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LATE PAYMENTS IN THE CONSTRUCTION INDUSTRY: COMPARATIVE LAW AND POLICY APPROACH IN THE UAE

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In the construction industry, payment practices vary considerably across the globe, often influenced by legal frameworks, cultural norms, and industry maturity. However, in general, late payments represent a significant challenge, particularly affecting subcontractors and suppliers, especially SMEs. Pay-when-paid clauses can transfer payment risk down the supply chain. Dispute resolution can be costly and time-consuming. Thus, in comparative law, various regulatory approaches have been adopted to address the issue. The UAE has seen a rapid growth in its construction industry over the past few decades, with numerous high-rise buildings, infrastructure projects, and mega developments transforming the landscape of the country. Such growth has given rise to the need for effective rules and policy tools to ensure that all parties involved in construction projects are protected and paid in a timely manner.

Keywords: construction industry – payment practices – late payments – comparative law – regulatory approach

I. CONSTRUCTION INDUSTRY AND PAYMENT PRACTICES

In the construction industry, business expenses are incurred and often must be paid before payments are received for work conducted. Cash flows out of a contracting or subcontracting business for wages and materials quicker than the time it takes for cash to flow in. Wages must be paid weekly or biweekly, and materials are typically purchased on 30-day invoice terms[1].

Payment practices in construction vary considerably across the globe, often influenced by legal frameworks, cultural norms, and industry maturity.

Developed economies, such as the USA, EU and UK, generally have more formalized payment mechanisms, with legal protections for prompt payment, adjudication processes and standardized payment terms. Other strengths are the increasing adoption of digital payment systems and Building Information Modeling for transparent project management.

However, late payments still remain a significant challenge, particularly affecting subcontractors and suppliers, especially SMEs. Pay-when-paid clauses can transfer payment risk down the supply chain. Dispute resolution can be costly and time-consuming.

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[1] Rabbet, 2023 Construction Payments Report, available at https://info.rabbet.com/2023ConstructionPaymentsReport.html#:~:text=Rabbet's%20game%2Dchanging%202023%20Construction,number%20for%20all%20players%20involved, p. 7.

In the United States, in 2023 an estimated 72% of subcontractors reported they waited longer than 30 days to receive payment. This number has spiked significantly from previous 49% in 2022 and 50% in 2021[2].

General contractors are not immune from the impacts of slow payments and also see value in expediting payments for subcontractors. In the US, 67% of general contractors incurred financing costs while floating payments to subcontractors, a slight change from 62% in 2022, 63% in 2021, and 65% in 2020[3].

In the European Union, the economy and especially the construction sector have long been afflicted by late payment. Construction companies and especially SMEs have experienced impacts ranging from loss of income, bankruptcies, limited ability to invest in their growth and hire new employees[4].

In 2023, 57% of EU construction companies accepted longer payment terms than they are comfortable with, to preserve their client and customer relationships. 39% of SMEs said they would be more likely to request longer payment terms from suppliers or pay an invoice later than agreed, compared to 35% of large businesses. 53 per cent of businesses admitted they would accept longer payments from large companies, but just 38% said they would accept that from SMEs[5].

In developing economies, for example India and Southeast Asia, on one hand, the strengths are the growing infrastructure investment and construction activity, and emerging digital payment platforms and mobile banking solutions.

On the other hand, these regions often face greater challenges with payment delays, due to factors such as lack of standardized payment terms and contract enforcement, informal payment practices and reliance on cash transactions, limited access to financing and credit for smaller players and power imbalances between large contractors and SMEs, corruption and bribery risks.

In the Middle East, and in particular in the UAE, the strengths are the robust growth and dynamism of the construction industry, the strong government support for infrastructure development and mega-projects, the increasing adoption of new technologies like Building Information Modeling and digital payment systems, and recent legal reforms to protect SME contractors and ensure timely payments.

The weaknesses are traditional payment practices that often involve longer payment cycles and reliance on post-dated cheques, power imbalances between large contractors and smaller subcontractors, and dispute resolution processes that can be lengthy and complex. However, there is a growing recognition of the need for modernization.

