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- DG ENTREPRISES -*

**Review of the effectiveness of European
Community legislation in combating late
payments**

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PRELIMINARY NOTE

This report (the “Report”) is based on contributions made in the form of specific reports from all members of the team described below (the “Team”)¹. In particular, Frédéric Leplat contributed extensively both to the Report and to the research that led to it. Emilie Dessens managed the implementation of the research and the various reports. Isabelle Tinel made an invaluable contribution by convincing many contributors to participate and reporting on their contributions.

This is the English version of the Report. It is available in three languages, English, French and German. The English version shall be the reference for any interpretative issues.

The Report is based on many documents and contributions, most of which were too large to include, even as annexes. The relevant documents were transmitted to the European Commission. In any event, the objective here is not to deter readers by including large quantities of background information but rather to invite the reader to enjoy a synthesised and analytical work. Ideally the reader can then participate in the current thinking on late payments, payment terms, judicial procedures, contracts and the ways in which the EU can strengthen and enhance the competitiveness of small and medium sized enterprises within the Single Market and on the world stage.

¹ The contents of this Report are the sole responsibility of the Team Leader and can in no way be taken to reflect the views of the European Commission or of those who collaborated or participated in this Report since their participation, limited to specific portions of the Report, was reviewed and re-written to form the Report.

This Report is organised in eight Chapters. Chapters 1 and 2 present the context, objectives and methodology of the study. Chapter 3 presents a legal and economic analysis of the situation pre-Directive. Chapter 4 describes the tools proposed by the Directive to combat late payments in commercial transactions. Chapter 5 proposes an economic and legal analysis of the present situation in respect of late payments and payment periods. Chapter 6 aims to measure the impact of the Directive *stricto sensu*. Chapter 7 concentrates on the Directive's impact from the perspective of its relevance, coherence, usefulness and effectiveness. Chapter 8 concludes the report and makes a number of recommendations.

The terms beginning with capital letters that are not defined in this Report are defined by reference to the offer and the contract as approved by the European Commission ("Offer" and "Contract" respectively).

As Team Leader, I wish to thank the members of the Team, researchers, contact points and other contributors for their dedication to this project and the quality of their input.

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REVIEW OF THE EFFECTIVENESS OF THE EUROPEAN LEGISLATION IN COMBATING LATE PAYMENTS

Executive Summary

This Report contains an evaluation of the legal and economic impact of Directive 2000/35/CE on late payments in commercial transactions (hereafter the “Directive”). The aim of the Directive was to combat late payments between commercial entities and provide guidelines on reasonable payment delays.

The Directive first aimed to ensure that previously unreasonable legal or contractual payment delays became reasonable. Second, the Directive sought to curtail late payments - namely, payments made after the expiry of an agreed or applicable payment delay period. Together, payment delays plus late payments result in long payment periods and the Directive intended to address these.

The rationale behind the Directive was that long payment periods were having an effect on European businesses, and mainly on small and medium sized enterprises² (hereafter “SMEs”). In particular, the risks and market distortions created by extended payment periods jeopardizes the ability of these European businesses to take advantage of the Single Market. Further, long payment periods strain cash flow and fuel uncertainty. They prevent SMEs from adequate and timely investment in research and development, technology and the labour force. As a result, long payment periods impede the development, competitiveness and profitability of SMEs, and even endanger their survival.

² Defined under the Commission Recommendation of May 6, 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.5.2003, p.6.

On the issue of long payment periods and late payments, the European Commission adopted a recommendation on May 12, 1995 (the “Recommendation”) and a communication on July 17, 1997 (the “Communication”)³. Following these, the European Commission considered that the situation was not improving, and that EU Member states (“hereafter Member States”) had not been able to resolve the issue.

Nor was it considered that private firms such as debt collection agencies could be instrumental in improving the situation at a European level. Debt collection agencies do resolve some of the issues posed by long payment periods. However, the presence of these agencies in only a limited number of Member States, the fact that many agencies have a regional or national presence at most, and the extra costs involved for SMEs in using agencies meant additional measures were needed to address the matter of late payments. Hence the European Union adopted the Directive.

This Report shows that regulatory action has been taken in most EU Member states to improve payment periods and fight late payments in commercial transactions. In some EU Member States no action was required, as they already complied with the principles outlined in the Directive. In new Member states, action taken was less obvious because their entry to the EU was very recent. But generally, Member States have taken action.

This Report also shows that some Member States are monitoring issues relating to late payments and have engaged in a number of reforms to promote better payment practices. The Report concludes that the actions undertaken by Member States following the adoption of the Directive have had an economic impact, although separating out the effects of recent measures to implement the Directive from other factors, such as changes in the economic cycle, is difficult.

The statistics collected in the Report indicate that the average late payment time (i.e. the period between when payment was due and when it was made) in Europe in

³ Communication from the Commission, Report on Late payments in Commercial Transactions, OJ C 216, 17.7.1997, p. 10 and Recommendation of the European Commission on Payment Periods in Commercial Transactions OJ No L 127, 10.6.1995, p 19, and, for the Communication, OJ No C 144, 10.6.1995, p.3.

2005 was 12.9 days, shorter than that in 1995 which was of 15.7 days⁴. In the third quarter of 2002 (August 8, 2002 being the deadline for transposing the Directive), this average was 15.2 days. This shows the very positive effect of the Directive. Average late payment times stalled in their progression by the end of 2002 and have consistently dropped ever since, saving SMEs across Europe millions of Euros. In addition, payment delays have not increased but rather, stabilized. These statistics indicate that the Directive has generally had a positive impact and prevented further increases in average total payment periods (meaning payment delays plus late payment times). However, the situation remains worrying in specific sectors and individual countries.

The Report notes that businesses' perception of late payments has changed⁵. Late payments, which were previously viewed in some countries as "part of our culture", are increasingly perceived as an unacceptable abuse of the client's position and a breach of contract. One may thus conclude that the European business culture is changing.

While the impact of the Directive is generally positive, the differences between Member States remain a concern. The situation in some Member States has improved only modestly and in some cases has regressed. This indicates that, so far, the Directive has not led to the expected harmonizing effect⁶. Disparities between a number of Member States in terms of payment periods have persisted.

This Report finds that more time and regular monitoring is needed to completely assess the late payment situation and the impact of the Directive. Other policies may need to be defined and implemented to tackle the problem. In particular, Member States need to set an example in their public sectors. In many Member States whole sectors such as health need urgent reform. Judicial reforms also need

⁴ « *Les comportements de paiement des entreprises en Europe* », Bilan 2005, Etude ALTARES (Dun and Bradstreet Worldwide), 08.02.2006. These statistics do not include all EU Member States because the objective is to show statistical information over ten years which for obvious reasons is impossible if all current Member States are included. Further, the statistics used as a reference are Dun and Bradstreet's statistics as they are the only ones that cover this period.

⁵ *Late payment could damage your reputation*, Better Payment Practice Group, Press release 24.08.2004

⁶ *SMEs under threat from late payments*, INTRUM JUSTICIA, 2005, p. 9.

to be finalised. SMEs will need to use the tools at their disposal, and a review of SME practices in terms of accounts receivable management is required to establish whether late payments and resulting cash flow problems are caused solely by debtors.

There are also improvements that can be made in terms of the Directive itself, as some of its provisions do not match its ambitious goals. The European Court of Justice recently noted that the Directive does not “*harmonise all the rules relating to late payments in commercial transactions*”⁷. Although the Court is unclear on which rules it would include in “*all the rules*”, it highlights the inherent limits of the Directive. Some provisions would benefit from being strengthened and included in a regulation. Penalties for late payments should constitute real deterrents and reimbursable recovery costs clearly defined. Representative organisations should be empowered to act regardless of supposed competition law issues. Payment periods should be fixed. Others provisions such as the retention of title clause are not particularly relevant in the context of late payments or long payment periods and should be reconsidered.

In terms of other economic impacts such as those on unemployment and insolvencies, positive statistics in these areas of the last few years cannot be considered part of the Directive’s impact. Any impact of the Directive on unemployment and insolvencies would be limited and come with a significant time lag.

⁷ See also *Commission of the European Communities v. Italian Republic*, Judgment of the Court, case C-302/05, 26.10.2006 at paragraph 23.

1 INTRODUCTION

Long payment periods strain cash flow and fuel uncertainty for many businesses and in particular, SMEs⁸. At best, long payment periods substantially increase the cost of doing business. At worst they lead to strings of bankruptcies and lay-offs⁹. The risks of long payment periods are accentuated in intra-Community trade as the costs of international accounts receivables management and debt recovery are higher. This is exacerbated by important differences in regulation and practices amongst Member States concerning payment periods.

1.1 Context - EU action in the field of late payments

The European Commission adopted on May 12 1995 a recommendation on payment periods in commercial transactions¹⁰ (the “1995 Recommendation”). This is based on the EC Treaty and on a European Parliament Resolution adopted on 21 April 1993 calling on the Commission to make specific proposals on late payments. The 1995 Recommendation follows consultations with stakeholders¹¹ and the determination of economic objectives for the EU¹².

By adopting this recommendation, the European Commission sought to achieve two objectives. First, the European Commission highlighted the negative effects of long

⁸ OECD SME, 2002. In, *Successes and Challenges for SMEs*, 2003, the SME Union observes that “*payment delays caused by big companies are twice as frequent as those caused by SMEs. Further, delays in payments from big companies to SMEs are twice as long as those from SMEs to big companies*”. p. 16. See also The OECD Observer, n. 2009, 12.97/01.98, p. 19.

⁹ See European Commission Green Paper on a *European Order for payment Procedure and on Measures to Simplify and Speed Up Small Claims Litigation*, COM (2002) 746 final. December 20, 2002, p.8. See *Finance and SMEs, Basel II, Late payments and special SME ratings*. See *European Payment Index*, Intrum Justicia, 2004. See *The Activities of the European Union for SMEs*, 2005, p. 22. See *Successes and Challenges for SMEs*, SME Union, 2003, p. 16.

¹⁰ European Commission recommendation of 12 May 1995 on payment periods in commercial transactions. OJ L 127, 10.6.1995 p. 19 - 22 or OJ C 144, 10.6.1995, p.3.

¹¹ European Commission consultation on the situation as regards payment periods in Member States of the European Union. SEC(92) 2214 final, 28.11.1992.

¹² European Commission White Paper on Growth, Competitiveness and Employment. COM(93) 700 final, 5.12.1993. European Commission Strategic Program on the Internal Market. COM(93) 256 final, 22.12.1993. European Commission Integrated Program for SMEs and the craft sector of May 25, 1994; COM(94) 207 final, 3.6. 1994; OJ C 323, 21.11.1994, p. 19.

payment periods on SMEs, growth and competitiveness, and recommended ways and means to tackle the problem. Second, the European Commission invited Member States to implement effective measures that would lead to more reasonable and consequently harmonized payment periods for commercial transactions within the Internal Market.

The 1995 Recommendation was followed by references to problems relating to long payment period problems in the context of SMEs' programmes¹³. Eventually, after a European Parliament resolution dated July 4 1996¹⁴ asking the European Commission to consider a more effective instrument to limit long payment periods, the European Commission adopted a report paving the way for the adoption of a Directive¹⁵ (the "1997 Report"). The 1997 Report was adopted within the more general context of the European Commission Action Plan for the Single Market¹⁶. In the 1997 Report the European Commission comments on lack of progress in the fight against late payments following the 1995 Recommendation.

Shortly thereafter a proposal for the Directive was submitted by the European Commission. A few years later the Directive was adopted.

The reason for adopting the Directive is thus based on a double observation:

1/

SMEs suffer from long payment periods. These in turn cause SMEs heavy administrative and financial costs. Moreover, they constitute one of the principal causes of insolvency amongst SMEs, constantly threatening their survival and causing job losses, while generally harming the competitiveness of SMEs in Europe.

Late payments therefore represent an obstacle to the success of the Single Market. Furthermore, excessively long payment periods existing in some Member States constitute an obstacle to the proper

¹³ European Commission proposal for a Council decision on the third Multi-annual Program for SMEs. COM(96) 98 final 20.3.1996, p. 6.

¹⁴ European Parliament resolution on the Commission Recommendation on payment periods in commercial transactions, A4-0161/96. OJ C 211, 22.07.1996 p. 42.

¹⁵ European Commission report on late payments in commercial transactions of July 17, 1997. OJ C 216, 17.7.1997, p. 10.

¹⁶ European Commission Action Plan for the Single Market. CSE(97) 1 final, 4.6.1997.

functioning of the Internal Market because these differ significantly from the Community average.

2/

The fight against late payments in the Internal Market cannot be carried out in an effective manner by the Member States acting individually. Corrective measures are therefore better implemented at Community level as dictated by the subsidiarity principle.

1.1.1 The Single Market and late payments

The Commission estimates that the Internal Market has engendered an increase in European GDP and created millions of jobs¹⁷. As is stated in a report from the High Level Group chaired by Wim Kok, “*sustainable economic growth has always been associated with market opening and strong growth in trade*”¹⁸.

Intra-EU trade has steadily increased in the last six years¹⁹.

Differences in payment practice between one Member State and another lead to extra costs. Important variation in payment periods among Member States increases the cost of doing business across borders.

In a situation where long payment periods are applied to both suppliers and clients, costs are partly offset by the long payment period that applies to suppliers²⁰. But where for example suppliers need paying within thirty days and clients are only obliged to pay within ninety days, an imbalance results that can constitute an important extra cost of doing business. This is the cost of extra working capital needed to compensate for the difference between the payment periods which apply

¹⁷ SEC(2002) 1417, ‘*The Internal Market – 10 years without frontiers*’.

¹⁸ Report from the High Level Group chaired by Wim Kok, “*Facing the Challenge - The Lisbon Strategy for Growth and Employment*”, November 2004, p. 25.

¹⁹ Eurostat statistics on intra-EU25 trade.

²⁰ They are only partly offset because company fixed costs such as labour, tax and rent are immediate.

to client and supplier²¹. This additional cost can threaten the growth or survival of SMEs.

The same reasoning applies to cross-border transactions. When the average payment period in Member State A is thirty days and the average payment period in Member State B is ninety days, SMEs from Member State A will find it difficult to sell products or services to Member State B companies, especially when in Member State A late payments may lead to high interest rates and recovery costs and damage awards.

Harmonization of payment periods and its resulting benefits is therefore necessary to ensure that in terms of their ability to compete with one another in the Single Market, companies are placed on an equal footing.

Another important issue regarding payments in the Single Market is the stance of Member States towards creditors who wish to force payment and redress a breach of contract when parties are from different Member States. Any increase in cross-border commercial transactions inevitably leads to a potential increase in the number of cross-border late payments and disputes. The failure of Member States to deal with this reality has contributed to the creation of obstacles that have hindered the Single Market. These take the form of legal and administrative barriers²². The Directive seeks to remedy this.

The existence of Article 65 in the Treaty of Amsterdam²³ confirms that judicial procedures are potential legal barriers to the functioning of the Internal Market²⁴. Article 65 invites European institutions to take measures as necessary to ensure that the Internal Market functions unhindered, including instances where civil procedure may have an effect on cross-border civil and commercial matters. The Vienna Action Plan confirms this. Even if the Directive was adopted prior to the entry into force of the Treaty of Amsterdam and has Article 95 of the Community Treaty for its

²¹ Professor GLAIS STUDY, « *Etude sur les délais de paiement* », Pour la Commission d'Examen des Pratiques Commerciales, Professeur Michel Glais, February 2005, p. 3.

²² Report from the High Level Group chaired by Wim Kok, "*Facing the Challenge - The Lisbon Strategy for Growth and Employment*", November 2004, p. 26.

²³ OJ 1997 C 340.

²⁴ In this Report Internal Market and Single Market refer to the same concept.

basis, the Treaty of Amsterdam's breakthroughs and the Vienna Action Plan's²⁵ principles were well integrated within it.

If the fight against late payments was justified to ensure the continuous expansion of the Single Market, it is even more valid beyond the Single Market, in "*a genuine European Area of Justice*" where "*individuals and businesses should not be prevented or discouraged from exercising their rights by the incompatibility or complexity of legal and administrative systems in the Member States*"²⁶.

1.1.2 The importance of SMEs to the European Union

Clearly the Directive's main goal is to assist SMEs by limiting the negative effects of late payments on their activities. SME protection and promotion has been an essential policy objective of the EU for the past fifteen years. And the relationship between SME protection and combating late payments has been clearly established by EU institutions²⁷.

²⁵ Council and Commission Action Plan of 3 December 1998 on "*how best to implement the provisions of the Treaty of Amsterdam on the creation of an area of freedom, security and justice*"; text adopted by the Justice and Home Affairs Council of 3 December 1998 (known as the Vienna Action Plan);

²⁶ Tampere Council, 15/16 October 1999, EU Bull. 10-1999, pp. 7-15.

²⁷ European Parliament resolution of April 21, 1993 on sub-contracting and public procurement contracts, Resolution A3 - 0123/93, PV 07 II, 21.4.1993. European Parliament resolution on the Integrated Program, Resolution A4 - 0022/94, PV 28 II, 24.10.1994. European Parliament resolution on the Commission Recommendation on payment periods in commercial transactions, A4-0161/96. Opinion of the European Parliament on the Proposal for a European Parliament Resolutions and Council Directive on combating late payment in commercial transactions of 17 September 1998, OJ C 313, 12.10.1998, p. 142. Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions; JO L 200, 8.8.2000 p. 35 - 38. Opinion of the Economic and Social Committee of June 30, 1993, OJ C 249, 13.9.1993. Opinion of the Economic and Social Committee on the Commission's Green Paper on Public procurement in the European Union: Exploring the way forward, OJ C 287, 22.9.1997, p. 92. Opinion of the Economic and Social Committee on the Proposal for a European Parliament and Council Directive combating late payment in commercial transactions of 10 September 1998, OJ C 407, 28.12.1998 p. 50 -55. European Commission consultation on the situation as regards payment periods in Member States of the European Union, SEC(92) 2214 final, 28.11.1992. European Commission White Paper on Growth, Competitiveness and Employment, COM(93) 700 final, 5.12.1993. European Commission Strategic Program on the Internal Market, COM(93) 256 final, 22.12.1993. European Commission Integrated Program for SMEs and the craft sector of May 25, 1994, COM(94) 207 final, 3.6. 1994, OJ C 323, 21.11.1994, p. 19. European Commission recommendation of 12 May 1995 on payment periods in commercial transactions, OJ L 127, 10.6.1995 p. 19 - 22 or OJ C 144, 10.6.1995, p.3. European Commission proposal for a Council decision on the third Multi-annual Program for SMEs, COM(96) 98 final 20.3.1996, p. 6. European Commission Action Plan for the Single Market,

SMEs are mainly suppliers of goods and services and thus the primary targets of long payment terms. Further, they are the enterprises most vulnerable to cash-flow strains provoked by long payments periods because of their financial breadth. They are thus on their own ill-equipped to deal with long payment periods unassisted. However, SMEs in Europe collectively are together an economic power-house, and as such they are essential to the enhancement of the Single Market²⁸.

1.1.2.(a) SMEs suffer from long payment terms

SMEs alone are fragile entities. They are often undercapitalized and have difficulties accessing capital. Their regulatory administrative compliance costs are disproportionate to their size²⁹. Further, with a generally weak own equity base, SMEs are vulnerable during recessions and often unable to accommodate needed structural changes and business re-orientations. Their vulnerability during recessions is accentuated by their narrow client spread and the resulting over-reliance on specific client activity to maintain revenue streams. These characteristics also help to explain why long payment periods affect them most, and highlight the squeeze effect of limited access to capital combined with an unwillingness to offend the precious customer.

CSE(97) 1 final, 4.6.1997, European Commission report on late payments in commercial transactions of July 17, 1997. OJ C 216, 17.7.1997, p. 10. European Commission, communication to the European Parliament concerning the Common position of the Council on the proposal for a European Parliament and Council Directive combating late payment in commercial transactions. SEC/99/1398 final. Proposal for a European Parliament and Council Directive combating late payment in commercial transactions, OJ C 168, 3.6.1998, p. 13. European Council decision on the third Multi-annual Program of December 6, 1996, OJ L 6, 10.1.1997, p.5. Council Common Position of 29 July 1999, OJ C 284, 6.10.1999, p. 1.

²⁸ European Commission recommendation of 12 May 1995 on payment periods in commercial transactions, OJ C 144, 10.6.1995, p.4 and 5.

²⁹ This has been stressed in the Presidency Conclusions of the Bruxelles European Council of March 23/24, 2006, Council of Europe, May 18, 2006, 7775/1/6 REV 1.

1.1.2.(b) SMEs need protection

SMEs considered as a group represent the economic powerhouse of the EU. Representing nearly all business activity in the Union, SMEs are the biggest sector in this economy. They include twenty three million enterprises and employ nearly seventy-five million people. Fifty percent of job creation is attributable to SMEs and more than half of the EU's GDP is generated by their activities. Such a large number of SMEs signifies a healthy economy. Moreover SMEs are usually more dynamic than big enterprises because they are geared to operate on leaner structures.

1.1.3 The multidisciplinary character of late payments

In Article 3, the Directive provides for procedural safeguards similar to those foreseen in Article 7 of Directive 93/13/EEC on Unfair Contract Terms³⁰. These are aimed at safeguarding creditors against powerful buyers who try to impose long contractual payment periods on them.

1.1.4 Evaluating the evolution of late payments and the impact of the Directive

This Report is part of the assessment of the Directive that the European Commission has undertaken to conduct in respect to the impact of this Directive. Article 6(5) of the Directive states that:

“The Commission shall undertake two years after 8 August 2002 a review of, inter alia, the statutory rate, contractual payment periods and late payments, to assess the impact on commercial transactions and the operation of the legislation in practice. The results of this review and of other reviews will be made known to the European Parliament and the Council, accompanied where appropriate by proposals for improvement of this Directive.”

³⁰ OJ L 95 of 21.4.1993, p. 29.

1.2 Objective of this Study - The Directive's impact

This Report aims to establish whether the contents of the Directive and its implementation by the Member States were sufficient to modify the situation such as it is described in the European Commission communication titled "*Report on late payments in commercial transactions*"³¹.

This Report includes more than a regulation impact assessment in that it is less focused on the transposition status of the Directive than (i) on the effective implementation of its provisions by Member States, (ii) the difficulties that SMEs have had in using it, (iii) its relevance, coherence, usefulness and effectiveness, (iv) its economic impact and (v) the recommendations on future actions that can further its goals.

This general objective is supplemented by specific objectives.

The specific objectives of the study involve the following:

- (1) Evaluation of the role and effectiveness of the provisions of the Directive in the fight against late payments, in particular concerning:
 - a) Statutory late payment interest rate;
 - b) Contractual payment periods;
 - c) Representation of SMEs by officially recognised organisations or organisations recognised as having a legitimate interest before the courts or before the competent administrative bodies;
 - d) Contractual terms (especially when deemed "grossly unfair");
 - e) Compensation for all relevant costs; and
 - f) Recovery procedures.

³¹ (97/C 216/07) 5JO C 216, 17.7.1997, p. 10.)

- (2) Evaluation of the payment practices by public contracting authorities or by the private sector: to what extent do these constitute a problem requiring special measures?
- (3) Determination of the way, if any, in which late payments harm the competitiveness of European businesses.
- (4) An update on the results which occur in the European Commission 1997 Report derived from questioning of SMEs on the incidence of late payments.
- (5) Identification and analysis of, and recommendations on legal concepts appearing in the Directive which might be interpreted differently by executive and legal administrations.
- (6) Identification and presentation of good commercial practices.
- (7) Presentation of the implementation of principles set out by the Directive within the framework of the public markets.
- (8) Definition of categories for practical application of the Directive and the regulations for transposition.
- (9) Making recommendations, if necessary, to supplement the principles set out by the Directive.
- (10) Highlighting the relevance, coherence, usefulness and effectiveness of the Directive.

2 METHODOLOGY

The methodology (the “Methodology”) to implement the Project involves a legal and economic analysis.

The Directive is a legal instrument chosen for its flexibility. At the European level it harmonizes the legal treatment of late payments and therefore includes various harmonization tools.

The Methodology firstly involves studying the legal impact of the Directive and the regulations that implement it. An analysis of the situation and the concrete evolution of late payments in the European Union is then conducted, providing an economic and social perspective and impact assessment.

To study the legal impact of the Directive, it is necessary to collect the relevant information from each EU Member State.

Concurrently, the economic impact assessment is conducted through analysis of recently collected, fresh economic and social data, taking note of macroeconomic phenomena which could adversely affect companies in the European Union and supplant late payments as a cause of SME poor health.

An evaluation of both legal and economic impacts of the Directive leads to conclusions on the Directive’s overall relevance, coherence, usefulness and effectiveness, and enables submission of workable recommendations.

2.1 Presentation of the Methodology

The Methodology involved three phases. The first consisted of identifying the means to collect relevant data to implement the Project. The second involved

collecting data. The third phase consisted of analysing the data collected and preparation of this Report.

The data collection process facilitated direct and indirect gathering of public and private data.

2.1.1 Means used to collect data

Data was collected using the following means:

- Research on the Internet and in public databases;
- Research in private data bases;
- Direct contact by telephone, email and in person with information holders and use of questionnaires; and
- Creation of statistics aimed at confirming and completing the collected information through an online survey (www.retardsdepaiement.org or www.latepayments.org, (hereafter the “Late Payments Survey” or “LP Survey”).

Annexe 3 identifies the persons contacted who participated in the implementation of the Methodology and are the contact points for this study.

2.1.2 The use of a survey, questionnaires and interviews

The Project implied the supply of specific information that economic or legal sources and public or private statistics do not provide as such. Further, if the collection of data from multiple organisations ensured a complete and neutral overview, it did not provide sufficiently detailed and precise answers to every detailed question on late payments. More active information gathering tools were necessary.

As part of the LP Survey, a questionnaire (“Questionnaire”) was devised and submitted by the International Research Center (CRI-IRC.ORG), online and completed through canvassing of SMEs.

The targets of the Questionnaire were:

- very small, small and medium sized companies,
- public authorities, and
- craftsmen and the professions.

A website was created using the internet addresses: www.latepayments.org and www.retardsdepaiement.org in order to:

- present the objective of the study, and
- disseminate the Questionnaire.

The online survey was conducted in:

- French, and
- English.

A website was created to provide information on the study and facilitate participation.

37,500 companies were contacted to answer the Questionnaire. Only 1,437 answers were recorded by the statistics software. The resulting statistics are included under **Annexe 2**.

An important list of organisations which represent companies in the European Union has been drawn up. These organisations disseminated information on the study and drew attention to the existence of the Questionnaire. A list of the organisations which advertised the study and disseminated the Questionnaire was transmitted to the European Commission. Further, printouts of the websites which mention or have

mentioned the study and the survey have been transmitted to the European Commission.

Media in all Member States were contacted. Those organisations are listed in a report transmitted to the European Commission.

To complete the Questionnaire interviews which included mainly closed questions were conducted with companies, lawyers and company representative associations to provide a qualitative appreciation of the causes of and remedies for late payments in Member States.

Debt collection companies, insurance companies, banks, lawyers, accountants, and public organisations have also been directly contacted. They were provided with questionnaires corresponding to their field of expertise or sector of activity. Relevant information was then collected from this source.

2.2 Methodology to assess the legal situation

The general objective of legal data collection was to gather enough information for a complete analysis of the situation and produce a report on the legal impact of the late payment Directive. In particular, legal data collection was aimed at determining whether this regulation is relevant, coherent, effective and useful in a legal sense.

The specific objective of the legal data collection was to obtain information embedded in:

- the relevant regulations,
- doctrinal papers,
- the jurisprudence,
- articles, reports, essays, and studies on the subject of late payments,
- articles, reports, and studies on wider questions indirectly related to late payments,
- indications of the actual trend regarding the legal aspects of late payments,

- examples of good commercial practices and codes of conduct and other “soft law”,
- examples of contracts and contractual practices implementing the Directive,
- examples of grossly unfair contractual terms,
- indications of delays in litigation procedures,
- statistics on the duration of litigation procedures regarding late payments, and
- statistics or studies on late payments in public procurement contracts.

2.2.1 Collection of public and private legal data

2.2.1.(a) Online resources of national legislations

To implement legal data collection, different resources were identified. These resources are either general or limited to a specific country.

Official resources for every Member State were identified. Non-official resources were also identified.

The websites visited among different Member States were included in a list submitted to the European Commission.

