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Guide to protecting your business

Introduction

In the current economic environment, it is inevitable that some of your contractual counterparties are suffering financial distress. We suggest the following steps to protect you should any of those counterparties go into an insolvency process.

Contracts

- Make sure you have a written contract and that the terms are clear and tailored to the situation and are regularly reviewed.
- If you are going to use standard terms, make sure that they are properly incorporated into your contract, ideally by the counterparty expressly agreeing to them in writing.
- If the counterparty has standard terms, make it clear that your terms, not its, apply.
- Limit assignability wherever you can to give you as much certainty as possible as to the party you are contracting with and include set-off where possible..
- If you are trading with counterparties that are based outside of England and Wales you should make it clear that English law applies to your dealings with them and that, ideally, the English courts have exclusive jurisdiction to determine any disputes.

Credit control and Insurance

- Keep the period of your payment terms as short as possible and be active on your credit control.
- Conduct detailed due diligence on your customer's financial position before you contract with them and continually review the position during the relationship.
- Look to charge interest and have the flexibility to be able to amend your terms to move, for example, to cash on delivery or account if you are concerned about your counterparty's financial position.
- Keep your ear to the ground for industry rumour about the financial performance of your counterparties and, where possible, your contract should permits you to request information from the counterparty as to their financial position or disclosure of key information that may be relevant to your trading relationship with them..
- Explore and, if appropriate, available and cost effective, obtain insurance to protect against customer insolvency or non-payments.

Retention of title

- Title generally passes on delivery so If you trade on terms where you supply before you are paid, you run the risk of your counterparty going into an insolvency process and you recovering little or nothing of what you are owed.

- You should therefore consider retaining title in what you supply until you have been paid, through a retention of title ("ROT") clause and, if you do, tailor that clause to your business.
- There are two types of ROT clause, a simple clause, where you retain title to the particular goods sold under the contract until they are paid for in full and an all monies ROT clause where you retain title in all goods supplied until all debts owed have been settled in full.
- With a simple ROT clause you will need to identify the goods supplied under a particular unpaid invoice for this to be effective, but this is not required with an all monies clause, albeit that you will still have to identify the goods that you have supplied.
- You should also ensure, as far as you can, that your goods are not mixed or incorporated into other's
- In order for a ROT claim to succeed you must be able to identify your product supplied so, as soon as you are aware that your counterparty has gone into an insolvency process, you should put the insolvency practitioners on notice that you have a valid ROT clause, attend the counterparty's premises to identify your goods and ensure that they are separately stored and remain identifiable.

Trusts

- You may want to consider setting up a trust either for you to hold a counterparty's money or a counterparty to hold money on your behalf (eg payments for goods supplied) to protect you on the counterparty's insolvency process.
- The law on trusts is complex but, in principle, you require three certainties to set up a trust to exist – certainty of words, subject matter and objects.
- One of the main objectives of creating a trust in a commercial context is to ensure that the trust assets do not form part of the insolvent estate of a company or individual if there is an insolvency procedure in relation to that person at a later date.

Liens

- A lien is a contractual, statutory or common law right to retain possession of goods until the party asserting the lien has been paid.
- Unlike retention of title, a lien does not give the claimant any title in or ownership of the goods, simply the right to retain possession of goods until payment has been received.
- A lien on its own does not give the claimant the right to sell the goods and take the proceeds so this must be added into the documentation/terms.

Protection of Intellectual property rights (IPR)

- You should ensure that your key IPR is properly protected (where appropriate by registration if you own it) and in the right ownership.
- If you licence IPR, you need to have a written licence and ensure, as far as possible, that your entitlement is exclusive and the licence is recorded at the relevant intellectual property office.
- There is a difference between a party being insolvent and being in an insolvency process. Ideally you should have the right to terminate a licence if the counterparty is insolvent to give you the maximum flexibility.
- As a licensee, one option to reduce insolvency risk is to assign the IPR into a non-trading special purpose vehicle (SPV) with the licensee taking a security interest in the SPV shares.
- If relevant, the licensee should also look to have the source code held in escrow with the licensor's insolvency as a trigger of release.

Security and guarantees

- If a counterparty grants valid and enforceable security in your favour you will be a secured creditor ranking, in the main, ahead of unsecured creditors with a greater prospect of recovery on a counterparty's insolvency process.
- The granting of security may also give you some control through the ability to enforce.
- This will depend on the nature of security you are granted, but a fixed charge/mortgage ranks in priority to a floating charge over the business and assets
- Other forms of security include pledges, step in rights, set off and bonds and could include the holding of cash on deposit.
- The validity of security may be challenged on the basis that the debtor obtained no corporate and/or monetary benefit in granting the security.
- A floating charge will be invalid if it was granted within 12 months of the debtor entering an insolvency process (or 2 years if the debtor and creditor are connected) and there was no fresh consideration granted at the time the charge was created.
- If the counterparty has already granted security to a lender, your security will rank behind the prior security.
- The other secured creditor may also require you to enter into a deed of priorities whereby you agree, amongst other things, not to take enforcement action without first giving notice to and liaising with them.
- Alternatively, you may seek a guarantee and indemnity from a third party in respect of the counterparty's liabilities and/or performance, but check covenant strength.
- There must be a corporate benefit received by the third party in return for granting the guarantee. A guarantee may be unlimited or limited to an agreed amount.
- If it is an individual granting a guarantee, they should be encouraged to seek independent advice as to the consequences of granting the guarantee to reduce the chance of a potential challenge as to the validity of the guarantee when you are attempting to enforce it.

Get in touch

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