One of the main challenges faced by contractors, subcontractors and suppliers in the UAE is late payments. Delays in payments can have a significant impact on such businesses' cash flow, making it difficult for them to meet their financial obligations and continue

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2 Subcontractors are drawing down their reserve capital by using business savings and personal savings more in the last year. The use of business savings to float payments increased by 52% and the use of personal savings spiked by 105%. Reliance on retirement savings more than doubled from last year. See: Rabbet, 2023 Construction Payments Report, cit., p. 7-8.

3 In 2023, 67% of general contractors relied on their personal savings. It is noteworthy that there was close to a 68% increase from 2022 to 2023 in the reliance on business savings. See again: Rabbet, 2023 Construction Payments Report, cit., p. 7-9.

4 European Construction Section Observatory, Indicators on late payment in the construction sector, August 2021, available at https://single-market-economy.ec.europa.eu/sectors/construction/observatory/analytical-reports_en, p. 5.

5 See: Intrum, "Don't do as I do" – a third of European businesses practice late payment hypocrisy, 6.7.2023, available at https://www.intrum.com/press/press-releases/press-release-article/?id=EA03B75D405D8BC6#Dont_do_as_I_do__a_third_of_European_businesses_practice_late_payment_hypocrisy.

operating efficiently. Late payments can also lead to disputes between parties involved in a construction project, which can further delay payments and disrupt the project timeline. Another challenge faced by contractors, subcontractors and suppliers is the lack of transparency in payment processes. Not having clear visibility into when they can expect to receive payments for their work, can make it difficult for them to plan their finances and allocate resources effectively.

Furthermore, contractors, subcontractors and suppliers may also face challenges in enforcing payment terms and recovering unpaid invoices. The legal process for recovering unpaid debts can be time-consuming and costly, which can further strain such businesses' finances. This can be particularly challenging for smaller operators who may not have the resources to pursue legal action against non-paying clients[6].

II. Late Payments: Reasons, Impact and Comparative Law

Looking at the reasons for late payments, 50% of EU businesses blame late payments on poor routines, admin and processes, claiming that processes are not strong enough to support financial sustainability despite economic uncertainty[7].

Businesses across Europe are spending more than a quarter of the working year, 74 working days, chasing late payments. The time spent chasing late payments by European businesses costs the European economy 275 billion euros[8]. 1/2 invoices are not paid on time, and 1/4 bankruptcies are due to invoices not being paid on time[9].

While the issue of late payment is more and more relevant, still limited comparable, consistent and regular data are available. To address this gap, the European Commission developed the EU Payment Observatory, to monitor the situation of late payment in the EU economy and provide data to support policy making[10].

The number of businesses making use of the rights to compensation for late payment provided by the EU Late Payment Directive[11] is growing. The regulation entitles businesses to charge interest when customers pay late, as well as to seek 40 euros in compensation for recovery costs for each invoice paid late. While businesses are concerned about confronting their clients and customers with demands, 47 per cent of respondents in 2023 say they sometimes or always enforce their LPD rights, up from 42 per cent in 2022[12].

However, to have more effective legislation, various stakeholders have deemed it appropriate to strengthen it[13]. Thus, the European institutions have proposed a stronger

[6] See: H. Zakaria, Understanding the UAE's Construction Industry Payment Security Legislation, 14.4.2024, available at https://hzlegal.ae/understanding-the-uaes-construction-industry-payment-security-legislation, p. 7-8.

[7] See again: Intrum, "Don't do as I do" – a third of European businesses practice late payment hypocrisy, cit.

[8] Intrum, European Payment Report 2023, available at intrum.com/epr2023, p. 19-20.

[9] Factsheet of the Late Payment Regulation, 12.9.2023, available at https://single-market-economy.ec.europa.eu/publications/late-payment-regulation-factsheet_en, p. 1.