2.2.1.(b) Public institutions

Public institutions for each Member State were identified and contacted. It is difficult to obtain relevant official contacts in each Member State since the institutions responsible for “combating late payment” vary according to the State. Further, since the Directive covers a broad spectrum of issues, many different organs of a State may be concerned. Moreover, various Member States do not have a formal follow-up system for legislation implementation or may not carry out systematic regulatory impact assessments.

The list of the Member State Ministries and authorities involved in public procurements contacted for this study has been transmitted to the European Commission.

Relevant information was obtained for all Member States in varying details.

2.2.1.(c) Professional organisations (lawyers, debt collection companies, associations in charge of the fight against late payments)

Organisations that deal with late payments on a legal level were contacted and relevant information was collected.

The organisations identified in the different Member States include:

- lawyers,
- companies involved in debt collection, credit management, credit insurance and factoring; (INTRUM, Eurofactor, Coface, ATRADIUS, Euler Hermes),
- accountants (Grant Thornton...),
- company representative organisations, and
- Chambers of Commerce.

Information on the legal treatment of late payments was obtained for all Member States in varying details.

2.2.1.(d) International organisations and others

A number of studies from the World Bank and the International Finance Corporation have been collected, in particular a World Bank study updated in 2005 on legal procedures regarding late payments disputes. This study includes twenty-three out of twenty-five EU Member States. It is precisely focused on legal procedures regarding disputes on late payments/outstanding payments and proposes results in the form of indicators such as:

- number of procedures per year,
- global duration of decision-making,
- steps in the decision-making process,
- duration to summons,
- duration of the deliberation, and
- procedural cost as a percentage of the debt.

World and country reports and relevant updates have been collected from the World Bank with updates³².

Economic and legal studies from the OEDC were collected.

Other studies from international organisations were collected.

In total, thirty or so relevant legal studies were collected on issues related to late payments.

2.2.1.(e) Other online resources

Databases and other official and non-official online resources were used. These databases and other online resources are in addition to the ones already mentioned in this report. They include:

INTRUM JUSTICIA
WORLD BANK
OECD
UNICE
UNIDO
ATRADIUS

³² See www.doingbusiness.org under « enforcing contracts ».

2.2.1.(f) SMEs

As part of the LP Survey, in the 25 Member States, around 400 companies have been directly contacted by telephone and in person with legal questions. Nine questions out of fifteen or so were of a legal nature. These questions were:

- 1/ Do you have problems with customers paying you late?
- 2/ If yes, how do you deal with this?
- 3/ Do you know what law applies to combating “late payments” in commercial transactions, for both
 - a) public contracts ?
 - b) private contracts ?
- 4/ Can you identify your legal rights in case of a late payment by a client?
- 5/ Are these rights useful and sufficient?
- 6/ Would you have any suggestions for improving the system?
- 7/ Do you exercise these legal rights in practice?
- 8/ Do you charge automatic late payment interest or only the reminder fee?
- 9/ Is the court procedure to recover debts fast? How many days does it take to obtain a decision?

The statistical results of this survey are attached as **Annexe 1**.

2.3 Methodology to assess the economic situation

The general objective of the collection of economic data is to enable the analysis and production of information for a report on the economic impact of the late payments Directive, and in particular to determine if this regulation is relevant, efficient, effective and useful on an economic level.

The specific objective of the economic data collection as described below is to obtain the following information:

- employment statistics and/or studies,
- bankruptcy statistics and/or studies,
- indebtedness of companies statistics and/or studies,
- access to credit statistics and/or studies,
- statistics on late payments amounts and numbers,
- indicators or studies on companies' competitiveness, and
- statistics on contractual payment delays.

A fundamental aspect of statistics data collection is the independence of the organisation collecting the data. Also vital is sufficient opportunity for checking the relevance of data through appropriate comparisons. A number of private organisations, in particular companies specialized in debt collection, regularly carry out surveys on the evolution of late payments in Europe. These surveys are useful for the present study and can be used as an information source, but they have to be completed and verified against other data from other organisations in order to obtain a neutral result and guarantee the relevance of the recommendations that follow.

2.3.1 Collection of public and private economic data

2.3.1.(a) Official studies

Official statistics regarding late payments and related information were collected from different ministries and central banks within Member States, Eurostat and national statistics organisations.

The list of ministries contacted was transmitted to the European Commission.

The list of central banks contacted was transmitted to the European Commission.

The list of national statistics organisations contacted was transmitted to the European Commission.

Country information including statistical data on late payments, employment, bankruptcies and companies' competitiveness were collected where available, and transmitted to the European Commission.

The central banks of each Member State have been contacted individually. Economic and statistical country reports on payment delays, late payment interest, company indebtedness and company financial difficulties were collected when available, and were transmitted to the European Commission.

The questions to these organisations centered on:

- employment figures since 2000,
- bankruptcies since 2000,
- indicators of company competitiveness since 2000,
- indicators of company debt rate since 2000,
- indicators of average amounts of outstanding payments since 2000,
and
- indicators of delays and/or late payments.

The information collected was not always complete and does not always answer the questions directly or fully. However, in general, such information is sufficient for an economist to form an assessment of the Project's implementation.

Websites run by these organisations were also consulted.

2.3.1.(b) Professional organisations (accountants, chambers of commerce, and company representation associations)

Specialized organisations were contacted which, as a result of their activities, might have economic information related to late payments. Relevant information was collected from these organisations.

Organisations contacted in the different Member States include:

- debt collection, credit insurance, credit management and factoring companies (INTRUM, Eurofactor, Coface, ATRADIUS, Euler Hermes),
- accountants (Grant Thornton),
- company representative organisations, and
- Chambers of Commerce.

The following companies or entities were identified as having published studies on the question of payment delays.

- Intrum Justitia;

The European Payment Index is produced by Intrum Justitia, which carries out a written survey in more than 20 European countries on a bi-annual basis involving several thousand companies. The results of the survey are published in the European Payment Index Reports (Spring Report and Autumn Follow-up Report). The half-yearly interval is intended to capture and compare international trends and provide companies with a reliable basis for decision making and effective benchmarks.

- Dun and Bradstreet and Altares;

Dun and Bradstreet organises a survey of the payment behaviours of European enterprises. Over one billion commercial transactions of companies forming part of the Dun Trade Programme are monitored on a monthly basis. The survey is carried out in seven member states, which are: Belgium, Netherlands, France, Germany, United Kingdom, Spain and Italy. The survey provides data on late payments by size of industry and duration of late payments and by sector. It provides a breakdown of the sectors which experience most late payments, as well as a comparison with the EU average. Comparative statistics are

provided for the period 1995 to 2006 in the case of some of the indicators. This implies that an analysis pre-directive and post-directive can be carried out. It also allows a comparison of trends for some indicators to be made, as well as an analysis of how the member state compares to the EU average. Altares is subsidiary of Fininfo, which originated from the Dun and Bradstreet French subsidiary company and from “BIL”, the “Base d’Informations Légales”. It is an international supplier of financial information for financial institutions and companies. The Altares Studies on the Payment Delays in Europe are published quarterly.

- Eurofactor;

In 1998, EUROFACTOR, which helps companies manage their customer base, established, in partnership with the Association Française des Crédit Managers et Conseils (AFDCC) (the French Association of Credit Managers and Advisers), a barometer of customer base management which focused on France originally and which has been extended to all of Europe since 2001. The last study was carried out by CSA Institute and BIPE. The objective of the AFDCC and EUROFACTOR is to provide companies with a tool to measure, at regular intervals, the practices and trends in accounts receivable management. The barometer encompasses all small and medium-sized companies employing from 6 to 500 salaried workers (but up to 1000 in Germany) in the following countries: Germany, Belgium, Spain, France, Italy, Portugal and the United Kingdom.

- Grant Thornton;

The International Business Owners Survey (IBOS) is the only survey of its type, covering over 7,000 medium-sized businesses in 30 economies worldwide. Now into its fourth year, it is a valuable source of global business information, gauging opinions on the economic outlook and company expectations for the year ahead. It

also builds on data collected in Europe as part of the former European Business Survey (1993 to 2002). Primarily through telephone interviews, respondents give their opinions on business confidence, export plans and business constraints.

- Atradius ;

The Atradius Payment Practices Barometer is a survey of the payment behaviour of European companies. Atradius and the Financial Times Deutschland investigate payment practices in Europe within the framework of an ongoing study, the Atradius Payment Practices Barometer. To this end, 1,200 companies from six European countries were asked for the first time in 2006 about their assessment of payment practices of their business partners, and about the protective measures they use to ensure payment for goods and services.

- COFACE;

Coface is a subsidiary of Natexis Banques Populaires and of Groupe Banque Populaire. It provides a full range of solutions for companies of all sizes, sectors and nationalities to help them optimize their trade receivables, namely credit management services (information and receivables management) to manage them; credit insurance to manage and protect them; and receivables finance (factoring and securitisation) to manage, protect and finance them.

- EULER HERMES SFAC;

Euler Hermes SFAC is part of the Allianz Group. It is a credit-insurance company providing insurance and factoring solutions to companies of all sizes. Euler Hermes evaluates the financial position of purchasers worldwide on a daily basis and assists companies base their business development on reliable customers. It also provides

debt collection services and compensation for losses due to buyer insolvency.

It should be noted that statistics and results from the European Payment Index Survey, Grant Thornton Survey, Eurofactor Survey, COFACE Payment Index and the Atradius Payment Practices Barometer, should be interpreted with caution, as they may target companies, their members or clients, which have late payment problems.

All these organisations were contacted.

In addition to collecting their studies, these organisations were contacted to:

- participate in the LP Survey,
- complete the Specialist Questionnaire, and
- provide updated information.

2.3.1.(c) *International organisations and others*

General and country reports were collected from EU institutions, the World Bank, the OECD, UNICE, UNIDO and other international organisations.

2.3.1.(d) *Other online resources*

Databases and other official and non-official online resources were used. These are in addition to those already mentioned in this report and include:

INTRUM JUSTICIA
COFACE
DUN AND BRADSTREET / ALTARES
GRANT THORTON
WORLDBANK

OECD
UNICE
UNIDO
EULER/HERMES
ATRADIUS

2.3.1.(e) SMEs

In the 25 Member States, around 400 companies have been contacted directly by telephone or in person with questions on economic issues. Four questions out of fifteen concerned economics. These questions are:

1/ What would you say is the average payment delay for you for both

a) public contracts ?

b) private contracts ?

2/ What would you say is the percentage of late payments (payments made after the normal payment delay) for both

a) public contracts ?

b) private contracts ?

3/ Have you noticed a decrease in payment delays in the last few years?

4/ Have you noticed a decrease in late payments in the last few years?

The statistical results of this survey are attached as **Annexe 1**.

2.3.2 Legal information

Procedures

It is not possible at present to obtain official statistical information on procedures in the European Union. The statistics departments of the countries that participated in the European Commission for the Efficiency of Justice 2005 study on the length of

proceedings in different justice systems were contacted³³. Some provided responses, others stated that in the area of undisputed claims in debts transactions no statistics were available because they either did not compile statistics that differentiate between disputed and undisputed claims, or because for historical reasons such statistics are not compiled at all.

2.3.3 Economic information

In order to obtain the best possible evaluation of the Directive's impact and take into consideration the variety of information that different stakeholders (public institutions, debt collection agencies, factoring companies, company representative organisations) may provide, information was collected from a number of different sources. This information is additional to what was collected directly through a survey. Because these sources used different methods to obtain their statistical information it is not practicable to organise comparisons. It should be noted that statistics on the length of payment periods are seldom reliable as methods and criteria used from one year to the other change.

This is accentuated by the Directive's multidisciplinary scope.

However, one could consider that because the information collected includes the input of many institutions including officially recognized ones, the results provide a sufficiently precise and neutral view of the situation with the inconsistencies ironed out.

Even with acceptable results, however, to evaluate the economic impact of the Directive is not an easy task as many factors can contribute to the payment period situation deteriorating or improving. Some of these factors may not be remotely connected to the Directive. It is tempting to attribute any improvement to the Directive as a convenient explanation for such fluctuations. This is the reason why

³³ European Commission for the Efficiency of Justice (CEPEJ), *Checklist of indicators for the analysis of lengths of proceedings in the justice system*, December 2005

this Report should be read with the understanding that even if a significant amount of information has been gathered from reliable sources, the parallels drawn between the Directive and economic phenomena are mostly speculative and that only general trends may be assessed.

Summary of Chapter 2: Methodology³⁴

- Public and private databases were researched for information directly and indirectly related to late payments both from an economic and legal standpoint.
- In total more than 1200 documents were collected.
- Questionnaires were prepared and disseminated via various interested organisations including European Information Centers and the Media.
- Questionnaires were submitted using an online survey, the telephone, interviews.
- Many organisations were contacted to participate in this study including more than 37,500 companies.
- In total more than 1,900 people participated in the questionnaires

³⁴ This and following chapter summaries should not be used to draw conclusions from if read in isolation. Rather they should serve as a guide for readers to locate those sections in the text of most interest to them. These summaries provide a little more information than a table of contents.

3 THE SITUATION PRE-DIRECTIVE

3.1 The Economic Situation

The pre-Directive situation is difficult to evaluate. Many studies of it have been conducted using various methods. In its 1997 Report, the European Commission itself acknowledged that the statistical information it held was only useful for a “fairly good overview of the situation”. Many companies perform regular surveys on issues concerning payment periods. However, given the difficulties of surveying companies within the whole territory of the EU, many organisations and agencies have limited their research to a few countries, and sometimes just to a single sector. Information gathering tools, basic assumptions, questioning methods and information selection used by these companies have never been readily identifiable. Therefore it has been very difficult, and still is, to provide a precise statistical analysis of late payments in the EU over many years. Further, in those surveys which over time have encompassed additional countries, it is not clear whether the impact of inclusion of new Member States has been taken into account when calculating the global statistical result. The degrading of late payments could, therefore, have been related to the inclusion of a new country, for example, rather than to the actual evolution of the situation in the original group of countries surveyed the previous year.

The European Commission used various sources of information to confirm the necessity for EU action³⁵.

It established that late payments caused insolvencies, cost businesses billions of Euros every year and led to hundreds of thousands of job losses.

³⁵ http://ec.europa.eu/enterprise/regulation/late_payments/rationale.htm

Other studies revealed that a year after the adoption of the Directive and one year before the expiry date for its transposition, some sectors remained particularly badly hit, with payment periods reaching as many as 760 days³⁶ in some instances.

3.2 The Legal Situation

Prior to the adoption of the Directive a number of Member States had already enacted measures to shorten payment periods by addressing both payment delays and late payments. Some countries such as the United Kingdom³⁷ had adopted measures following the 1995 Recommendation³⁸. Others such as Finland³⁹, Denmark⁴⁰ and Sweden⁴¹ had put a set of appropriate instruments in place prior even to the 1995 Recommendation. Others had no specific regulation addressing the issue⁴². It is important to note that those who had regulations in place prior to the 1995 Recommendation are also those who effectively benefit from the shortest payment periods today. The Directive by and large uses instruments similar to those used by the pioneers in the fight against long payment periods. It is also important to note that records in these countries show satisfactory payment periods more than

³⁶ *EUCOMED Situation Summary and Guidance for Members on the Late Payments Directive 2000/35/EC*, 31.12.2001.

³⁷ *The Late Payment of Commercial Debts (Interest) Act 1998*; Statutory Instrument 1998 No. 2479 *The Late Payment of Commercial Debts (Interest) Act 1998* (Commencement No. 1) Order 1998; Statutory Instrument 1998 No. 2480 *The Late Payment of Commercial Debts (Rate of Interest) Order 1998*; Statutory Instrument 1998 No. 2481 *The Late Payment of Commercial Debts (Interest) Act 1998* (Transitional Provisions) Regulations 1998; Statutory Instrument 1998 No. 2482 *The Late Payment of Commercial Debts (Interest) Act 1998* (Legal Aid Exceptions) Order 1998; Statutory Instrument 1998 No. 2765 *The Late Payment of Commercial Debts (Rate of Interest) (No.2) Order 1998*; Statutory Instrument 1998 No. 3024; Statutory Instrument 1999 No. 1816 *The Late Payment of Commercial Debts (Interest) Act 1998* (Commencement No.2) Order 1999; Statutory Instrument 2000 No. 2225 *The Late Payment of Commercial Debts (Interest) Act 1998* (Commencement No.3) Order 2000; Statutory Instrument 2000 No. 2740 *The Late Payment of Commercial Debts (Interest) Act 1998* (Commencement No.4) Order 2000.

³⁸ European Commission recommendation of 12 May 1995 on payment periods in commercial transactions. OJ L 127, 10.6.1995 p. 19 - 22 or OJ C 144, 10.6.1995, p.3.

³⁹ Interest Act (633/1982).

⁴⁰ Lov om renter ved forsinket betaling m.v., jf. lovbekendtgørelse nr. 583 af 1. september 1986.

⁴¹ 1975 Debt Law. Räntelag (1975:635).

⁴² Italy did have regulation aimed at protecting creditors against late payments in particular those originating from the public sector. However, that regulation was not adapted. See law n.833/1978.

fifteen years after their implementation⁴³. This means that with a Directive that was to be implemented as of August 8, 2002 (with ten new Member States in 2004), the expectation two to four years later in terms of changes in practices and behaviours should not be too high. The Directive's real effect will be in the long term as past experiences show and the recent picture is too confused for a clear conclusion.

3.3 Transparency and business practices

Prior to the Directive, some countries had enacted measures aimed at clarifying payment terms in contracts and identifying acceptance procedures for the delivery of goods or services⁴⁴.

3.4 Information

Prior to the Directive, some countries such as Spain and the United Kingdom devised credit and collection management information programmes for SMEs⁴⁵.

3.5 Penalties for late payments

A number of countries allowed compensation for late payments without, however, providing a set legal framework for enforcing it. Few countries provided for a statutory right to interest on late payments. The 1995 Recommendation had had an effect though, as law was enacted in many countries and draft laws prepared in others that did provide for compensation. But the legal scope of these laws was limited, concerning only public bodies⁴⁶ or subcontractors⁴⁷ and providing for low

⁴³ Grant Thornton Study on Late Payments 1996.

⁴⁴ The September 1996 voluntary British Standard for Prompt Payment.

⁴⁵ Programs set up in the UK by the Department for Industry and Trade and in Spain through a Centre for Personalized Information.

⁴⁶ Ireland

⁴⁷ Italy

interest rates on encompassing late payments⁴⁸. Significant differences between rates of interest among Member States and the sometimes complex mechanisms used to calculate these rates meant that such measures could not have a positive impact on the Single Market.

3.6 Recovery of costs associated with collection

Prior to the Directive the creditor had little chance of recouping costs related to recovery. Mostly, Member States offered no legal right to the costs related to recovery. Those costs include expenses associated with follow-up letters, collection agency costs, lawyers' fees, procedural costs and judgment enforcement costs.

3.7 Procedures

Prior to the Directive various initiatives had been carried out in a number of Member States. In countries such as Portugal, Denmark, the Netherlands and England laws or draft laws had been adopted or proposed providing that where the debt was small, usually around 4000 Euros, fast procedures without the need for a lawyer were available. It should be noted that these procedures did not usually resolve cross-border issues, as most applied in cases where the debtor was local. A French creditor could not obtain injunctive relief before the French courts if the debtor was Austrian, even if the contract stated that any and all disputes or claims should be exclusively decided by French courts. This is still the case today in France. Access to courts for "injunction de payer" is reserved for claims against French debtors exclusively⁴⁹. This is also the case in Austria, Belgium, Italy and Luxembourg⁵⁰. However, some countries such as Portugal did have legislation as early as 1998 which enabled creditors to obtain injunctive relief, even when the debtor was foreign⁵¹.

⁴⁸ See Annexe to European Commission report on late payments in commercial transactions of July 17, 1997. OJ C 216, 17.7.1997, p. 21.

⁴⁹ It is important to note that such cases would not even make it past the French Greffe.

⁵⁰ See European Commission Green Paper on a European Order for payment Procedure and on Measures to Simplify and Speed Up Small Claims Litigation, COM (2002) 746 final., December 20, 2002

⁵¹ Law 269/98 of September 1, 1998 on payment injunctions.

In any case, no regulation was specifically aimed at facilitating access by foreign creditors to judicial procedures. As a result bad debtors are advantaged in cross-border relations, and SMEs are often reluctant to extend their activities beyond their Member State of origin.

3.8 Collection agencies

Collection agencies have an important role to play in shortening payment periods. They benefit from a regulatory Europe harmonized on late payments with strong laws against delinquent debtors, because they are often better equipped to ensure payment than small creditors. Using a debt collection agency can be the means for a creditor to outsource a task he or she does not wish to deal with, while it increases the chances of eventual payment. However prior to the Directive, in many Member States, collection agencies were either not well regulated or illegal. Interestingly, those Member States where collection agencies thrived were notably those that had the shortest payment periods. These were Finland, Sweden and Denmark.

Summary of Chapter 3: The Situation Pre-Directive⁵²

- Late payments and long payment periods were a concern and were found to be the cause of insolvencies, losses to businesses in the billions of Euros and hundreds of thousands of jobs every year.
- Disparities in payment period lengths between Member States hindered the growth of the Internal Market.
- Some Member States had started to regulate payment practices but most had not.
- In many Member States the amount of recovery costs that could be reimbursed constituted a deterrent against law suits.
- In many Member States the length of judicial procedures constituted an even greater deterrent.
- Some Member States had implemented SME protection programs and good practices guidelines and were promoting more transparency in business dealings but many did not.
- Collection agencies were not able, either as a result of regulations or because of the local culture, to limit the effect on SMEs of late payments and unreasonably long payment periods.

⁵² This and following chapter summaries should not be used to draw conclusions from if read in isolation. Rather they should serve as a guide for readers to locate those sections in the

4 THE INSTRUMENTS PROPOSED BY THE DIRECTIVE

The Directive applies to commercial transactions between undertakings⁵³ or between undertakings and public authorities⁵⁴ which involve the provision of goods and services for payment.

4.1 The Directive and late payment interest

The Directive requires Member States to introduce a right to claim interest in the event of late payment.

4.1.1 Why does the Directive seek to impose an interest rate on late payments?

The Preamble of the Directive provides that:

“(16) Late payment constitutes a breach of contract which has been made financially attractive to debtors in most Member States by low interest rates on late payments and/or slow procedures for redress. A decisive shift, including compensation of creditors for the costs incurred, is necessary to reverse this trend and to ensure that the consequences of late payments are such as to discourage late payment.”

text of most interest to them. These summaries provide a little more information than a table of contents.

⁵³ The Directive defines an undertaking as meaning “any organisation acting in the course of its independent economic or professional activity, even where it is carried on by a single person”; This includes professionals but not consumers.

⁵⁴ Public authorities are defined by reference to the four Directives on Public Procurement 92/50/EEC, 93/36/EEC, 93/37/EEC and 93/38/EEC already in force. Article 1 of Directive 93/38/EEC states that public authorities “shall mean the State, regional or local authorities, bodies governed by public law or associations formed by one or more of such authorities or bodies governed by public law.”

4.1.2 *How does it do so?*

The Directive provides that Member States must ensure that interest is paid on late payments, but also in cases of excessively long payment periods, and that the interest rate to be applied is both harmonized and appropriate in late payment situations and long payment delay situations.

“Article 2. Definitions

For the purposes of this Directive:

. . . .

4. “interest rate applied by the European Central Bank to its main refinancing operations” means the interest rate applied to such operations in the case of fixed-rate tenders. In the event that a main refinancing operation was conducted according to a variable-rate tender procedure, this interest rate refers to the marginal interest rate which resulted from that tender. This applies both in the case of single-rate and variable-rate auctions;...”

Article 3(1) the Directive provides the following:

“Article 3 Interest in case of late payment

1. Member States shall ensure that:

(a) interest in accordance with point (d) shall become payable from the day following the date or the end of the period for payment fixed in the contract;

(b) if the date or period for payment is not fixed in the contract, interest shall become payable automatically without the necessity of a reminder:

(i) 30 days following the date of receipt by the debtor of the invoice or an equivalent request for payment; or

(ii) if the date of the receipt of the invoice or the equivalent request for payment is uncertain, 30 days after the date of receipt of the goods or services; or

(iii) if the debtor receives the invoice or the equivalent request for payment earlier than the goods or the services, 30 days after the receipt of the goods or services; or

(iv) if a procedure of acceptance or verification, by which the conformity of the goods or services with the contract is to be ascertained, is provided for by statute or in the contract and if the debtor receives the invoice or the equivalent request for payment earlier or on the date on which such acceptance or verification takes place, 30 days after this latter date;

(c) the creditor shall be entitled to interest for late payment to the extent that:

(i) he has fulfilled his contractual and legal obligations; and

(ii) he has not received the amount due on time, unless the debtor is not responsible for the delay;

(d) the level of interest for late payment ("the statutory rate"), which the debtor is obliged to pay, shall be the sum of the interest rate applied by the European Central Bank to its most recent main refinancing operation carried out before the first calendar day of the half-year in question ("the reference rate"), plus at least seven percentage points ("the margin"), unless otherwise specified in the contract. For a Member State which is not participating in the third stage of economic and monetary union, the reference rate referred to above shall be the equivalent rate set by its national central bank. In both cases, the reference rate in force on the first calendar day of the half-year in question shall apply for the following six months;

(e) unless the debtor is not responsible for the delay, the creditor shall be entitled to claim reasonable compensation from the debtor for all relevant recovery costs incurred through the latter's late payment. Such recovery costs shall respect the principles of transparency and proportionality as regards the debt in question. Member States may,

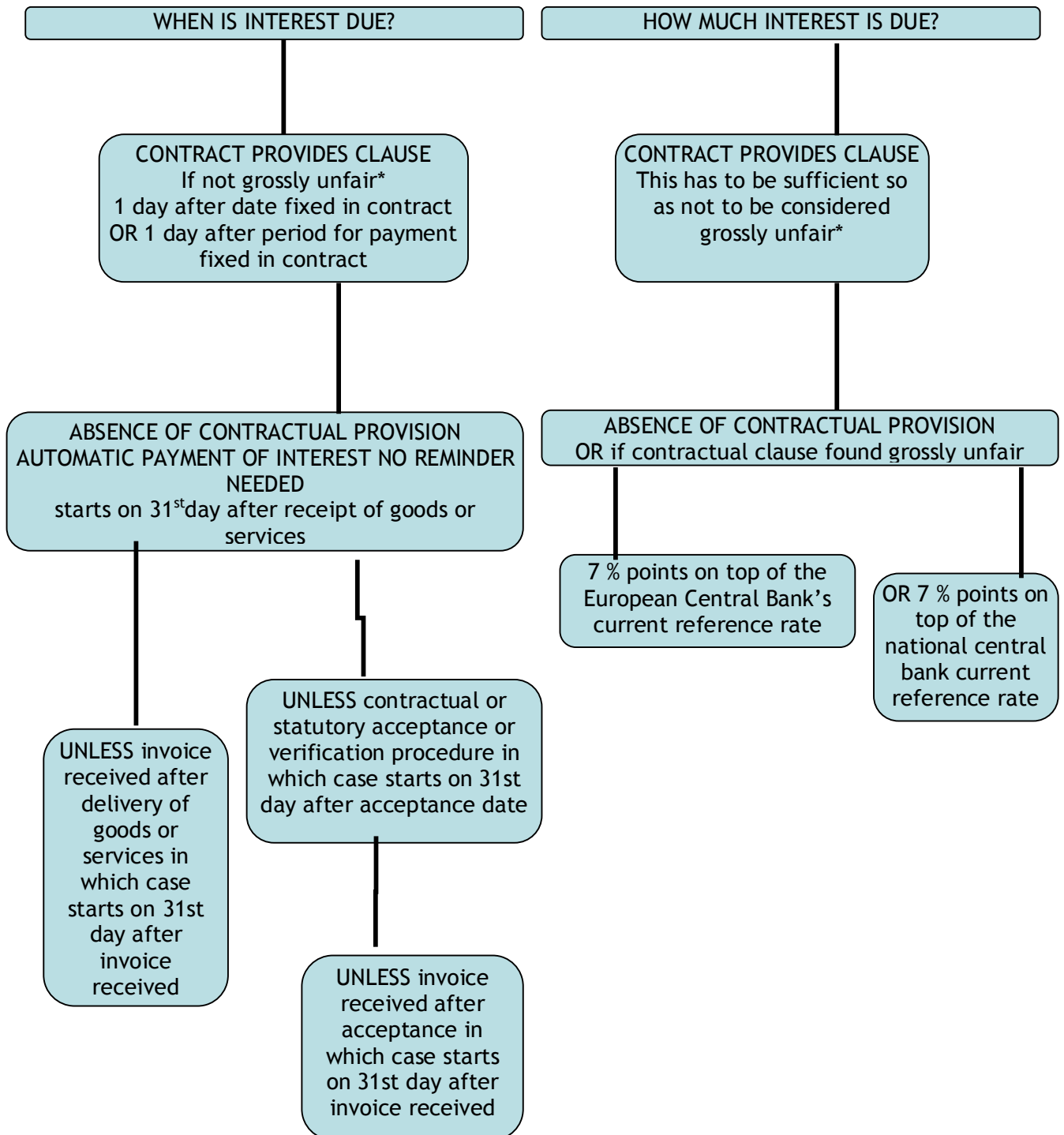
while respecting the principles referred to above, fix maximum amounts as regards the recovery costs for different levels of debt.

