

REGULATORY IMPACT ASSESSMENT

1. (i) Title of the measure:

Transposition into Scottish Law of EC Directive 2000/35/EC on combating late payment in commercial transactions

2. (i) The issue and objective:

2.1 The proposed regulations will transpose into Scottish law the provisions of the EC Directive on combating late payment in commercial transactions (2000/35/EC) that must be implemented by all Member States before 8 August 2002.

2.2 On 17th July 1997 the European Commission published a Report on late payments in commercial transactions. The Report suggested that heavy administrative and financial burdens are placed on business, particularly small and medium-sized enterprises (SMEs), as a result of excessive payment periods and late payment. It also cited late payment as a major cause of insolvencies, threatening the survival of businesses and resulting in numerous job losses.

2.3 The Commission Report also found that in some Member States contractual payment periods differ significantly from the Community average. It reported that differences between payment rules and practices constitute an obstacle to the proper functioning of the internal market by limiting commercial transactions between Member States.

2.4 The purpose of the Directive is to address the difficulties faced by businesses, especially SMEs, as a result of late payment, by giving them the statutory right to claim interest on late payment and reasonable compensation for all relevant recovery costs.

2.5 The Directive supports the aim of improving payment periods across Member States. If implemented correctly in all Member states it should regulate all cross-border commercial transactions irrespective of whether they are carried out between private or public undertakings.

2. (ii) Risk Assessment:

2.6 Prior to devolution the UK Government introduced legislation to give businesses a statutory right to claim interest if another business pays its bills late.

However, EC Directive 2000/35/EC covers, amongst others, two key areas that are not included in the domestic legislation and that are likely to result in changes to the existing legislation:

- a right to claim reasonable compensation from the debtor for all relevant recovery costs incurred as a result of the debtor's late payment, unless the debtor is not responsible for the delay; and
- the opportunity for organisations officially recognised as or having a legitimate interest in representing small and medium sized enterprises to take action according to the national law on the grounds that contractual terms relating to late payment are grossly unfair to the creditor.

2.8 The rights provided are legal entitlements; in instances where the purchaser/debtor does not fulfil the legal requirements the supplier/creditor may choose to go to court to enforce their entitlement(s).

2.9 Drawing on research by Dun and Bradstreet for the UK we estimate that up to 1,000 businesses in Scotland fail each year as a consequence of late payment. The Directive aims to reduce this figure and the number of job losses associated with insolvencies.

2.10 The United Kingdom is required by Community law to implement the Directive into UK law. Failure to do so could lead to proceedings being brought by the EU Commission in the European Court. The UK would also be liable to Francovich damages, i.e. possible claims by UK citizens for compensation for non-implementation.

3 (i) Identification of options:

3.1 Point 2.7 above identifies the 2 key areas that need to be addressed if Scotland is to successfully implement the Directive. In summer 2001 a consultation was held to allow interested parties to comment on our proposed approach and options for implementing the Directive.

3.2 The consultation document identified 8 options to implement the Directive's provision for the entitlement to reasonable debt recovery costs (see Annex 1).

3.3 With regards to representative claims (second point in 2.7 above), 3 options were identified by the Lord Chancellor's Department (LCD), and they were put forward in the consultation paper. In relation to Scotland these options would depend on procedural arrangements being made in the Scottish courts.

3. (ii) Selection of options:

3.4 Seven responses were received to the consultation and 5 of them commented on the implementation options. There was no clear consensus on a favoured option.

3.5 In England, Wales and Northern Ireland the responses to the consultation and a series of meetings with a sub-group of the Better Payment

Practice Group reduced the options to 2: a fixed scale of costs based on the size of the debt (option 1) and a combination option involving both a fixed scale of costs and actual recovery costs for older debts passed to a third party for collection (option 7). Discussions with representative organisations of small businesses resulted in agreement that option 1 should be adopted.

3.6 Option 7 was not selected because it can be reasonably expected that the need to keep and organise the evidence required to be able to recover actual costs would disproportionately impact on small businesses. Additionally small businesses are less likely to have the resources, both time and financial, to be able to present the evidence that would be required to claim actual costs. Therefore the entitlements offered through option 7 can be seen to act as a barrier to small businesses, when in fact the Directive was adopted primarily for their benefit.

3.7 The entitlement to actual debt recovery costs that option 7 was to have provided also raised the issue of gaming. This is because an agency contracted to recover a debt would have less pressures to keep their price for the service down, as their direct customer would no longer be paying the bill, but instead using the legislation to pass the charge on to the debtor who has paid late.

