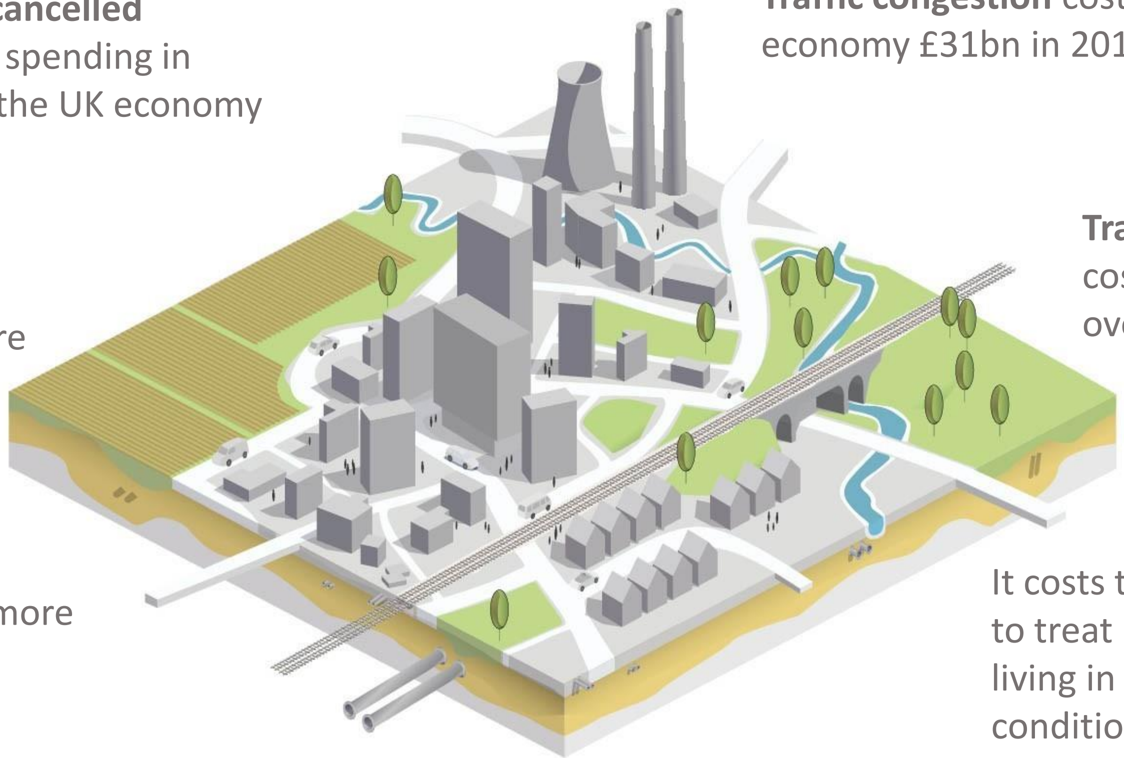
Department for
Business, Energy
& Industrial Strategy

What is wrong with construction?

Delayed and cancelled infrastructure spending in 2015/16 cost the UK economy £6bn

Traffic congestion costs the UK economy £31bn in 2016

20% of total construction costs are for **re-work**



Train delays in the UK cost the economy over £1bn annually

Homes and offices consume up to 4x more **energy usage** than designed

It costs the NHS **£600m pa** to treat illnesses caused by living in poor housing conditions in England

Transport and Energy supply contribute to more than 50% to UK's total greenhouse gas emissions

Disruption from **flooding** costs the UK economy £1bn pa

Why doesn't construction deliver?

