

PENALTY FOR DELAYED PAYMENTS IN COMMERCIAL CONTRACTS



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CONTRACT

This Contract is entered into by and between _____
The term of this Agreement shall begin on _____
termination date of _____

This Contract may not be modified in any
Parties. This document and any attachments shall be binding on
the Parties. This Contract shall be enforced under the laws of the State of _____
assigns and shall be enforced under the laws of the State of _____
In consideration of the mutual promises made by the Parties, the Parties
agrees that it shall _____



PENALTY FOR DELAYED PAYMENTS IN COMMERCIAL CONTRACTS

A commercial contract essentially involves three main things – Offer, Acceptance and Consideration (usually in terms of money). Every commercial contract will have its terms negotiated and agreed including the financial terms, in exchange for the goods and services provided and will clearly set out extent of liability in the event of default. It is a general rule that the party to the contract that is held to perform is liable for breach of contract if he does not perform. The defaulting party is obligated to cover the loss or damage caused by him to the innocent party for failing to uphold his contractual obligation. The parties may agree to payment of certain sum as compensation or levy penalty as consequence of breach of any terms of the contract, including a delay in payment.

Overdue payments are a menace and could disrupt the ease and flow of business. In order to prevent late payments, penalty clause is provided in goods or service agreement to dissuade parties from breaching the contract. Levying penalty in commercial contracts may seem attractive as it may enforce the performance of the contract. However, invoking such penalty provisions are met with restrictions either by the Courts or statutes.

In this present article, we shall list out the statutory rights of various jurisdictions and the observation of courts exclusively on the Penalty imposed on delayed payments.

Country	Inference	Provisions
United Kingdom (UK)	<ul style="list-style-type: none"> • Statutory rules on late payment – Interests can be charged and debt recovery costs can be levied.¹ • A fixed sum can also be charged for recovering the late payment in addition to claiming interest.² 	<ul style="list-style-type: none"> • Late Payment of Commercial Debts (Interest) Act 1998 • Statutory period: <ul style="list-style-type: none"> ➤ 30 days for Public authorities (B2P) ➤ 60 days for Business transactions (B2B) ➤ If the payment date is not agreed, it is late 30 days after either the receipt of invoice or the delivery of goods/services. • Statutory Interest: <ul style="list-style-type: none"> ➤ 8 % interest above the Bank of England base rate per annum for B2B transactions ➤ If the Contract has a different interest rate, Statutory interest cannot be claimed.
France	<ul style="list-style-type: none"> • Statutory rules on late payment – Interests can be charged 	Article L. 441-6 of the French Code de commerce (Commercial code) <ul style="list-style-type: none"> • Statutory period: <ul style="list-style-type: none"> ➤ Must not exceed 60 days from the date of invoice or 45 days from the end of the month that the invoice was issued.³ ➤ The French commercial code now provides that invoices shall be issued "on the date of delivery or completion"⁴ ➤ An administrative penalty of up to €375,000

¹ <https://www.gov.uk/late-commercial-payments-interest-debt-recovery>

² <http://www.legislation.gov.uk/ukpga/1998/20/section/5A>

³ https://www.economie.gouv.fr/files/files/directions_services/mediateur-des-entreprises/PDF/english-guide.pdf

⁴ within the meaning of paragraph 3, I of Article 289 of the French tax code (Code général des impôts).