4.1.3 *What is the expected impact?*

Interest is due to a creditor who has fulfilled his or her contractual and legal obligations and has not received payment on time.

Interest is not due if the debtor is not responsible for the delay.

Principle: the statutory payment period is 30 days unless provided otherwise in a contract.



**Contracts may provide for longer payment periods and different interest rates. However, if they unreasonably extend payment periods or lower interest rate percentages on late payments, they could be considered unenforceable, lead to damages claims and be replaced by the statutory provisions.*

4.2 The Directive and recovery costs

Unless the debtor is not responsible for the delay, the Directive also states that a creditor should be entitled to claim reasonable compensation from the debtor for all relevant recovery costs incurred as a result of late payment.

4.2.1 Why does the Directive seek to compensate the creditor for the costs of payment recovery?

The Preamble of the Directive provides that:

(16) “...A decisive shift, including compensation of creditors for the costs incurred, is necessary to reverse this trend and to ensure that the consequences of late payments are such as to discourage late payment”.

4.2.2 How does it do so?

The Directive provides that Member States must ensure that creditors are able to obtain compensation for the costs incurred in trying to obtain payment after the payment delay period expires.

Article 3(1)(e) of the Directive provides the following:

“...unless the debtor is not responsible for the delay, the creditor shall be entitled to claim reasonable compensation from the debtor for all relevant recovery costs incurred through the latter's late payment. Such recovery costs shall respect the principles of transparency and

proportionality as regards the debt in question. Member States may, while respecting the principles referred to above, fix maximum amounts as regards the recovery costs for different levels of debt”.

4.2.3 What is the expected impact?

The expression “recovery cost” is not defined in the Directive. Article 3(1)(e) does not state which recovery costs are “relevant”. Further, in paragraph 17 of the Directive, it is stated that *“the reasonable compensation for the recovery costs has to be considered without prejudice to national provisions according to which a national judge can award to the creditor any additional damage caused by the debtor's late payment, taking also into account that such incurred costs may be already compensated for by the interest for late payment.”*

There is no mention that recovery costs should be automatic.

As a result, the expected impact lies mainly in the right to a legal action that the Directive creates. That is, a right to claim compensation before a judge from the debtor for recovery costs incurred because of late payment, leaving the court free to evaluate the scope of such costs and the reasonableness of the compensation, and even to consider that the interest on late payment includes such costs and provides adequate compensation.

4.3 The Directive and grossly unfair contractual clauses

Pursuant to Article 3 of the Directive, Member States are to ensure that adequate and effective means exist to prevent the use of contract terms that, after consideration of all circumstances of the case, may be considered grossly unfair.

In addition, Article 3 offers SME representative organisations the opportunity to take legal action if an agreement contains grossly unfair provisions.

4.3.1 Why does the Directive seek to redress grossly unfair contractual clauses?

The Preamble of the Directive provides that:

“(19) This Directive should prohibit abuse of freedom of contract to the disadvantage of the creditor. Where an agreement mainly serves the purpose of procuring the debtor additional liquidity at the expense of the creditor, or where the main contractor imposes on his suppliers and subcontractors terms of payment which are not justified on the grounds of the terms granted to himself, these may be considered to be factors constituting such an abuse. This Directive does not affect national provisions relating to the way contracts are concluded or regulating the validity of contractual terms which are unfair to the debtor”.

4.3.2 How does it do so?

The Directive provides that Member States must ensure that means exist to limit the presence of or effect on creditors of grossly unfair contractual terms. In Article 3(3),(4) and (5), the Directive provides the following:

“ 3. Member States shall provide that an agreement on the date for payment or on the consequences of late payment which is not in line with the provisions of paragraphs 1(b) to (d) and 2 either shall not be enforceable or shall give rise to a claim for damages if, when all circumstances of the case, including good commercial practice and the nature of the product, are considered, it is grossly unfair to the creditor. In determining whether an agreement is grossly unfair to the creditor, it will be taken, inter alia, into account whether the debtor has any objective reason to deviate from the provisions of paragraphs 1(b) to (d) and 2. If such an agreement is determined to be grossly unfair, the statutory terms will apply, unless the national courts determine different conditions which are fair.

4. Member States shall ensure that, in the interests of creditors and of competitors, adequate and effective means exist to prevent the continued use of terms which are grossly unfair within the meaning of paragraph 3.

5. The means referred to in paragraph 4 shall include provisions whereby organisations officially recognised as, or having a legitimate interest in, representing small and medium-sized enterprises may take action according to the national law concerned before the courts or before competent administrative bodies on the grounds that contractual terms drawn up for general use are grossly unfair within the meaning of paragraph 3, so that they can apply appropriate and effective means to prevent the continued use of such terms ”.

4.3.3 What is the expected impact?

Paragraph 19 of the Directive’s Preamble states that the Directive “*does not affect national provisions relating to the way contracts are concluded or regulating the validity of contractual terms which are unfair to the debtor*”. This is to be opposed to Article 3(4). Consequently the expected impact lies in the rights granted creditors or their representative organisations to bring legal actions before national courts when they believe they are the victims of grossly unfair contractual clauses. The Directive does not define the expression “grossly unfair”, and leaves Member States and courts the freedom to determine both the circumstances that would characterize a grossly unfair clause and the consequences that should be attached to such a finding.

The expected impact thus lies mainly in the legal action rights that the Directive creates. These are as follows:

1/The right to seek damages in case a contract unreasonably extends payment periods or lowers interest rate percentages on late payments, or alternatively the right to claim that such contracts be unenforceable if the circumstances point to them being grossly unfair.

2/The right to the benefit of statutory terms, unless otherwise decided by a court for reasons of fairness, in case a contract unreasonably extends payment periods or lowers interest rate percentages on late payments.

3/The right of representative organisations to go before competent authorities and request the removal of grossly unfair terms.

4/A right to a payment delay that cannot be extended, or alternatively to be entitled to an interest rate on late payments that is substantially higher than the statutory rate in cases of categories of contracts which by statute include payment periods of more than 30 days but less than 60 days.

4.4 The Directive and retention of title

Article 4 of the Directive recognises that when a retention of title clause has been expressly agreed between the parties to a contract, the seller will retain title to the goods until they are fully paid for.

The Directive is one of the first EU regulations to contain provisions relating to property law⁵⁵. Both the Directive and the European regulation on insolvency proceedings (“Insolvency Regulation”)⁵⁶ affect property law as they deal with certain aspects of retention of title clauses.

⁵⁵ Sjef van Erp, Editorial - *Principles of European Property Law: A Pragmatic Choice between Convergence and Divergence*, vol 9.4 ELECTRONIC JOURNAL OF COMPARATIVE LAW, (December 2005), <<http://www.ejcl.org/94/editor94.html>>. One could also mention Council Directive 93/7/EEC on the return of cultural objects unlawfully removed from the territory of a member state, 1993 OJ (L 74) 74 and that intellectual property is also harmonized at the EU level.

⁵⁶ Regulation (EC) No 1346/2000. Council regulation of 29 May 2000 relating to insolvency proceedings, OJ L 160, 30.6.2000.

4.4.1 Why does the Directive seek to modify retention of title regulations?

The Preamble of the Directive provides that:

“(21) It is desirable to ensure that creditors are in a position to exercise a retention of title on a non-discriminatory basis throughout the Community, if the retention of title clause is valid under the applicable national provisions designated by private inter-national law”.

4.4.2 How does it do so?

“Article 2. Definitions

For the purposes of this Directive:

. . . .

3. ‘Retention of title’ means the contractual agreement according to which the seller retains title to the goods in question until the price has been paid in full;

. . . .

Article 4. Retention of title

1. Member States shall provide in conformity with the applicable national provisions designated by private international law that the seller retains title to goods until they are fully paid for if a retention of title clause has been expressly agreed between the buyer and the seller before the delivery of the goods.

2. Member States may adopt or retain provisions dealing with down payments already made by the debtor”.

4.4.3 What is the expected impact?

Where the retention of title clause is valid under Member States’ law or the law contractually designated by the parties (or any national provisions as designated by private international law), the creditor is granted the right to retain title to the

goods in question until they are paid in full, if such was the agreement between the parties before delivery of the goods. This expected impact is rather limited but is confirmed by the European Court of Justice in a judgment of October 26, 2006. The Court states under paragraph 29 of its decision that *“In view of the wording of Article 4(1) of Directive 2000/35 and the purpose of that directive, it cannot be inferred from that provision that it is intended to affect any rules other than those which expressly provide, firstly, that it is possible for the seller and the buyer expressly to agree a retention of title clause before the goods are delivered and, secondly, that it is possible for the seller to retain title to the goods until they have been paid for in full”*. Any other rules such as those of enforceability *“of retention of title clauses against third parties, whose rights are not affected by Directive 2000/35, are still governed exclusively by the national legal orders of the Member States”*⁵⁷. This right may be limited in case of down payments already made by the debtor.

The retention of title clause does not apply to services.

4.5 The Directive and obtaining an enforceable title

Article 5 of the Directive requires Member States to ensure that an enforceable title can be obtained, irrespective of the amount of the debt, within 90 calendar days of the lodging of the creditor’s action, provided that the claim or aspects of the procedure are undisputed.

The volume of intra-EU trade has increased many-fold since the inception of the Internal Market. New means of providing services, using new technologies to mass market, sell and manage sales and distribution channels and increased ease of transport within the EU have also meant that the value of exchanges declines, while the number of exchanges increases. Such increased trading activity inevitably leads to a rise in the number of disputes, with disputes involving smaller companies. Consequently, many disputes before national courts are now of a very different

⁵⁷ *Commission of the European Communities v. Italian Republic*, Judgment of the Court, case C-302/05, 26.10.2006 at paragraph 30.

nature from those which arose before the Single Market. Today they often involve entities from different countries communicating in a variety of languages and belonging to multiple legal traditions⁵⁸. They also frequently involve small amounts. From this perspective, long judicial or administrative procedures to obtain a decision awarding payment would deter companies from using the courts to settle disputes or claims, and render meaningless other provisions of the Directive. The Directive thus proposes solutions to remedy this.

The Directive is one of the first EU regulations that seek to impact judicial systems and procedures in EU Member States⁵⁹. In this, its content is a novel effort to harmonize a field until this point left to the exclusive powers of Member States. Further, the Directive was a precursor of what was to come as it was drafted within the context of the Treaty of Amsterdam⁶⁰, which came into force on May 1, 1999⁶¹, and the Vienna Action Plan which in paragraphs 15 and 16 refers to “*legal certainty and equal access to the courts, both to be guaranteed by certainty over the competent court and over the applicable law, and by speedy and honest proceedings followed by an effective enforcement of the decision*”⁶².

4.5.1 Why does the Directive seek to have an impact on judicial systems and procedures?

The Preamble of the Directive provides that:

⁵⁸ To explain the ever increasing levels of trade and investment between the US and the UK, the president of the US Chamber of Commerce, Tom Donohue, stated that “*We have a common language, a common system of finance and a similar judicial system, and I can see all kinds of investment continuing from the US*”. (Independent UK 17 Jun 2003)

⁵⁹ M. Freudenthal, “*The Future of European Civil Procedure*”, vol 7.5 ELECTRONIC JOURNAL OF COMPARATIVE LAW, (December 2003), <<http://www.ejcl.org/ejcl/75/art75-6.html>>

⁶⁰ Council and Commission Action Plan of 3 December 1998 on “*How best to implement the provisions of the Treaty of Amsterdam on the creation of an area of freedom, security and justice*”; text adopted by the Justice and Home Affairs Council of 3 December 1998 (known as the Vienna Action Plan); OJ C 19/01 of 23 January 1999.

⁶¹ OJ 1997 C 340.

⁶² Council and Commission Action Plan of 3 December 1998 on “*How best to implement the provisions of the Treaty of Amsterdam on the creation of an area of freedom, security and justice*”; text adopted by the Justice and Home Affairs Council of 3 December 1998 (known as the Vienna Action Plan); OJ C 19/01 of 23 January 1999.

“(20) The consequences of late payment can be dissuasive only if they are accompanied by procedures for redress which are rapid and effective for the creditor.”

4.5.2 How does it do so?

The Directive provides that Member States must ensure that efficient and expedient procedures exist for creditors to obtain an enforceable title. In article 5, the Directive provides the following:

“Article 2. Definitions

For the purposes of this Directive:

. . . .

5. "enforceable title" means any decision, judgment or order for payment issued by a court or other competent authority, whether for immediate payment or payment by instalments, which permits the creditor to have his claim against the debtor collected by means of forced execution; it shall include a decision, judgment or order for payment that is provisionally enforceable and remains so even if the debtor appeals against it.”...

“Article 5 Recovery procedures for unchallenged claims

1. Member States shall ensure that an enforceable title can be obtained, irrespective of the amount of the debt, normally within 90 calendar days of the lodging of the creditor's action or application at the court or other competent authority, provided that the debt or aspects of the procedure are not disputed. This duty shall be carried out by Member States in conformity with their respective national legislation, regulations and administrative provisions.

2. The respective national legislation, regulations and administrative provisions shall apply the same conditions for all creditors who are established in the European Community.

3. *The 90 calendar day period referred to in paragraph 1 shall not include the following:*

(a) periods for service of documents;

(b) any delays caused by the creditor, such as periods devoted to correcting applications.

4. *This Article shall be without prejudice to the provisions of the Brussels Convention on jurisdiction and enforcement of judgments in civil and commercial matters(13).”*

4.5.3 What is the expected impact?

To measure the Directive’s impact *stricto sensu* one must look at the very specific hypotheses that the Directive deals with:

1/ An undisputed claim;

2/ In relation to a debt resulting from a commercial transaction whatever its amount;

3/ An undisputed procedure;

4/ There should be no discrimination between EU creditors;

5/ Enforceable title should be obtained within 90 calendar days of the lodging of the creditor’s action; and

6/ Enforcement delays for the title are excluded from the scope of the Article.

It should be added that the Preamble to the Directive specifically provides that:

“(23) Article 5 of this Directive requires that the recovery procedure for unchallenged claims be completed within a short period of time in conformity with national legislation, but does not require Member States to adopt a specific procedure or to amend their existing legal procedures in a specific way”.

Further, paragraph 20 of the Preamble makes a statement about the necessity for non-discriminatory procedures.

The expected impact is thus limited to a specific situation which does not require correspondingly specific action from Member States.

4.6 Areas the Directive does not regulate, which consequently are not expected to be altered by the operation of the Directive

The Directive seeks to harmonize issues related to payment periods where payment is made as remuneration for commercial transactions. It does not regulate transactions with consumers, interest on specific types of payments, or payments made as compensation for damages or insurance payments.

4.6.1 *Access to judicial procedures*

Under the Directive, creditors may still have to file actions before the courts in the area where the debtor is located. The Directive is only interested in the time it takes to obtain an enforceable title from the date of the lodging of a claim. However, in many instances lodging a claim in a Member State in which one is not a national or in which one is not located can be quite burdensome. Up to very recently, it was virtually impossible to make payments to the French “Grefe” at the Commerce Tribunal as it excluded many methods of payment.

4.6.2 *Enforcement of enforceable titles judicial procedures*

The time it takes to enforce an enforceable title can vary greatly from Member State to Member State, as is shown by the WB Survey presented below. However, the Directive does not include this in its scope.

4.6.3 Service of judicial and extra judicial documents

The time it takes to serve judicial and extra judicial documents is still lengthy despite Regulation 1348/2000⁶³. Such periods of time can range from 30 to 180 days⁶⁴. However, the Directive excludes this area from its scope.

4.7 Areas the Directive leaves up to Member States to include within the scope of the Directive, and which as a result are not expected to be affected by the Directive

First, the Directive provides that Member States may maintain or bring into force provisions that are more favourable to the creditor than the provisions necessary to comply with the Directive. The Directive does not provide a freeze on more favourable regulations. This basically means that Member States whose regulation is more favourable to the creditor can regress to the minima provided by the Directive.

Second, Member States may exclude:

- debts that are subject to insolvency proceedings instituted against the debtor,
- contracts that have been concluded prior to 8 August 2002, and
- claims for interest less than 5 Euros.

The consequences of this are unclear, especially those pertaining to the last part which, if read in conjunction with the recovery cost provision, could mean that neither recovery costs nor interest are to be paid on small debts even when paid late. This is highlighted later in Section 6.

⁶³ *Study on the Application of Council Regulation (EC) No 1348/2000 on the service of Judicial and Extra Judicial Documents in Civil or Commercial Matters*, Mainstrat, May 2004, p. 149.

⁶⁴ See doingbusiness.org

4.8 Timing of the Directive's impact

Pursuant to Article 6 of the Directive, Member states have until 8 August 2002 to transpose the Directive into national legislation, and they must inform the Commission when they have done so.

As a result, Member States were not expected to enact legislation that would have an effect before August 8, 2002. In reality some Member States transposed the Directive late, limiting the impact of the Directive in the EU in the years 2002 to 2005.

In respect to new Member States, their legislation is evaluated from May 1, 2004. The impact of the Directive will not be felt in these countries before 2006 or 2007.

Finally, in some Member States the Directive applies to business transactions that are entered into after the entry into force of the transposition measures. This means that many business transactions were not effected by the Directive or transposition measures. This dilutes further the impact of the Directive in the years 2002 to 2004.

Late transposition, the arrival of new Member States and the application of some transposition measures to new transactions mean that the full impact of the Directive would only be felt some years after August 2002.

Summary of Chapter 4: The Instruments Proposed by the Directive⁶⁵

- The Directive applies to commercial transactions between undertakings or between undertakings and public authorities which involve the provision of goods and services for payment.
- This Chapter analyses each tool that the Directive proposes to fight late payments in commercial transactions, and evaluates what the expected impact of each tool could be, based on the letter of the Directive.
- The Directive imposes that an automatic interest rate be paid on late payments and defines the method for calculating such interest rate.
- The Directive imposes a statutory payment period of 30 days unless provided otherwise in a contract.
- The Directive aims to fight unreasonably long payment periods and other grossly unfair contractual clauses but provides Member States with some interpretative leeway.
- The Directive provides that relevant recovery costs should be reimbursed but provides no definition of “relevant recovery costs”.
- The Directive provides that creditors should be able to retain title to the goods until these are paid for, but imposes no harmonization on the laws regulating retention of title in each Member State.
- The Directive provides that for late payments in the case of undisputed claims a creditor should be able to obtain an enforceable title within 90 days but Member States do not have to adopt specific procedures or amend their existing legal procedures.

⁶⁵ This and following chapter summaries should not be used to draw conclusions from if read in isolation. Rather they should serve as a guide for readers to locate those sections in the text of most interest to them. These summaries provide a little more information than a table of contents.

5 THE PRESENT SITUATION

This section presents an observation of the economic situation, its evolution and an overview of the measures adopted in the European Union which are related directly or indirectly to fighting long payment periods. This overview is based on information collected through research, surveys and reports provided by various companies, SME representative organisations and institutions, and from questionnaires completed by local researchers or partners. Information has also been gathered from surveys that were conducted online, by telephone and in person. The effects of the measures adopted in the European Union are evaluated through statistics showing trends in payment behaviour and SME health.

Many companies perform regular surveys on issues relating to payment periods. However, methodologies used in conducting such studies are not always available or transparent: when they are they often differ from those used in other studies, making comparisons difficult. Furthermore, information relating to payment behaviour over long periods of time and gathered to understand the impact of the Directive is not always reliable. For example studies conducted even within a single company might well demonstrate significant changes of format over time, or gather data from a different range of sources for each survey. Where the EU is concerned, companies or institutions which engage in such studies have frequently included different countries in different years⁶⁶. Company techniques and methods for conducting surveys are more precise today and include more participants than was the case even five years ago. Finally, some studies are so limited in scope that the results may appear not to reflect the legal reality. This is the case in a recent World Bank study on “*enforcing contracts*”, in which fast-track procedures for small claims or procedures for payment injunctions are not included because the “defendant” contests the claim and the debt value equals 200% of the country’s income per capita⁶⁷. The World Bank example is representative of virtually the worst possible

⁶⁶ Interview with Leif Hallberg, Director of Public Relations at Intrum Justicia, of July 25, 2006.

⁶⁷ See <http://www.doingbusiness.org/ExploreTopics/EnforcingContracts/> .

scenario ⁶⁸ in terms of late or disputed payments. Nonetheless, the study is presented as a valid measure of “*the efficiency of the judicial (or administrative) system in the collection of overdue debt*” in the country in question⁶⁹. It seems illogical to allow a situation in which the case claim is disputed but a subsequent appeal excluded. Why would a “defendant” contest the claim and then not appeal the first decision which would further delay payment? Examples like this one demonstrate that while some studies are of interest to this area of enquiry, it is not possible to draw firm conclusions from them. Rather it is necessary to take them into consideration in order to understand the broader picture of the late payment situation in the EU.

5.1 Economic situation

The study of the economic situation involves two different types of study. First, it involves studying the impact *stricto sensu* of the late payments Directive on payment behaviour in the EU. Second, it involves studying the broader impact of the late payments Directive to try and confirm whether late payments are directly responsible for high numbers of bankruptcies and increased unemployment, and if they are, whether the late payment Directive has assisted in limiting that effect. If the first study leads to the conclusion that the late payment Directive has had no impact on late payments, the conclusion for the second study should be that the Directive has not had a general impact on the economy. However, if there are instances in Europe where unemployment has fallen, bankruptcies have fallen and late payments have increased, the absolute relationship described in earlier studies between late payments and SME health and employment levels may have to be reconsidered.

Further, it is important to clarify that late payments are only one factor amongst many others which cause cash-flow problems leading to insolvencies or liquidations.

⁶⁸ The worst possible scenario would be the one in which the “defendant” files an appeal, which the study does not consider.

⁶⁹ Following the World Bank study, to obtain payment of a debt, it normally takes 208 days and 23 procedural steps to obtain a judicial decision and enforcement in Sweden. Given that Sweden has the lowest level of late payments in Europe based on the World Bank study one would conclude that either fast judicial procedures are irrelevant to fighting late payments, or that 208 days is a reasonable period in which to efficiently fight late payments.

Even for insolvencies directly related to late payments, the responsibility may be shared by creditor and debtor. Creditors that do not manage credit well expose themselves to late payments⁷⁰. Many interviewed representative organisations and SMEs, and earlier studies, amalgamate the percentage of liquidations attributed to cash-flow problems with the effect of late payments on bankruptcies and employment. It should be clarified that if, for example, 40% of liquidations result from cash-flow problems, this does not automatically mean that all cash flow problems result exclusively from late payments. There are many factors that contribute to cash flow problems within companies, and late payments can be one of them. Many studies across Europe conclude that cash flow problems are mainly related to access to financing, or initial capital structures of companies, or even the cost of dealing with red tape and tax burdens. Thus, before calculating the social cost of those 40 liquidations out of 100, it is important to clearly establish the percentage actually due to late payments. Establishing this is beyond the scope of the Report, unfortunately. But clarifying that the relationship between late payments, cash-flow, insolvencies and employment is much more complex than some studies or organisations have suggested is important. Consequently, the expected economic impact of the Directive is unlikely to be simply a discernable and sudden fall in insolvencies and a corresponding rise in employment levels.

Finally, the benefits of the Directive may be achieved with a lag. Thus, although in some cases no significant reduction in payment period length will be observed, this does not imply that the Directive is ineffective, but rather that the reduction may occur in the coming years.

⁷⁰ See *New Credit Management help for Start Ups*, Better Payment Practice Group, Press release 24.08.2004.

5.1.1 Competitiveness

Competitiveness is a priority for the EU. As stated before, SMEs are the thrust of EU competitiveness. Late payments as such do not hinder competitiveness. However, by weakening SMEs they limit the chances of EU competitiveness to flourish.

Competitiveness is both essential within the Single Market and in a globalised environment. Competition increases competitiveness. If barriers to cross-border transactions such as allowing late payments, grossly unfair contractual practices or lengthy payment periods and their consequences limit competition in the Single Market⁷¹, competitiveness will be lessened in external markets. SMEs need to be able to build up their strength within the Single Market.

5.1.1.(a) Competitiveness and research and development

Innovation is at the forefront of competitiveness for the EU. Although late payment issues are not directly linked to innovation, anything that will affect the capacity of companies to invest into new technologies and innovate will have an effect on competitiveness. Thus, late payments and long payment periods affect competitiveness of EU SMEs, specifically because of their negative impact on innovation. EUCOMED argues that long payment delays are “*particularly detrimental to the innovation process in the medical devices sector. They provide a strong disincentive to new enterprises who are often key to the development/marketing of innovation*”⁷². EUCOMED further argues that beyond innovation, long payment periods have a negative impact on the quality and price of products offered to patients, and on growth and employment opportunities in the medical devices sector.

⁷¹ Or foster competition and a competitive advantage in abusive practices rather than in product and service quality, pricing and innovation.

⁷² *EUCOMED situation summary and guidance for members on the late payments directive*, EUCOMED, 13.12.01, p.7.

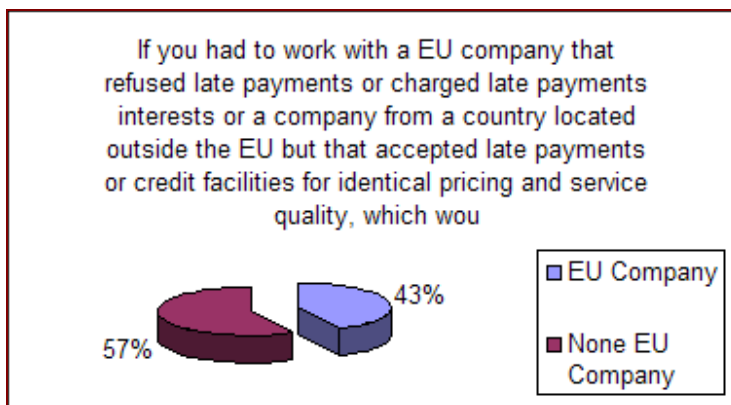
The LP Survey shows that 13% of respondents consider that late payments have a very strong impact on research and development. 45% of SMEs consider that late payments have an impact on research and development investment. This confirms that late payments limit competitiveness.

5.1.1.(b) Competitiveness and pricing

The costs incurred by late payments means that SMEs will be less competitive price-wise in a globalised environment, especially if their competitors do not have to factor in such costs to their product prices. The LP Survey shows that 32% of respondents increased the price of their products as a result of late payments. This means that although companies may have competitive products, these products will be more expensive than those of competitors that do not have to factor late payments into pricing.

5.1.1.(c) Competitiveness and flexibility

There is no reason why foreign companies would react differently to EU SMEs when asked the question whether they would rather work with a company that was flexible on payment conditions. The LP Survey finds that EU companies are sensitive to companies that grant them good payment conditions.



This illustrates the dichotomy that faces SMEs at a specific point in time, and the choices that have to be made concerning the type of competitiveness that the EU wishes to rely on to give it a comparative advantage. Cash-flow strained companies

will appreciate trade-credit. Very young SMEs too. However, short trade-credits will accelerate business cycles, generate more growth and enable an SME focus on innovation, business development and product quality rather than on imminent default and its psychological burdens.

5.1.1.(d) The existence of payment periods or trade credit as beneficial to competitiveness⁷³

Trade credit plays an important role in economic development. It is a critical financial resource and facilitates the continuous employment of resources in the economy and drives risk-taking and investment. Trade credit, which involves supplying goods and services on a deferred payment basis, i.e., sellers accepting payment after the delivery of goods and services, is an important source of short-term finance for businesses, particularly smaller firms, whose stocks and flows of trade credit are typically twice the size of those for bank credit⁷⁴. Empirical studies of their respective financial structures have shown that, in comparison to large firms, small ones are less liquid, exhibit more volatile cash flows and profits, and rely more heavily on short term debt funding. Moreover, they are more likely to be credit rationed, with financial institutions restricting the flow of funds to sectors when they are unable to fully evaluate the risks involved⁷⁵, or unwilling to take risks when the numerous other services they provide to individual customers are comparatively risk free (account fees, credit card fees, transaction fees, check fees...).

