



Credit Control: The Legal Issues



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1. Introduction

Cash is the life blood of any business. Good credit control requires attention to a number of important legal issues. This fact sheet gives practical guidance on what you should do and how you should do it. If you have a particular debt collection issue that needs attention, please also read the Everyman fact sheet on Debt Collection.

Companies supplying goods rather than services, particularly at low margins, must be extra vigilant on credit control. A £50,000 bad debt on a 10% margin requires £500,000 worth of future sales just to tread water!

2. The Starting Point

At the risk of stating the obvious, good credit control starts with providing a good customer service. Often what may present itself as a credit control problem arises because of one of the following:-

- non-existent or poor credit control procedures before taking on a new customer.
- undertaking work that the supplier does not have the resources or experience properly to take on leading to poor customer service. In tough recessionary markets, customers are more demanding and some may be looking for reasons not to pay on time or at all.
- not properly estimating or pricing a job; this may be because of inexperience or failing to take the time and trouble to determine what the job really requires. This may lead the customer to perceive that you have cut corners or under-delivered as he takes issue with what he considers to be poor service.
- poor project management, leading to customer disappointment.
- not being clear and taking your credit terms seriously: if you don't your customers certainly won't!
- not issuing invoices promptly: an invoice issued when the customer is pleased with a job well done is much more likely to be paid promptly but if

you wait the customer may have forgotten your excellent service.

- failing to chase unpaid invoices: it is best to do this even before the due date as a reminder.
- not having a consistent and effective "escalation procedure" for late payers: you must work through a process which ends with a 7 day "pay or else" letter which might include a halt of supplies for on-going customers. A solicitor's letter and court proceedings must then be contemplated.

3. Legal Issues: The Basics

As a supplier, you must make sure that your terms of supply are brought to the attention of the customer early on and are agreed, preferably in writing. Terms of business on the back of an invoice will be ineffective.

With a well organised and well advised customer, there may be what is often called "the battle of the forms". The customer will issue an order with its terms of purchase. The supplier then acknowledges the order with its terms of sale.

For the supplier, the best solution is to require customers to sign up to your terms of supply when they become a customer. You can do that by incorporating this step as the first in your credit control procedure.

4. Assessing the Key Risk Issues for your Business

In preparing your standard terms of sale, you need to have identified the key risk areas for your particular business. Consider the following:-

- when supplying high value capital goods, you will almost certainly want a retention of title clause: the customer should not become owner until he has paid for the goods. Repossessing goods can, in some instances, be the only and a highly effective practical remedy.
- for project work of extended duration, you will almost certainly want stage payments to protect you against the risk of non- or late payment.

- where the customer appears to be a poor credit risk and the contract value is high, you may want to insist on a bank performance bond or cash escrow.

- for perishable goods, you will want to stipulate that the customer must reject the goods within a very short timescale if he is not happy with them.

- where there are multiple potential customers (e.g. in a group of companies), you need to be clear that you have identified the correct customer and that someone with the relevant authority (e.g. a Director) has signed the contract.

- where your own as well as third party goods are supplied by you (with perhaps little or no margin on those third party goods), you will want to ensure that your contractual liability for those goods is limited to the contractual rights you enjoy. So you should stipulate that you hold any product warranties or guarantees for your customer's benefit but otherwise are not liable for defective goods.

- where the failure of your goods or services could cause significant loss to the customer, you will want to have capped your liability.

- where your product or service is complex, you will want to insist that the customer buys on the basis of his own investigation of the performance against his requirements.

Failure to properly identify these legal risks could leave your company exposed to something much worse than a bad debt.

5. Insuring the Risks

In some industries, it is common for suppliers to take out insurance against non-payment by customers. It can also be possible to factor (i.e. sell) book debts on what is called a non-recourse basis (i.e. risk of non payment is with the buyer of the debt).

Product liability, public liability and professional indemnity insurances can all be relevant, depending on the nature of your business. These insurance policies need to be checked for specific

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policy wording and exclusions. Your solicitor and/or specialist insurance broker will be able to help you.

6. Conclusion

Good credit control must start with good business practice. A key element of good business practice is legal risk management.

Effective legal advice requires advisers who will take the time and trouble to understand your business, including your future plans.

For more information contact:

James Hunt on 0845 868 0962
james.hunt@everymanlegal.com

Ed Burrell on 0845 868 0965
ed.burrell@everymanlegal.com



Everyman Legal Limited
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www.everymanlegal.com