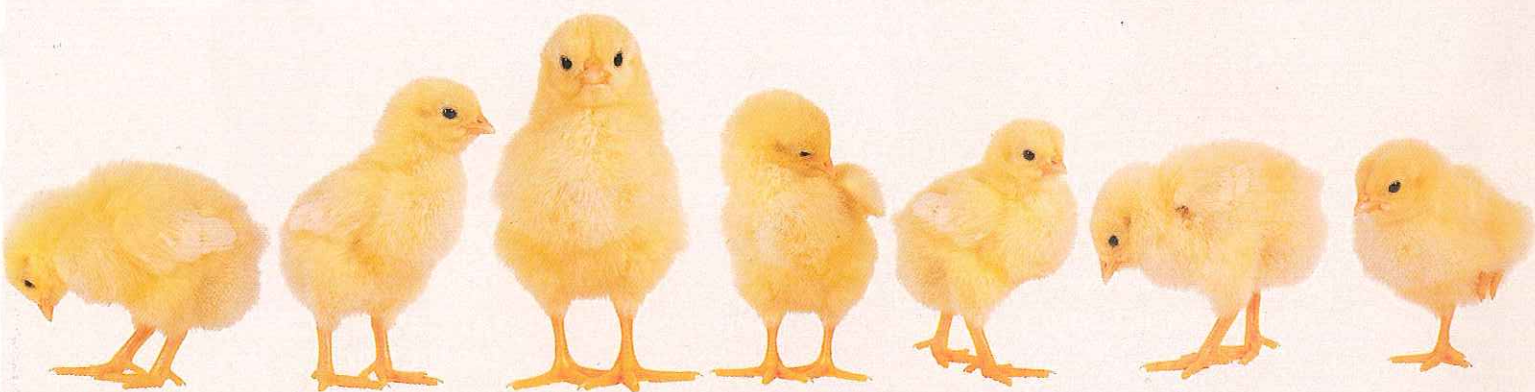


CREDIT MANAGEMENT

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COUNTING CHICKENS

The impact of the new EU Directive

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Hatching a plot



Hannah Drozdz surveys the new EU rules on late payment and its likely implications on business.

IN 2000 the European Parliament adopted its first set of rules designed to combat the thorny issue of late payments in commercial transactions.

The rules had two broad objectives: firstly, to reduce the financial and administrative burdens placed on businesses by excessive payment periods and late payments; and secondly to ensure that businesses could trade throughout the internal market under conditions which guarantee that trans-border trade did not entail a greater risk than domestic trade.

The European Parliament has issued a new set of rules designed to further strengthen the position of suppliers that must be in force across the European Union by 16 March 2013. So what is the current regime? What changes are being made with the introduction of new rules and how may the new provisions work in practice?

The existing regime

The 2000 EU rules set a minimum standard of rights for unpaid suppliers – national parliaments were free to adopt more stringent rules provided they ensured as a minimum the rights the EU had designated. The rules only affect business to business transactions or transactions between a business and the public sector. They do not affect transactions where at least one of the transacting parties is a consumer or (in most cases) where the parties had agreed other terms.

The EU rules introduced a statutory right for a supplier to claim interest (at an enhanced rate of seven percent over the reference rate) for late payment and

a default credit period of 30 days – unless the contracting parties had agreed otherwise. At present, the default credit period runs from the later of the supplier's delivery of the goods or performance of the services; or the day the supplier notifies the buyer of the amount of the debt.

The UK incorporated the first EU rules into law from August 2002, but set the statutory interest rate at 8 percent over the reference rate, being the base rate of the Bank of England. Before this, in the UK, only small businesses (categorised as 50 or fewer employees) had automatically enhanced rights to claim interest on unpaid commercial debts (where no other terms had been agreed).

It is still open for a supplier and a buyer to agree a different credit period and what contractual remedies will be available to the supplier if the payment is late. Where the parties have not agreed

“The European Parliament has issued a new set of rules designed to further strengthen the position of suppliers that must be in force across the European Union by 16 March 2013 ...”