⁷³ Section based on Report by Professor Lino Briguglio, Spéphanie Vella and Nadia Farrugia, edited by Jean Albert and submitted to the European Commission on August 31, 2006.

⁷⁴ *The Demand for Trade Credit: An Investigation of Motives for Trade Credit Use by Small Businesses*, Board of Governors of the Federal Reserve System, Elliehausen G. and Wolken J., Washington, DC 20551, September 1993; *Paying Your Bills: An Empirical Study of Trade Credit. Working Paper, University of Michigan*, Wilner B.S. (1996). *Late Payment and Credit Management in the Small Firm Sector: Some Empirical Evidence*, Cardiff Business School, CMRC Leeds University Business School and Nottingham University Business School, Ann Arbor; Peel M., Wilson N., Howorth C. (1999).

⁷⁵ *Financial Differences Between Large and Small Firms*, Walker, E. and Petty, W., *Financial Management*, Winter 1978, pp.61-68; *Size, Financial Structure and Profitability: UK Companies in the 1980s*, Cosh, A. and Hughes, A., In *Finance and the Small Firm*, Hughes, A. and Storey D.J. London: Routledge, 1994.

Trade credit has been around as long as trade itself⁷⁶. For example, a study of 15th century Britain suggests that sales on credit (i.e. trade credit) “... accounted for more than half of all credit transactions” and notes that, “...many firms had more of their assets tied up in credit than in capital”. Interestingly, the latter was not always deliberate, “... in many cases the creditor never intended to extend credit to the debtor; these debts originated when debtors failed to pay for goods on delivery ...”⁷⁷ It is also argued that trade credit was vital to the establishment of commerce in the United States during the colonial period⁷⁸.

An important aspect of trade credit is the two-way nature of the transaction. Many firms use trade credit as customers and provide it as suppliers. For small firms supplying trade credit can be an important strategic or competitive tool that plays a role in increasing business activity. Firms may extend trade credit in an attempt to differentiate their own product/finance offering from competitors and/or use trade credit periods as a signal to the market of high and consistent product quality and/or long-term presence in the market. Extending credit generates information on customers and reduces search costs which may facilitate some price discrimination⁷⁹. Suppliers may use trade credit as a means of competing in markets and generating sales and customer loyalty. Trade credit as a competitive tool is many-faceted and can be used to respond to customers’ sensitivities to total effective price (goods plus finance); their needs or demand for short-term finance; their focus on product quality and after-sales service and their requirements for continuity and reliability in the timing and quality of supplies. Trade credit enables sellers to predict cash receipts more accurately, allowing them to reduce their precautionary cash balances⁸⁰.

⁷⁶ *Small Business Demand for Trade Credit, Credit Rationing and the Late Payment of Commercial Debt*, Wilson, N., Singleton, C., and Summers, B., Working Paper, University of Bradford, Credit Management Research Group, Bradford, 1997.

⁷⁷ *Debt and Credit in the Urban Economy: London 1380-1460*. Bennet E.Z., PhD Thesis, University of Yale, 1989.

⁷⁸ *The Sinews of American Commerce*. Foulke, Dun and Bradstreet, inc., 1941.

⁷⁹ *Trade Credit and Credit Rationing*, Crawford, University of Bristol DP No92/323, 1992.

⁸⁰ *The Demand for Trade Credit: An Investigation of Motives for Trade Credit Use by Small Businesses*, Elliehausen G. and Wolken J., Board of Governors of the Federal Reserve System, Washington, DC 20551, September 1993.

According to the transactions theory of trade credit, firms can economize on the joint costs of exchange by using trade credit⁸¹, while in accordance with the financing motive, imperfect capital markets enable suppliers to finance buyer firms at a lower cost than can financial institutions⁸², mitigating the credit rationing a firm may experience in financial markets.

However, it is rationalized and standardized trade-credit that can increase transparency in the market and accelerate business cycles, thereby enhancing competition and firm competitiveness⁸³. Disparities in payment periods and the ability to charge or not charge late payment interest or excessive long payment periods create an environment that is not conducive to good business practices, where prompt payment discounts or uncharged interest on late on long payments are in fact rebates.

5.1.1.(e) However, payment periods can cause cash-flow difficulties that in turn effect competitiveness negatively

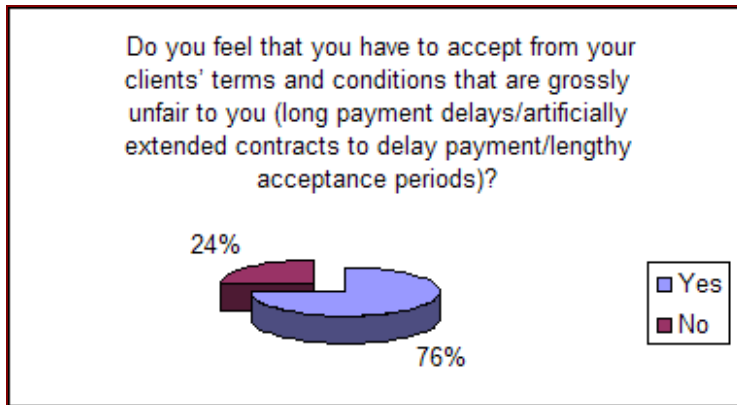
This is because, while trade debtors may generate a future cash flow, they need to be financed while waiting for this cash to be paid. Also, currently trade credit contracts are by their nature incomplete and often established between supplier and buyers with asymmetric bargaining positions.

The LP Survey shows that three quarters of companies felt that they had to accept terms and conditions from their clients which were grossly unfair, namely long payment delays, artificially extended contracts to delay payment and lengthy acceptance periods.

⁸¹ Ferris, 1981.

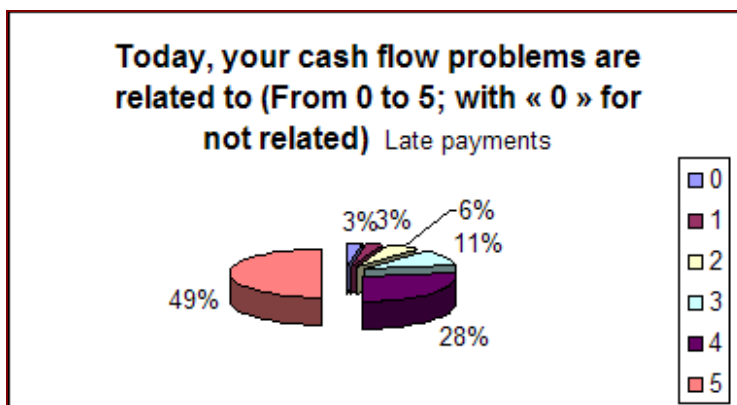
⁸² Schwartz, 1974; Smith, 1987,

⁸³ See WTO Panel Report in *Japan - Measures Affecting Consumer Photographic Film and Paper*, WT/DS44/R, March 31, 1998.



Another effect on competitiveness is derived from the cash-flow problems resulting from payment periods.

The LP Survey shows that the majority of companies believe that their cash flow problems are related to late payments, with less blame being placed on contractual payment delays, expensive credit and taxes.



Cash-flow problems resulting from payment periods are caused by three factors.

First, the main cause of cash-flow problems that result from late payments is the cost for companies of dealing with longer payment terms for customers and shorter payment terms for suppliers. Where for example suppliers need paying within thirty days and clients are only obliged to pay within ninety days, an imbalance results

that can constitute an important extra cost of doing business⁸⁴. This is the cost of extra working capital (hereafter “Payment Period Working Capital Cost” or “PPWCC” or “marginal cost”) needed to compensate for the difference between the payment periods which apply to client and supplier or the trade credit cost⁸⁵. The PPWCC is more important for smaller companies as they are more likely than larger ones to be in payment period squeezes (“PPS” or “Payment Period Squeeze”) which result from the negotiation of payment periods with powerful customers and not less powerful suppliers. Very small companies sometimes have to pay suppliers cash because suppliers do not trust their credit worthiness. At the other end the client will use the knowledge that it has of its importance to a small company to impose very long payment periods. In such circumstances the PPWCC will be unbearable for the small company.

In some sectors, it is argued the PPS is low because the trade credit is similar throughout the supplier-customer chain. This is confirmed partly in the LP Study. 63% of companies stated that when paid late they slowed payments to their suppliers, creating a snowball effect. This can hardly be considered a virtuous circle that could enhance competitiveness.

The PPWCC has been recognized as the most important late payment related problem for companies. This is a reason why in France, for example, the government is promoting a sector by sector approach so as to reduce the PPWCC in specific sectors.

The effect of the PPWCC increases as the client base of the company grows. As a result PPWCC has an exponential negative effect on growth. The greater the number of clients, the less payment periods granted by suppliers will compensate for the effect of the credit granted clients.

High PPWCC due to late payments and long payment delays is thus negative on growth, and as a consequence on competitiveness.

⁸⁴ Report prepared for this study, *La lutte contre les délais excessifs et les retards de paiement en France: de récentes avancées significatives*. Professeur Michel Glais, 08.2006.

⁸⁵ « *Etude sur les délais de paiement* », Pour la Commission d’Examen des Pratiques Commerciales, Professeur Michel Glais, February 2005, p. 3.

Second, even in a system where the PPWCC is low as a result of a good balance between supplier and customer payment periods relative to supplier and customer value, long payment periods and late payments have a negative impact on cash flow because some company fixed costs are subject to advance, cash payments or short payment periods. Labour costs, labour related costs, social contributions, rent, utilities (“Fixed-Costs Suppliers” or “FCS”) represent in some countries a huge proportion of company expenses, especially in the EU. If one factors these FCS into the PPWCC, the PPWCC would remain important as long as the payment periods granted to customers are not lowered to balance the impact of the FSC. This is a reason to doubt the positive effect of a sector by sector approach in harmonizing payment periods. FCS remain. Employees are protected by law and must be paid on time. Worse, rents (office, equipment, insurance) are paid in advance. They constitute an expense for companies. This expense increases when clients pay late. Companies cannot slow payments to employees to offset the trade credit. As a result, in situations or sectors where payment periods are long, employers will be reluctant to employ people because of the rigidity of the labour regulations on one side and the long payment periods imposed by clients on the other. This constitutes yet another PPS. Payment periods need to be lowered substantially to avoid this type of situation as it has an impact on employment. Companies may be reluctant to employ people because of the employment related PPWCC. This in turn impacts growth and innovation as companies have inadequate human resources to grow and innovate.

Third, the PPWCC does not take into account the cost of the financial uncertainty created by late payments. In order to survive the eventuality of a late payment a company may have to provision extra working capital. This has a cost and it will be at the price of growth, employment or innovation.

Late payments and long payment periods cause more than cash-flow problems. They create an environment that is not conducive to growth, innovation or employment. Late payments can make it necessary for firms to increase borrowing and to extend overdraft facilities. A survey by the Bank of Scotland discovered that 68% of SMEs regularly suffered cash flow problems as a result of delayed payments. Time and

resources can be taken up on maintaining and collecting late payments instead of being devoted to other areas of business. Late payments can affect the ability of businesses to pay their workforce and relationships between management and employees, while those between companies, suppliers and customers are also placed under strain⁸⁶. If as stated earlier banks are unable or unwilling to lend to SMEs because of the difficulty they have in evaluating SME default risk on the loan, late payments only contribute to that difficulty. By definition, a late payment is an unforeseen element that can have material adverse effects on SMEs. So on top of creating an insecure environment within the SME, it also increases risk exposure, shutting down hopes of borrowing.

European business managers by the thousands see payment uncertainties as a major obstacle to cross-border trade and therefore to growth⁸⁷. The classic hindrances such as 'administrative obstacles' or 'customs duties and taxes' remain less significant obstacles⁸⁸. There is at present a gap between the free circulation of goods and services on the one hand and the timely receipt of corresponding payments on the other. The existence of this gap is confirmed by a survey according to which 21% of businesses would export more if payment delays were shorter (Enterprise DG).

5.1.1.(f) More generally, the negative impact of disparate and long payment periods and more particularly late payments on the economy are several

Of between 30 and 40 billion invoices in Europe each year as many as one billion default and turn into debt collection cases⁸⁹. Late payments lead to company insolvencies, with the European Commission claiming that one out of four insolvencies is due to late payment, leading to the loss of 450,000 jobs each year, thereby contributing to the high level of unemployment in Europe⁹⁰. Furthermore,

⁸⁶ Direct Combined Business Omnibus on Late Payments, 2004.

⁸⁷ European Payment Survey, 2005.

⁸⁸ Not that they should not be addressed.

⁸⁹ European Payment Survey, 2005.

⁹⁰ Enterprise DG.

outstanding debts worth €23.6 billion are lost every year through insolvencies caused by late payments.

5.1.1.(g) Balancing the benefits and costs of payment periods

There are thus economic benefits and economic costs to trade credit. This suggests that there must exist an optimal level of trade credit. This is shown in the diagram below, which indicates that the marginal benefits of trade credit fall as the level of trade credit rises, while the marginal costs of trade credit rise as the level of trade credit rises.

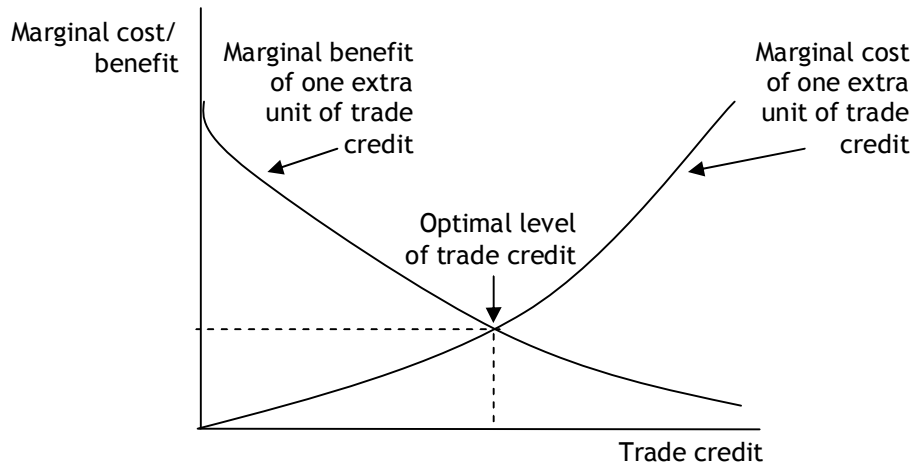
The PPWCC or marginal cost of trade credit increases exponentially in case of late payment due to the impact of the uncertainty factor that would have to be taken into account.

The marginal benefits of trade credit are the additional benefits received when one more unit of trade credit is granted. Marginal benefits tend to fall as the level of trade credit increases, due to diminishing returns. Thus, the additional benefits received by increasing trade credit in generating sales, for example, declines as the level of trade credit increases. The diagram below shows a downward sloping marginal benefits curve, indicating that additional benefits decline as the level of trade credit increases.

The marginal costs of trade credit are the additional costs imposed when one more unit of trade credit is granted. Marginal costs tend to rise as the level of trade credit increases. The rise in the marginal costs of trade credit is shown in the diagram below.

The intersection point of the two curves - marginal benefit of one extra unit of trade credit and marginal cost of one extra unit of trade credit, indicates the optimal level of trade credit.

Figure 1



For firms to remain competitive, especially on international markets, they need to be able to offer payment delays. However, these payment delays should be limited to an optimal level that takes into account FCSs. It is better in the EU to shorten and standardize payment periods given the important cost of FCS (labour and rents especially). Late payments should be considered unacceptable.

5.1.1.(h) Double edged sword - to what extent do payment facilities from foreign companies give them a comparative advantage? Is competitiveness only measured by the price of products or services?

The theoretical arguments which form the foundation of the late payments directive essentially protect the rights of firms, particularly SMEs, which on account of late payments face cash flow shortages, which in turn restrict trade and possibly also lead to insolvency. An argument in favour of the directive is that late payments restrict the harmonization of the European market and undermine the competitiveness of these firms.

However a valid counter-argument to this hypothesis is that the late payments directive may also undermine the competitiveness of small firms. It is important to

bear in mind that a significant aspect of trade credit is that almost invariably among businesses it has two distinct faces. Generally all firms are both debtors and creditors. For small firms, supplying trade credit is as important as receiving it. Indeed supplying trade credit can be an important strategic or competitive tool that plays a role in capturing new business, in building consumer relationships and in price competition.

Cut-throat competition in the global market is exerting intensive pressure, especially on small firms, to the extent that in general firms must also compete on their payment terms. Therefore if firms extend their credit payment period they are more likely to be favoured than those that minimize the payment period as much as possible and also apply interest on late payments.

However, if one concedes that Europe's competitiveness and growth is driven by SMEs, and that SMEs are less able to compete on trade credit than larger firms, it is in the interest of the EU to impose short payment periods at least within its borders.

Further, the EU's competitive advantage does not lie in its labour costs or in the cost of doing business there. It lies in its brain power and innovative capacity and it is that competitive advantage that it needs to focus on⁹¹.

5.1.1.(i) The Challenges of competitiveness

Competitiveness is complex. Flexibility is important as shown above. However, companies need to play by the same or similar rules so that they compete fairly.

Like many countries throughout the world, EU Member States as well as the EU as a bloc are faced with countless challenges emerging from an increasingly globalised world economy. These challenges dictate that EU enterprises must be able to adapt to such change and identify their own strengths, weaknesses, opportunities and threats.

⁹¹ More interaction between European financial institutions, some of which are world leaders in earnings and capitalization and SMEs, could enable more of a focus on competitiveness based on payment terms.

Enterprises must seize the opportunities linked to globalisation and perceive them as a potential source of growth as well as a potential source of employment creation. This however entails that firms must become increasingly competitive in the products and services that are offered on the market.

Enterprise competitiveness depends on the ability of firms to adjust in a cost-effective manner to demand exerted by the market. In a bid to be or become competitive enterprises must make sure that labour and capital productivity is efficient and effective, and that where possible there are no idle resources. It also demands that firms innovate and seize opportunities which allow them to tap into markets which yield the highest returns. To become competitive firms must also ensure a healthy financial situation and minimize all costs, especially those such as late payments, which are not in any way perceived as increasing the firms value.

Government can assist in limiting unfair and anti-competitive practices so as to ensure that competitiveness is not a measure of elements exogenous to normal market conditions. Late payments constitute a breach of contract; they are not a competitiveness tool. Similarly, competing on long payment periods distorts competition in a market by artificially displacing it to another market. For example, when companies compete for a contract to provide computers and they start competing on payment periods, the market has changed. The competition in the computers market has stalled and been displaced to the financial products market.

According to the Business Competitiveness Index compiled by the World Economic Forum for 2003, European Member States do not fare too badly compared to other countries for which the index is compiled. Indeed Finland ranks the highest in terms of the business competitiveness index. Finland is followed by the USA and then consequently by a number of other European countries such as Sweden, Denmark, Germany and the UK. An interesting point to note is that these countries also have the lowest late payments levels. They also have strict laws of payment behaviour. Competitiveness in the EU depends partly on Europe's capacity to become more entrepreneurial, i.e., to encourage the creation of new companies, to make SMEs

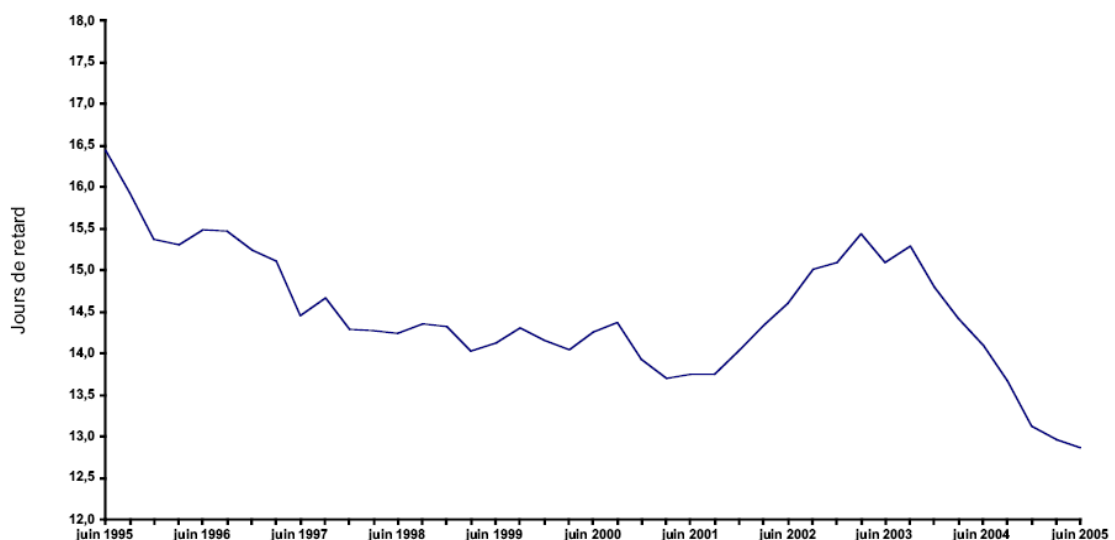
more competitive and to encourage their growth. Improving the payment culture of the EU is thus essential for increasing its competitiveness.

In conclusion, short standardized payment periods with no allowance for late payment will have a positive effect on competitiveness in the EU as it increases transactions transparency, and payment certainty, and limits the PPWCC, thus offsetting the high impact of FCS.

5.1.2 Late payments evolution⁹²

Late payments in Europe have dropped from around 16 days in 1995 to 12.8 days in 2006, according to Altares Reports (See figures 2 and 3 below). The figures show that late payments were on a downward trend until March 2001, when they started to rise gradually until payments reached a delay of just over 15 days two years later. Since September 2003, late payments have generally been on a downward trend and in March 2006, late payments were 3.2 days lower than in June 1995.

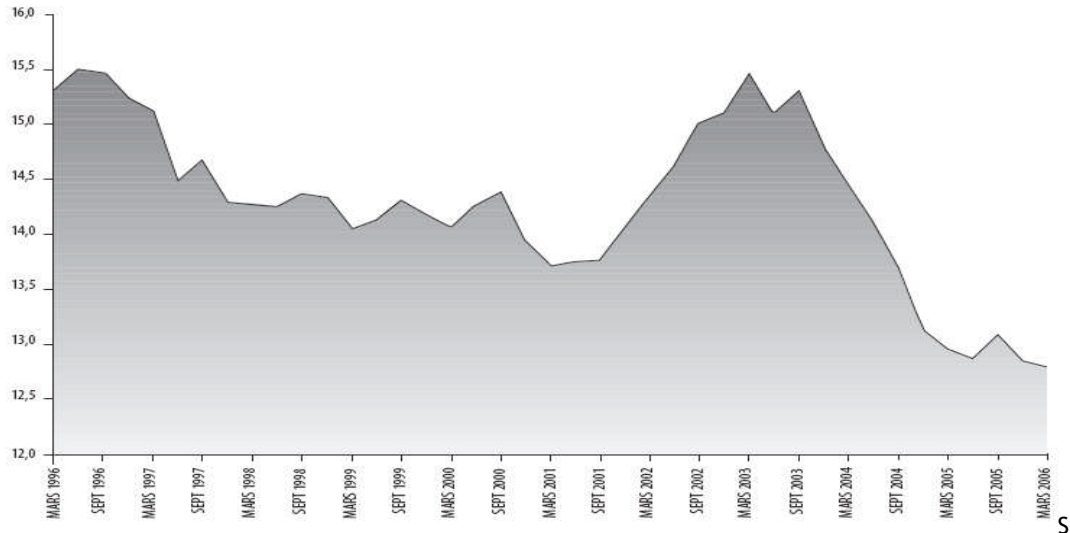
Figure 2



⁹² Section based on research conducted by the whole Team and a report prepared by Nadia Farrugia and Stephanie Vella under the supervision of Professor Lino Briguglio and Jean Albert presenting a statistical analysis of payments behaviour, insolvencies and unemployment and submitted to the European Commission on August 31, 2006.

Source: Altares, Bilan 2005, Les comportements de paiement des entreprises en Europe.

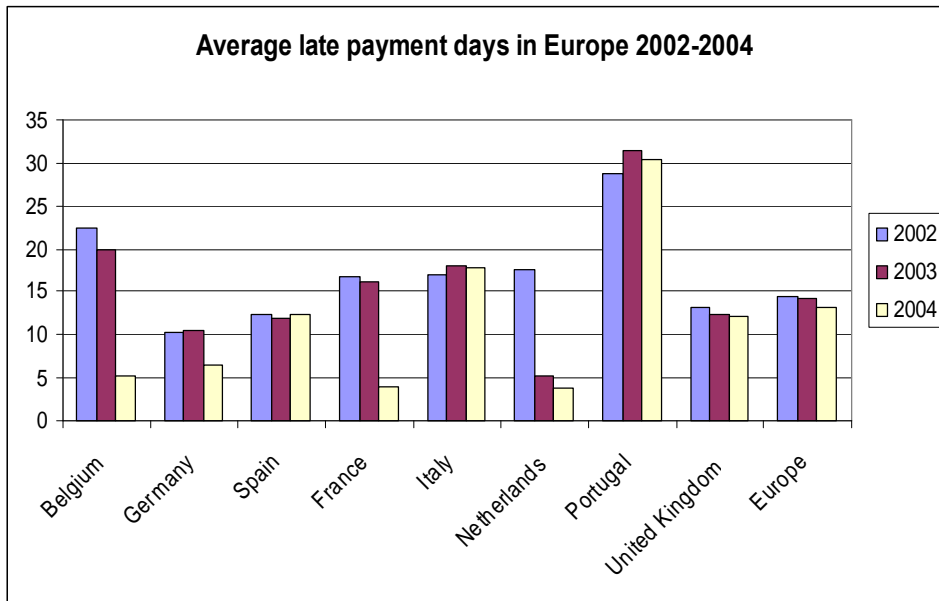
Figure 3



Source: Altares, Les retards de paiement des entreprises en Europe 1^{er} trimestre 2006

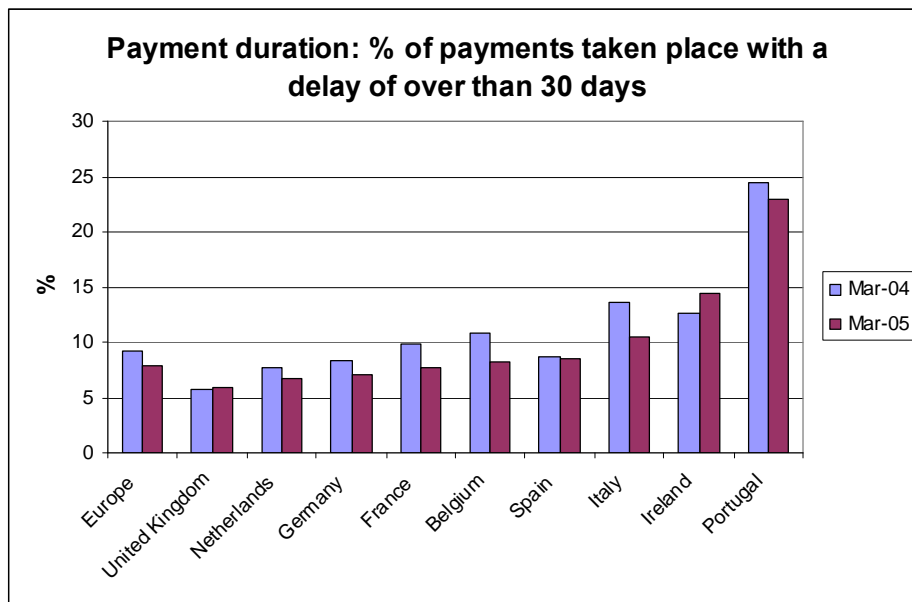
Figure 4, based on the data shown in Figures 3 and 4, provides a snapshot of the evolution in the average late payment days in Europe for the period 2002 to 2004. Moreover, it gives the data for a number of EU countries. Figure 4 shows the consistent drop in the average late payment days in Europe during the period. It shows that the Netherlands experienced a significant drop in average late payment days during 2003 and that Belgium and France experienced similar significant drops a year later. Average payment days also decreased in Germany, Portugal and the United Kingdom. They increased slightly in Spain and remained constant in Italy. The figure also shows that in 2004, average late payment days were highest in Portugal, over 30 days, and very low in Belgium, Germany, France and the Netherlands. Figure 5, which shows the percentage of payments made with a delay of more than 30 days, shows an improvement in EU performance during 2005. This reflects developments in all the countries surveyed, except in Ireland, which experienced an increase in payments made with a delay of more than 30 days, and the UK, which experienced no change in performance.

