

## **The right to charge interest on late payment in commercial transactions**

**by Josef Busuttil**

The Malta Association of Credit Management (MACM) is pleased to note that the European Parliament has approved the final text of a new directive on combating late payment in commercial transactions. The Directive 2011/07/EU, which has replaced 2000/35/EC, came into force on 16 February and Member States (including Malta) will have to transpose this law within two years.



Although there may be some anomalies in the amended Directive, MACM notes with satisfaction the EU concerns about the significant number of invoices that are being paid late. The EU Commission recognises that late payment negatively affects the cash flow of businesses, does not allow firms to invest in their business operation, limits competition and adversely affects the bottom line of firms with a severe consequence on the economy at large, especially in recessionary times as we are currently experiencing in Europe.

The European Commission emphasises that SMEs' access to finance should be facilitated and that a legal and business environment supportive to timely payments in commercial transactions should be developed. This is good news for the Maltese business community since it consists mainly of SMEs, which are more vulnerable.

The new Late Payment Directive will replace the existing Directive 2000/35/EC, which was transposed to Maltese Law by Legal Notice 233 of 2005. The main scope of the new Directive is to change the current commercial culture of paying late. This Directive is intended to serve as a deterrent for business customers that pay their suppliers late.

This Directive applies to all commercial transactions including all the transactions carried out between undertakings or between undertakings and the public authorities. Government, local councils and other public bodies are therefore included whenever a public procurement contract is signed with the private sector.

As a general rule, both public and private sectors have to pay their bills for goods and services provided by their suppliers by not later than 30 days. Nevertheless, in business-to-business transactions, the Directive allows credit to be extended up to 60 days if both parties so agree. However, extending credit beyond 60 days is only permissible if "expressly agreed" by the creditor and the debtor in the contract of sale and provided that it is not "grossly unfair" to the creditor. This provision is aimed to protect SMEs that in many cases are forced to agree on longer credit terms, especially when they deal with bigger firms.

By saying “expressly agreed in the contract” the co-legislators wanted to make sure that the parties specifically state the necessary terms and conditions in the contract, which are then signed by both. The use of a credit application form that includes the terms and conditions of sale together with the payment terms agreed by both parties is always advisable. This document should be duly signed by both parties and both parties should retain a copy of this document for any future reference. MACM provides a sample of this document, available on [www.macm.org.mt](http://www.macm.org.mt)

In defining what is “grossly unfair” to the creditor, the following circumstances of the cases should be considered:

- a. any gross deviation from good commercial practice, contrary to good faith and fair dealing;
- b. the nature of the product or the service; and
- c. whether the debtor has any objective reasons to deviate from the payment period.

This means that if the date or period for payment is not fixed in the contract, the creditor is entitled to eight per cent plus the ECB intervention rate for late payment following 30 calendar days from the date of invoice or from the date of delivery of the goods or services. The creditor is also entitled to obtain from the debtor a minimum sum of EUR40 as compensation for recovery costs incurred. In addition, other expenses incurred by the creditor due to the debtor’s late payment can be claimed. These expenses may also include legal and debt collection agency fees.

It is to be noted that the Directive prohibits abuses in contracts that put the creditor at a disadvantage. This refers to where a term in a contract or a practice relating to the date or period for payments is not justified on the grounds of the terms granted to the debtor, or it mainly serves the purpose of procuring the debtor additional liquidity at the expense of the creditor. Therefore, late payments of 120 days and in some industries even more than 180 days without signed agreement by both parties are surely abuse, against normal practice and hence unacceptable.

For the public-to-business payments, the general deadline is 30 days. If the payment periods are to exceed 30 days, this has to be “expressly agreed” and “objectively justified in the light of the particular nature of the contract”. This new Directive allows Member States to choose a payment period of not more than 60 days for public entities providing healthcare.

Nevertheless, MACM still feels that this new Directive will not be as effective as it is desired for a number of reasons.

Many businesses may find this Directive intrusive and confusing. One can observe that the EU is trying to persuade Members States to accept a EU-wide 30-day rule but it still allows the private sector to agree on longer payment terms subject that both parties sign to such payment agreements.

In today's commercial world, firms are competing aggressively, products and services are becoming homogenous with little scope for differentiation and in some industries supply is exceeding demand. Therefore, suppliers are using credit as an effective tool to compete in the market and to differentiate their products and services in order to gain and sustain competitive advantage. In such a business scenario, extending credit may well be expected without charging interest for late payment unless legal action is necessary to be taken against the debtor.

MACM is also concerned about sending the wrong message to the business community relating to good credit management practices. A supplier should determine the payment terms according to the risks involved in that particular credit and the cost of the products / services at point of sale. Standardised credit terms of 30 days do not make much business sense!

Questions should also be made in respect to certain commercial circumstances, which happen quite often in the day-to-day business. For example, what will happen if there is a dispute between the creditor and the debtor and an invoice remains unpaid either justly or simply to avoid payment?

The Directive also refers to the right of the supplier to include a "Retention of Title" clause in the contract. How effective will this clause be in our local case? It is important that government looks into the implications of this law and ensures that the legal system can support all aspects of this directive.

The Directive obliges Member States to ensure that an enforceable title will be obtained, irrespective of the amount of the debt, within 90 calendar days of the lodging of the creditor's action or application at the court. In Malta, we have the judicial letter system, a fast track system to recoup money, commonly known as 166A. But to date, it does not cater for all amounts of debt and the court may also find difficulties to notify the debtor and hence the creditor will not be able to get an executive title on time. Here, MACM suggests that

Judicial Letters will be applicable to any amount of debt and that the court marshal system will be privatised for better effectiveness and efficiency.

In view of the current situation, MACM stresses the importance of good credit management practices to prevail. No EU Directive, legislation or court action can replace good credit management practices. Therefore, credit practitioners should be skilled and trained to grant and extend credit profitably by listening to their customers' needs and focusing their limited resources where it pays most.

Credit is the oil that keeps the wheel turning in business and it is the responsibility of both the creditor and the debtor that credit is granted/extended ethically, sensibly and in a formalised manner.

On the occasion of MACM 10th anniversary, a one-day conference is being organised on 12 May at the Radisson Blu Resort, St Julian's. Local and foreign speakers will be addressing the delegates and more information about the current economic and credit scenario will be discussed in detail. This conference is being sponsored by HSBC Bank Malta.

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