3.8 Option 1 was selected for England, Wales and Northern Ireland because it is simple and easy to use and has no requirement for businesses to keep special records. As a result it is hoped that this will encourage small businesses to use their new entitlement.

3.9 In order to maintain a level playing field for businesses across the UK it was decided that the rights of creditors in Scotland should be the same as in the rest of the UK. Therefore it was decided to adopt the same option as in England, Wales and Northern Ireland: option 1.

3.10 The compensation available to businesses through the implementation of option 1 was agreed with representative organisations of small businesses and is shown below:

<u>Size of the unpaid debt</u>	<u>To be paid to the creditor.</u>
Under £1,000	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

3.11 The compensation sums are a recognition of the fact that telephone calls and letters will have been directed to the debtor because the creditor, and in particular the small business creditor, will attempt to get the debtor to pay the money owed, and as such the compensation sums provide the reasonable compensation for debt-recovery costs that the Directive expects.

3.12 The term “grossly unfair” refers to contractual terms that seek to vary or oust the statutory entitlement to interest.

3.13 The implementation of a “third party action” was identified as the most appropriate solution to the requirement that SMEs have the right to have someone represent them and challenge grossly unfair terms.

3.14 The “third party action” based solution will allow organisations that can demonstrate a legitimate interest in the small or medium sized businesses that they wish to act on behalf of, to do so and challenge the grossly unfair terms that have been identified by either the businesses concerned or the organisation itself.

4. (i) Identify the benefits:

4.1 The Late Payment of Commercial Debts (Interest) Act 1998 currently provides small businesses with a statutory right under contract law to claim interest for the late payment of commercial debts.

4.2 The transposition of the Directive will bring about the following changes:

Article in the Directive	Benefit provided by the Directive
Article 1, Article 2.1 & Article 6.1	Extension of the scope of our existing late payment legislation so that all commercial undertakings and the public sector will be able to claim late payment interest. Additionally the availability of this right will be brought forward from 1 November 2002 to 7 August 2002, so as to meet the requirements of the Directive.
Article 3.1(d)	With regard to the calculation of late payment interest, the transposition of the Directive will fix the reference rate for calculating the rate of interest for periods lasting 6 months. At the end of each 6-month period, the Bank of England base rate component of the late payment interest rate will be fixed to the Bank’s rate at the start of the next 6-month period; i.e. late payment interest rate will no longer float to reflect the changes that might happen to the Bank of England base rate during a 6-month period.
Article 3.1(e)	All creditors will be entitled to reasonable debt recovery costs, when the creditor is not the cause of the late payment.
Article 3.5	This will entitle organisations that represent small and medium sized enterprises to challenge grossly unfair contractual terms that undermine the intent of the late payment legislation.

4. (ii) Quantifying and valuing the benefits:

4.3 The transposition of the Directive has the potential to provide three broad benefits:

- i) fewer firms will go out of business as a result of late payments;
- ii) the economy will function more efficiently, because the same number of transactions will continue to take place but it will do so at a lower cost due to less paperwork, time and direct costs spent chasing late payments; and
- iii) trade with European Union member states may increase as payment risks are reduced by the availability of similar late payment rights throughout the EU.

4.4 The effectiveness of the legislation is proportionate to businesses willingness to use (indirectly and/or directly) the rights that they have been given.

4.5 Unless the debtor is not responsible for the delay, the Directive will allow the creditor to claim reasonable compensation from the debtor for relevant recovery costs incurred as a result of the latter's late payment, in addition to claiming statutory interest.

4.6 In addition, the Directive does not detract from a creditor's common law right to sue for damages, including foreseeable consequential losses arising from the debtor's late payment. In these circumstances, a judge would take into account whether or not losses had already been compensated for by the interest for late payment.

4.7 It can also be argued that the right to claim interest and compensation would prove to be an effective late payment deterrent, which in turn is likely to be welcomed by small firms and their representatives.

4.8 Drawing on research by Dun and Bradstreet for the UK we estimate that up to 1,000 businesses in Scotland fail as a consequence of late payment. The Directive aims to reduce this figure and the number of job losses associated with insolvencies.