Figure 4



Source: Dun and Bradstreet Survey

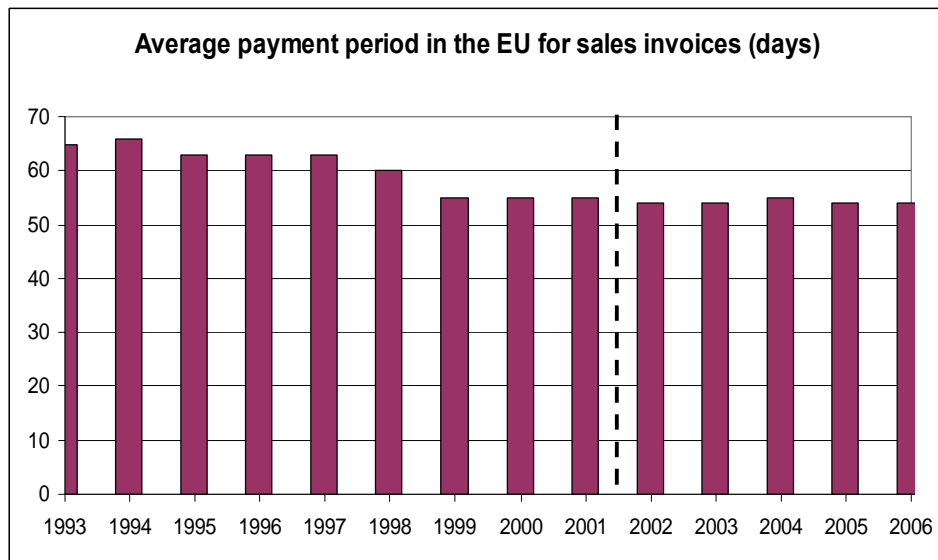
Figure 5



Source: Dun and Bradstreet Survey

Figure 6 gives the average payment period in the EU for sales invoices using data from the Grant Thornton Survey, where the average payment period is made up of the payment term plus the payment delay. Thus, changes in the average payment period could be due to changes in either or both components of the average payment period. Figure 6 shows a decline in the average payment period in the EU for sales invoices. There is a clear drop in the average payment period between 1998 and 1999. The payment period seems to have stabilised thereafter.

Figure 6

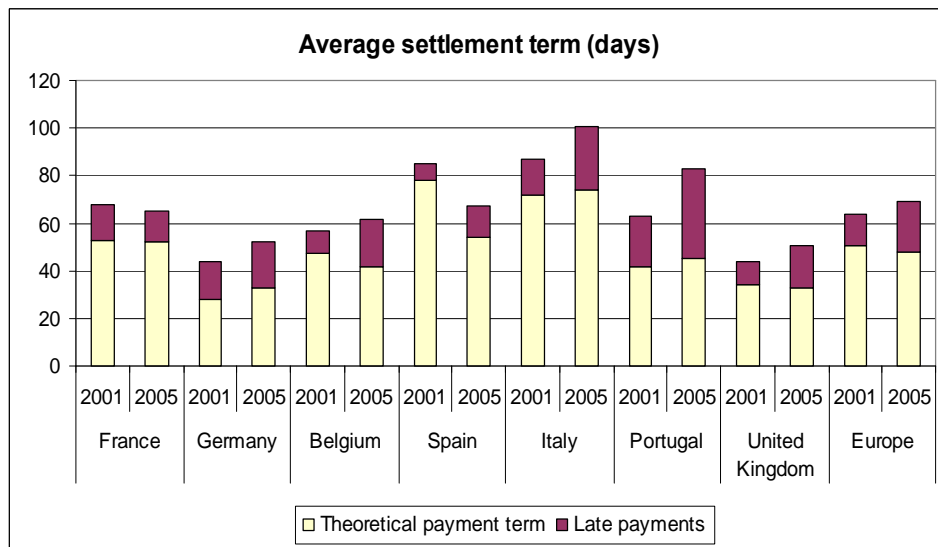


Source: IBOS, Grant Thornton

Similarly, Figure 7 shows the average settlement term in days for a selection of EU Member States. The calculation of the average settlement term is made on the basis of the following hypotheses: theoretical term + delays in payments among the different categories of clientele in proportion to their distribution in % of turnover. The data in Figure 7, which is based on the results of the Eurofactor Survey, show deterioration in payment performance in Europe in 2005, compared to the situation in 2001. Indeed, late payments increased in Europe, notwithstanding a decrease in the theoretical payment term. The table also shows average settlement terms, broken down into theoretical payment terms and delays in payment for a number of EU countries. The average settlement term is reported to have increased in

Germany, Belgium, Italy, Portugal and the United Kingdom. In all cases except Germany, this increase was due to an increase in late payments. It is interesting to note that although Spain reported a rather significant drop in its average settlement term, this was entirely due to a large drop in its theoretical payment term. Indeed, late payments increased during the period analysed.

Figure 7

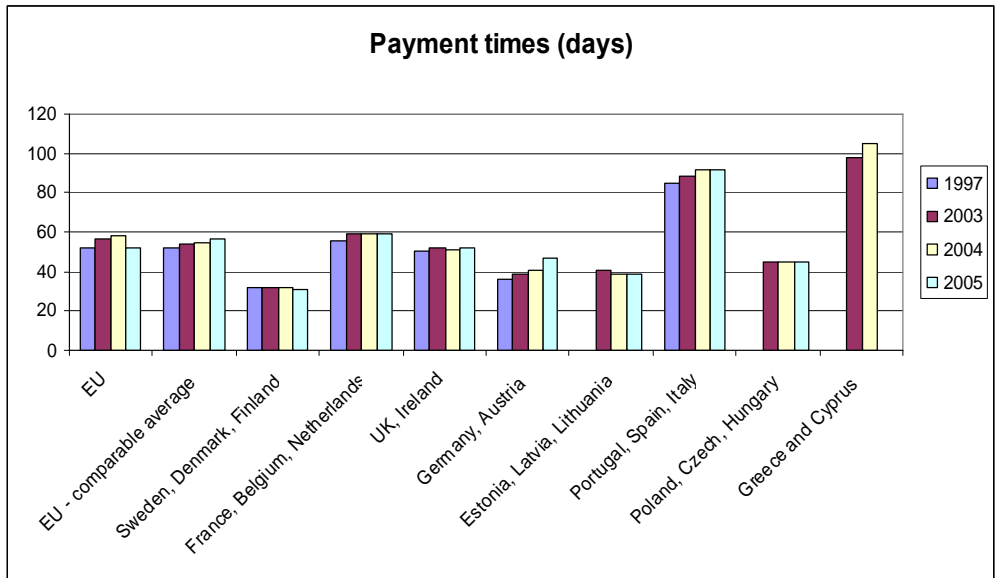


Source:

Eurofactor Survey

The improvement in payment performance in the EU in recent years is also implied by the survey results of the European Payment Index, which show a drop in payment times (days) during 2005 (see figure 8). Indeed, payment times dropped from 58 days in 2004 to 52 days in 2005, the same level as in 1997. The introduction of new countries into the survey, namely Poland, the Czech Republic, Hungary, Greece and Cyprus in 2003, may indicate that the EU average payment times (days) computed for 1997 may not be strictly comparable to more recent data. Thus, a comparable average for the EU was computed excluding the newly introduced countries. The comparable average does not confirm an improvement in payment times. Indeed, the drop in payment times during 2005 principally reflects the exclusion of Greece and Cyprus from the survey.

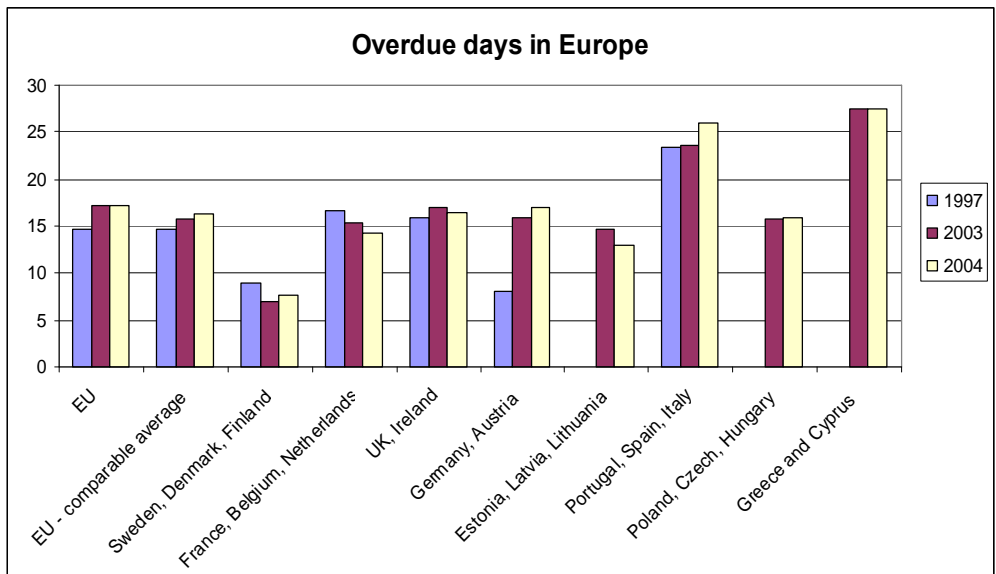
Figure 8



Source: European Payment Index

Figure 9, which shows the number of overdue days in Europe, from the European Payment Index, indicates that the number of overdue days remained constant during 2004, but was higher than that in 1997. The EU comparable average, computed as explained above, shows an increase in overdue days during 2004. Figure 11 shows that overdue days dropped in France, Belgium, the Netherlands, the UK, Ireland, Estonia, Latvia and Lithuania.

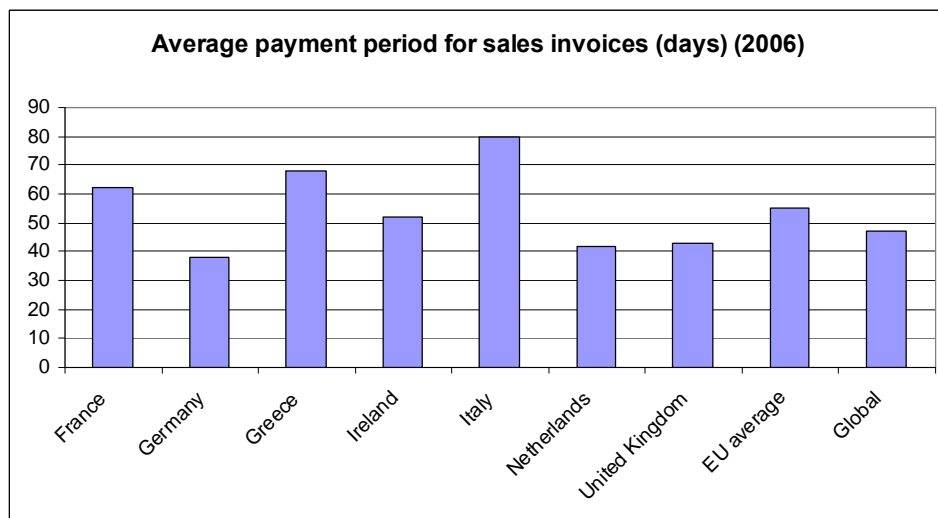
Figure 9



Source: European Payment Index

Figure 10 shows the average payment period for sales invoices for a number of EU countries for 2006 drawn from the Grant Thornton Survey. Of significant interest is the average payment period for the world economy, also provided in Figure 10. Figure 10 shows that the EU average payment period for sales invoices is higher than the global average. It should be noted that this could be due to higher terms of payment or/as well as higher late payment days. Countries whose average payment period for sales invoices is lower than the global average provided are Germany, the Netherlands and the United Kingdom.

Figure 10

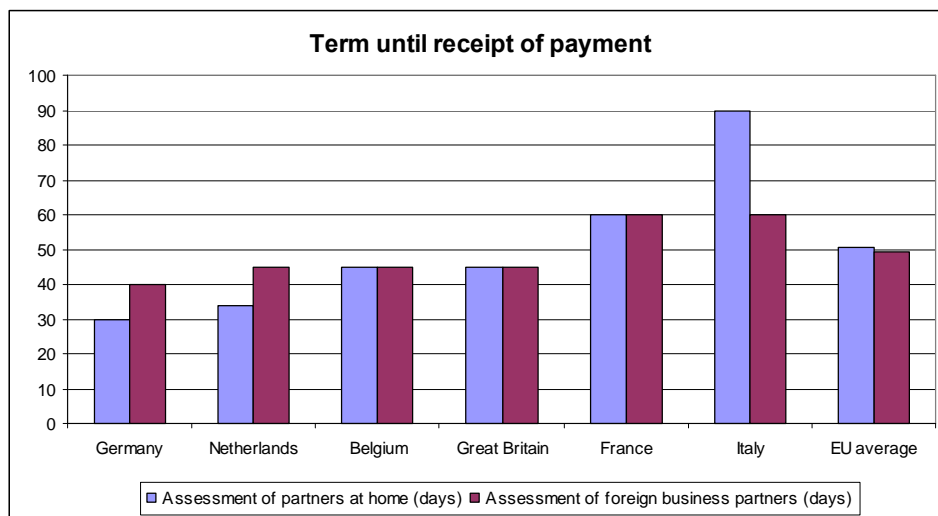


Source: IBOS, Grant Thornton

Atradius' Payment Practices Barometer Summer 2006 Survey provides an assessment of local and foreign business partners in a number of EU countries. The assessment of partners doing business on the domestic front shows replies to the question: "How long does it take until local business partners settle their debts?". The assessment of foreign business partners shows replies to the question: "How many days does it take, on average, until foreign business partners settle their debts?", with all foreign sector assessments being from the countries being surveyed. Figure 11 shows that domestic business partners in Germany and the Netherlands react most quickly to invoices, with an average of around 30 or 34 days until payment is received. Companies from Italy (90 days) and France (60 days) have to wait significantly longer for payments from domestic business partners. Meanwhile, companies from France

and Italy have to wait longest for payments from abroad. On average business partners from abroad require 60 days to fulfil their obligations. Although different results are obtained from the different member states surveyed, the computed average shows very similar results for home and foreign assessment, both standing at around 50 days before payment is received.

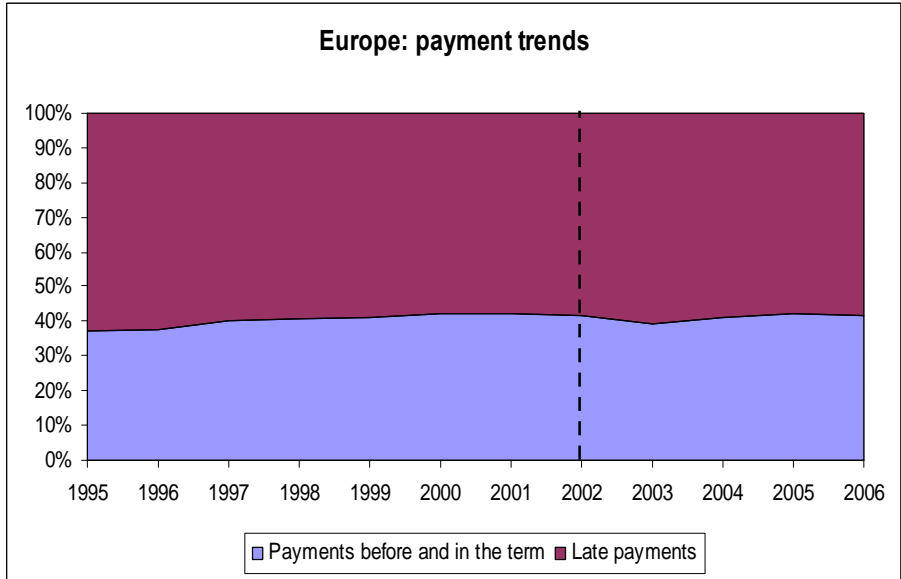
Figure 11



Source: Atradius Payment Practices Barometer, Summer 2006 Survey

Figure 12 shows the percentage of payments effected before and in the term under consideration and the percentage of late payments for the period 1995 to 2006. The data is provided by Dun and Bradstreet. The figure shows that these percentages remained quite stable during the period analysed. Indeed, payment performance improved during 1995 and 1996 and remained constant until 2003, when there was a slight deterioration. An improvement was however registered during 2004, which was maintained during 2005 and 2006.

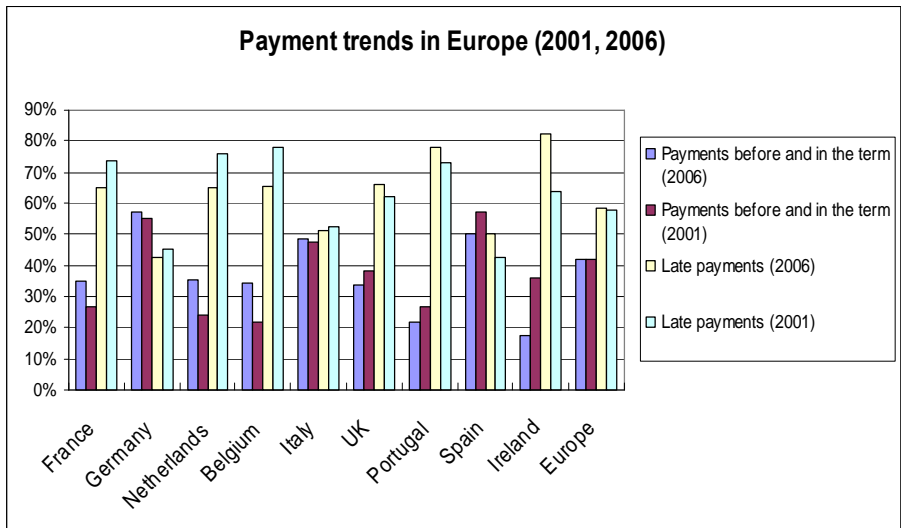
Figure 12



Source: Dun and Bradstreet Survey

A more detailed breakdown of payment trends, also provided by the Dun and Bradstreet Survey, is shown in Figure 13. It gives a comparison of the percentage of payments effected before and within the term, and the percentage of late payments, for 2001, before the Directive came into force, and for 2006. This figure also indicates that payment performance remained stable in Europe during the period analysed. Moreover, Figure 13 exhibits the payment performance of the European countries for which the survey was carried out. Payment performance has deteriorated in a number of European countries, namely France, Germany, the Netherlands, Belgium and Italy. Improvements were recorded in the United Kingdom, Portugal, Spain and Ireland.

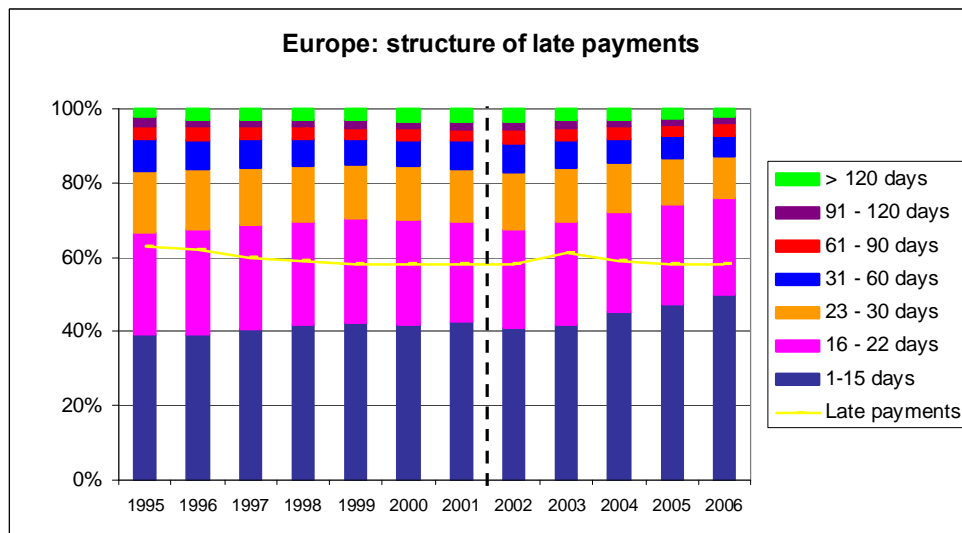
Figure 13



Source: Dun and Bradstreet Survey

Dun and Bradstreet provide further information on the age structure of late payments (see Figure 14). Data provided from 1995 to 2006 shows positive changes in the late payments evolution. Indeed, from 2002 onwards, a clear increase in the number of late payments, being 1-15 days, can be observed, while a clear decrease can be observed in the percentage of late payments between 16-22 days, 23-30 days, 31-60 days, and most importantly in late payments being older than 120 days. Thus, Figure 14 shows that even though late payments are still a factor in commercial life in Europe, payments are being effected at a faster rate than was the case previously.

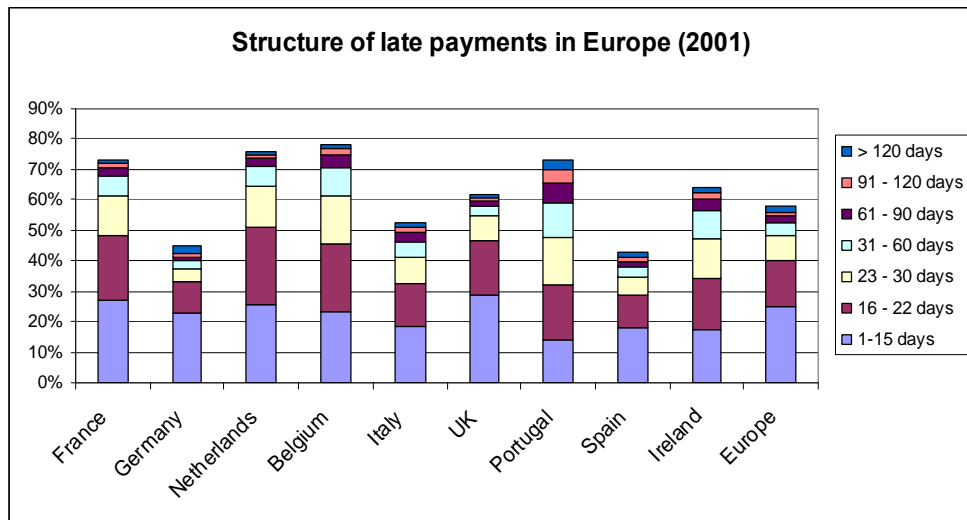
Figure 14



Source: Dun and Bradstreet Survey

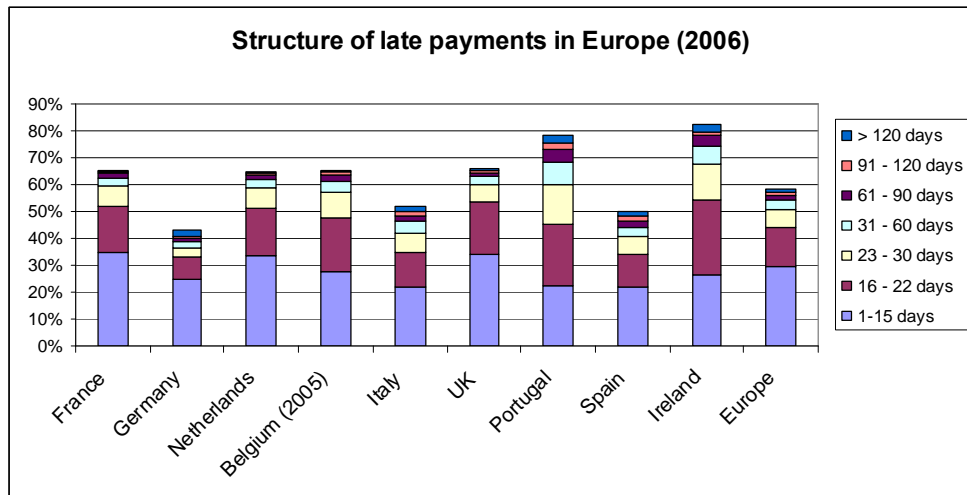
Figures 15 and 16 allow a comparison of the age structure of late payments before the Directive was implemented and the current situation. Data are provided for a number of EU member states for which the Dun and Bradstreet Survey is carried out as the EU average, which was shown in Figure 14 above. The figures show the decrease percentage of late payments as well as the increase in late payments which are 1-15 days old and the drop in older late payments. Thus, these figures point towards an improvement in the situation of late payments in Europe.

Figure 15



Source: Dun and Bradstreet Survey

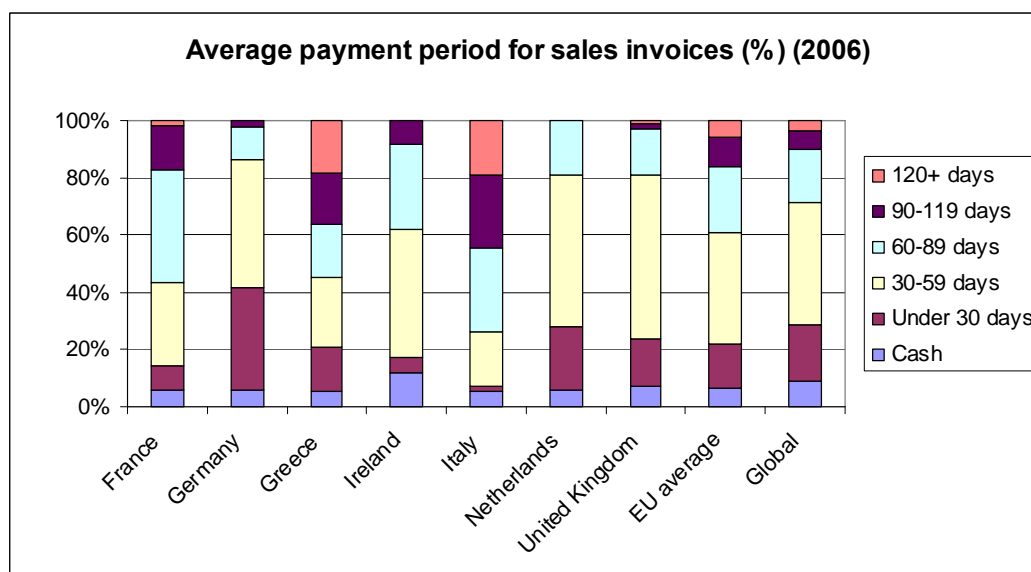
Figure 16



Source: Dun and Bradstreet Survey

Figure 17 provides similar statistics from the Grant Thornton Survey for 2006. Moreover, it gives information for the global average. An examination of Figure 17 reveals that the payment structure in Europe is still inferior to the global average, with older payments due being larger in the former than in the latter and younger payments due being lower in Europe than the global average indicates. The figure shows that Greece and Italy have a large proportion of late payments which are more than 120 days old and a small proportion of payments being paid before the term or which are less than 30 days old. It is due to these two countries that the EU average has been negatively affected. All other countries in the sample have payment structures which are better than the global average.

