EXPLANATORY MEMORANDUM TO

THE LIMITED LIABILITY PARTNERSHIPS (REPORTING ON PAYMENT PRACTICES AND PERFORMANCE) REGULATIONS 2017

2017 No. 425

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations apply to large limited liability partnerships (LLPs), with modifications, a requirement to publish certain information twice per financial year about their practices, policies and performance in relation to paying suppliers. The reporting requirement is set out in the Reporting on Payment Practices and Performance Regulations 2017 (the "Company Reporting Regulations"), which apply to certain companies. The large LLPs in scope of the requirement are those that have, in the two preceding financial years, exceeded certain thresholds for qualifying as medium-sized under the Companies Act 2006 (see section 7 below). Newly established LLPs are not required to report in their first financial year.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland.

4. Legislative Context

4.1 The Company Reporting Regulations implement section 3 of the Small Business, Enterprise and Employment Act 2015; using the regulation-making powers in that section for the first time, to create a new reporting requirement about certain companies' payment practices, policies and performance.

4.2 These Regulations are made under the powers contained in sections 15 and 17 of the Limited Liability Partnerships Act 2000, which enable legislation relating to companies to be applied to LLPs. This instrument applies to LLPs the provisions of the Company Reporting Regulations, with modifications to reflect the different structures of companies and LLPs.

4.3 It is intended that this instrument will be laid before Parliament at the same time as the Company Reporting Regulations.

5. Extent and Territorial Application

5.1 This instrument extends to England and Wales, Scotland and Northern Ireland.

5.2 The territorial application of this instrument is England and Wales, Scotland and Northern Ireland.

5.3 The UK Government is responsible for this policy in England and Wales, and in Scotland. The Northern Ireland Assembly passed a legislative consent motion in relation to section 3 of the 2015 Act (under which this instrument is made) extending to Northern Ireland, on 20 January 2015. The Northern Ireland administration has been informed about this instrument and it applies to the whole of the United Kingdom.

6. European Convention on Human Rights

6.1 The Minister for Small Business, Consumers and Corporate Responsibility, Margot James, has made the following statement regarding Human Rights:

"In my view the provisions of the Reporting on Payment Practices and Performance Regulations 2017 are compatible with the Convention rights."

7. Policy background

What is being done and why

7.1 Late payment is a major issue for UK businesses, particularly small businesses. As of December 2016 the overall level of late payment debt owed to micro, small and medium sized businesses is £26.3bn.[1] Late payment causes problems for businesses that are not paid on time as it: adversely affects their liquidity; constrains their ability to invest; and can force businesses to exit the market.

7.2 There are several existing measures which seek to address late payment. The Late Payment of Commercial Debts (Interest) Act 1998 enables businesses to claim interest for late payment. Since 2009, the voluntary Prompt Payment Code has enabled good payers to highlight their positive practices and be recognised as prompt payers. In the public sector, it is a requirement for public sector buyers (other than devolved bodies) to have 30-day payment terms in their new contracts and through their supply chains. Additionally, public sector buyers are required to publish annual data on their payment performance.

7.3 However, late payment continues to be an issue, particularly for small businesses who can find it difficult to challenge larger customers, and so further legislation is required. Effective markets are generally characterised by high levels of information available to both sides of the market. Greater transparency about large businesses' payment practices can give small businesses greater understanding of those they do business with, without unduly interfering with freedom of contract. The instrument therefore imposes a reporting requirement on large companies to publish details of their payment practices and performance. The greater transparency delivered by this is also intended to drive a culture change toward more prompt payment, as payment practices and performance are increasingly a reputational issue for company boards.

7.4 The benefits of the policy will come through reductions in payment times to suppliers, driven by transparency and scrutiny. Whilst these benefits are difficult to quantify, an illustrative estimate suggests that even a small 0.25 per cent overall reduction in the

[1] BACS payment data - https://www.bacs.co.uk/NewsCentre/PressReleases/Pages/%C2%A326_billion_owed_in_late_payments_but_this_won%E2%80%99t_get_worse_under_Brexit_say_smaller_UK_businesses.aspx

cost burden of chasing late payments would lead to annual benefits of £22.9m to UK businesses.

7.5 It is estimated that there are about 15,000 companies and LLPs that will be required to report (under this instrument and the Company Reporting Regulations). LLPs will be in scope if, in their last two financial years, they exceeded two or all three of the thresholds in s465(3) of the Companies Act that determine whether a company can qualify as medium-sized (these apply to LLPs under the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008). At the time of publication, these thresholds are: £36 million annual turnover; £18 million balance sheet total; and an average of 250 employees in the year.

7.6 The instrument also applies a further test to parent LLPs, which requires their group to have exceeded two or all three of the thresholds in s466(4) of the Companies Act (applied to LLPs as above) that determine whether a parent LLP can qualify as medium-sized . At the time of publication, these thresholds are: aggregate turnover of £36 million net of group transactions (or £43.2 million gross); aggregate balance sheet total of £18 million net (or £21.6 million gross); and an aggregate number of 250 employees.

7.7 Changing the behaviour of large businesses could have a significant impact across the economy as analysis in the impact assessment shows that late payment by large businesses can have an impact all the way down the supply chain.

7.8 As the policy aim is to improve transparency about large businesses' payment of suppliers, the businesses in scope of the duty will be required to publish information covering their payments in relation to contracts for goods, services or intangible assets (including intellectual property); and which are connected to the carrying on of a business. Contracts for financial services will not be covered by the duty to report because they are substantially different to contracts for goods and other services and so are not comparable. This exclusion only applies to contracts for financial services but it does not exclude financial companies themselves when they are contracting for other goods or services.