- **Unsustainable business model – project and revenue based**
  - Firms have few/no balance sheet assets, so are vulnerable to downturns
  - Supply chains dissolve once projects are completed – learning is not retained, so productivity is low
  - Disincentivises investments in innovation and skills – which would make the industry more sustainable and productive in the long term
- **Adversarial relationships within supply chains**
  - Inappropriate transfer of risk down the supply chain
  - Unethical behaviours – rebate schemes, payment delays, non-payment, abuse of market power
  - Average time to pay by BuildUK members 46 days
- **Unlawful payment and contractual practices**
  - Pay when paid clauses
  - Non-issuance of payment notices/other documentation

Consequences of Late Payment

- At height of the last recession 10 sub-contractors were failing every day
- Almost 1 in 2 failing due to payment problems
- In 2010 Cabinet Office analysis of top 10 construction companies found average number of days to pay their suppliers was 64 days
- Subcontractors are recording 60+ days as standard and can be as high as 100
- Limited bank lending to offset payment delays > making situation worse
- Poor payment affects credit rating > making borrowing more expensive

Fair Payment - Why

- **Construction 2025** – fair financial arrangements and certainty of payment are critical success factors to *"…create the conditions for construction supply chains to thrive by addressing access to finance and payment practices*".

- **Latham Report** – specified there should be a duty that parties to a construction contract should deal with each other and the supply chain fairly and in a spirit of mutual co-operation.

- **Supply Chain Payment Charter** – 11 commitments around fair payment – payment in full, no unreasonable delays, prompt payment, fair practice in relation to retentions, transparency and honesty

The Legal Framework

- **Housing Grants, Construction and Regeneration Act 1996**
  - Right to be paid in interim or staged payments
  - Right to suspend work for non-payment
  - Client required to issue payment notice within 5 days of due date
- **Late Payment of Commercial Debts (Interest) Act** and **Late Payment of Commercial Debts Regulations** (2013)
  - Right to charge interest on outstanding debts
  - Regulations set limits on payment periods of 30 calendar days (public authorities) and 60 days (businesses)
- **Public Contracts Regulations 2015**
  - Require 30 day payment terms in supply chain contracts from date of payment notice

Action on Fair Payment

1. **Transparency**
   - Prompt Payment Reporting
   - Industry Initiatives

2. **Payment Practices**
   - Payment Performance
   - Retentions
   - Project Bank Accounts
   - Crown Commercial Services Frameworks