Figure 17



Source: IBOS, Grant Thornton

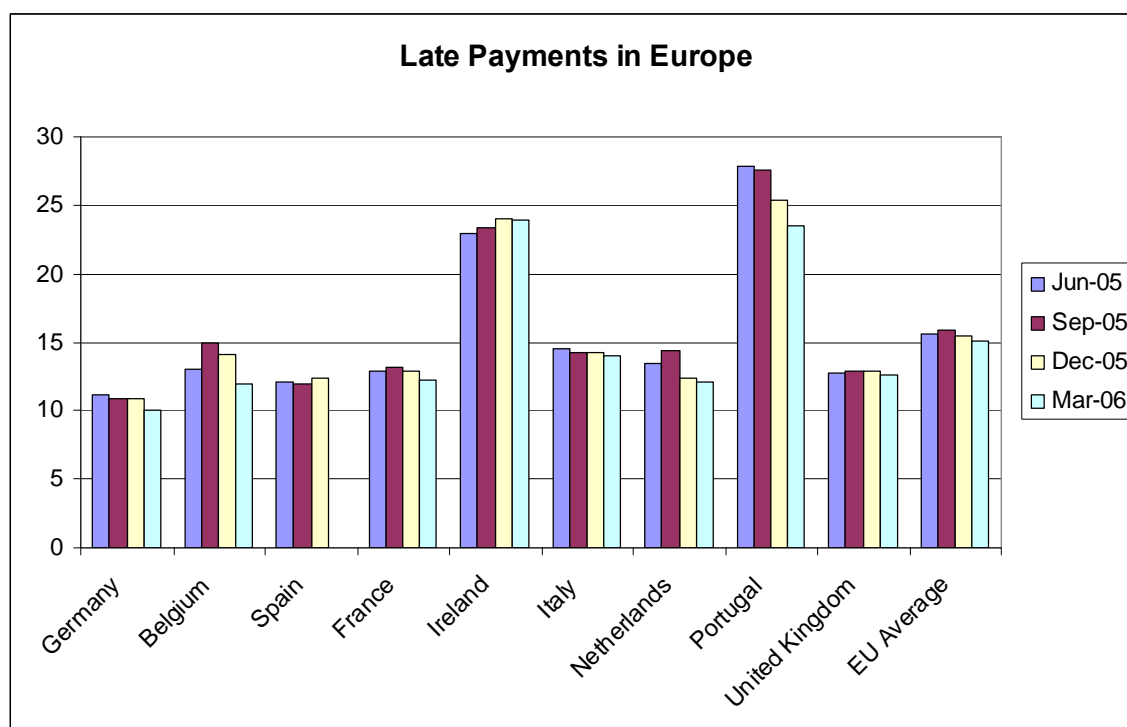
The LP Survey indicates that most companies surveyed pay within 30 days and between 31 and 60 days. Only 14% of companies claim that they pay invoices immediately, while 78% of the companies surveyed state that they have paid their invoices 30 days after receipt. Of this group, 64% also state that they have paid invoices beyond the delay contractually accepted by the supplier. Almost half of the companies surveyed claim that over 50% of invoices paid by their clients are paid beyond the payment delay date. Almost a third of the companies surveyed stated that they usually accept payment delays of around 31 to 60 days. In the survey of representative organisations, it emerged that the average payment delay was over 100 days and two-thirds stated that between 20% and 50% of all invoices are paid after the payment delay expiry date. 35% of the representative organisations surveyed stated that they considered a 60 day delay as an abusive contractual payment delay. The survey of state-owned enterprises revealed that they generally pay their invoices between 61 and 90 days late. A further 45% stated that on average between 20% and 50% of invoices are paid beyond the agreed contractual payment delay. Almost two thirds of the state-owned enterprises interviewed said that they had noticed a reduction in late payments in the last few years.

It should be noted that the theoretical payment term, or contractual terms of payment, as they are also known, are not likely to vary in the short-term, while late payments are less likely to remain stable. This is evident from Table 1 and Figure 18, where Table 1 shows the contractual terms of payment and Figure 18 shows late payment days, for the period June 2005 to March 2006. Table 1 shows that all countries included in the survey reported the same contractual terms of payment during the four quarters analysed. The only exception is Belgium, which increased its contractual terms of payment in March 2006. Some countries in Figure 18 show some variation in the number of late payment days during the four quarters analysed, mainly Portugal, Belgium and Ireland. However, for the EU as a whole, only marginal differences were observed.

Table 1: Contractual terms of payment

	Jun-05	Sep-05	Dec-05	Mar-06
Germany	30-50	30-50	30-50	30-50
Belgium	40-60	40-60	40-60	60-90
Spain	60-90	60-90	60-90	-
France	50-70	50-70	50-70	50-70
Ireland	30-50	30-50	30-50	30-50
Italy	60-90	60-90	60-90	60-90
Netherlands	30-50	30-50	30-50	30-50
Portugal	60-90	60-90	60-90	60-90
United Kingdom	30-50	30-50	30-50	30-50
Source: Altares, 2005, 2006				

Figure 18



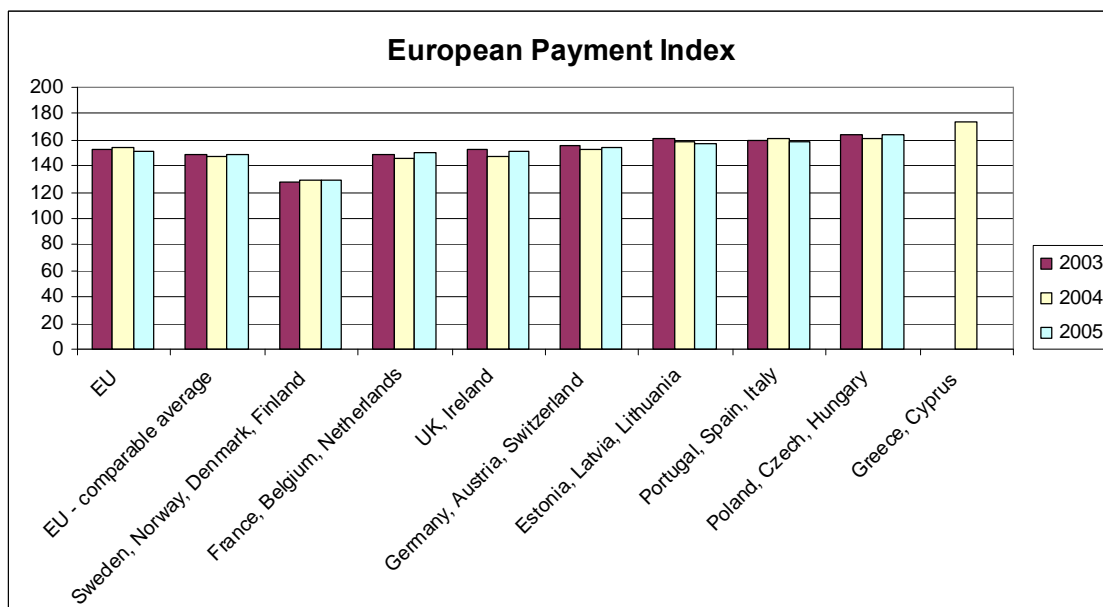
Source: Altares

It should be noted that late payments may be due to differing cultural attitudes towards paying suppliers rather than constituting signals of an intention to default. While late payments may affect business performance negatively, payment losses and bad debts have an even worse impact on activity. Thus, the analysis will now focus on the risk of defaulting and the actual percentage of payment losses and bad debts which have taken place.

Figure 19 shows the results of the European Payment Index for the period 2003 to 2005 for a number of EU countries, which have been grouped into regions. The average for the EU and the EU comparable average (due to the inclusion of new countries into the analysis) is also provided. The European Payment Index shows constant payment high risks during the period 2003 to 2005. Intrum Justitia state that an index value of 100 means that no payment risks exist, while an index value of 101 to 124 points implies that businesses are to introduce precautionary measures and controlling processes for their protection. From 125 points onwards, increasingly urgent measures are recommended to lower the risk profile and where the value is more than 175 points, this is an absolute necessity. Sweden, Norway, Denmark and Finland have the lowest payment risks, while Greece and Cyprus have the highest. It should be noted that Italy's

payment risk is relatively not much higher than the other countries in the sample, notwithstanding its bad performance. This could possibly be due to low payment losses, which will be analysed below.

Figure 19

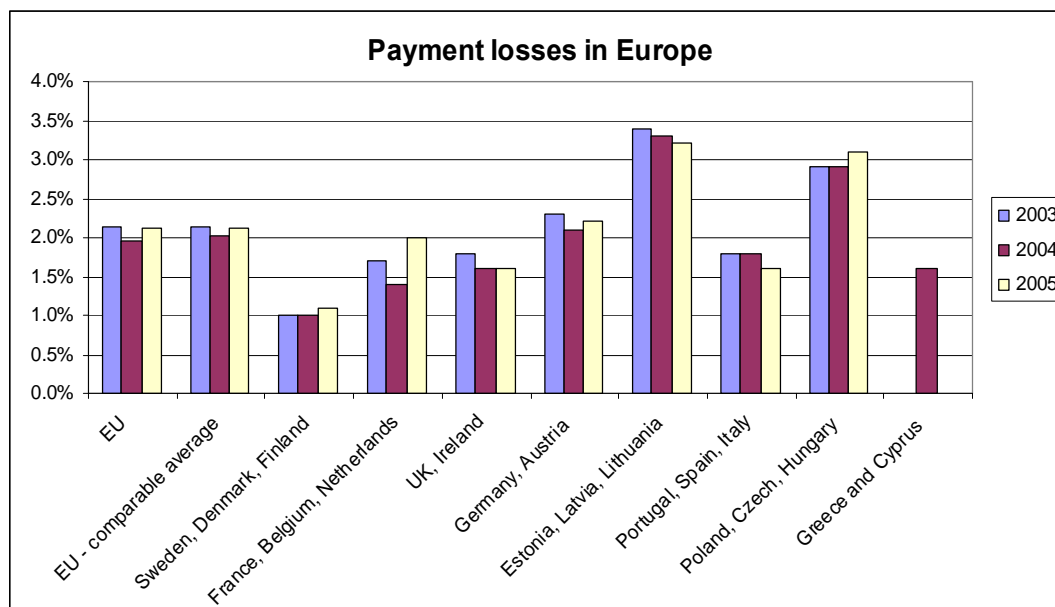


Source: European Payment Index

Figure 20 shows payment losses in Europe. Figure 21 gives the ratio of bad debts to sales. Both provide information on the extent of default in the EU as a whole and in a selection of EU Member States. Figure 20 uses data from the European Payment Index, while Figure 21 uses the Eurofactor Survey. Figure 20 shows that payment losses in the EU during 2005 are at the same level as in 2003, as after dropping in 2004 they increased again in 2005. These results hold for the EU average as well as the EU comparable average, implying that the introduction of new countries into the analysis does not distort the overall picture being obtained. Interestingly, Figure 20 shows that payment losses in Greece and Cyprus and in Portugal, Spain and Italy, are lower than the EU average. It also shows that the Eastern European countries, namely Estonia, Latvia, Lithuania, Poland, the Czech Republic and Hungary have very high payment losses, although the former group of countries has experienced a slight decrease in payment losses during the period reviewed. Poland, the Czech Republic and Hungary have, unfortunately, experienced an increase in payment losses during 2005, as have France, Belgium and the Netherlands, Germany and Austria, as well as Sweden, Denmark and Finland. Payment losses remained constant in the UK and

Ireland during 2005, after having fallen during 2004, while payment losses in Portugal, Spain and Italy dropped in 2005 after having remained constant a year earlier.

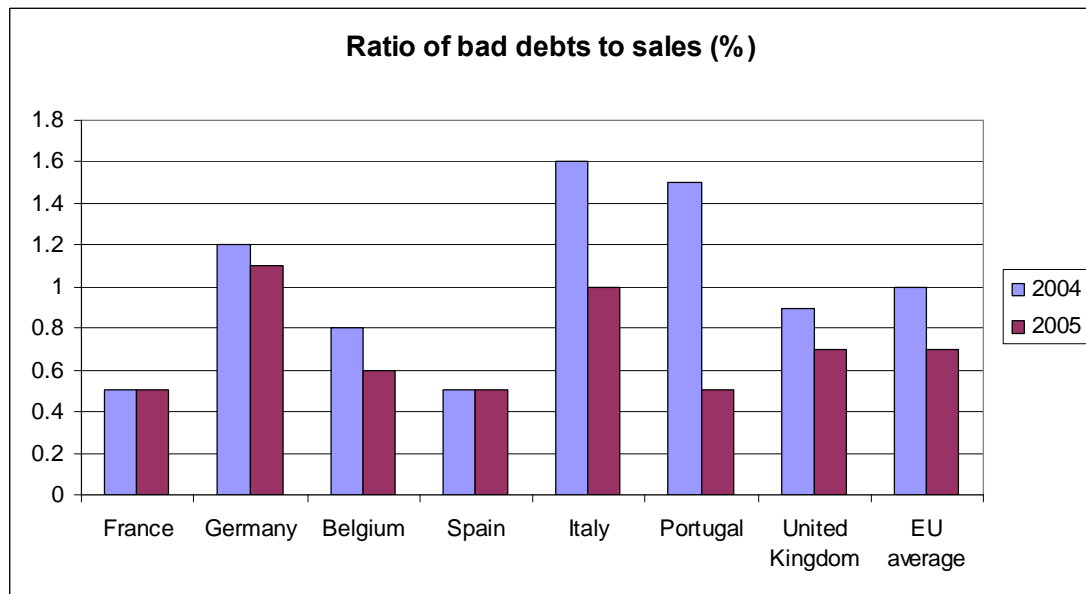
Figure 20



Source: European Payment Index

A different picture of events is provided in Figure 21, which shows the ratio of bad debts to sales, as given by the Eurofactor Survey, with the figure in Italy being higher than the EU average, although a considerable drop was experienced during 2005. The ratio of bad debts to sales in Portugal, which was very high in 2004, also dropped considerably and in 2005, was even lower than the EU average. Indeed, Figure 21 shows no worsening in payment performance during 2005. The performance of France and Spain remained constant, while the ratio of bad debts to sales in all other EU countries in the survey dropped. Overall, the ratio dropped from 1% in 2004 to 0.7% in 2005.

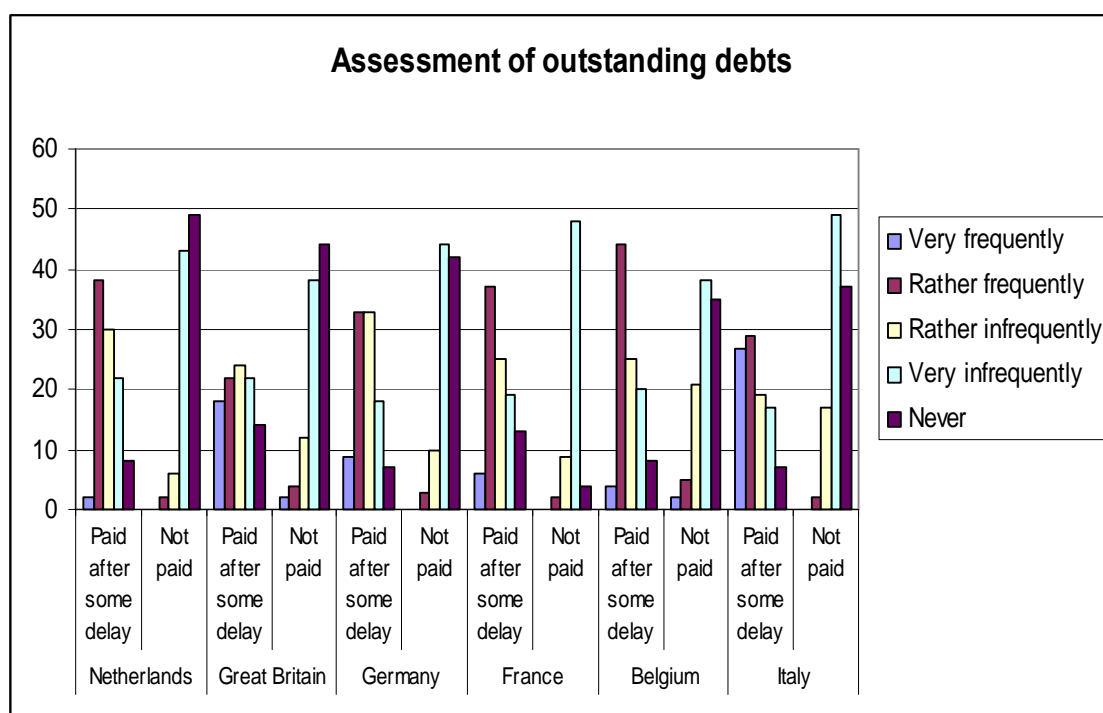
Figure 21



Source: Eurofactor Survey

Figure 22 depicts information from the Atradius Payment Practices Barometer. It enables an assessment of the delay in payments by domestic business partners and asks respondents to rate business partners in the case of 'outstanding debts being paid after only some delay' and in cases of 'outstanding debts not being paid at all'. In 40-56% of the assessed domestic sectors there were 'frequent' or 'rather frequent' payment delays. The most frequent delays were in Belgium, and, above all, Italy. Only 30-50% of the assessed domestic sectors had had no payment failures at all in the last six months. On the whole, payment failures occur rather infrequently. When they are compared to those in other countries, domestic payment failures in Germany, France and Great Britain occur most frequently. Frequent failures are experienced most rarely in the Netherlands.

Figure 22

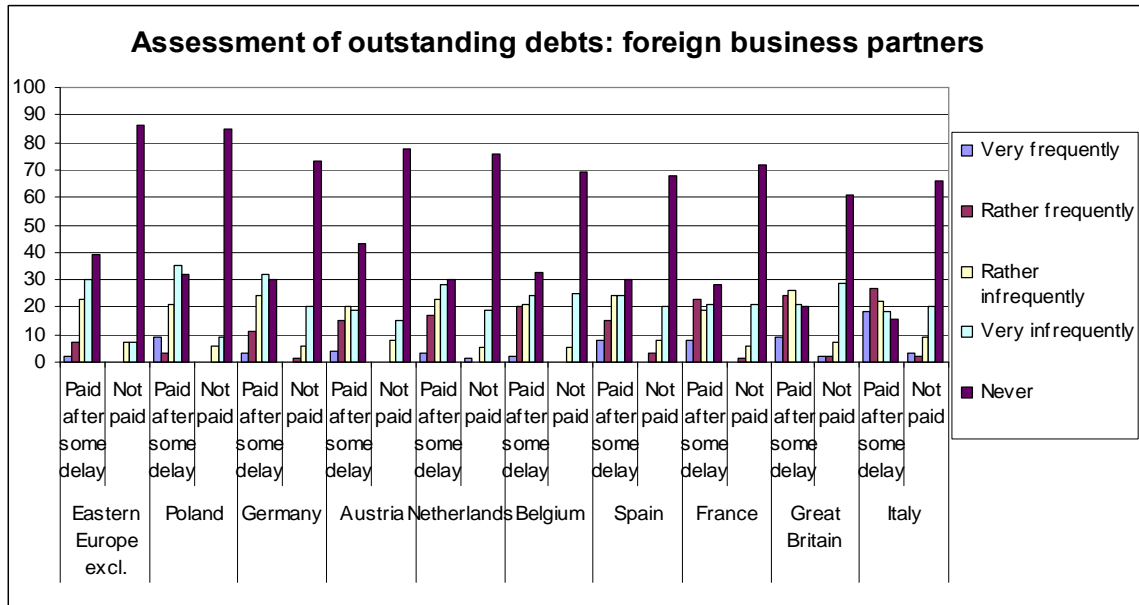


Source: Atradius Payment Practices Barometer

Using information from the Atradius Payment Practices Barometer, Figure 23 shows an assessment of outstanding debts by foreign business partners. Respondents were asked to rate international business partners on situations in which, “outstanding debts were only paid after some delay” and in which, “outstanding debts were not paid at all”. All countries presented in this survey represent countries with which the companies questioned carried out business most frequently.

Respondents indicated that payment delays occur most frequently with business partners from Italy, Great Britain and France. Conversely, delays with business partners from Eastern Europe, Germany and Austria occur quite rarely. In 86% of the sector assessments with business partners from Eastern Europe there were no payment failures in the last six months. In comparison, there were no payment failures in only 61% of the business relationships with companies in Great Britain. The report states that bad debts with international business partners occur less frequently than among domestic business partners. It provides justification for this statement by arguing that the cause for this could be due to domestic transactions occurring more frequently than exports.

Figure 23

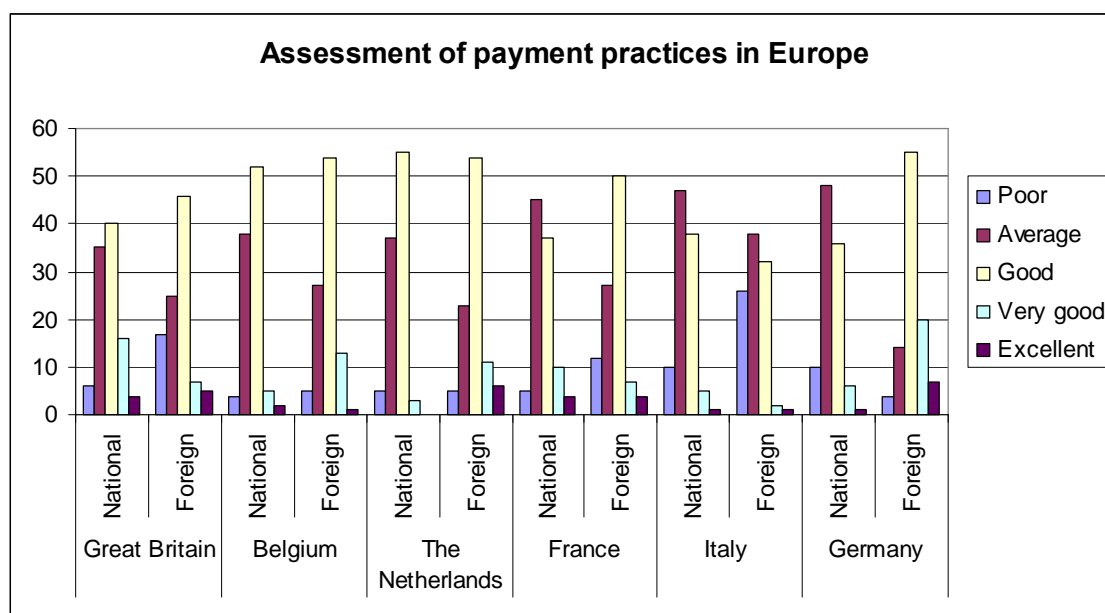


Source: Atradius Payment Practices Barometer

Figure 24 shows the results of an assessment of payment practices, at home and abroad. On the whole, respondents considered domestic payment practices to be fair to good: in all countries, at least 40% assessed the payment practices as “average” or even “poor”. The British assess their business partners at home comparatively positively, with 20% of the respondents rating them as “very good” or “excellent”. Conversely, German and Italian respondents were very critical, with almost 60% of German and Italian respondents giving a rating of domestic payment practices of “average” or “poor”.

Regarding the assessment of payment practices abroad, Italian companies received the worst assessment. But the payment practices of companies from Great Britain and France were also assessed critically. Foreign business partners assessed the payment practices of companies from Austria, Germany, the Netherlands and Eastern Europe most positively.

Figure 24

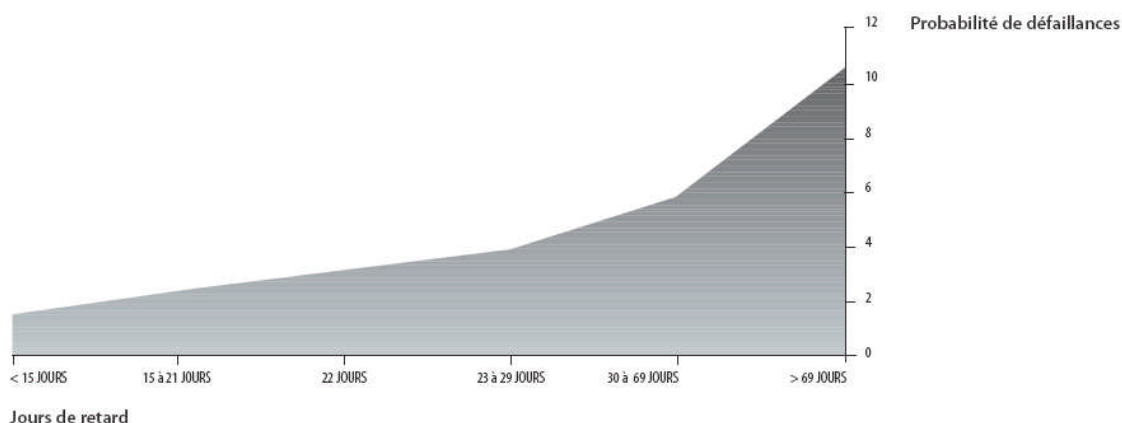


Source: Atradius Payment Practices Barometer

At the inception of the proposal for a Directive of 2000 to support the fight against late payments in commercial transactions, the European Commission noted that one in four failures was due to late payment. These insolvencies involve the loss of almost 24 billion Euros of unrecovered credit. Late payments alone total 90 billion Euros per annum and represent 10.8 billion Euros in lost interest. Figure 25 shows the probability of default associated with the length of late payments. It shows that this probability is around 2% when the receivable is less than 15 days old, increasing gradually to around 4% when the receivable is between 23 and 29 days old. Following that the probability of default increases at a faster rate to around 6% when the receivable is between 36 and 69 days old. When the receivable is over 69 days old, the probability of default rises to more than 10%.

Figure 25

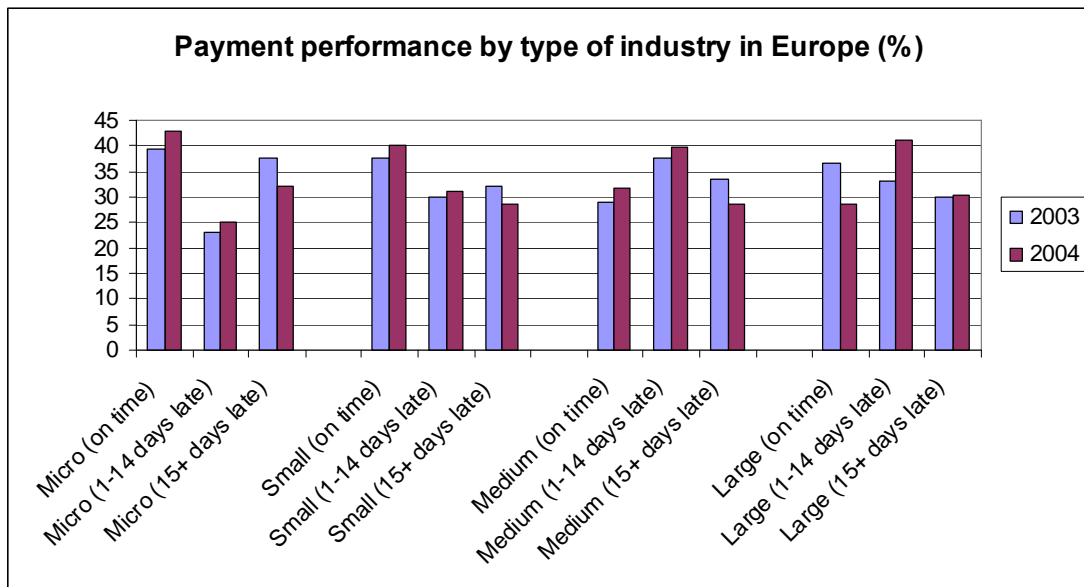
PROBABILITÉ DE DÉFAILLANCE ASSOCIÉE AU RETARD DE PAIEMENT



Source: Altares

The analysis now focuses on payment performance by type among European industries. Figure 26 below gives this performance data for 2003 and 2004. It shows that in 2004, payment on time was negatively related to the size of enterprises. Indeed, the rate of payment was fastest in micro and small enterprises, but slowed steadily as the scale of the companies scrutinized increased. In other words the smaller the enterprise, the shorter the payment period tended to be, with large entities being the slowest. However, it is interesting to note that micro enterprises had the largest proportion of payments being effected over 15 days late. The figure shows that payment performance in Europe in 2004 changed rather significantly from the previous year. In fact in 2003, although micro enterprises had the largest proportion of payments being paid on time as had been the case in 2004, large enterprises had a greater proportion of payments being paid on time than medium enterprises. All enterprise types increased the proportion of payments being paid on time during 2004 except large enterprises, which experienced a decrease. All enterprises increased the proportion of payments being effected between 1-14 days late, especially large enterprises. The proportion of payments being made over 15 days late dropped in all enterprise types, except in the case of large enterprises, where the proportion remained constant.

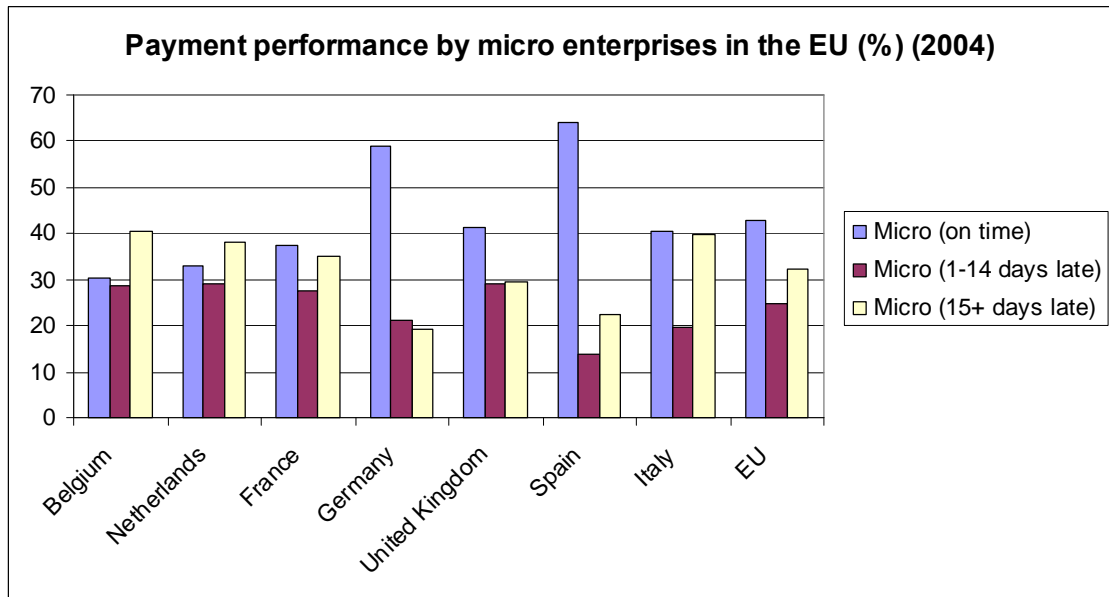
Figure 26



Source: Dun and Bradstreet Survey

Figure 27 displays the payment performance by micro enterprises for the EU as a whole, as well as for a selection of EU Member States for which the Dun and Bradstreet survey is carried out. The figure shows that in 2004, Spanish and German micro enterprises had the largest proportion of payments made on time. The United Kingdom, France and the EU average were also among the countries demonstrating the most positive prompt payment trends although figures in this group were lower than in Spain and Germany. Micro enterprises in Belgium and Netherlands had the largest proportion of their payments being made over 15 days late.

