

## Late payments and SME's: a wind of change?

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A very welcome new legislation has been recently enacted by the House of Parliament. Namely, the Law on Combating Late Payment in Commercial Transactions transposes Directive 2011/7/EU into national law.

The Law is in force since 27/7/2012 and effectively, abolishes previous legislation in the area of late payments. The Law is very similar, if not identical in many respects, with the Directive. In sum, the new Directive entitles a seller who does not receive payment for goods and/or services within 30 days of the payment deadline to collect interest (at a rate of 8 percent above the European Central Bank rate) as well as 40 Euro as compensation for recovery of costs. For business to-business transactions a 60 day period may be negotiated subject to conditions. The seller may also retain the title to goods until payment is completed and may claim full compensation for all recovery costs.

Statistics indicate that insolvencies lead to the loss of 450,000 jobs in the EU and 57% of businesses in Europe claim to have problems with liquidity. An increase of 10% is being noticed since last year and 50% since 2008. Many of small and medium sized enterprises (SME's) go bankrupt on a daily basis due to late payments or non-payments of their invoices. And, of course, apart from all these, research' studies indicates that significant financial and administrative burdens are placed on businesses as a result of late payments. Some countries alongside the European Union, have initiated effective measures to combat late payments. An example is the UK which is considered to be an exemplar across Member States in its approach to challenging the long-standing culture of late payment because of its early adoption of legislation and its wider strategy for improving business awareness. In countries, therefore, such as Cyprus, where no effective measures were initiated to combat late payments, the new law is of course, a very positive development.

### **Commercial transactions**

The new regime will entitle the creditor to interest for late payment without the need of a reminder where the following conditions are satisfied: (a) the creditor has performed its contractual obligations; and (b) the creditor has not received the amount due on time (unless, of course, the debtor is not responsible for the delay).

The scope of the new law is very wide and it is intended to cover all commercial transactions irrespective of whether they are carried out by a private or public undertakings and public authorities. Consequently, the Law will apply to transactions between main contractors and their suppliers and subcontractors and lawyers should be aware that liberal professions will also be covered. Therefore, broad meaning is given to the terms "undertaking" and "commercial transactions" so as to encompass

all transactions between undertakings which lead to the delivery of goods or the provision of services for remuneration.

In simple terms, the applicable rate of interest for late payment will be 8% plus the European Central Bank's intervention rate. This rate cannot be negotiated and any rate below this threshold is in principle considered to be grossly unfair.

Where the above conditions are satisfied, the creditor is entitled to interest for late payment from the end of the period for payment fixed in the contract, or, if such payment date is not fixed:

- (i) within 30 days from the date of receipt by the debtor of the invoice;
- (ii) where such date is uncertain, 30 days after the date of receipt of the goods or services;
- (iii) where the debtor receives the invoice earlier than the goods or the services, 30 days after the date of the receipt of the goods or services;
- (iv) where a procedure of acceptance is provided for in the contract and if the debtor receives the invoice earlier or on the date on which such acceptance or verification takes place, 30 days after that date.

It is important to mention that there are provisions which aim to prevent unreasonably long periods of time for payment for goods or services supplied. A norm of 60 days is mentioned but this can be altered provided it is expressly agreed between the parties in the contract and it is not grossly unfair to the creditor (see further below for the meaning of gross unfairness). This is likely to mean that buyers will not be able to simply change their standard terms and conditions to allow for longer payment terms. In addition, companies which enjoyed lengthy payment terms from their clients will face difficulties in maintaining them as a result of the new Law.

The Law does not affect the ability of the parties to agree on payment schedules providing for instalments.

### **Compensation for recovery costs**

An interesting innovation is the statutory right to compensation for the incidental costs of recovering late payment. Where interest for late payment becomes payable, the creditor is entitled to obtain from the debtor a fixed sum of 40 euro, without the need for a reminder as compensation for the creditor's internal recovery costs (e.g. time spent by employees in chasing the matter up). In addition, the creditor is also entitled to obtain reasonable compensation from the debtor for any recovery costs exceeding that fixed sum and incurred due to the debtor's late payment. An example would be the expenses incurred in instructing a lawyer or employing a debt collection agency.

### **Unfair contractual terms and practices**

In order to avoid the instances where companies with significant bargaining power would be able to contract out the rules on late payment, it is clear that if a term in the

agreement, a practice relating to the date or period for payment, the rate of interest for late payment or the compensation for recovery costs is “grossly unfair to the creditor”, then it will be invalid and unenforceable.

In determining gross unfairness to the creditor, all circumstances of each case shall be considered, including any gross deviation from good commercial practice, contrary to good faith and fair dealing, the nature of the product or the service and whether the debtor has any objective reason to justify deviation.

The Law goes on to specify certain examples which will be considered as grossly unfair. These include, amongst others, contractual terms or practices which exclude interest for late payment.

### **Retention of title**

Another welcome development is that the new Law allows the seller to retain title to the goods until they are fully paid for, provided such a provision has been expressly agreed between the buyer and the seller before the delivery of the goods.

### **Recovery procedures for unchallenged claims**

A fast track judicial procedure is also available and judgment can be obtained (i.e. the order for payment by the Court) within 90 days from the date of the application to the Court, provided that the debt or aspects of the procedure are not disputed. The periods for service of documents and any delays caused by the creditor (e.g. periods devoted to correcting applications) shall not be taken into account when calculating the period above.

### **Public authorities**

The new Law will also apply to commercial transactions taking place between undertakings and public authorities. The relevant provisions are very similar to those applying to commercial transactions but with a number of small differences and certain “generous” derogations.

### **Conclusion**

The new Law is intended to create the mechanisms for driving payment on time and all written contracts and invoices should set out a clear expectation from the outset from each of the parties, so as to assist for this purpose. It is also important to understand that legislation is also only useful where invoicing is accurate and timely. In the English Consultation Paper, it is noticed that there is an assumption on the part of both the supplier and customer that their standard terms apply and the evidence suggests that over half of all transactions take place with no prior agreement on payment terms. The most impressive statistic is that only one in ten suppliers regularly credit-check customers. These are also common phenomena in Cyprus.

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In considering the impact of the new Law, it is important to understand that it is not a panacea for late payment. Resorting to legal action is not a practical option due to costs and to the fact that most supplier relationships are long-standing. Therefore, it is of utmost importance to check that the customer is capable of making payment by undertaking a credit check, to ensure that the personnel involved in the credit management is adequately skilled and that invoices are properly addressed, dated and completed with a good description of the services/goods.

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