4.9 Research also suggests that approximately £17 billion is owed to small businesses at any one time; this figure includes payments that have not been received within 30 days or other agreed credit period. A survey published by the Credit Management Research Centre in July 2000 confirms that 60% of customers pay their invoices at or near the due date. The Small Business Service concludes that 40% of this £17 billion will be paid late. For Scotland we estimate that is equivalent to £400 million,

4.10 Further research by the Credit Management Research Centre confirms that most overdue accounts fall into the 15 – 30 days overdue category. By calculating the statutory interest owed against this outstanding debt, estimating 30 days overdue, we can provide an example of the likely level of interest owed to small businesses:

£400 million x 12% = £48 million (the annual rate)
divided by 365 = £131,507 (the daily rate)
x 30 days = **£3,945,210**

4.11 Representative organisations will judge whether in their view the costs of a particular action are justified by the likely benefits; i.e. the removal of the imposition of the grossly unfair terms that an undertaking had tried to impose.

4.12 Quantification and valuation of the benefits in question would require assessing the number of claims made currently, and extrapolating the number of claims that *would not otherwise have been made*. Clearly, when a large area of these proposals deals with potentially small and otherwise insignificant claims that may be consolidated, these benefits are difficult to identify on a quantitative basis.

4.13 The potential for savings in both court fees and legal expenses through the use of representative actions is substantial. Clearly the case exists for major savings in court fees if there is a substantial number of potential claimants whose actions have the same basis in law as one chosen to be a representative or “test” case.

4.14 The use of representatives such as consumer and other bodies can assist in securing savings of this kind as well as facilitating access to justice. Where it is possible focusing all the legal issues in one single action is always better than spreading the contentious material over many actions.

4. (iii) Issues of equity or fairness:

4.15 It is believed that there are no substantial issues relating to equity or fairness involved in these proposals.

4.16 The Directive should regulate all cross-border commercial transactions irrespective of whether they are carried out between private or public undertakings. The size of the business is also irrelevant so it does not place a particular emphasis on any particular part of the business community.

4.17 On the issue of representative actions, the impact of the proposed reform is to increase the accessibility of existing rights to challenge grossly unfair contractual terms by allowing SMEs to benefit from existing provisions without having to go to court themselves. Claims under representative actions are less likely to increase litigation against small businesses since by their very nature such businesses are less likely to have impacted a large number of people.

Compliance costs for business, charities and voluntary organisations

5. (i) Business sectors affected:

5.1 As indicated by the first item in the box under 4.2 above, the transposition of the Directive will extend the scope of the late payment legislation so that all businesses and organisations, irrespective of size, will be able to use it.

5.2 As a result of the process of devolution undertaken when the Government first came to power in 1997, Scotland has undertaken its own implementation of the Directive. England, Wales and Northern Ireland will be covered by the Department of Trade and Industry implementation exercise.

5.3 We have worked and continue to work closely with the Department of Trade and Industry to ensure that as far as is possible there is “read across” and that within the constraints of the distinctive legal systems late payment legislation is consistent throughout the United Kingdom.

5. (ii) Compliance costs for a typical or micro business:

5.4 The statutory right to claim interest and compensation is not compulsory. It is for the supplier to decide whether or not to make a claim. In this respect the Directive does not place any additional burdens on UK business.

5.5 Given the voluntary nature of the Regulations, it is not possible to calculate the impact of claims for reasonable compensation for a typical business. However, provided bills are met on time, the expense of interest and compensation charges would not have an impact.

5.6 Since representative claims would in effect act as an aggregation of a large number of small individual claims, it is arguable that the direct legal costs would be less for a single representative claim than for several individual claims. There is also the possibility that claims will be brought which hitherto were not considered worthwhile to pursue by the SME concerned because of the small sums involved.

5.7 Representative bodies will have to judge whether the costs of a particular action are justified by the likely benefits, as they will not be able to fund their activities through litigation.

5.8 It is unlikely that representative bodies will have sufficient funds to enable them to bring claims other than in worthwhile and genuine cases. The court will be required to consider whether they are acting responsibly and in the interests of those they represent, as discussed in the consultation paper.

5.9 Claims for damages would, obviously, be larger when a representative claim was sought rather than an individual claim. It is expected that

responsible businesses would wish to investigate and address any representative claims brought in an appropriate manner. Parties should seek to negotiate satisfactory settlements or consider alternative dispute resolution. In the event that representative claims do come before the court, they will be handled proportionately.

5.10 It is not proposed to allow representatives to receive damages in the event of bringing a successful representative claim, such payments are only appropriate to those who have directly suffered detriment.