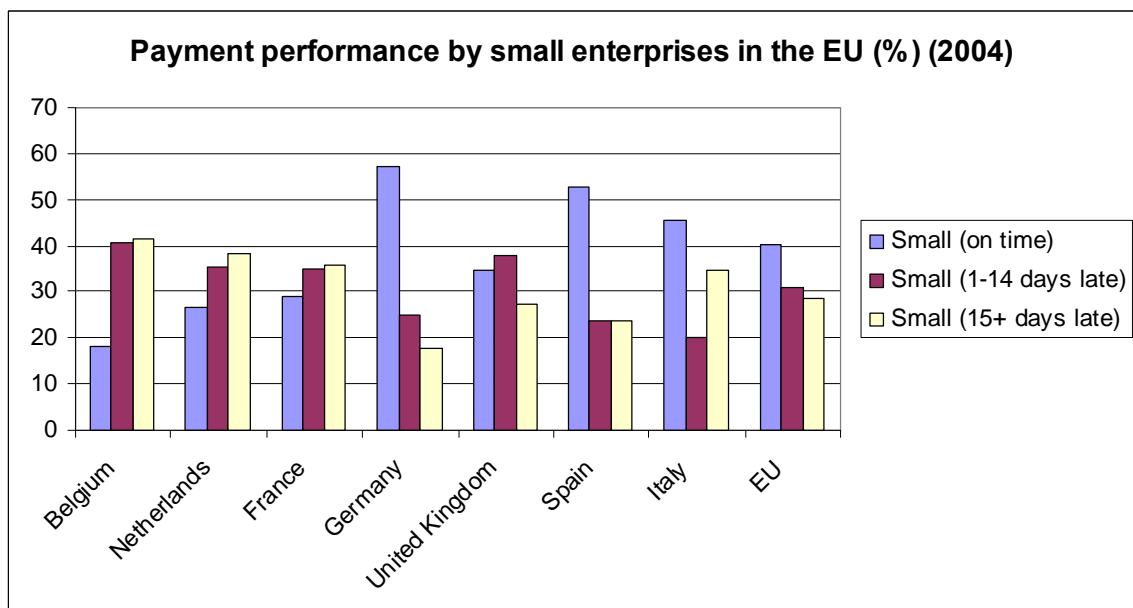
Figure 27



Source: Dun and Bradstreet Survey

Payment performance by small enterprises in the EU is shown in Figure 28. The chart shows that, like the average for the EU, small enterprises in Germany, Spain and Italy had the largest proportions of payments being made on time (in decreasing order of importance). Conversely, punctual payments made by small enterprises in Belgium, the Netherlands and France represented the smallest proportion of payments. These enterprises had the largest proportion of payments being effected over 15 days late.

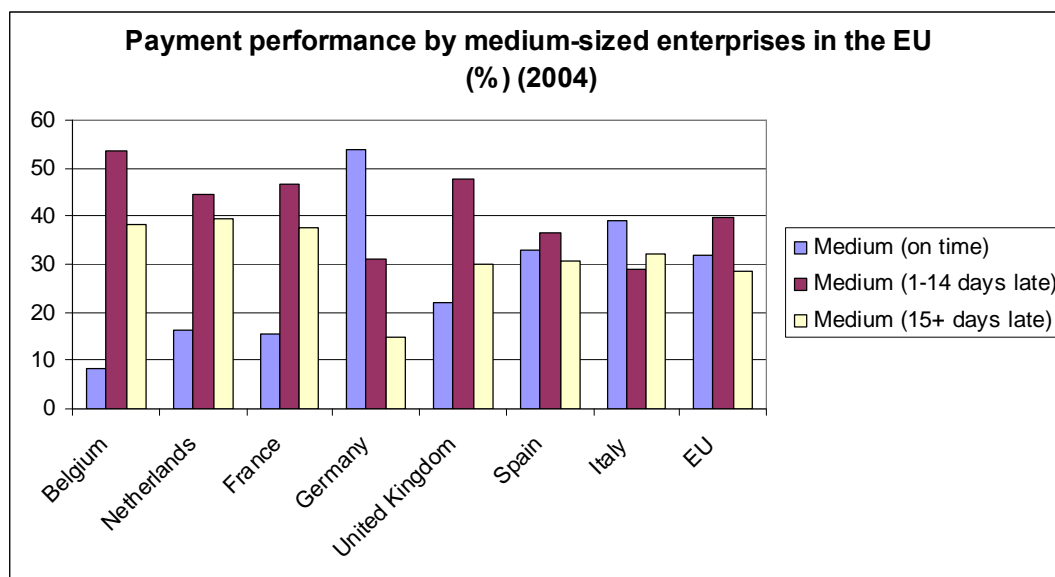
Figure 28



Source: Dun and Bradstreet Survey

Medium sized enterprises in the EU made their payments mostly between 1-14 days late (see Figure 29). Payments made over 15 days late represented the smallest proportion of payments effected. The countries whose medium sized enterprises had the largest proportion of payments being made on time were Germany and Italy. Because the overall figure is low, however, this implies that medium sized enterprises in all countries mostly paid late. Enterprises in Belgium, France and the Netherlands were the worst payers in this regard. German enterprises had the smallest proportion of their payments being made over 15 days late.

Figure 29

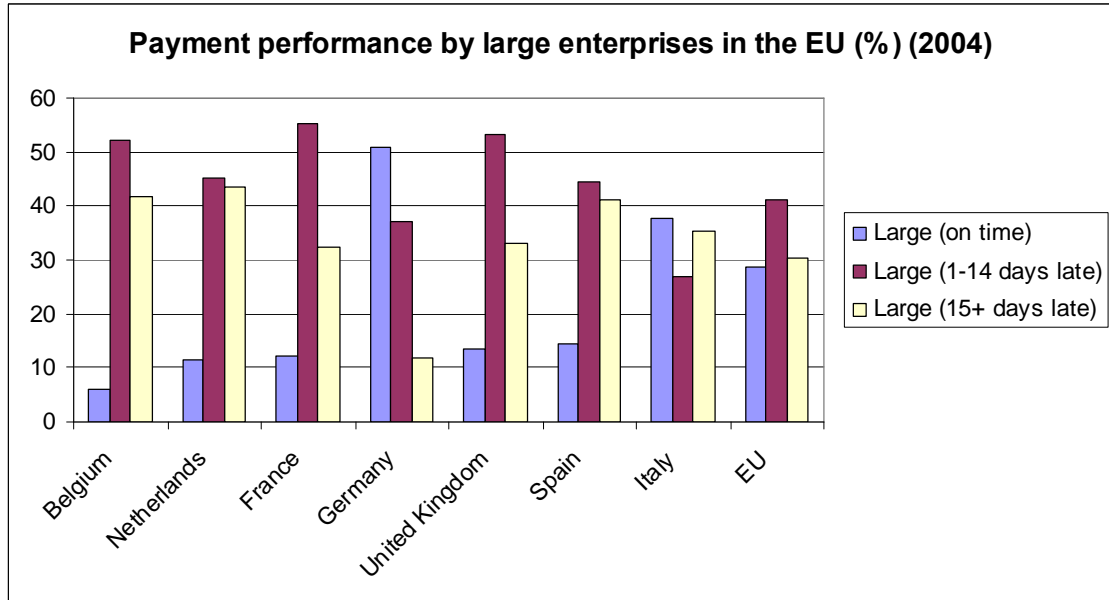


Source: Dun and Bradstreet Survey

A similar situation exists in the case of large enterprises, as can be seen in Figure 30. Again, enterprises from Germany and Italy showed the largest proportion of their payments being made on time. In contrast, large enterprises in Belgium had the smallest proportion. The Netherlands, France, the United Kingdom and Spain also had lower proportions of their payments being made on time. The EU average shows that large enterprises in the EU mostly paid between 1-14 days late. This is reflected mainly in payment practices in France, Belgium, the United Kingdom, Spain and the Netherlands. The EU average shows that the proportion of payments being made over 15 days late was larger than the

proportion of payments being made on time. This reflected payment practices in all countries, except in Germany and Italy.

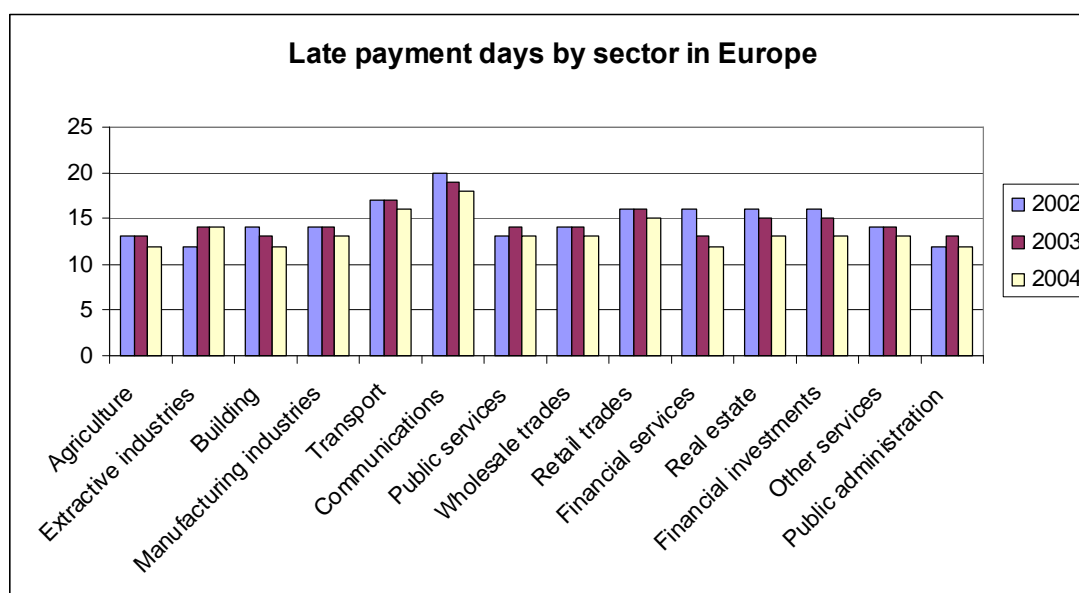
Figure 30



Source: Dun and Bradstreet Survey

Figure 31 shows late payment days by sector in Europe for the period 2002 to 2004. The figure is a very positive one, in that it shows an improvement in late payments in almost all sectors, except for extractive industries. It also demonstrates that late payments are at their highest levels in the communications and transport sectors. Late payments are least common in agriculture, building, financial services and public administration.

Figure 31



Source: Dun and Bradstreet Survey

Following the above assessment of late payment trends in Europe, an assessment for each individual Member State has been carried out and presented to the European Commission⁹³. The depth of analysis and the volume of information provided depend exclusively on the availability of information for any particular Member State. Thus, not all Member States will be analysed to the same degree of detail. Late payment trends and practices in Luxembourg and Malta were not analysed since none of the organisations or institutions which collect data on late payments include these two countries in their surveys.⁹⁴ The Late Payment

⁹³ Report prepared under the supervision of Professor Lino Briguglio and Jean Albert presenting a statistical analysis of payments behaviour, insolvencies and unemployment on a per country basis and submitted to the European Commission on August 31, 2006.

⁹⁴ In the case of Luxembourg, the only information found was from the IBOS-Grant Thornton Survey, which reported that in 2006, the average payment period for sales invoices (contractual terms of payment plus payment delays) was 46. This is lower than the EU average for the same year, which stood at 54.

Directive was implemented in Luxembourg in April 2004 and in Malta in July 2005.

5.1.3 Insolvencies in the EU and their relationship to the evolution of late payments

As observed earlier in the report, SMEs often suffer from an acute lack of liquidity as a result of delayed payments by their customers. This contributes to the risk of insolvency that weighs on many young, small companies. The LP Survey confirms that for 8% of respondents, late payments impact directly and significantly their survival chances. 47% of respondents consider that late payments have an impact on their survival chances

The European Commission considers that long payment periods and late payments are the cause of insolvencies and job losses throughout the EU. This observation explains the resulting Directive.

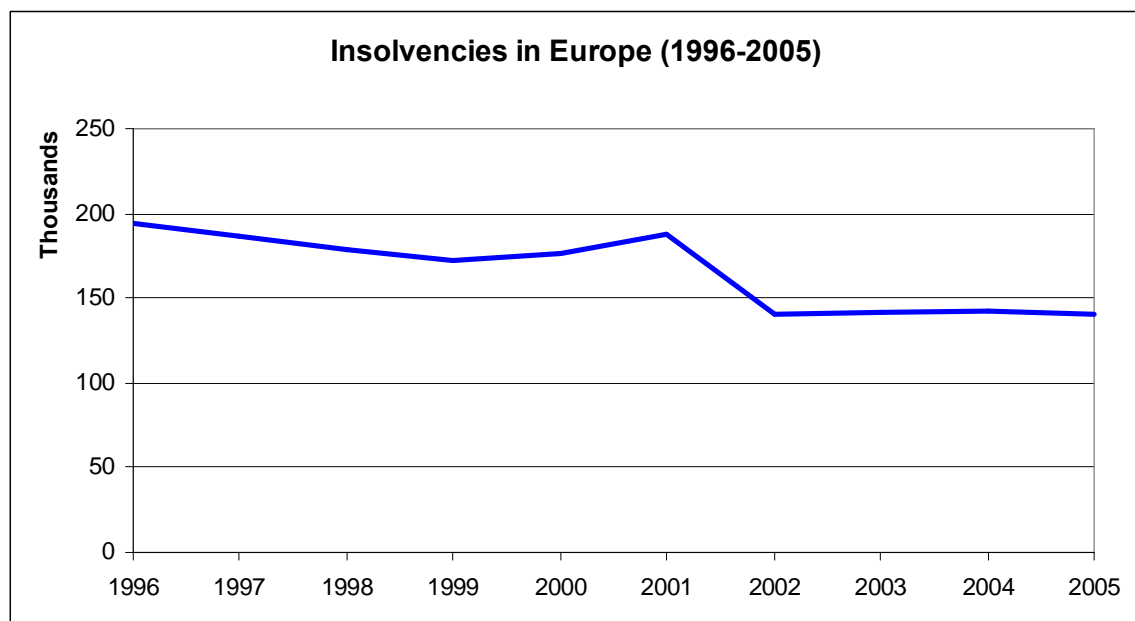
Although as previously stated the impact of the Directive on insolvencies may only be observed over a long period of time, it is important to initiate the process of discerning the relationship between insolvencies and late payments in this Report.

In some cases no reductions in insolvencies will be observed. This does not imply that the Directive had no effect, but rather that insolvencies may fall in the future due to the lag effect of the Directive's impact on late payments.

Further, insolvency statistics are particularly unreliable. This is not due to those who compile them but because of the significant differences that exist between Member States in respect to the concept of insolvency and how insolvencies are dealt with. For example, an analysis of the insolvencies in each Member State shows that insolvency levels are very high in Austria and Luxembourg and very low in Spain and Greece. This seems surprising. As an explanation, it should be noted that in Spain, companies which are insolvent are rarely declared so legally because court proceedings are too expensive. As a result there are few cases of insolvencies in Spain and many "corporate ruins". It is thus difficult to propose a

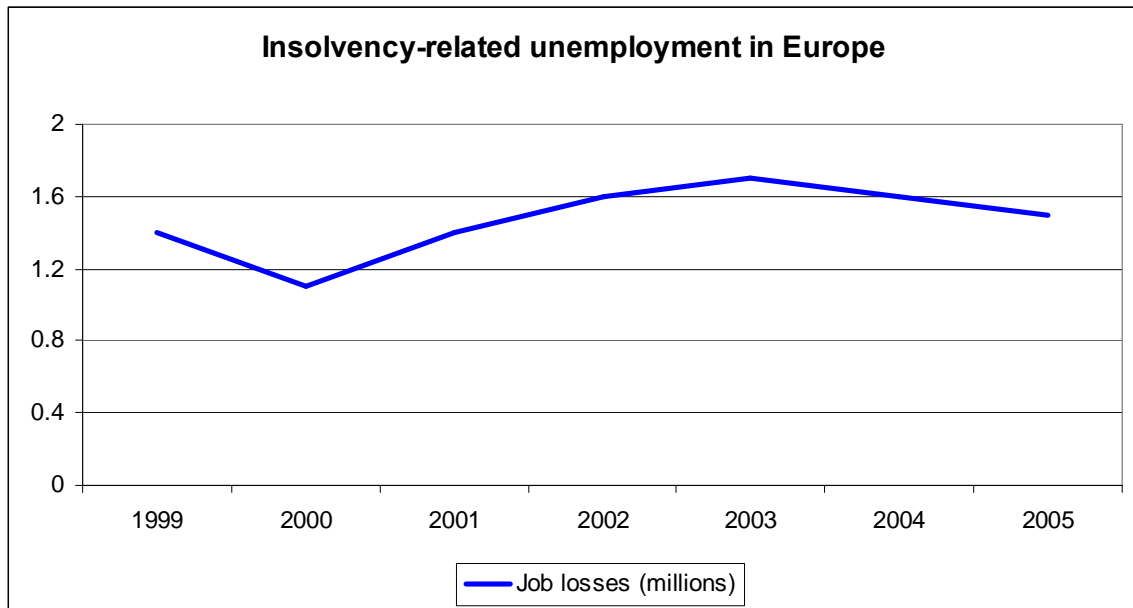
precise comparative study of insolvencies in Europe. However, chronological comparisons can assist in evaluating general trends provided methods of appreciating insolvencies have not changed.

According to data from Creditreform Economic Research Unit, there was a considerable drop in insolvencies in 2002 in the EU, from around 200,000 to approximately 150,000. Business insolvencies were relatively constant during the period 2002 to 2004, but they dropped further during 2005.



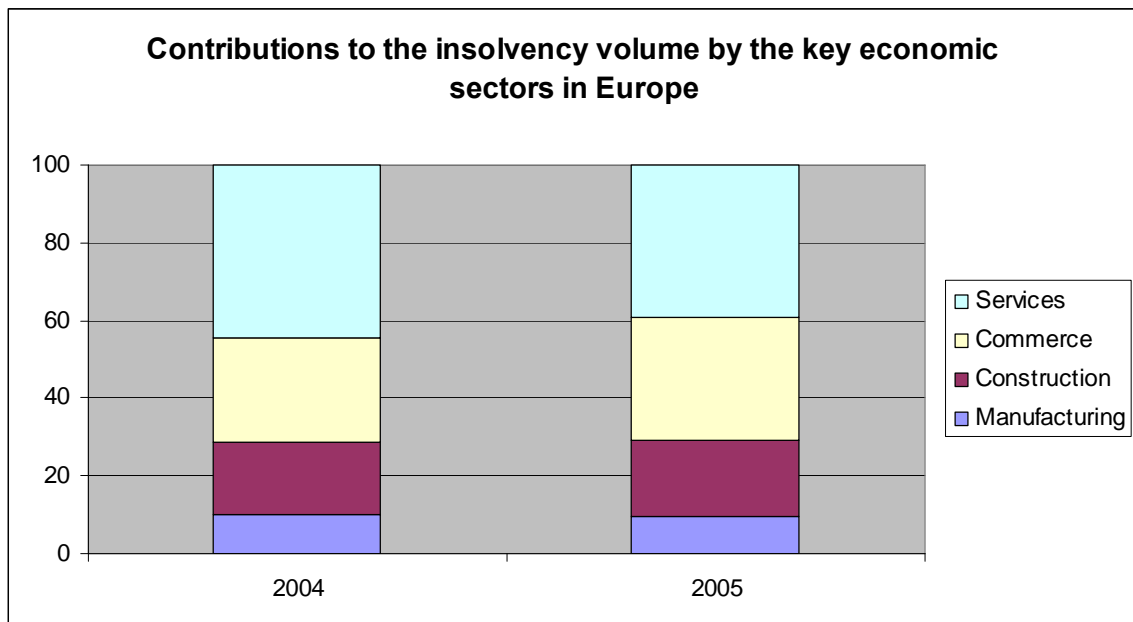
Source: Creditreform Economic Research Unit

As a result of the drop in insolvencies, insolvency-related unemployment has been falling since 2003, after rising since 2000.



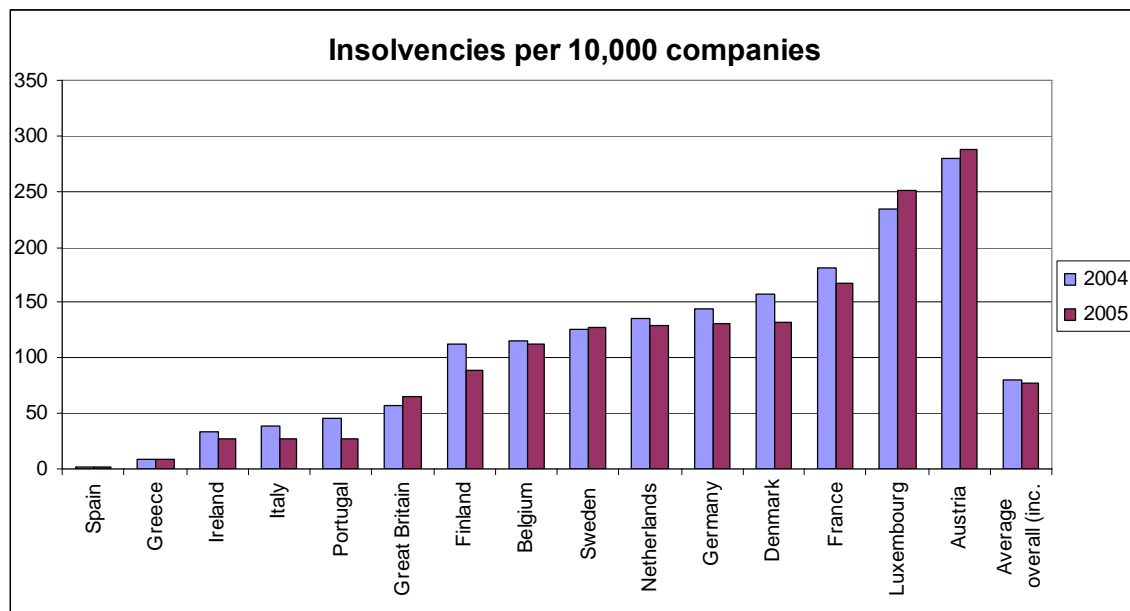
Source: Creditreform Economic Research Unit

The figure below shows that over 60% of insolvencies arise in the services sector. Commerce, construction and manufacturing follow in order of importance. This is interesting because the services sector is not particularly point-pointed as a late payments burdened sector.



Source: Creditreform Economic Research Unit

Comparing the insolvency figures for 2005 to those in 2004 shows an improvement, i.e., a reduction in the number of insolvencies per 10,000 companies. The largest reductions occurred in Finland and Denmark, while the largest relative reduction took place in Portugal.



Source: Creditreform Economic Research Unit

5.1.4 EU unemployment and the relationship with the late payments evolution

One of the economic and financial rationales for the adoption of the Directive is essentially to reduce the number of insolvency related job losses across the EU due to late payments. In the nineties, late payment related insolvencies were reported to have led to the loss of 450,000 jobs each year, thus increasing the level of unemployment in the EU⁹⁵.

This section presents the evolution of unemployment levels in the EU in the last few years. It also tries to draw parallels between this evolution and the progression of bankruptcies and by extension late payments in the EU over the same period.

⁹⁵ See European Commission 1997 Report.

It should be noted however, that it is very difficult to assess whether the Directive has had any impact on unemployment levels across the EU or in any of the Member States. First, the Directive is a recent regulation only implemented in the new Member States after 2004. Second, the Directive's impact on unemployment is neither expected to be direct nor significant even in the long term. Third, and related to the second point, unemployment rates are influenced by myriad factors pertaining mainly to the economic activity of the country in question, the structure and flexibility of the labour market and specific active and passive policies adopted by each of the Member States.

A high unemployment rate constitutes a great challenge for economic policy makers and the Directive may only have an indirect long term effect on employment. Indeed, following the 2000 EU summit titled the Lisbon Agenda the EU agreed that measures aimed at tackling unemployment will have to address the structural nature of the problems related to it.

The unemployment rate in the EU-25 fell to 8.7% in 2005. In 2005, the unemployment rate in the EU-15 dropped to 7.9%, compared to 8.1% in 2004. This is a sign that measures are starting to have an effect. However, drawing a parallel between the Directive's impact on late payment levels and a drop in the unemployment level might be overstating the case.

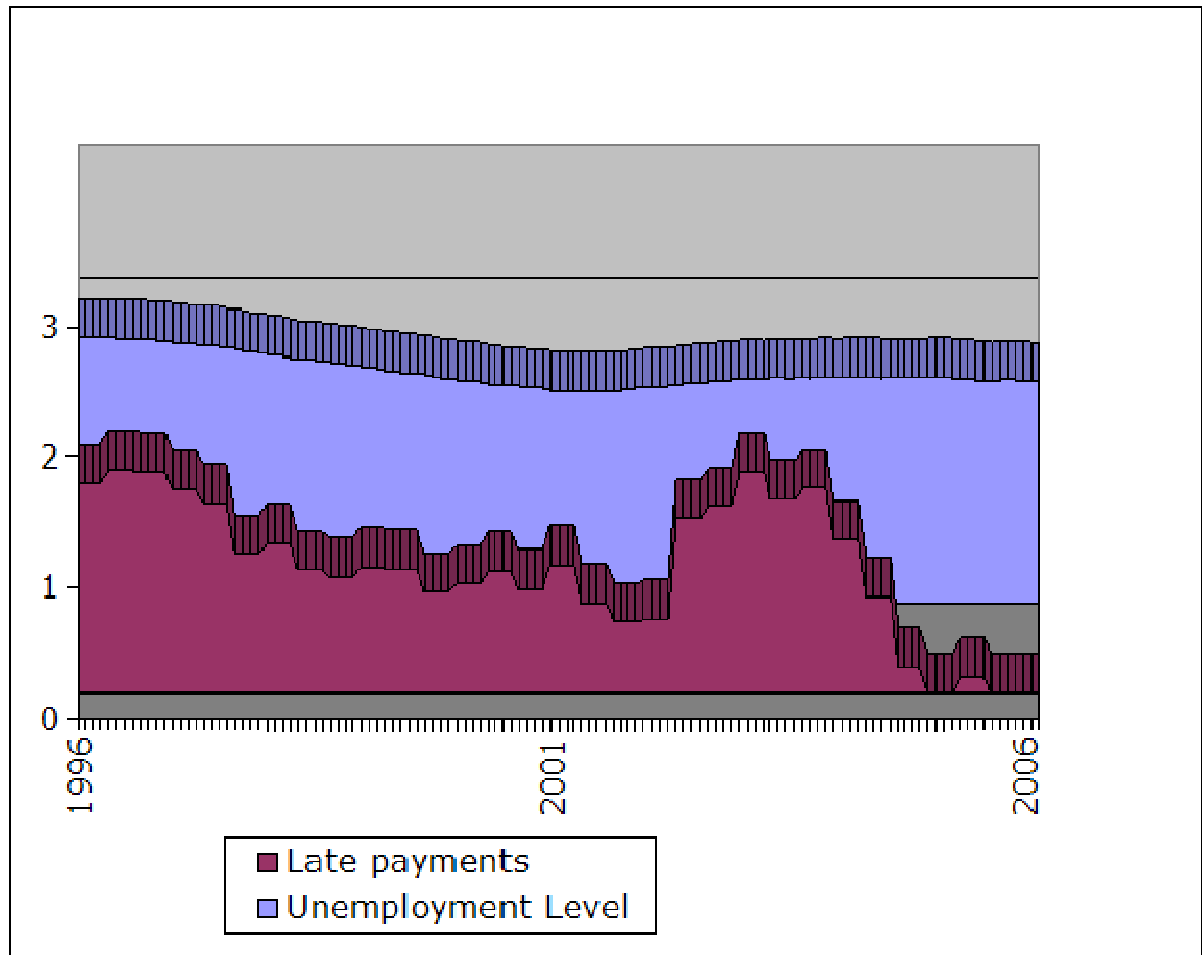
However, parallels may be found between levels of late payments, unemployment and insolvencies in respect to the economic cycle. Economic slow-downs tend to produce high numbers of insolvencies, high late payments and payment default levels as well as rising unemployment⁹⁶.

