

# FIT FOR FUTURE Platform Opinion

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<b>Topic title</b>	Directive on combating late payment in commercial transactions <a href="#">2021 AWP</a> <a href="#">Directive 2011/7/EU</a> <i>Legal reference</i>
<b>Date of adoption</b>	08 December 2021
<b>Opinion reference</b>	2021/SBGR2/06
<b>Policy cycle reference</b>	<input type="checkbox"/> Contribution to (ongoing) legislative process <i>Commission work programme reference</i> <input checked="" type="checkbox"/> Contribution to the (ongoing) evaluation process <a href="#">Ex-post evaluation of Late Payment Directive, 2018 Commission study, 2019 European Parliament Resolution on the implementation of the Late Payment Directive.</a> <i>Title of the (ongoing) evaluation</i> <input type="checkbox"/> Included in Annex VI of the Task force for subsidiarity and proportionality <input type="checkbox"/> Other
<b>Have your say: Simplify!</b>	<i>No relevant suggestions on this topic were received from the public.</i>
<b>Commission follow up</b>	REFIT Scoreboard: <a href="#">Late Payments Directive</a> Have your say portal: <a href="#">Late payments – update of EU rules</a> Annual Burden Survey: <a href="#">The EU's efforts to simplify legislation</a>

## FIT FOR FUTURE PLATFORM'S SUGGESTIONS SUMMARY

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In order to tackle the existing problems that are a consequence of late payments the Fit for Future Platforms suggest a wide range of non-exclusive measures. These are divided into short and long term measures.

*Short term suggestions:*

- Suggestion 1: Define grossly unfair**
- Suggestion 2: Explore reversing the burden of proof for grossly unfair**
- Suggestion 3: Explore a shift in the burden of proof from SMEs to large companies**
- Suggestion 4: Encourage SMEs to exercise their rights by providing advice and information about payment terms.**
- Suggestion 5: Make payment terms transparent**
- Suggestion 6: Self-regulation**

*Long term suggestions:*

- Suggestion 7: Explore tightening up contractual payment terms to a maximum of 30 days for payments from a large company to a SME**
- Suggestion 8: Automatic offsetting by law for damages resulting from late payments by government organizations**
- Suggestion 9: E-invoicing**
- Suggestion 10: Governmental supervisor**

## SHORT DESCRIPTION OF THE LEGISLATION ANALYSED

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To protect European businesses, in particular SMEs, against late payment and to improve their competitiveness, Directive 2011/7/EU on combating late payment in commercial transactions was adopted on 16 February 2011. This directive puts in place measures, which will contribute significantly to employment, growth and an improvement in the liquidity of businesses.

Main provisions of the directive:

- public authorities have to pay for the goods and services that they procure within 30 days or, in very exceptional circumstances, within 60 days;
- enterprises have to pay their invoices within 60 days, unless they expressly agree otherwise and provided it is not grossly unfair;
- automatic entitlement to interest for late payment and €40 minimum as compensation for recovery costs;
- statutory interest of at least 8% above the European Central Bank's reference rate;

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- EU countries may continue maintaining or bringing into force laws and regulations which are more favourable to the creditor than the provisions of the directive.

### **Further sources of information**

[Legislation framework webpage](#)

[Ex-post evaluation](#)

[Late Payment Expert Group – Directive 2011/7/EU \(E02710\)](#)

[2018 Commission’s study](#)

[2019 EP Resolution](#)

[SME Strategy 2020](#)

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## **PROBLEM DESCRIPTION**

### **Setting the stage**

The Late Payment Directive (2011/7/EU) was adopted in 2011. Whilst the Late Payment Directive has reduced delays for both business-to-business and business-to-platform transactions, still only 40% of businesses in the EU are paid on time and late payment account for one out of four bankruptcies among SMEs in the EU.<sup>1</sup> This widespread problem has also been noted by an [Ex-post evaluation](#), a [2018 Commission’s study](#) and a [2019 EP Resolution](#). In response the European Commission stated in its 2020 SME strategy, as SMEs suffer most from unfair payment practices, that there needs to be a decisive shift towards a new business culture in which prompt payment is the norm. In order to do so it will support the implementation of the Late Payment Directive by equipping it with strong monitoring and enforcement tools.