[10] The Observatory monitors trends and developments on payment performance and behavior in commercial transactions in the EU. It collects, analyses and disseminates data and provides a repository of relevant initiatives and policy documents. Further information is available at: https://single-market-economy.ec.europa.eu/smes/sme-strategy/late-payment-directive/eu-payment-observatory_en.

[11] Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions (recast). Text with EEA relevance, OJ L 48, 23.2.2011. Hereafter also "LPD".

[12] See: Intrum, European Payment Report 2023, cit., p. 22.

[13] For example, 55% of companies think there should be an increase to the 40 euros minimum compensation for recovery costs and/or to the interest rate charged on late payments, currently set as the European Central

legal instrument, a Regulation on combating late payment in commercial transactions[14], which is directly applicable in Member States after its entry into force[15] and provides:

- A mandatory maximum payment term of 30 days;
- Compulsory payment of interest that shall accrue until payment of the debt;
- Enforcement and redress measures to protect creditors against bad payers, with Member States to set up enforcement authorities to monitor and ensure the application of the rules;
- Increasing credit management and digital financial literacy of SMEs;
- A clear-cut list of unfair practices and contractual terms;
- Alternative Dispute Resolution[16].

In the United Kingdom, the Late Payment of Commercial Debts (Interest) Act 1998 created a statutory framework in the UK for tackling late payment, amended lastly in 2013, when the recast 2011 EU Late Payment Directive was transposed into UK law. Regulations made under sections 3 and 161 of the Small Business, Enterprise and Employment Act 2015, and for limited liability partnerships, made under section 15 and 17 of the Limited Liability Partnerships Act 2000, introduce a duty on the UK's large companies and limited liability partnerships to report on a half-yearly basis on their payment practices, policies and performance.

In April 2022, UK Government published a Statutory Review of the Regulations[17]. The review concluded that the Regulations have brought greater transparency to the payment practices and performance of large businesses, and the policy remains appropriate because there is an ongoing need to ensure greater compliance in terms of prompt payment and to increase awareness of the performance of large businesses in this area.

Following the conclusions of the Statutory Review, in 2023 Government consulted on extending and amending the Regulations. The review of consultation responses concluded that:

- The Regulations will be extended for up to 7 years[18], with a review to take place after 5;
- Qualifying businesses will be required to report the total value of payments due in the reporting period that have not been paid within agreed terms, alongside existing requirements to report on the total volume of payments due;
- The Regulations will include an effective method of reporting the proportion of disputed invoices whilst still including them as late payments in overall payment time data;
- A requirement is introduced that payment performance data must be included in the business's Annual (Director's) Reports[19];

Bank's lending rate, plus eight percentage points. 53% of businesses say they would exercise their rights under the LPD more frequently if the existing rules were reviewed, while 37% believe that increased enforcement from a public body with powers to consider complaints and issue sanctions would make them more likely to exercise their rights under the Directive. See again: Intrum, European Payment Report 2023, cit., p. 23.

14 Proposal for a Regulation of the European Parliament and of the Council on combating late payment in commercial transactions, COM(2023) 533, 12.9.2023.

15 Unlike the Directive that must be transposed into national laws before it is applicable in each Member State.

16 See: Factsheet of the Late Payment Regulation, 12.9.2023, cit., p. 2.

17 To assess the extent to which the Regulations have achieved their objectives, if those objectives remain relevant, whether the Regulations remain the appropriate vehicle to deliver the policy, and if there have been any unintended effects of the Regulations. See: https://www.legislation.gov.uk/uksi/2017/395/resources.

18 Beyond their expiry date of 6 April 2024.

19 This is subject to the outcome of the ongoing Financial Reporting Council review of non-financial reporting.

- Where relevant, reporting must include information on standard retention payment terms and retention payment performance statistics for qualifying construction contracts[20].

In the United States, in 2023 the estimated cost of slow payments has surged to $273 billion, approaching 14% of total construction costs, with a 17% increase in the cost of slow payments in 2023 compared to 2022[21].