1. Transparency

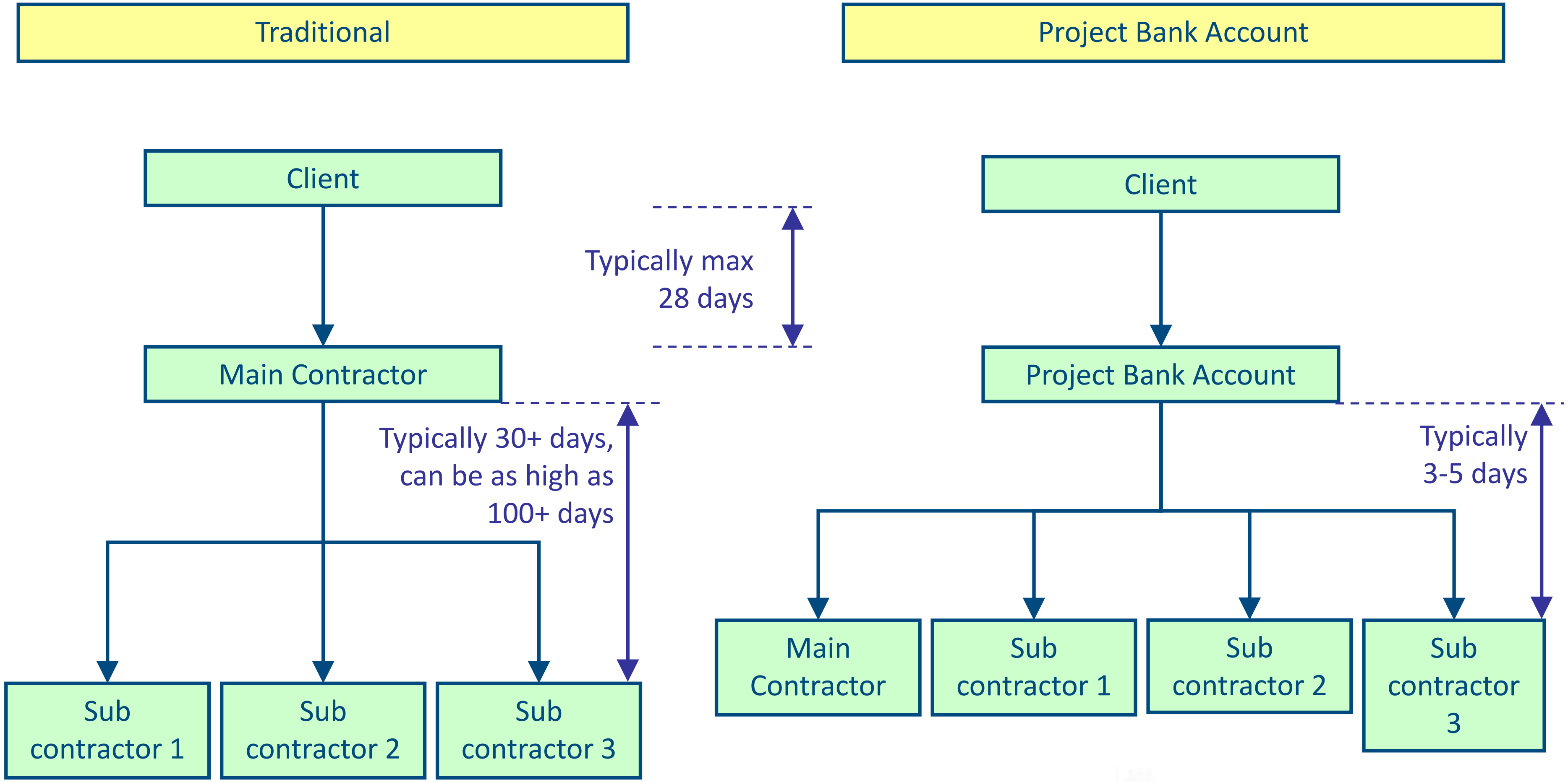
- **Duty to Report on Payment Practices and Performance**
  - Section 3 of the Small Business, Enterprise & Employment Act (2015) requires all large firms and LLPs to publicly report twice yearly on payment policies and performance.
  - Commenced 6 April 2017 – most firms have published 2/3 sets of data.
  - Criminal offence not to publish data within 30 days of the end of a reporting period – publishing false data punishable with a fine.

- **BuildUK Payment Performance League Table**
  - Includes contractors, clients and professional services firms.
  - Gathers data on: 1) average time to pay; and 2) average percentage paid beyond terms.
  - 2 rounds so far (July 2018 and Feb 2019) – improvements in average time to pay (45-43 days) and percentage paid beyond

2. Payment Practices

1. **Payment Performance:**
   - Crown Commercial Services PPN 04/18 – taking account of a suppliers approach to payment in the procurement of major contracts (>£5m) – recommends questions on payment performance, 30 day terms.
   - Standard 95% of invoices paid within 60 days in two standard reporting periods – uses payment reporting relationship provisions.
2. **Retentions:**
   - Industry representatives are working with BEIS to see if it is possible to achieve a consensus on retentions.
3. **Project Bank Accounts (PBAs)**
   - Infrastructure & Projects Authority considering how to support policy – to use PBAs unless there are compelling reasons not to
   - CCS Construction Frameworks encourage the use of these
4. **CCS Frameworks**
   - Require fair treatment of suppliers, 30 day payment and “liquidity” initiatives e.g. supply chain finance schemes

PBA – Funding Flows



Conclusions

- Poor payment practices are rife within construction – and detrimental to the efficient operation of the construction supply chain.

- A range of policy measures have been introduced – around transparency and driving better payment practices.

- Key payment policies included in CCS frameworks and guidance – aiming to embed best practice and drive fair payment practices within the industry.