The Fit For Future Platform believes that the urgency of late payments problems has become even stronger due to the COVID-19 crisis. In some member states payment delays have tripled in March 2020 as compared to the same period in 2019, whilst in other member states SMEs have found the payment terms unilaterally extended by their debtors.

As the Fit for Future Platform is a high-level expert group that helps the Commission in its efforts to simplify EU laws and to reduce related unnecessary burdens, it is important to know that for each day of reduction in payment delays, EUR 158 million is saved by European companies in finance costs.<sup>2</sup> This adds to a feeling of urgency to reduce late payments.

This Fit for Future Platform opinion advises the European Commission on how to achieve a new decisive shift towards a new business culture in which prompt payment is the norm. In order to do so it first identifies the problems that arise from late payments. It then looks at shortcomings in European legislation. Finally, several solutions are proposed that can be achieved either on the short term or long term. In order to be able to draft the opinion, desk

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<sup>1</sup> EU Commission ‘SME Strategy’, 2020;

<sup>2</sup> European Commission, Late Payment Directive evaluation;

research has been undertaken. This formed the basis for a survey that was sent to all members of the Fit for Future Platform. The answers helped to fact check the findings of the desk research, to reformulate the findings and brought forward many usable good practises in member states. Before being finalised a draft opinion was presented in subgroup 2.

The focus of this opinion is on SMEs, as SMEs suffer most from late payments since they don't have the means to cope with the effects. This doesn't mean however that SMEs themselves are always paying on time or do not make use of the identified loopholes in legislation.

## **Problems related to late payments in the European Union**

Existing evidence and the input of stakeholders from the Fit for Future Platform suggest there are several problems that arise from late payments in the European Union.

The Fit for Future Platform has identified the following non-exclusive list of problems that arise from late payments in the European Union:

### **1) Liquidity problems**

Long payment terms and late payments can lead to liquidity problems. As a result, companies cannot meet their financial obligations (such as payments and loans). This problem is especially urgent for start-ups or companies with a rapidly growing or declining turnover. However, this problem does not apply exclusively to this group.

### **2) Unnecessary reservation of working capital**

Due to long payment terms and late payments, an unnecessary amount of working capital has to be reserved. As a result, companies are limited in their financial flexibility and have less capital available for investments and innovations. A company that is paid late has no time nor capacity to invest and become more digital, more green, more sustainable and more resilient. Addressing late payment therefore is necessary to create the conditions for a successful triple transition of the economy as a whole ( green, digital, resilience).

### **3) Unnecessarily high loans**

By withdrawing working capital, companies have to take out unnecessarily high loans or other financial provisions. As a result, long payment terms and late payments cause additional costs that directly affect the profitability of a business.

### **4) Lost income**

Long payment terms and late payments cause companies to lose income. This has economic consequences as they are deterred from investing (and therefore innovating). When a company is unable to assume the working capital funding needs, it can lose its clients which in turn influences its level of competitiveness in the market.

### **5) Unlikely to hire new employees**

Due to long payment terms and late payments, companies have to deal with either uncertainty or a loss of income. This has the result that they are not likely to hire new employees.

### **6) Less cross-border trade**

Due to their own experiences or the experiences of other companies with long payment terms and late payments, some companies do not trade with international parties. They consider this

as an increased risk because they do not know how to deal with the occurrence of late payments abroad. This leads to a sub-optimal functioning of the EU internal market.

### **7) Hard to meet financial obligations to governments**

Due to late payments, companies do not always have the financial means to meet their obligations to governments. This concerns obligations based on legal regulations (and not based on voluntary relationships with another market party), such as taxed and social security contributions.

### **8) Lost time**

A company that needs to chase its invoices loses time and costs that cannot be invested in the business. This can also be considered as an administrative burden.

The Fit for Future Platform has **acknowledged** that the above mentioned problems are a result of shortcomings in the European legislation. Overall, companies seem to be generally aware of the regulations on payments terms. They know to a limited extent what the regulations entails and how they can theoretically hold their customers accountable. Seeing the extensive list of problems companies face even with European legislation it should be concluded that at the moment this European legislation offers too little protection for SMEs.

