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EU Late Payment Directive in Place in Member States, Needs More Promotion for Creditors to Reap Benefits

Studies continue on the impact of the Late Payments Directive (also known as Directive 2011/7/EC of the European Parliament and the Council of the European Union dated Feb. 16, 2011), which is designed to speed up payments in commercial transactions. It represents an ambitious commitment by European governments to reverse the ingrained culture within companies and the public sector to delay payments of invoices significantly.

The Late Payment Directive has now been transformed by all eurozone member states into respective national law—Germany became the last to finalize in July 2014. An official, government-backed study, including detailed statistical information on the impact of the directive, will be presented to the European Parliament (and available to the public) on March 16, 2016. However, figures from a private firm's studies in 2014 and 2015 suggest member states need to undertake greater efforts to bring these creditor-friendly provisions to the attention of businesses, as less than 10% of those polled reported a benefit resulting from the effort. Many even remain unaware of the Directive's existence.

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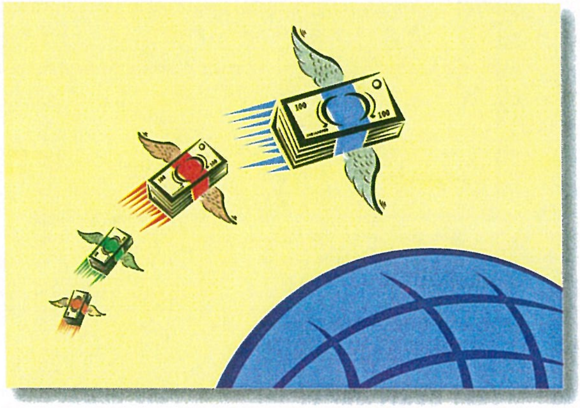
Brief Summary of the History of the Initiative against Late Payment

Late payments of invoices cause financial problems, especially for small- and medium-sized enterprises that depend on sufficient liquidity. The initiative to improve payment times dates back to 1995. On May 12, 1995, the European Commission adopted a recommendation on payment periods in commercial transactions (Official Journal [OJ] L 127, 10.6.1995, p. 19) at the urging of the European Parliament. Statistics indicated, however, that there was, at best, miniscule improvement to late payment activity in many member states following its adoption. Thus, the European Parliament concluded that the objective of combating late payments in the



internal market cannot be sufficiently achieved by the member states acting individually. Therefore, the European Parliament and the Council of the European Union adopted Directive 2000/35/EC of June 29, 2000 on combating late payment in commercial transactions. This first attempt at a Late Payment Directive was to be transformed into the laws of the member states by Aug. 8, 2002.

In addition, the European Commission in subsequent years adopted further regulations to facilitate the enforcement of payment claims within the EU. (Regulation [EC] No 805/2004 of April 21, 2004 creating an European Enforcement Order for uncontested claims; Regulation [EC] No 1896/2006 of Dec. 12, 2006 creating an European order for payment procedure; and Regulation [EC] No 861/2007 of July 11, 2007 establishing a European Small Claims Procedure.) The objective was that businesses could trade throughout the European market under improved conditions, ones which ensure that transborder operations do not entail greater risks than domestic sales.

However, commercial payment behavior did not change. Many payments in commercial transactions between economic operators or between economic operators and public authorities were still made far later than what was agreed to between the parties—the public sector, especially, was considered to be very late-paying, typically. Late payments of invoices were widespread within the European Union and, often, there was no sanction based on the extra costs to creditors. This led to significant financial damages, as each year thousands of European undertakings filed for insolvency. Small and medium-sized enterprises often are most affected. As a result, late payment has an effect on the free traffic of goods and services within the European market and, thus, it is a disadvantage for the whole economic standing of the EU.

> Where interest for late payment becomes payable, the creditor may demand a fee of €40 (euros) per invoice. This sum, viewed as compensation for the creditor's own recovery costs, is also payable without the necessity of a reminder.

Main Content of the Late Payment Directive

To improve the protection of business against this and to strengthen the competitiveness, a newer Late Payment Directive completely replaced the former effort. Adopted in 2011, the present iteration of the Directive strengthens provisions against late payment, and it especially harmonizes the expected payment periods in transactions between businesses and public authorities. The Late Payment Directive now gives a strict framework for payment periods, the interest for late payment the creditor can request and the compensation for recovery costs the creditor can claim from the debtor in addition to the interest for late payment.

Payment periods between private companies

If the parties of a transaction concerning the delivery of goods or rendering of services have not agreed on a date or a period for payment, the creditor is automatically entitled to interest for late payment: (i) 30 calendar days following the date of receipt by the debtor of the invoice or an equivalent request for payment; or (ii) 30 calendar days after the date of receipt of the goods or services; or (iii) where debtor receives the invoice earlier than the goods or services, 30 calendar days after the receipt of the goods or services. The creditor is entitled to interest for late payment 30 calendar days after that date when a procedure for acceptance of the goods or services is to be provided for by statute or in the contract and if debtor has received the invoice or request for payment earlier, or on the date on which such acceptance takes place. The creditor is not obliged to issue reminder letters. Only where the creditor has not fulfilled its own contractual or legal obligations or where the debtor is not responsible for the delay of payment will the creditor not be entitled to interest for late payment.

If the parties have agreed on a date or a payment period, a creditor may request interest for late payment, which begins one day after the originally agreed payment date. Again, no further reminder by the creditor is required.

With respect to payment periods, the Late Payment Directive restricts the right of the contractual parties to set extensively long payment periods. The maximum payment period which can be agreed is 60 calendar days after receipt of the invoice or delivery of the goods. An agreement exceeding this shall only be effective if this was specifically agreed to and is judged to be not grossly unfair to the creditor.