Don't count your chickens

By Pierre Haincourt MICM

IT was back in April 1993 that the European Parliament called for the European Commission (EC) to start reflecting on the issue of Late Payment in Commercial transactions. At that time, a handful of debt collection professionals, funded by a small EU grant, were travelling Europe on behalf of the EC, gathering views and collecting data from creditors. They started to work on a new framework within which the late paying debtors would bear the full burden of debt recovery costs. All we could hear then was 'pigs might fly' (quand les poules auront des dents).

Well, although you could tell me 'don't count your chickens...' (ne vend pas la peau de l'ours avant de l'avoir tué), it does look like, 20 years on, we're finally there. Well, unless the Department for Business Innovation and Skills' (BIS) interpretation of the recast Directive drastically differs from ours, of course.

So, let's assume that all will go well and that the BIS will release, by 16 March 2013, and in the full spirit of the New Directive, a re-enforced Late Payment Act. This means that we would:

- Keep the default credit period at 30 days
- Keep the default Late Payment Interest at eight points above the BoE base rate
- Keep the three-tier fixed compensation (£40-£70-£100) for the Creditor's in-house chasing costs
- Get a brand new Article setting out that external debt recovery costs are recoverable from the debtor

So, now that creditors can subcontract the collection of overdue

business accounts to a third party Collection Agency (or a Law Firm) absolutely free of charge, what will change?

In the 14 years that the Late Payment of Commercial Debts (Interest) Act 1998 has been in force, our experience is that a growing number of debtors have been paying late payment interest and compensation, so the Act is gradually making a name for itself and I think it is becoming accepted that late payment should not equate to free credit and should attract penalties.

Similarly, as the Law states that the late payer must now pick up the cost of debt collection, there is no major change in principle, just an increased cost for the debtor to bear.

But creditors will have the final say. Creditors are our clients, and although we can tell them what we think, we will do as they ask. Some creditors do not wish to use the provisions of the Late Payment Act because they fear they won't get their clients back in one piece at the end of the collection process if they do. This is what they believe and we should respect this.

At the opposite end of the spectrum, some clients will say: 'I don't want you to cost me a penny!' and insist that we recover interest, compensation and our fees from their debtors, each and every time. In this spirit, some of our clients have, in the past, funded legal action to recover interest and compensation alone, when a debtor has refused to pay these without a valid reason, and guess what: they obtained judgment, and got paid.

More than before, debt collectors, especially if they want to attract all client types, will need to be more flexible and check what level of service their clients require. Firstly, their debt collection software will need to be able to cope

with these legislative changes. Then, their terms and conditions will have to be reviewed and their service agreements will need to take into account the various collection strategies, either globally, or on a case-by-case basis, and the option of applying (or not) the Late Payment Act to individual debt collection assignments will need to be clearly defined, to meet the client's expectations.

But let's be realistic here. In some cases, for one reason or another, the debtor won't pay the interest, the compensation or the debt collection cost, and in such cases, we will all need to remember that the service agreement is a contract between the debt collection agency and the creditor, and that, if the debtor is unable or unwilling to pay, and/or if the creditor does not wish to fund legal action to recover these, then the creditor will, ultimately remain liable for our fees. So is this really a free debt collection service for creditors? Well, maybe not every time.

But in another twenty years, much like in Scandinavia, 95 percent of overdue accounts might get referred to debt collection agencies as soon as they fall due, and Credit Control Departments might become new profit centres for businesses. So what do you think? 'Time will tell' (qui vivra verra), or 'pigs might fly' (quand les poules auront des dents)?

Pierre Haincourt MICM is Owner/Manager of Credit Limits International, Committee Member of the Kent Branch of the ICM, past Director of Foreign Affairs of the CSA, and past Board Member of Federation of European National Collections Association (FENCA).

these terms, the law sets the fall-back position. While the parties can agree on any terms they like, the law insists that any contractual remedy for late payment must be 'substantial', otherwise the courts can strike out that part of the contract as invalid and the automatic statutory late payment rules will apply. The courts will consider all the circumstances of a contract to decide whether a remedy is substantial or not – such as:

1. Whether the credit period differs significantly from the industry standard or other supply contracts the supplier operates;
2. Whether the interest rate applied to late payments either fails to act as a deterrent to the buyer (because it is lower than the buyer's cost of borrowing) or fails to compensate the supplier (because it is lower than the supplier's cost of borrowing);
3. Whether it is fair and reasonable, having regard to matters such as the relative bargaining strength of the parties, to allow the contractual remedy to oust or vary the right to statutory interest; or
4. Disproportionate information requirements that must be fulfilled under the contract before any credit period starts.