## **The Fit for Future Platform has found the following shortcomings in the Late Payment Directive:**

### **1) Ambiguous provisions**

At the moment the Late Payment Directive states that ‘enterprises have to pay their invoices within 60 days, unless they expressly agree otherwise and provided it is not grossly unfair’. However, the term ‘Grossly unfair’ has not been defined. This lacking definition leaves companies plenty of space to deviate from the set 60 days. The possibility to deviate from the 60 days term B2B payment term results in the unwanted situation that grossly unfair payment terms are still part of the (price) negotiations<sup>3</sup>.

### **2) Unequal level playing field**

Although freedom of contract is a very important European value governments have to ensure a level playing field. As has been mentioned above grossly unfair payment terms are still part of the (price) negotiations. SMEs however do not have a (similar) negotiating position compared to large companies. This can result in:

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<sup>3</sup> Conform the findings of the Evaluation of 2016 (COM 2016 534) and with the conclusions of the Commission study “Business to business transactions - A comparative analysis of legal measures vs. soft-law instruments for improving payment behaviour”, 2018. As underlined in these documents, Directive 2011/7/EU has been more effective in addressing payment delays from the public sector than payment delays B2B. This is mainly due to the fact that the provisions on payments from the public sector are drafted in a more precise and stringent way than those applicable to payments between businesses;

- 1) SMEs making concessions on their prices to achieve a reasonable payment term and/or;
- 2) SMEs having to accept a long payment term in order to receive a reasonable price and/or;
- 3) SMEs making concessions on their prices and accept a long payment term.

In some cases payment terms can also result in some large companies deliberately using long payment terms to gain a strategic advantage. Some use the scope offered by the Directive in the most optimal way when making deviating agreements about payments terms. Especially when large amounts of money need to be paid, large companies are increasing their liquidity when it comes to payment terms. In other words, by extending payment terms, inventories or projects are pre-financed.

### **3) Burden of proof placed at creditor**

At the moment the burden of proof for declaring an agreement with long payment term as ‘grossly unfair’ is placed with the creditor. Proving that an agreement can be seen as ‘grossly unfair’ is not only extremely hard given the fact that there is no definition, it’s difficult for small firms with little to no legal support. This troublesome process specifically deters SMEs from exercising their rights. Especially since instigating such a process can also hurt good relations with the debtor.

### **4) Lack of supervision**

Another problem is that SMEs often do not make use of their right to collect interest in case of late payments (mainly Article 3 of the Directive) or reimbursement of collection costs (Article 6 of the Directive) because they want to maintain a good relationship with their customers. Even if contracts are terminated, they do not wish to disrupt this relationship. Moreover, most SMEs expect that calling back the statutory compensation afterwards will not be sufficiently rewarding.

It should also be realised that long imposed payment terms by large companies often remain under the radar. SMEs cannot make this public because of fear of sanctions by larger companies. This is mainly due to the lack of supervision and the fact that the Directive does not provide SMEs with the tools to take action against such larger companies.

### **5) Legal action can be too costly or takes too long**

The directive allows legal action to be taken by companies when invoices are not paid in time. However, the cases of non-payment procedures in Court can, in some Member States, be too costly for SMEs. This constitutes a burden as these cases tend to drag on for years. It hampers the enforcement of the directive as SMEs might be deterred from taking legal action.

## SUGGESTIONS

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In order to tackle the aforementioned problems and gaps in the legislation the Fit for Future Platform puts forward a list of 10 wide ranging suggestions. These suggestions form a palette of possible solutions that can be explored by the European Commission to establish a new business culture.

Given the urgency of the problem the Fit for Future Platform makes a division between short term suggestions and long term suggestions. Implement the short term suggestions can commence relatively soon. They could improve the legislation by making it more effective and future proof. On the long term they can support the transformation towards a new business culture in which late payments is not considered the norm anymore. Of course, any new legislative initiative should be evidence-based.