		for legal entities replaces the criminal fine in case of failure to comply with French invoice legal requirements ⁵ ;
Germany	<ul style="list-style-type: none"> • Penalty for late payment came into force by Directive 2011/7/EU.⁶ • New time limits for contractually agreed payment terms, default, statutory interest on late payment, claim for payment of a fixed compensation in case of late payment are imposed by this directive.⁷ 	<ul style="list-style-type: none"> • Directive 2011/7/EU • Statutory Provisions: <ul style="list-style-type: none"> ➤ Payment cannot be longer than 30 days from receipt of goods or service.⁸ ➤ Fixed compensation of EUR 40 (new Sec. 288 (5) sentence 1 BGB) ➤ the default interest rate on claims for payment was raised from 8 to 9 percentage points above the basic rate of interest (new Sec. 288 (2) BGB)⁹
Turkey	<ul style="list-style-type: none"> • In the event of default in payment of price, the other party can claim damages for such default or delay or withdraw from the contract. • Parties may agree for penalty clause if the primary obligation is not fulfilled. Therefore, a penal clause is not a stand-alone clause.¹⁰ • if the main obligation becomes invalid due to the performance, release, set-off or novation, the secondary obligations as penalty clause become invalid as well. However, The nullity of the penalty clause shall not affect the validity of the main obligation due to the secondary nature of the penalty clause.¹¹ 	<ul style="list-style-type: none"> • Turkish Code of Obligations <ul style="list-style-type: none"> • 6098 - provides for fundamental provisions regarding default and performance of debts; • Article 179, Article 182/2. • Statutory period: <ul style="list-style-type: none"> ➤ If the payment term or date is determined – No notice need be given; payment period shall be maximum of 60 days from the receipt of invoice.¹² ➤ If the payment term or date is not determined –payment period shall be maximum of 30 days after the receipt of invoice.¹³ ➤ Parties are free to determine the penalty interest.
Belgium	<ul style="list-style-type: none"> • Penalty for late payment 	<ul style="list-style-type: none"> • Directive 2011/7/EU of 16 February 2011 on

⁵ To help reduce delays in the payment of invoices, the French government has modified Article L. 441-9 of the French commercial code, by Ordinance N° 2019-359 of April 24, 2019, taken pursuant to the EGalim law (French law on agriculture and nutrition) N°2018-938 on Oct. 30, 2018.

⁶ https://ec.europa.eu/growth/smes/support/late-payment_en

¹¹ <https://turkishlawblog.com/read/article/78/delay-penalties-in-public-procurement-contracts>

¹³ supra

¹² <https://www.mondaq.com/turkey/contracts-and-commercial-law/683050/the-consequences-of-late-payment-in-the-procurement-of-goods-and-services>

¹⁰ <http://www.erdem-erdem.av.tr/publications/newsletter/contractual-penalty-under-turkish-law/>

⁷ supra

⁸ https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html

⁹ supra

	came into force by Directive 2011/7/EU ¹⁴	combating late payment in commercial transactions. <ul style="list-style-type: none"> • Statutory Provisions: <ul style="list-style-type: none"> ➤ Payment cannot be longer than 30 days from receipt of Invoice or equivalent request.¹⁵ ➤ In case of SMEs, the payment cannot exceed 30 days.¹⁶ ➤ when the date of receipt of the invoice or the equivalent request for payment is uncertain or the debtor receives the invoice or equivalent request for payment before the goods or services, 30 calendar days from the date of receipt of the goods or services.¹⁷
Russia	<ul style="list-style-type: none"> • Penalty for delayed payments provided by law cannot be claimed if the same is not mentioned in the Agreement.¹⁸ 	<ul style="list-style-type: none"> • Article 395 of the Civil Code of Russia provides for creditor to claim for recovery of interest due to non- fulfilment or delay in fulfilment of monetary obligation.¹⁹ <ul style="list-style-type: none"> ➤ If the penalty is unreasonable, the Court shall be entitled to decrease the amount of penalty only if the debtor files a motion for such request [Article 333 of the Civil code of Russia]²⁰
UAE	<ul style="list-style-type: none"> • The Commercial Code takes precedence over the UAE Civil Code in respect of the commercial transactions²¹ 	<ul style="list-style-type: none"> • The UAE Commercial Code²²: <ul style="list-style-type: none"> ➤ if contractually agreed, a creditor is entitled to interest as compensation for delayed payment either ➤ at the rate agreed by the parties (Article 77)²³; or ➤ at the prevailing market rate subject to a maximum of 12% in the absence of agreement (Article 76)
Singapore	<ul style="list-style-type: none"> • Contract laws based on English Common Law. Much of the law on contracts in Singapore are in the form of Judgements. 	<ul style="list-style-type: none"> • If the sum is intended to be a penalty aimed at ‘punishing’ the party-in-breach, the court will strike down the ‘penalty’ clause and award unliquidated damages instead to compensate the aggrieved party.²⁴