The rules also include the right to claim a fixed sum by way of compensation for late payment (in the UK this is set between £40 and £100 depending on the size of the debt) and additional reasonable debt recovery costs (where a supplier is using a solicitor or debt recovery firm to chase the debt). Again, this only applies where a supplier and buyer have not agreed different terms.

The new rules

The amended set of regulations that the EU has issued is in response to what it terms is the 'damaging culture of late payment in Europe'. In a recent survey, the EU revealed that the written off debt suffered by Europe's businesses amounted to €340 billion – a figure equal to Greece's total debt. The EU says that the new rules correspond to the 'need to switch to the culture of prompt payment in commercial transactions between businesses and between businesses and public authorities'.

The new provisions replace the EU's existing rules and include terms designed to:

1. Harmonise the credit period for payment by public authorities to businesses: public authorities across the European Union will have to pay for the goods and services that they procure within 30 days, or in exceptional circumstances, within 60 days.
2. Maintain contractual freedom in business commercial transactions: Businesses will have to pay their invoices within 60 days unless they expressly agree otherwise and provided it is not grossly unfair.
3. Penalise late payment: the statutory interest rate applied to late payments will be increased to 8



percent over the reference rate. This is obligatory for late payments by public authorities to businesses, but may be contracted out of for business to business supplies provided this would not be grossly unfair to the supplier.

4. Award suppliers a minimum fixed sum of €40 as compensation for the cost of recovering the debt, regardless of the size of the debt as well as a continued right to recoup the reasonable costs of recovering the debts.

The government has recently suggested that it would not take advantage of the "exceptional circumstances" exemption for goods and services provided to any public authorities and that the credit period in the new law will be a uniform 30 days for all supplies to public authorities. The government's own best practice guidelines suggest that central government departments should pay 80 percent of their invoices within 5 days and contractually require their contractors to pay sub-contractors within 30 days.

It is likely that the new rules will only apply to contracts entered into after 16 March 2013, because of the administrative cost to public departments of reviewing all existing contracts to check they comply.

At the moment, the UK has a tiered approach to fixed sum compensation depending on the level of the debt – involving a fixed sum payment of between £40 and £100. The smallest compensation payment currently in force exceeds the minimum level required by the new EU rules and the government has not yet confirmed whether the tiered system will stay.

In principle, suppliers will welcome tougher provisions for debtors who do not pay what they should when they should. The difficulty with the EU rules is that they might introduce elements of uncertainty into business transactions – for example: what is needed to

'expressly agree' a credit period of longer than 60 days and what sorts of provisions are 'grossly unfair' to a supplier? If the UK simply implements the EU's wording, it would be helpful for the government to issue guidance on these points.

In the only relevant reported court case found on the current provisions, *Yuanda (UK) Co Ltd v WW Gear Construction Ltd*, even the Judge complained that there was little guidance as to how to interpret the existing requirement for penalty interest to be a "substantial remedy".

In that case, a term that only allowed the supplier to claim interest at 0.5 percent above the base rate on a late payment was struck down as not being a substantial remedy. The main reason for this was that the industry standard for this type of contract (a construction contract) was usually five percent above base rate (as set in the JCT trade contract) and that there were no special circumstances (such as the size and particular nature of the contractor's business) surrounding the agreement to justify the lower charge.

Neither the new nor the old provisions will assist suppliers where the debtor is a consumer or where the debtor has entered a formal insolvency process.

Of course, it is not compulsory for suppliers to exercise these statutory rights to claim interest and compensation for unpaid debts. In each case, a supplier must decide whether to make use of the tools available to them at the risk of jeopardising existing business relationships. Hopefully, with new compulsory 30-day credit periods, public authorities will lead the way and set the example for the rest of the business world.



*Hannah Drozd is a professional support lawyer in the Corporate Recovery team at Gateley LLP.
hdrozd@gateleyuk.com*