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### Short term suggestions

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#### **Suggestion 1: Define grossly unfair**

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**Description:** At the moment enterprises have to pay their invoices within 60 days, unless they expressly agree otherwise and provided it is not grossly unfair. However, a definition of the term ‘Grossly unfair’ is missing. Therefore the Fit for Future Platform suggest to define the term grossly unfair. This echoes the 2019 EP Resolution as it called for similar guidance by the European Commission<sup>4</sup>. By defining the term a loophole in the current legislation is closed.

The term ‘Grossly unfair’ should be clarified in relation to payment terms in contractual agreements and commercial practices, and when contractual payment terms begin and end. Some member states remarked that such definition should take into account the nature of the goods or services and the time needed to sell them. Financial agreements with third parties, which might impose additional requirements on SME's, should also be revised under the definition of grossly unfair.

As the term is currently undefined the European Commission should also look at the possibility to define any agreement between an SME and a large company with a payment period longer than 60 days as unfair.

In accordance with common business practice the European Commission should also take into account sectoral differences in payment terms whilst defining ‘grossly unfair’. This can be done by allowing sectoral agreements by representatives of the business community deviating payment terms (for example, in the construction or retail sector). These sectoral agreements should be well known and public.

**Expected benefits:** An expected benefit is that the uncertainty about what constitutes a grossly unfair payment is taken away. A definition of the term provides clarity to the business community and helps to prevent unnecessary judicial costs. If the definition is clarified, business might also be hesitant to implement unnecessary long payments term which in turn helps to create a new business culture. In addition SME's might be convinced to make more use of their legal rights.

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<sup>4</sup> European Parliament resolution of 17 January 2019 on the implementation of Directive 2011/7/EU on combating late payment in commercial transactions (2018/2056(INI));

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However, providing a definition on grossly unfair will not completely solve the issue that SME's don't take legal action.

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### **Suggestion 2 & 3: Explore the reversal of the burden of proof for grossly unfair**

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**Description:** At the moment the burden of proof for a 'grossly unfair' payment term lies with the creditor. Without a common definition it's very difficult for (small) creditors to showcase that a deviating payment term is to be deemed 'grossly unfair'. The European Commission should therefore explore whether it's possible and feasible to shift the burden of proof to the debtor. This could be done by providing specific guidance on what constitutes 'grossly unfair' and how this should be treated. The analysis should explore what the potential positive and negative results could be of changing it so that it's up to the debtor to showcase why it's necessary to deviate from the given 60 days. In addition it should also be explored what the merits and detrimental effects are of changing the burden of proof solely from SMEs to large companies. .

Ideally, however, this shift in the burden of proof shouldn't be necessary when the term 'grossly unfair' is defined properly.

**Expected benefits:** Shifting the burden of proof to the debtor could take away the pressure from the creditor whilst adding it to the debtor that requires a deviating payment term. Creditors want to maintain a good relationship and don't want to start a judicial fight about what constitutes a necessary deviation. Shifting the burden of proof will probably not completely take away some SME's creditors reserves about taking legal action.

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### **Suggestion 4: Encouraging SMEs to exercise their rights by providing advice and information about payment terms**

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**Description:** Although most SMEs are well-informed about the regulations, some are still not aware. 70% of businesses in the EU do not claim interests and compensation when they are paid late (even if they are entitled to)<sup>5</sup>. There is a chance therefore that these companies will not rely on the rights of the directive. Various reasons contribute to this, in particular when there is a situation of asymmetry of size – the so-called “fear factor”. However, clear understanding and awareness of their rights can help companies to exercise them. Governments could support SMEs in this. Providing information and advice on payment terms plays a fundamental role to assure full compliance with the Directive. This concerns information about the legislation, contractual payment terms and the right to interest in the case of late payments amongst other things. In addition, education and training to improve knowledge on working capital and credit management (amongst other things) can be provided. This obtained knowledge might help SMEs to make more calculated business decisions on contracts that will give them a chance for development - even though it is high risk.

When guidance is provided on the term 'Grossly unfair' an information campaign can be used to raise awareness and improve the information flow.

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<sup>5</sup> Ex-post evaluation of the Late Payment Directive.