7.9 The information that LLPs will have to report on includes metrics such as descriptions of their standard payment terms and dispute resolution process and statements about their payment practices and policies, including availability of electronic invoicing and supply chain finance and membership of a payment code of conduct. LLPs will also have to publish statistics about their performance for each reporting period, including the proportion of payments due in the reporting period which were not paid within the contractual payment period; the proportion of payments made in the reporting period which were made within certain time frames; and the average (mean) number of days taken to make such payments, which is calculated by adding the number of days it took to make all of the relevant payments and dividing this by the number of those payments.

7.10 The open nature of the reporting is intended to encourage businesses to comply and to improve their payment practices, through public pressure and good payment behaviour by responsible companies leading the way, encouraging other businesses to seek to match the best.

7.11 In addition to these 'behavioural change' mechanisms a clear sanction for non-compliance is needed, to deter any businesses from seeking advantage from not complying with the requirement. The instrument provides that failure to publish a

report or publishing false or misleading information is a criminal offence. The sanctions are based on those for existing company and LLP reporting requirements. The Department will generally seek to encourage a business to comply with the reporting requirement before steps are taken to prosecute. For this reason, and because it may not be immediately apparent if false information is provided, the instrument extends the time limits for prosecution to those applicable in relation to other company and LLP reporting requirements.

7.12 The duty to report will help inform business decisions on whether or not to enter into contracts, as businesses will be able to compare the payment performance of alternative customers. The duty will also help businesses negotiate fair terms and prices in contract negotiations.

8. Consultation outcome

8.1 The then Government published the *Building a Responsible Payment Culture* discussion paper in December 2013. This paper sought views on a range of options which could address late payment and improve businesses' treatment of suppliers. These included non-legislative options; one of which was a proposal for voluntary reporting on payment practices and performance. Respondents were keen for greater transparency around payment practices, and there was support for a mandatory framework. The summary of responses and Government Response was published in May 2014. As a result of the responses to the discussion paper the power to impose a duty to report was introduced in the 2015 Act.

8.2 There was a detailed public consultation (the *Duty to Report on Payment Practices and Policies*) on the implementation of the duty to report between 27 November 2014 and 2 February 2015, including draft regulations to show how it would translate into secondary legislation. The summary of responses to the consultation was published in March 2015. 60 responses were received, primarily from business representative bodies, trade organisations and professional bodies. In addition, the Department held meetings with stakeholders during the consultation period. Since then, further work has been carried out, including discussion and engagement with stakeholders. The Department has also commissioned separate independent research to provide additional evidence for the impact assessment and for the digital service.

8.3 A Government Response, including updated draft regulations, was published on 2 December 2016 and is available on the gov.uk website. Consultation responses were broadly supportive of the implementation proposals, although some details have been refined in response to the consultation. In particular, the frequency of reporting has been changed from quarterly to twice a year because responses said that quarterly would be too onerous, without adding value. Businesses must publish reports on a web service provided by the Government, rather than on their own website or a publication such as the Gazette because reports need to be easily accessible. The Government response explains the changes from the proposals consulted on in more detail.

8.4 The consultation asked for views on whether the requirement should extend to large LLPs as well as large companies. Over half of respondents to the 2014/5 consultation agreed that LLPs should be included as well as large companies.

9. Guidance

9.1 The Government is publishing guidance for large businesses in scope of the duty on how to comply. The guidance may also be useful for businesses accessing the information. Copies will be placed in the House Libraries and sent to the scrutiny committees.

10. Impact

10.1 The expected impact involves a cost to large businesses in scope of the duty, with a benefit to suppliers (mostly small and medium-sized) that currently experience late payment from customers. The costs are those associated with complying with the providing reports on payment performance. Small, medium-sized and micro businesses are not in scope of the reporting requirement but will benefit from reductions in payment time that result from the increased transparency.

10.2 An Impact Assessment is submitted with this memorandum and is published alongside the Explanatory Memorandum on the legislation.gov.uk website. The impact assessment quantifies the expected costs and benefits of the duty. There are currently no requirements for companies to report on their payment practices, so this is a new cost on large businesses. The cost of producing accurate reports on their practices and payment performance include: familiarisation with the new requirements; adapting, purchasing and maintaining IT systems; updating processes; preparing and approving reports.

10.3 The transition costs to business are estimated to be £27.3m (including familiarisation, IT costs, information gathering, changes to processes). The ongoing annual costs to business are estimated to be £15.4m (including maintenance of systems and processes, cost of preparing, collating, approving and submitting reports twice a year).

10.4 The annual costs to government of enforcement are estimated to be £0.20m (investigating and prosecuting non-compliance).

10.5 The benefits of the policy come through reductions in payment times to suppliers. The reporting requirements will put information in to the public domain about the payment practices and performance of large businesses, exposing poor payment performance and allowing suppliers to check the payment record of potential customers before agreeing to enter in to a contract. The extra transparency should encourage better payment practices. Reducing payment times will benefit businesses by reducing the costs incurred through late payment, such as needing to raise external finance to cover cash flow shortages, or diverting administrative time chasing late payment.

11. Regulating small business

11.1 The legislation does not apply to activities that are undertaken by small businesses.

12. Monitoring & review

12.1 A review provision is included in this instrument. The Secretary of State must publish a report setting out the conclusions of the first review of these Regulations before 6 April 2022.

12.2 If this instrument is not remade as a result of that review, it will expire on 6 April 2024 (under regulation 1(3)).

13. Contact

13.1 Corinne Brooke at the Department of Business, Industrial Strategy and Energy can answer any queries regarding the instrument.

Telephone: 0207 215 6051 or email: corinne.brooke@beis.gov.uk