¹⁴ <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32011L0007>

²¹ <https://www.mondaq.com/contracts-and-commercial-law/786820/applicability-and-legal-entitlement-to-interest-under-uae-law>

²⁰ <https://www.legalmondo.com/2018/09/russia-contractual-penalty-can-exceed-total-value-contract/>

¹⁹ <http://supcourt.ru/en/files/16418/>

¹⁸ <https://www.internationallawoffice.com/Newsletters/Corporate-Commercial/Russia/Noerr/Supreme-Court-clarifies-Civil-Code-amendments-regarding-compensation-for-damages-and-contractual-penalties>

¹⁵ <https://www.mondaq.com/contracts-and-commercial-law/823780/stricter-payment-periods-for-commercial-transactions-with-smes?login=true>

¹⁶ supra

¹⁷ <https://www.lexology.com/library/detail.aspx?g=bcf3ff53-57bf-4308-947f-4138a1310719;>

²² <https://uaeahed.com/wp-content/uploads/2014/10/commercial.pdf>

²³ supra

India	<ul style="list-style-type: none"> Liquidated damages clause is enforceable. When the liquidated damages are not reasonable or extravagant, they are considered penalty. Statutory provisions under MSME Act available 	<ul style="list-style-type: none"> Sections 15 to 17 of the Micro, Small and Medium Enterprises Development Act, 2006 <ul style="list-style-type: none"> ➤ Maximum period allowed is 45 days from the date of delivery of goods/services. ➤ Defaulter liable to pay amount with compound interest from the date immediately following the date agreed upon, at three times of the bank rate notified by the Reserve Bank.²⁵
China	<ul style="list-style-type: none"> The overall legal policy is that the court does not support claims for liquidated damages which significantly exceeds the actual loss of the non-defaulting party.²⁶ 	<ul style="list-style-type: none"> The Supreme Court has issued an interpretation stating that if the liquidated damages pre-agreed by the parties are more than 1.3 times of the non-defaulting party's actual loss, then the portion in excess will not be enforced by the court. <ul style="list-style-type: none"> ➤ As noted above, if one party defaults in payment, effectively the other party is being forced to provide a loan to the defaulting party. ➤ Hence, in practice the court tends to simply apply the specific rules and caps relating to loan interest by analogy to non-loan agreements if the agreement is silent on late payment interest, rather than try to ascertain the amount of "actual loan" and then apply the general rule of "no more than 1.3 times of actual loss".²⁷
Japan	<ul style="list-style-type: none"> Statutory rules on late payment – Interests can be charged 	<ul style="list-style-type: none"> Statutory provisions as per Civil Code Japan <ul style="list-style-type: none"> ➤ Payment terms must be within 60 days after the performance or delivery, in contracts between large companies and subcontractors, even if they expressly agree upon a longer term.²⁸ ➤ The statutory interest rate for commercial transactions is 6 per cent per annum (Commercial Code Art 514).²⁹ ➤ The parties are free to agree to a different interest rate, but if such interest rate is contrary to public order and morals and such like, the statutory interest rate will apply.
Vietnam	<ul style="list-style-type: none"> Statutory rules on late payment – Interests can be charged 	<ul style="list-style-type: none"> Article 306, the 2005 Commercial Law provides for the right to demand interest on the delayed payment by the aggrieved party.³⁰

²⁴ <https://www.singaporelawwatch.sg/About-Singapore-Law/Commercial-Law>

²⁵ The Micro, Small and Medium Enterprises Development Act, 2006

²⁸ <https://gettingthedealthrough.com/area/88/jurisdiction/36/commercial-contracts-japan/>

²⁹ <http://www.law.tohoku.ac.jp/kokusaiB2C/overview/contract.html#part3>

²⁷ supra

²⁶ <https://www.lexology.com/library/detail.aspx?g=e252df8b-52b1-41dd-a17a-1485243bb34b>