The US Federal Prompt Payment Act[22] protects all tiers of contractors, subcontractors, and suppliers from late payments on federally-funded construction projects. It does this, in particular, by providing a timeline of when payments will be released to the prime contractor, subcontractors, and suppliers, respectively.

Prompt payment laws, then, vary across states, with each jurisdiction establishing its own framework to ensure timely compensation in the construction industry. However, in recent years, there has been a discernible shift as state legislatures actively revise these laws to provide stronger protections for claimants, and courts clarify and strengthen claimants' rights to prompt payment.

For example in 2018, Pennsylvania made changes to its Contractor and Subcontractor Payment Act focused on the protection of downstream claimants[23], and the California Supreme Court, deciding on the question whether a contractor may withhold retention payments when there is a good faith dispute of any kind between the contractor and a subcontractor, or only when the dispute relates to the retention itself, narrowly interpreted the good faith dispute provision and held that the "dispute" must relate to the specific payment due[24].

In the Middle East, more than one in four projects - 26.6% - were embroiled in cash flow and payment issues, which rank twice as high - 7th - as a causation factor of claims and disputes than in the rest of the world.

Faster mobilization increases the pressure on cash flow, but contractors are generally in a weak position when negotiating payment terms and seeking remedies for late payments[25].

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[20] UK Department for Business and Trade, Reporting on Payment Practices and Performance Regulations: Final Stage Impact Assessment, February 2024, available at https://www.legislation.gov.uk/uksi/2024/444/impacts, p. 4-5.

[21] 72% of contractors reporting payment delays longer than 30 days in 2023, versus only 49% reporting the same in 2022. Work delays due to payment delays have been reported by 67% of respondents, with 65% of subcontractors resorting to filing liens because of slow payments, that is a 141% increase from 2022. See: Rabbet, 2023 Construction Payments Report, cit., p. 19.

[22] 31 USC Ch. 39: Prompt Payment.

[23] Some of the key changes included: 1) clarifying that the protections of the statute could not be waived by the parties; 2) authorizing contractors and subcontractors to suspend performance in the event of non-payment, following the provision of statutorily required notice; 3) specifying that the failure to provide timely notice - within 14 days of receiving an invoice - containing a good faith basis for withholding waives the payor's right to withhold and requires payment in full; 4) requiring payment for undisputed items in an invoice, even if others are disputed; and 5) allowing a subcontractor or contractor to facilitate the early release of retention by posting a maintenance bond for 120 percent of the retainage held at substantial completion instead of waiting for payment after final acceptance of the work.

[24] United Riggers & Erectors, Inc. v. Coast Iron & Steel Co., 4 Cal. 5th 1082 (2018). See: J. R. Blease, B.J. Morris, Prompt Payment Laws Continue to Trend in Favor of Contractors, 6.12.2023, available at https://www.americanbar.org/groups/construction_industry/publications/under_construction/2023/winter2023/prompt-payment-laws-trend.

[25] CRUX Insight Sixth Annual Report, Forewarned Is Forearmed available at https://www.hka.com/crux-insight-sixth-annual-report-forewarned-is-forearmed, p. 50.

Predominantly, the construction industry emerges as one of the worst culprits. Large-scale projects, intricate supply chains, and multifaceted contractual obligations make it a breeding ground for payment delays[26].
On a positive note, the ongoing transition towards digital payments promises benefits including increased transparency, traceability of transactions, and reduced opportunity for payment delays[27].
To address these challenges, the United Arab Emirates has implemented legislation aimed at improving payment security in the construction industry. One of the key pieces of legislation is the UAE Construction Industry Payment Security Law, which was introduced in 2018. This law aims to regulate payment processes in the construction industry and ensure that contractors, subcontractors and suppliers are paid in a timely manner for their work.
Under the UAE Construction Industry Payment Security Law, parties involved in a construction project are required to adhere to specific payment terms and timelines. For example, contractors or subcontractors are entitled to receive interim payments at regular intervals throughout the project, based on the work completed. This helps to ensure that contractors have a steady cash flow and can meet their financial obligations.
The law also provides mechanisms for resolving payment disputes between parties involved in a construction project. In the event of a dispute, parties can refer the matter to a dispute resolution committee, which will work to resolve the issue in a timely manner[28].