5.11 It must be borne in mind that, when dealing with implementation costs with regard to regulation for representative claims, no difficult or complex new causes of action are being proposed. Implementation costs for businesses that have already adopted good business practices in relation to contract terms are therefore believed to be nil or negligible as no new regulatory burdens are being placed upon businesses as a result of these proposals.

5. (iii) Total compliance costs:

5.12 Due to the nature of the proposals, it is not possible to estimate with any useful degree of certainty the total compliance costs involved.

5.13 On representative claims, the proposals would not create any difficult or complex causes of action but they may increase the potential pool of litigants that businesses could face.

6. Results of consultation:

6.1 The Scottish Executive published the consultation paper, including possible options and the proposed approach for implementing the Directive, on 17 July 2001. The consultation closed on 5 October 2001. A summary of the consultation results can be found in Annex 2.

7. Monitoring and evaluation:

7.1 The Scottish Executive will review the effectiveness of the transposition of the Directive through the Review Regulatory Impact Assessment (RIA) which will revisit this RIA within 10 years of the legislation's introduction.

7.2 Article 6.5 of the Directive advises that the Commission will undertake a review of the Directive and its effectiveness.

8. Summary and recommendation:

8.1 This RIA explains how the EU Directive 2000/35/EC will be transposed, and discusses the steps that have been followed in determining how the transposition will be achieved, and why it is necessary.

8.2 Where options are available this document has explained why particular choices have been made. The options chosen are shown in the table below.

Article within the Directive, where it has been possible to generate transposition options	Option selected	Cost	Benefit
Article 3.1(e)	Option 1, a fixed scale of compensation based upon the size of the debt	None	No need to go to court to claim reasonable compensation for debt recovery costs.
Article 3.5	Third party action mechanism	None	<p>Small and medium sized businesses have a means to challenge the imposition of unfair credit terms and conditions.</p> <p>Reduced court costs if it is assumed that the organisation challenging is doing so on behalf of more than one business.</p>

8.3 In transposing this Directive and preparing this RIA the Scottish Executive has actively considered the UK Better Regulation Task Force's five key principles of good regulation:

- **Transparency** – by being open, and keeping the guidance simple and user-friendly
- **Accountability** – to Ministers and Parliament, and to users and the public
- **Targeting** – by focusing on the issue and minimising the side effects
- **Consistency** – by ensuring that people know where they stand

- **Proportionality** – by fitting the remedy to the risk and only regulating when we need to.

Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister: *Lewis Macdonald*

Date: *27 June 2002*

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Annex 1

The right to claim reasonable debt recovery costs **(options put forward in the spring 2001 consultation paper)**

Option 1

A fixed scale of cost based on size of debt.

Option 2

A fixed scale of costs based on collection activities.

Option 3

A fixed scale of costs based on age of debt.

Option 4

A fixed percentage charge.

Option 5

A scale of fixed percentages based on age of debt.

Option 6

Allowing a claim for actual costs incurred.

Option 7

A combination option involving an initial fixed charge, moving onto actual recovery costs for older debts passed onto a third party for collection.

Option 8

A combination option involving a fixed amount for every early collection step (similar to option 2) and a fixed percentage scale which increases with the age of the debt (similar to option 5).

Annex 2

Results of the 2001 consultation - Implementation of the Directive 2000/35/EC on combating late payment in commercial transactions

Seven responses were received and five of them commented on the implementation options.

Responses are mainly from trade associations/interested parties.

RESPONSES

Section 7 – Interest in cases of late payment

Three respondents said there were circumstances when the debtor is not responsible for the delay.

Two respondents said the UK should retain the current rate of interest.

Section 8 - Compensation

One respondent favoured a combination of options 1 & 4, one favoured option 4, one favoured option 7, one favoured option 8 and one favoured either an amended form of option 7 or option 1.

Section 10 – Representative Claims

One respondent said that businesses need not be individually named. One respondent said that they must be named.

Two respondents said a list should be prepared of organisations allowed to bring representative claims. One said that the Courts should consider whether those seeking to bring a representative claim are able to do so.

Section 13 – Transposition and Entry into Force

One respondent agreed that Scotland should adopt the named exclusions during transposition and one disagreed. One respondent said that some should be adopted and some not adopted.

Other Issues

One respondent believed that the Directive covered transactions which do not rest on contract, such as the provision of professional services by advocates. One correspondent did not feel that a broad-based legislative response to the issue of late payment was helpful to businesses.