> Any contractual term or a practice that seeks to exclude compensation for recovery costs shall be presumed to be grossly unfair.

Payment periods between companies and public authorities

In transactions with public authorities, the usual payment period which can be agreed shall not exceed 30 calendar days after receipt of the invoice or delivery of the goods or services. Only in transactions with any public authority which carries out vital economic activities of an industrial or commercial nature (subject to the Directive 2006/111/EC of Nov. 16 2006 on the transparency of financial relations between member states and public undertakings), or which provides health care and is duly recognized for that purpose, can the payment period be extended to 60 calendar days. Any other extension of the payment period shall not be possible.

Interest rate for late payment

The Directive provides that the interest rate for late payment shall be at least eight percentage points above the relevant national reference rate. An agreement excluding the claim for interest for late payment is deemed to be grossly disadvantageous. Such a contractual provision is either not enforceable or must oblige a party to pay compensation for damage. During the transformation of the Late Payment Directive into its own respective laws, many member states have increased the rate. For example, Germany set the rate at nine percentage points above the reference rate of the European Central Bank (ECB); in Bulgaria and France, the rate is 10 percentage points above the ECB reference rate.

> Analysts found that only 31% of the survey respondents were aware of the latest Late Payment Directive. Just 6% of companies believe they could actually benefit from the Directive, and 4% reported plans to make use of the right to charge interest for late payers.

Compensation for recovery costs

Where interest for late payment becomes payable, the creditor may demand a fee of €40 (euros) per invoice. This sum, viewed as compensation for the creditor's own recovery costs, is also payable without the necessity of a reminder. In addition to the fixed sum, the creditor shall also be entitled to obtain reasonable compensation from the debtor for any recovery costs exceeding that fixed sum and incurred due to the late payment. Such costs can include lawyer fees or a debt collection agency. Any contractual term or a practice that seeks to exclude compensation for recovery costs shall be presumed to be grossly unfair.

Impact of the Late Payment Directive on the Payment Behavior so Far

Since the Directive has been adopted by each member state a mere one to two years ago in most cases, statistics considered to be extensive and completely credible are limited. The European Commission has ordered a study to obtain information concerning the development of the payment behavior changes, with a focus on aspects including, but not limited to, how many creditors are actually collecting the €40 fee from late debtors and how the rules are being viewed from state-to-state.

One private survey, conducted by a leading European credit management service, Intrum Justitia, polled 8,979 participants from 29 European countries during the period between February and April 2015. In its *European Payment Report 2015* ("the *Report*"), Intrum Justitia analysts found that only 31% of the survey respondents were aware of the latest Late Payment Directive. Just 6% of companies believe they could actually benefit from the Directive, and 4% reported plans to make use of the right to charge interest for late payers.

Comparable with the figures published by Intrum Justitia in its European Payment Index 2014 ("the Index"), the figures show that the late payment of invoices remains a big problem for the economic development of businesses in the EU and that no significant improvement could yet be achieved. Problems remain especially prevalent with debtors based in Europe's Southern countries (Italy, Spain, Portugal) and some Eastern states (Croatia, Bulgaria). According to the Index and the Report, the public sector improved its payment behavior, but is still the slowest payer in the European Union—the average length of payment of such invoices reduced from 61 days in 2013 to 58 days in 2014 and, in most countries, the length of payment of invoices by public authorities still exceeds 30 days, according to the data. The longest period is in Italy with above 140 days.

In transactions between private businesses, the average length of payment of invoices also made slight improvements, declining from 49 days in 2013 to 47 days in 2014. The figures show that most of the length of payment of invoices is around or above 30 days in B2B transactions. The longest payment period in that category, again, involves debtors based in Italy (80 days). In short, the statistics show that the current situation remains far from the stated, 30-day payment period goal provided for in the Directive.

Meanwhile, bad debt losses increased from 3% in 2013 to 3.1% in 2014, and remained at that level into 2015, according to the Report. Approximately 88% of the companies taking part in the Index study and 86% in the Report survey saw that the main reason for the late payment is still financial problems being suffered by their debtors. Respondents in both characterized intentional late payments on the part of debtors as the second most prevalent issue and, behind that, administrative inefficiency, notably in the form of lackluster follow-up when payments are not received on time.

As a result, negative consequences persist for many companies that took part in the surveys.

- 63% of the companies involved in the Index study and 49% of those polled for the Report survey said they were suffering from a medium-to-high level of "liquidity squeeze."
- 55% from the Index and 46% from the Report noted a medium-to-high level of "loss of income."
- 50% from the Index and 40% from the Report said late payments were "prohibiting growth of the company."
- 36% of the Index and 31% of the Report said consequences of late payment levels they face are a "threat to survival."

Without significant acceleration in the payment of invoices, there is overall not a very good outlook for the future development and competitiveness of the European companies.

The risk forecast for 2014 in the Index provided that 46% of the European businesses that responded to the survey were pessimistic and predict the risk of late payments will actually increase in the next 12 months. For 2015, the Report does not provide a general average—however, a 12-month risk forecast was assigned for each country. Romania (39%), France with (34%) and Belgium (30%) earned the highest risk forecasts, according to the data.

These negative perceptions might still be owed to the bad economic situation in many countries in the EU. It is questionable whether the Late Payment Directive can realistically improve the payment behavior of debtors significantly if the overall economic situation does not improve. It will be interesting to review additional details concerning the impact of the Late Payment Directive on the payment behavior when the European Commission's report to the European Parliament is released on March 16, 2016.

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