III. CONSTRUCTION PAYMENTS PRACTICE AND REGULATORY APPROACH IN THE UAE

In the United Arab Emirates, the party selects a type of payment depending on the arrangements.
Negotiated price contracts typically involve fixed lump sum payments or measurements, where the work value is determined by a pre-set price schedule or bill of quantities. Prime cost payment is made for the costs of the labor and materials used, while cost plus payment is by prime cost plus an added percentage for profit. The usual payment method is based on the contract administrator's certification of completed work, occurring either periodically or at agreed-upon milestones.
Advance payments and interim payments are also widely used in the UAE construction contract law. For example, in government contracts, as per Circular No. 1 of 2019 from the Abu Dhabi Executive Council, payments should be settled within 30 days from the invoice date. The circular also mandates that undisputed amounts must be paid within 30 days in case of a dispute[29].
The UAE has seen a rapid growth in its construction industry over the past few decades, with numerous high-rise buildings, infrastructure projects, and mega developments transforming the landscape of the country. With this growth, however, comes the need

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26 Cedar Rose, Late Payments in the GCC Region: Present and Future, 19.7.2023, available at https://www.cedar-rose.com/article/15571-late-payments-in-the-gcc-region_-present-and-future.
27 McKinsey, The future of payments in the Middle East, 23.8.2021, available at https://www.mckinsey.com/industries/financial-services/our-insights/the-future-of-payments-in-the-middle-east.
28 See: H. Zakaria, Understanding the UAE's Construction Industry Payment Security Legislation, cit., p. 8.
29 See: A. Dmitrova, A. Fischer, Key Regulations of the UAE Construction Law, 8.2.2024, available at https://firstbit.ae/blog/key-regulations-of-the-uae-construction-law/#:~:text=The%20usual%20payment%20method%20is,construction%20contract%20law%20in%20UAE.

for robust legislation to ensure that all parties involved in construction projects are protected and paid in a timely manner[30].
One of the key pieces of this legislation is payment security laws, which are designed to safeguard the rights of contractors, subcontractors, and suppliers by ensuring that they are paid for the work they have completed. In the UAE, payment security laws are governed by Federal Law No. 6 of 2018 on the Regulation of the Relationship between Landlords and Tenants in the Emirate of Dubai, as well as other relevant regulations and decrees issued by the respective emirates.
These laws outline the rights and obligations of all parties involved in a construction project, including developers, contractors, subcontractors, and suppliers. They establish guidelines for payment terms, dispute resolution mechanisms, and penalties for non-compliance.
One of the key provisions of the UAE's payment security laws is the requirement for parties to enter into written contracts that clearly outline the terms and conditions of the project, including payment schedules, milestones, and dispute resolution mechanisms.
Another important provision of the payment security laws is the requirement for parties to issue payment certificates. These certificates are issued by the engineer or consultant overseeing the project and certify that the work has been completed to the required standard. Once a payment certificate has been issued, the party responsible for making the payment must do so within a specified timeframe, typically within 30 days.
In cases where payment is not made on time, the payment security laws provide mechanisms for parties to enforce their rights. For example, a contractor or subcontractor who has not been paid may issue a notice of non-payment to the party responsible for making the payment. If the payment is still not forthcoming, the unpaid party may suspend work on the project or terminate the contract.
The UAE's payment security laws also require parties to provide security for payment in the form of performance bonds, advance payment guarantees, or retention amounts, to ensure that contractors, subcontractors, and suppliers will be paid for the work they have completed even in the event of a dispute or insolvency.
Furthermore, the UAE's payment security laws establish procedures for resolving payment disputes, including the submission of claims, negotiation, mediation, and arbitration, to ensure that all parties have access to a fair, impartial and expedited process for resolving payment disputes[31].
In recent years, the UAE government has taken further steps to address payment security issues in the construction industry. One of the key pieces of legislation introduced to improve payment security is the UAE Construction Trust Account Law. This law requires developers to deposit funds into a trust account for each construction project, which can only be accessed by contractors and subcontractors upon completion of specific milestones, ensuring that they are paid promptly and helping to prevent payment delays and disputes.
Another important development in the UAE payment security legislation is the introduction of the Construction Industry Payment and Adjudication Law. This law provides a mechanism for resolving payment disputes in the construction industry through adjudication. Adjudication is a quick and cost-effective way to resolve payment disputes, allowing parties to seek a resolution without resorting to lengthy and expensive court proceedings.