³⁰ https://www.wto.org/english/thewto_e/acc_e/vnm_e/WTACCVNM43_LEG_11.pdf

		<ul style="list-style-type: none"> Precedent No.09/2016/AL3 and Article 114 , Resolution No.01/2019/NQ-HDTP provide details towards calculation of ‘average interest rate applicable to overdue debts in the market’.³¹
Australia	<ul style="list-style-type: none"> a provision in a contract that seeks to impose a penalty on a contracting party, is not enforceable.³² If it is not a penalty, a liquidated damages clause is enforceable under Australian law.³³ No statutory time limits for paying invoices. 	<ul style="list-style-type: none"> In certain circumstances, security of payment legislation ensures that suppliers carrying out construction work or providing related goods or services can receive and recover payments. Parties cannot contract out of the security of payment legislation. If a customer is required under security of payment laws to pay an invoice, this does not prevent the customer later challenging whether the supplier was entitled to payment.³⁴ Statutory Interest: <ul style="list-style-type: none"> No statutory interest rates Agreed interest rates must not be exorbitant otherwise it would be considered a penalty.
Canada	<ul style="list-style-type: none"> No Statute available. However, incorporating penalty clause in commercial transactions is prevalent. 	<ul style="list-style-type: none"> Over all nature of contract to be taken into account while incorporating penalty for late payment provisions: <ul style="list-style-type: none"> The courts consider such late-payment clauses to be penalty clauses, but will generally seek to reduce their severity, as opposed to nullifying them.³⁵
USA	<ul style="list-style-type: none"> Most jurisdictions in the United States adhere to the traditional common law rule against punitive damages for breach of contract, if there is no tortious conduct;³⁶ 	<ul style="list-style-type: none"> Statutory interests maybe charged on late payment; Rate of interest depends on State laws;³⁷
Mexico	<ul style="list-style-type: none"> Promissory agreements may include penalty clauses in case of breach by the defaulting party.³⁸ 	<ul style="list-style-type: none"> The penalty must not exceed the amount of principal obligation of the contract. In the absence of a penalty clause, by statute of law, a penalty of up to 6% may be applied; Evidence of existence of damages and losses need not be proved to demand penalty. The payment of penalty excludes payment of additional damages or loss³⁹

³¹ <https://www.lexology.com/library/detail.aspx?g=ce037376-f1a2-49cb-8f13-dbf1210f7da>

³⁶ <https://gettingthedealthrough.com/area/88/jurisdiction/5/commercial-contracts-usa>

³⁵ <https://www.mondaq.com/canada/contracts-and-commercial-law/348484/contractual-clauses-dealing-with-interest-on-late-payments-proceed-with-caution>

³⁴ Supra

³³ <https://www.lexology.com/library/detail.aspx?g=a231a53e-9b69-41f0-9999-185581e35796>

³² <https://www.mondaq.com/australia/contracts-and-commercial-law/521648/penalties-in-contracts>

³⁷ supra

³⁸ EY Global Legal Commercial Terms Handbook, 2017

Brazil	<ul style="list-style-type: none"> The Brazilian legal system has extensively regulated penalty clauses. 	<ul style="list-style-type: none"> According to Article 406 of the Brazilian Civil Code, the seller can charge interest on late payment of up to 12% per year, pro rata per day.⁴⁰
South Africa	<ul style="list-style-type: none"> Statutory provision available 	<ul style="list-style-type: none"> The Conventional Penalties Act of 1962 allows penalty to be levied. The Courts may reduce excessive penalty⁴¹

Thus, various Courts have time and again set out clearly that the compensation levied in a contract must be 'reasonable' and cannot be extravagant. In the absence of statutes providing exclusive provisions for penalty, it is imperative to draft the penalty clause in such a manner that the damages claimed is not extravagant and that the clause itself does not become a threat to the other party. It is common for most business to expect timely payment for the goods or services rendered. Timely payment is indeed critical for small and medium enterprises for smooth functioning of their business. The parties entering into contracts must be careful in negotiating payment terms and ensure that penalty provisions for delayed payment provided thereunder are enforceable thereby paving way for successful materialization of contract.

- Shelley Anandhavalli E.

³⁹ supra

⁴⁰ supra

⁴¹ <https://www.gov.za/documents/conventional-penalties-act-16-mar-1963-0000>