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**Expected benefits:** Information and awareness on payment terms play a fundamental role to assure full compliance with the Directive. However, SMEs will still be at risk from long payment terms and late payments. Even with full awareness SMEs might still not use the tools provided as they want to maintain a good relationship.

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#### **Suggestion 5: Make payment terms transparent**

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**Description:** A possible solution could be to make payment terms transparent through an obligation for or voluntary pledge from large companies to report on payment terms. Large companies are generally more sensitive to potential brand and image damage. The basic principle is that large companies are obliged or pledge to report annually on their contractual and realized payment terms to SMEs and the number of times they exceed the payment term. The reporting can be done, for example, in the financial or social annual report. Alternatively, the board report could be used to explain. At the moment it's not deemed necessary to include a check by an accountant as this would increase the burden significantly and would not be efficient with the existing loopholes in the legislation. To ensure its effectiveness, it could be necessary to implement this suggestion hand in hand with other suggestion, in particular suggestions 1, 7, and 9.

**Expected benefits:** More transparency about payment terms can help to achieve a new business culture and helps to add transparency to existing payment terms. It will become clear which companies make use of which payments terms. An obligation to report can however result in additional administrative burdens for large businesses and therefore costs incurred should be duly assessed first. If a member state already has a more far-reaching system in place (cf. suggestion 10), then reporting should not be made mandatory.

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#### **Suggestion 6: Self-regulation**

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**Description:** Applying self-regulation in this case could mean that a certain sector draws up a regulation about the expected payment behaviour of companies that fall within the relevant sector. The sector itself is responsible for the implementation and enforcement of the regulation. Companies that demonstrably comply with the regulation will receive a quality mark. This allows them to distinguish themselves from other companies and it enables SMEs as suppliers to make a more substantiated choice for a particular customer.

**Expected benefits:** Although not a silver bullet it can help to create a new business culture. Especially when pressure is applied on companies to join, it helps to enforce the legislation whilst not imposing significant burdens. However, the effectiveness of self-regulation relies on tight monitoring of signatories' compliance with the obligations that they have committed to observe, and on sanctioning lack of compliance.

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## Long term suggestions

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Long term suggestions, whilst improving the effectiveness of the legislation and supportive of a new business culture, are not easily implemented on the short term. Some provide a certain direction for the solution but not the necessary details. These will need to be expanded upon significantly before implementation is possible. Other long term suggestions will make the legislation more effective but to a certain extent also contain policy decisions. Given that the mandate of the Fit for Future Platform is to look at making European legislation more effective and future proof, it would be a deficiency not to name them.

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### **Suggestion 7: Explore tightening up contractual payment terms to a maximum of 30 days for payments from a large company to an SME**

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**Description:** In the long term contractual payment terms could also be tightened up to a maximum of 30 days (including the verification period) for payments from large companies to SMEs. Sectors may agree to make deviating agreements about the maximum payment term within their sector – retaining flexibility and freedom to contract where necessary. An example could be the retail sector in which agreements are often made about inventory financing and items on consignment. Such a substantial change would require a legislative process and a thorough analysis of the advantages and disadvantages to all parties in the supply chain.

**Expected benefits:** Tightening up payment terms could increase the liquidity and working capital of companies and influence its competitiveness – whilst potentially adding burdens elsewhere in the supply chain. The sectoral flexibility, although necessarily, could also be a reason why the improvement will not equally benefit all companies. When one considers that for each day of reduction in payment delays an estimated EUR 158 million is saved by some European companies in finance costs this change could have a massive potential to reduce the burdens and create a new business culture. However, it should be analyzed if tightening payment terms up to a maximum of 30 days has an adverse effect on the price negotiations and/or other factors pertaining to ordinary contractual agreements. In addition, creating too much differentiation between SME's and larger companies may also result in an impediment for growth.

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### **Suggestion 8: Automatic offsetting for damages resulting from late payments by government organizations**

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**Description:** This suggestion focuses on late payments by governments. The suggestion is to offset the negative consequences and costs resulting from late payments by government organizations. This creates much needed liquidity for companies. The only acceptable way to implement this would be to encourage Member States to ensure VAT refunds as soon as possible to ensure that business that are paid late by the State are not deprived of liquidity.<sup>6</sup>

**Expected benefits:** This suggestion helps SMEs that cannot pay their obligatory taxes on time due to the fact that invoices are not paid in time by the same public authorities. The only acceptable

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<sup>6</sup> EP Resolution of 2019.

