

## Trading Safely: Ensuring You Minimise Your Exposure to Distressed Customers

As we approach the busiest trading period of the year for many businesses they need to ensure they are doing what they can to protect themselves from the consequences of customers who go bust. The key concern for any supplier, whether of services or goods, is that they will get paid for the goods or services that they supply to their customers, and that where supplies are made on terms where the customer gets a period of credit, that these such debts will be settled.

In this context it is crucial that suppliers review their contracts to ensure that they contain provisions that will allow them to cease supplying to customers in financial difficulties. Typically contracts will contain clauses that trigger on the insolvency of a party, but if the trigger is formal insolvency proceedings this may be too late. Both the balance sheet test (fewer assets than liabilities, taking into account its contingent and prospective liabilities) and the cash flow test (pay its debts as they fall due) of insolvency are open to interpretation and debate and it is therefore advisable to make sure that supply contracts also refer to other less technical matters. These could be triggers such as the customer ceasing to trade or threatening to cease to trade, the customer failing to pay money due under the contract, the customer breaching the contract or the customers' creditors taking action against that customer.

If the supplier does have the right to terminate the contract it should consider its options before beginning the process of ceasing to trade with the customer. If the contract is particularly crucial to the customer's business, the supplier may be better advised to enter into a dialogue with the customer rather than take action which might push the customer into insolvency and thus crystallise the supplier's losses. Even a threat of action may force the customer to appoint an insolvency practitioner to avoid risking potential liability for wrongful trading. Supporting a customer, and playing a role in assisting a revival may provide the basis for a closer, more productive relationship.

Before taking action a supplier should ensure that it does in fact have the right to take action, as purporting to terminate a contract when no such right exists may result in the supplier being liable for a breach of contract. However, if the supplier threatens to terminate and then fails to take further action, it may face the argument that it has waived its right to terminate and affirmed the continuance of the contract unless the contract provides otherwise.

Decisive action is particularly necessary in the context of a distressed customer as if the customer enters into formal insolvency proceedings then any claim for payment will rank behind secured creditors as an unsecured debt, and will typically have little value. Suppliers should seek to ensure that any goods supplied on credit terms are covered by an appropriately drafted retention of title clause, being careful to ensure that while such clause is broad enough to cover the goods supplied, it is not so broad as to be deemed to be a charge and as such unenforceable in an insolvency context.

For further Corporate advice and assistance, please visit Pitmans Corporate website.

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