[30] H. Zakaria, Understanding the UAE's Construction Industry Payment Security Legislation, cit., p. 3-4.
[31] See: H. Zakaria, Understanding the UAE's Construction Industry Payment Security Legislation, cit, p. 6.

The UAE government has also introduced the Construction Industry Payment Security Initiative, which aims to improve payment security by promoting best practices and standardizing payment processes. This initiative includes guidelines for payment terms, invoicing procedures, and dispute resolution mechanisms, helping to create a more transparent and efficient payment system in the construction industry[32].

CONCLUSION: OPPORTUNITIES, CHALLENGES AND POLICY RECOMMENDATIONS

In conclusion, despite the benefits of the recent UAE payment security legislation, there are still relevant challenges that need to be addressed. Some companies may face delays in payments or disputes with clients, leading to financial strain and potential project delays.

Delayed payments are common, particularly for subcontractors and suppliers, leading to cash flow issues and financial strain. Long payment terms of 60-90 days or more are prevalent, exacerbating cash flow challenges. The reliance on post-dated cheques can also be risky, as they may bounce or be delayed.

One of the main issues is, in fact, the enforcement of payment terms, particularly for smaller contractors and subcontractors. Payment disputes can be lengthy and costly to resolve, further impacting SMEs.

On the other hand, there are also relevant opportunities that can lead to improving the practice of payments. First, as said, the UAE government has implemented measures to encourage timely payments and protect contractors, subcontractors and suppliers. Enforcing existing laws and imposing penalties for late payments will be key to their effectiveness.

The collaboration between stakeholders - government, contractors, clients, financial institutions - can also be key for driving positive change. In this perspective, for example, i) promoting standardized payment terms that are fair to all parties, particularly SMEs, ii) imposing a requirement for large companies to report annually on their payment practices and performance, iii) streamlining dispute resolution mechanisms to ensure fair and timely outcomes, and iv) providing training and support to SMEs on contract management, financial literacy, and dispute resolution, would help create a more transparent and efficient payment system[33].

Last but not least, the use of digital technologies and the adoption of digital payment platforms and e-invoicing can streamline payment processes and improve transparency. In particular, a) leveraging data analytics to track payment trends, identify bottlenecks, and develop targeted interventions, b) exploring innovative financing solutions like supply chain finance to improve cash flow for SMEs, and c) exploring the use of blockchain-based smart contracts can help automate payment processes and reduce disputes[34].

By implementing these recommendations, the UAE can create a more resilient, sustainable, and attractive construction industry that supports the broader vision of a thriving and sustainable economy for all stakeholders.

A reliable and transparent payment system will attract domestic and foreign investment. Digital transformation and innovative financing will drive innovation and competitiveness. Improved payment practices will boost the growth of SMEs, creating jobs and contributing to economic diversification. Finally, a fair and efficient payment ecosystem will enhance the UAE's reputation as a global business hub.

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[32] See again: H. Zakaria, Understanding the UAE's Construction Industry Payment Security Legislation, cit., p. 13.

[33] In this perspective, the recent introduction by the UAE government of the Construction Industry Payment Security Initiative seems to provide an interesting framework.

[34] See e.g., among others: A. Stazi, Smart Contracts and Comparative Law, Springer, 2021, and Id., Smart Contracts: Elements, Pathologies and Remedies, in 14 Comparative Law Review, 2023, 2, p. 101-113.