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way to implement such a system would be via fast VAT refunds. By ensuring swift VAT refunds companies will get the needed liquidity, which in turn could result in less companies going bankrupt.

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### **Suggestion 9: E-invoicing**

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**Description:** Electronic billing (e-invoicing) for all businesses and governments will lead to a more rapidly and reliable payment procedure. E-invoicing works (partly) automatically, which helps to speed up the process of billing and transferring. Additionally, it can also automatically charge interest when payments are overdue. The European Commission could explore in how far e-invoicing systems are ready for widespread use and what support for businesses or governments is needed in order to make it's use widespread.

**Expected benefits:** E-invoicing helps to speed up the process of paying and prevents that invoices are forgotten. In addition, it can help with automatically charging interest when payments are late.

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### **Suggestion 10: Governmental supervisor**

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**Description:** In case all of the above mentioned suggestions and mediation or arbitration systems are still not able to tackle the problem of late payments, the European Commission should explore the possibility to create a governmental supervisor structure. If the market doesn't make use of the provisions of the legislation and is thus not able to enforce compliance of agreements a governmental supervisor can take away this problem. The option to issue administrative fines can be part of the supervisor's tasks. When designing a position for a supervisor it is important to consider the wishes of SMEs that they do not aim for a disrupted relationship with their customers. A disputes committee or reporting point is therefore not the appropriate set of instruments because then both parties are always known or can be known to each other.

An independent governmental supervisor can support the SMEs by taking steps (negotiation and mediation) to combat late payments and enforce the Directive. The assigned tasks should be concrete and procedures should be fast and easy. The supervisor could also capitalise on the efforts done by business support organisations at the national level to engage in additional methods to solve late payments or unpaid invoices.

**Expected benefits:** A governmental supervisor can greatly improve compliance with the Directive. It's able to enforce the directive without hurting the good relationships between creditor and debtor. This is however the most far reaching suggestion and should only be further explored when other measures do not seem to work. In addition, the cost of setting up such a structure should be taken into account.

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## DISSENTING VIEWS

### *BusinessEurope*

While in the Opinion some relevant suggestions are proposed, we would not be able to support the suggestion to tighten up contractual payment terms to a maximum of 30 days for payments from a large company to an SME. This does not respect the principle of contractual freedom in business-to-business relations, one of the foundations of Europe's private law.

#### *Rationale for dissenting views on the suggestions:*

The definition of payment terms is an essential element of flexibility when negotiating commercial contracts. Companies themselves should determine the terms and conditions of a transaction, which may include such issues as the price, warranty period, delivery, and terms and conditions of payment. Consequently, terms of contract relating to payment terms are just one of many parameters on which companies compete. Also worth-noting that there are concrete examples of business where 30 days payment terms would not advantage SMEs (e.g. textile / fashion sector where the suppliers may be paid as the merchandise is sold). Last, tightening up contractual payment terms might have as end results unintended effects on price (e.g. higher costs for the purchaser and/or a lower price for the seller) and therefore impact some other aspects of a contract.

#### *Alternative suggestions:*

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#### **Suggestion 7: Explore the possibility of a tightening up of contractual payment terms to a shorter period**

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**Description:** In the long term contractual payment terms could be tightened up (including the verification period) for payments among parties. Maintaining their freedom of contract, sectors may agree to make deviating agreements about the maximum payment term within their sector. An example could be the retail sector in which agreements are often made about inventory financing and items on consignment.

**Expected benefits:** Tightening up payment terms could increase the liquidity and working capital of companies and influence its competitiveness. The sectoral flexibility, although necessarily, could also be a reason why the improvement will not equally benefit all companies. When one considers that for each day of reduction in payment delays an estimated EUR 158 million is saved by European companies in finance costs this improvement could have potential to reduce the burdens and create a new business culture.

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