The table below shows the late payment level and the unemployment level curves. The latter curve is shown in blue⁹⁷. The period covered is from 1998 to 2005. In general, late payment trends seem to change ahead of unemployment trends, indicating that there may be a relationship between the two. However,

⁹⁶ Although, payment periods may be lengthened in economic acceleration cycles with the increased activities compensating for what would otherwise lead to cash-flow strains for SMEs.

⁹⁷ Compiled from Dun and Bradstreet and Eurostat information. These are general trends as the Dun and Bradstreet information does not include all 25 Member States. 1 unit of Unemployment rate for the 25 countries = 10%. 1 unit of Late Payments = 10 days with 0 = 12 days.

it is not possible to conclude from this that one has influenced the other. Rather, it probably shows different sensitivities to economic cycle changes.



These country-by-country analyses indicate that unemployment is essentially high in the five largest economies of Western Europe, namely Greece, France, Germany, Italy and Spain. However, two of the new Member States, namely Slovakia and Poland, have registered extremely high unemployment rates of 16.3% and 17.7% respectively.

In 2005, the lowest unemployment rates in the EU were registered in Ireland (4.3%), Luxembourg (4.5%), Netherlands (4.7%), United Kingdom (4.7%) and Denmark (4.8%). Unemployment rates were highest in Poland (17.7%), Slovakia (16.3%), Greece (9.8%) and France (9.5%).

Among the Member States, fourteen registered a drop in the unemployment rate from 2004; seven registered a higher unemployment rate, while the rate remained unchanged from 2004 in four of the EU Member States.

Unemployment levels in the EU have decreased in the last three years, and so have late payment levels. One could draw a parallel between these and conclude that the Directive has had a direct positive impact on unemployment. But as stated earlier, unemployment levels find their causes in many more factors than just a single piece of legislation.

The level of late payment may, as one of these factors, have contributed to a business environment likely to foster on the one hand more job creation, and on the other fewer job losses. However, more than the direct effect if any that measures such as the Directive may have on insolvencies and unemployment, it is the culture that the Directive inspires that will have the greatest impact yet.

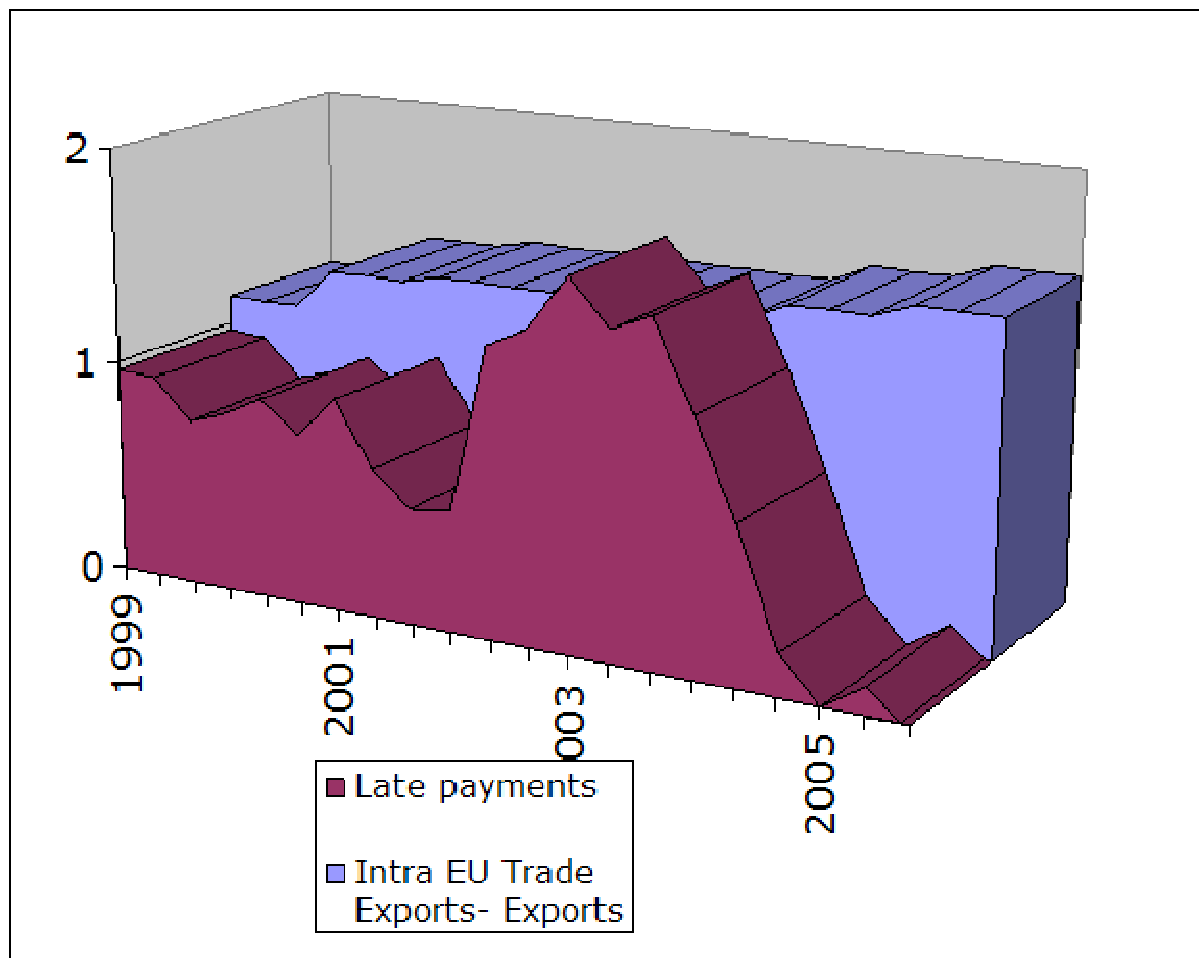
The Lisbon Agenda sets a focus on growth and employment, with particular emphasis on shaping the policies allowing business across the EU to create more and better jobs. It is within this context that the Directive must be understood and where its most direct economic impact lies. It **contributes to creating the business culture** that will foster more and better jobs. A culture of systematic breach of contract and grossly unfair clauses creates uncertainties, extremely short term benefits for debtors, stress and low morale for business owners. The Directive contributes to a culture where the ideals of entrepreneurship, accountability and ethical engagement in business prevail, and in which SME confidence levels can rise to create the virtuous circle that limits insolvencies and unemployment increases⁹⁸.

5.1.5 Cross border trade, the Single Market and the late payment levels evolution

As stated earlier the Directive aims at facilitating cross-border trade. By harmonizing legislation in the field of late payments the European Commission sought to reassure SMEs on the payment terms they could expect. As shown in

⁹⁸ *Perpective de l'OECD sur les PME*, 2002, p. 19.

the graph below, intra-EU cross border commercial transactions have increased steadily in the last few years⁹⁹. Where late payments levels decreased most corresponds to a period of pick-up for EU intra-trade. This observation should be mitigated though, as a survey performed in late 2004 in the UK found that payments issues remained a deterrent to intra EU trade¹⁰⁰.



In a survey carried out by Intrum Justitia in 2004, it was observed that more than 9000 companies interviewed in 22 European countries had indicated that payment uncertainty was seen as the major obstacle for cross-border trade.

⁹⁹ Data sourced from Eurostat. 1 unit of Intra EU Trade for the 25 countries = 1000 million Euros. 1 unit of Late Payments = 10 days with 0 = 12 days.

¹⁰⁰ Better Payment Practice Group updates advice for exporters, Press Release 30.11.2004.

According to the LP Survey, the issue of late payments has a bearing on the decisions of 46% of companies surveyed when they consider working with companies from other countries of the EU.

This section attempts to assess whether intra-EU trade has in any way been affected following the adoption of the Directive. However, a quantitative assessment of this potential influence on intra-EU trade is not possible since the directive has not been in force for a sufficient period of time to establish a qualitative assessment. Moreover, there are a number of other factors such as individual country development, economic growth and the value of the Euro vis-à-vis other currencies, which also influence the level of intra-EU trade.

Despite these difficulties, an attempt is made in this section to analyse the development of intra-EU trade over the span of seven years by means of a graphical assessment. Following Eurostat statistics, in general both imports and exports have increased over the entire time span. The growth rate of intra-EU exports and imports, while positive, did slow down after 2000 but picked up after 2004 as the global economy began to revive.

Further, country by country analysis indicates that for countries which adopted the Late Payments Directive in 2002, intra-EU exports increased after 2002. In fact countries such as Estonia, Greece, Sweden, France, Netherlands and Italy, experienced a higher growth rate in intra-EU exports in 2003 compared to the previous year. However as stated previously, while the late payments directive may have had a positive influence in fuelling intra-EU exports, there are also other factors which may have had a bearing. However, holding all other factors constant and assessing the direct relationship between intra-EU exports and the late payments directive requires a longer data series.

For other countries such as Finland, Hungary, Denmark, Ireland, Austria, the United Kingdom and Belgium, intra-EU exports seemed to pick up at a faster pace in 2004 implying a possible lag between the time when the directive was imposed to the possible eventual effect on intra-EU exports.

Other countries adopted the late payments directive in 2003 and 2004 respectively. In general intra-EU exports for these countries continued to

increase, with some countries such as Poland and Slovenia experiencing a faster growth rate in their intra-EU level of exports after adopting the directive.

However as stated beforehand, these observations cannot be given too much weight in that there are a number of other factors which influence intra-EU trade, and therefore it is difficult based on this type of analysis to link late payments and intra-EU trade. In fact a counter argument to the one presented above is that a comparison of the results of a survey carried out by Intrum Justitia in 1997 and 2004 indicates that the average payment delay has become paradoxically two days longer. Therefore it is highly unlikely that the increase in intra-EU exports is due to the late payments directive. Moreover while the late payments directive has been in place for almost four years for some of the Member States it does not in any way imply that the transposition regulations actually benefit SMEs.

5.1.6 Economic activity and the relationship with the late payments evolution

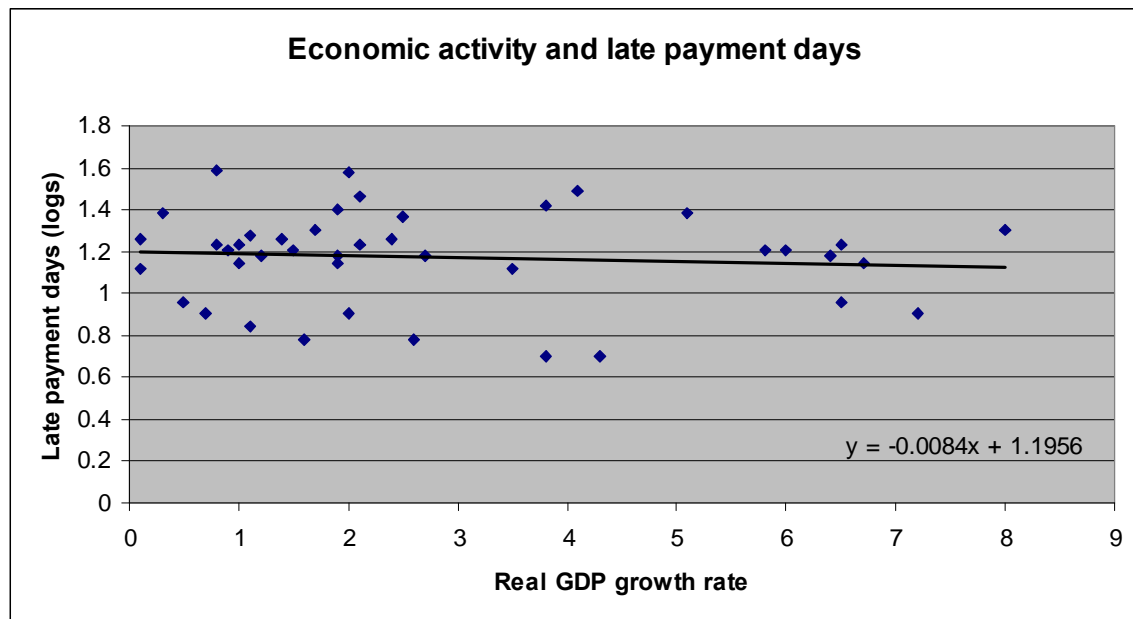
It is often contended that changes in late payments could be due to economic activity. More specifically, it is thought that when economic activity is buoyant, late payments will be low, and that when economic activity is weak, late payments will be high.

In the LP Survey, over half of the respondents said that they believe that late payment practices are unrelated to economic cycles.

Furthermore, almost two-thirds of the respondents believe that low banking interest rates have a positive effect on late payments.

Economic activity has been rather weak in the EU in recent years. In fact, after increasing till 2002, the real GDP growth rate dropped. Although it rose in 2006, the real GDP growth rate was still lower than the 2002 figure. This may imply that late payments might have experienced a greater reduction since 2002 had there been greater economic activity.

Indeed the figure below indicates that economic activity is negatively related to late payment days. The chart is a scatter diagram of cross-sectional data for late payment days and real GDP growth, for a number of EU states for the period 2003 and 2004. Data for late payment days is from the European Payment Index, while the real GDP growth rate is from Eurostat. Possibly, a stronger relation could have been achieved had a longer time span been available for study.



Source: Eurostat, European Payment Index

5.1.7 Other reasons that could explain the evolution of the situation relating to late payments in recent years

5.1.7.(a) Improved credit management

Late payments may have fallen in recent years due to improved credit management techniques and more efficient measures taken by companies to protect themselves against bad debts.

Atradius conducted a survey on this. It asked the following question: Do you or does your company take deliberate steps to protect yourself from payment risks? Around 70% of the companies surveyed responded that they take measures to protect themselves against bad debts. Companies from Germany and the Netherlands protect themselves most frequently, while companies from Belgium and Italy protect themselves most seldom. The report states that there are no

significant differences between smaller and bigger companies or between companies from different sectors.

The Atradius Payment Practices Barometer shows that 29% of all companies protect themselves with credit insurance, while 19% of the companies use advance payment or cash payment. Given a usage rate of 9% each, protection using internal or external collection companies is also a frequently used measure.

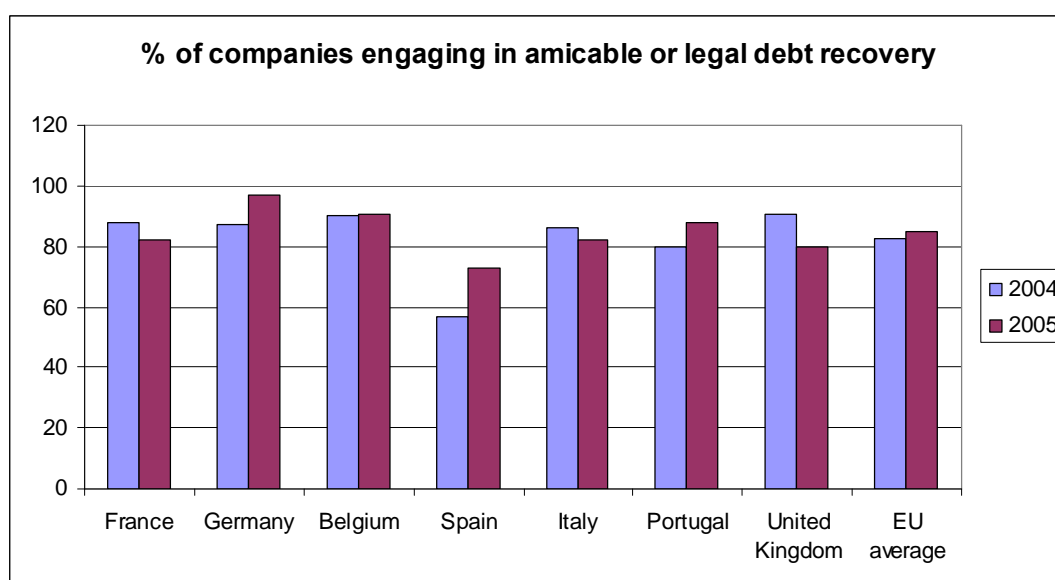
An analysis of the measures used by the six EU member states covered by the survey indicates that 23% of the Belgian companies in the survey use credit insurance to protect themselves against bad debts, with other measures being of minor importance. In the Netherlands, credit insurance is the most commonly used measure of protection, however, in comparison to other countries the proportion of companies which protect themselves through the use of collection services (internal or external) is quite high. In Italy, credit insurance is used by fewer companies than in other countries as a measure of protection against bad debts, while advance payments and cash payments are of greater importance. In France, credit insurance is the most commonly used measure of protection against bad debts, with a high proportion of companies protecting themselves by legal measures. In Great Britain, the credit insurance instrument is of outstanding importance, with the gap between credit insurance and other possible measures being bigger than in all other countries in the survey. Companies from Germany use advance payment or cash payment more frequently than companies from other countries. It is striking that in Germany the total sum of protection measures is particularly high. In other words, German companies employ more measures to protect themselves than companies from other countries.

The Eurofactor survey also gives an indication of the efforts made by companies in EU Member States to protect themselves against late payments.

Many EU Member States are resorting to external services to manage customer accounts, as can be seen in the figure below. The largest increase was recorded by Portugal, while France, Germany and Italy registered a reduction in external services used.

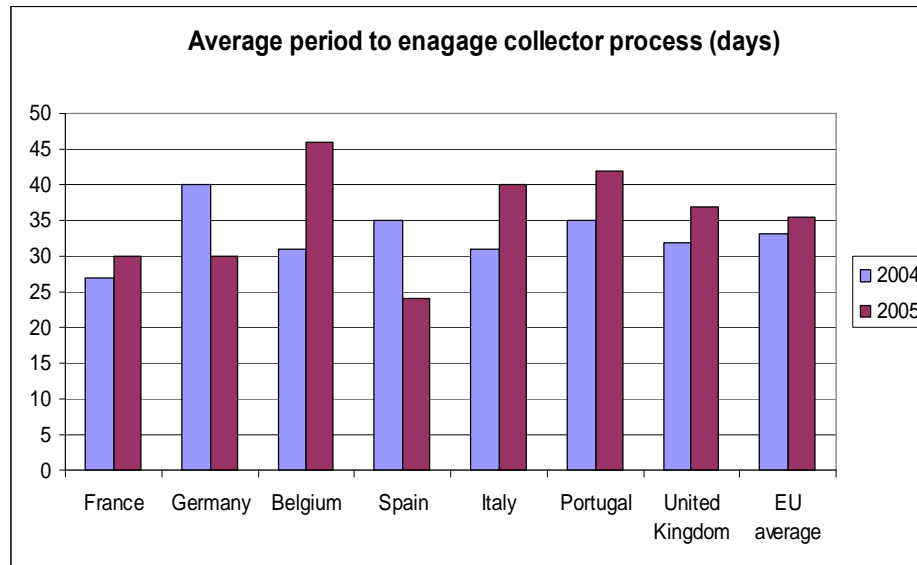
It is estimated that the cost of managing customer accounts varies by a ratio of one to three, according to the country. In France and Belgium, it comes to 1% of turnover, in the United-Kingdom 1.5%, Spain 1.6%, Germany 1.7%, Portugal 2.3% and Italy 2.8%. It increased in all countries in 2004.

When it comes to recovery of debts, more than 8 firms out of 10 in each country declare that they have undertaken an amicable or contentious procedure in 2005, almost the same as a year earlier. Spain has the lowest percentage of firms, although this has gone up significantly when compared to 2004. In Germany almost all companies are engaged in amicable or litigious debt recovery.



Source: Eurofactor Survey

The collection process is launched approximately 35 days after the theoretical due date, up slightly from 2004. The period is shortest in Spain, at less than 25 days and longest in Belgium at over 45 days. It should be noted that during 2005, Spain experienced significant gains in efficiency, while Belgium registered losses, according to the results of the Eurofactor Survey.



Source: Eurofactor Survey

5.1.7.(b) Providing information and organising surveys as tools to promote good business practices

The Directive has had an impact on the way late payments are perceived in the EU. They are not considered normal or acceptable anymore. Another fundamental element of the cultural change is the development of good commercial practices¹⁰¹.

- **Information**

Numerous professional associations¹⁰² have distributed information to their members regarding late payments and their rights as a result of the Directive and transposition measures. The adoption of the Directive like the national transposition measures has been largely relayed by such organisations.

¹⁰¹ *Application of the Directive on Late Payments in the Construction Sector*, FIEC, 12.12.2005. p. 4.

¹⁰² For example Charter adopted on March 11, 2004 by the Comité Interprofessionnel des Fournisseurs du Laboratoire.

FIEC (European Construction Industry Federation) carried out a survey¹⁰³, on a European level to assess the application of the Directive in the construction sector¹⁰⁴. This initiative is not isolated¹⁰⁵.

In many instances, these professional bodies represent both creditors and debtors as their representation is sector driven. This is important because it explains their positioning in respect to payment periods and their methods to deal with the issue.

In France, a survey of representative organisations found that 75% of these distributed information concerning the question of payments periods¹⁰⁶ to their members.

In addition, both the Member States¹⁰⁷ and the European Commission widely disseminated information on the question of late payment. The Commission even published a practical guide for companies¹⁰⁸.

Some Governments have gone beyond this to provide extensive and practical information on how to collect debts owed. In the UK, the Government provides a guide on the steps to collect a debt¹⁰⁹.

¹⁰³ *Application of the directive on Late payments (2000 :35/EC) in the construction sector*, Survey carried out by FIEC, 12.12.2005. p. 4.

¹⁰⁴ Participated in the survey :

For Germany : HDB (Hauptverband der Bauindustrie), ZDB (Zentralverband des Deutschen Baugewerbes) and EFFC (European Federation of Foundation Contractors);

For Spain : SEOPAN (Asociacion de Empresas Constructoras de Ambito Nacional) ;

For France : FFB (Fédération Française du Bâtiment), FNTP (Fédération Nationale des Travaux Publics) ;

For Finlande : RT (Rakennusteollisuus RT) ;

For Italy : ANCE (Associazione Nazionale dei Costruttori Edili), AGI (Associazione Imprese Generali) ;

For Ireland : CIF (Construction Industry Federation) ;

For Portugal : AECOPS (Associação de Empresas de Construção e Obras Publicas) ;

For the UK : CC (Construction Confederation).

¹⁰⁵ See for example, EDMA Late payments in Europe for IVDs, Days of Outstanding Sales, 2005.

¹⁰⁶ Professeur Michel GLAIS, *Etude sur les délais de paiement pour la Commission d'Examen des Pratiques Commerciales*, février 2005.

¹⁰⁷ See for example :

http://www.finances.gouv.fr/directions_services/eic/dossier/archives/retpai.pdf

¹⁰⁸ http://ec.europa.eu/enterprise/regulation/late_payments/leaflet_fr.pdf

¹⁰⁹ <http://www.businesslink.gov.uk/>

In the UK the Better Payment Practice Group (“BPPG”) has been created to fight late payments. This organisation originally worked with the Credit Management Research Center of the University of Leeds to find ways to identify and disseminate information on best practices amongst small businesses¹¹⁰. The BPPG is supported by a number of major companies. It can be found at www.payontime.co.uk and provides information on the following:

- Late payments in general¹¹¹ ; and
- Consequences of late payments.

Above all, the site provides for online calculation of penalties in case of late payment.

In Spain, an online magazine called DSO ESPANA NEWS was started on September 19, 2006. This effort is headed by Professor Pere J. Brachfield¹¹². The magazine’s objective is to provide information on financing, cash-flow management, credit management and debt recovery.

- **Recommendations**

- 30 day contractual delays

The Comité Interprofessionnel des Fournisseurs du Laboratoire (“CIFL”), for example, recommends that its clients progressively reduce their payment periods to 45 days by the end of 2004 and 30 days by the end of 2005¹¹³. Group of Electronic Materials and Security industries (“GIMES”)¹¹⁴ recommends a similar reduction schedule.

¹¹⁰ SME Outlook, OECD, 2002, p. 213.

¹¹¹ http://www.payontime.co.uk/downloads/late_payment_brochure.pdf

¹¹² Professor of Credit Management at the Escuela de Administración de Empresas and Director of Centro de Estudios de Morosología de EAE.

¹¹³ Charter adopted on March 11, 2004 by the Comité Interprofessionnel des Fournisseurs du Laboratoire.

¹¹⁴ Charter on late payments adopted November 21, 2002 by GIMES.

Article 2. « *Le calendrier à respecter La réduction des délais de règlement devrait se faire progressivement et suivre l'échéancier suivant :*

- 1er janvier 2003 : aucun nouveau contrat stipulant un paiement au-delà de 65 jours

- 1er janvier 2004 : aucun nouveau contrat stipulant un paiement au-delà de 30 jours

Conformément aux récentes dispositions législatives, il est convenu que le point de départ du délai de paiement court à compter de la date de réception des marchandises ou d'exécution de la prestation demandée. »

The 30 day contractual payment period is now widely accepted¹¹⁵.

A dedicated survey of professional organisations carried out specifically in France shows that 45% of the organisations canvassed have forwarded such recommendations regarding payment periods to their clients¹¹⁶.

- Maximum payment delays and other practices constituting abuse

Some professional organisations have adopted codes of conduct which state that payment terms which go beyond their recommendation are considered abuses¹¹⁷.

These codes of conduct or charters often include the following prescriptions.

- Obligation of debtor not to change or impose changes on agreed terms;
- Avoidance of practices that extend payment periods artificially such as long acceptance periods, or contesting invoices at the end of a payment period;
- Limitation on the acceptance or verification periods to the minimum, with the provision that beyond 15 days the goods or services are deemed accepted;
- Limitation on the use of creditor imposed discounts for prompt payments;
- Avoidance of limits on the applicability of the retention of title provision such as in cases of part payment.

¹¹⁵ See Opinion n° 2004-03 of the Commission on Commercial Practices in respect to the Union des Producteurs de Granulats's proposal for a recommendation on payment delays and in particular Article 1 of its Charter which states « *Objectif : un délai de paiement de 30 jours.* »

L'UNPG recommande aux producteurs de granulats de réduire dès à présent et progressivement les délais de paiement dont ils conviennent avec leurs clients pour se rapprocher à terme d'un délai de 30 jours. L'UNPG rappelle qu'à ce jour, en l'absence d'un délai contractuel particulier, le délai de paiement supplétif est de 30 jours. »

¹¹⁶ Professeur Michel GLAIS, *Etude sur les délais de paiement pour la Commission d'Examen des Pratiques Commerciales*, février 2005.

¹¹⁷ See Opinion n° 2004-03 of the Commission on Commercial Practices in respect to the Union des Producteurs de Granulats's proposal for a recommendation on abusive payment delays « *L'UNPG considère que tout délai de paiement supérieur à 70 jours à compter du 1^{er} janvier 2006 devra être considéré comme abusif.* »

See also Charter on late payments adopted November 21, 2002 by GIMES which states in its Article 3 « *Le G.I.M.E.S rappelle qu'en considération des nouvelles dispositions législatives, tout délai de paiement supérieur à 65 jours nets doit être aujourd'hui considéré comme abusif* ».

- **Management**

Credit and collection agencies have techniques aimed at reducing the payment periods and regularly offer credit management advice to their clients¹¹⁸. These include the following.

- Optimisation of credit management techniques and processes to reduce late payments and litigation ;
- Setting up procedures and using software for the monitoring and collection of debts;
- Promoting increased use of the electronic means of payment;
- Defining credit rating techniques;
- Payer profiling to determine collection strategies;
- Rigorous approach to potential client profiling ;
- Early dispute risks identification and evaluation ;
- Sensitisation of sales forces to contracts terms and conditions and to the ways in which these have an impact on pricing, cash-flow and margin.

Other organisations provide information on how best to manage accounts receivables. The COFACE for example outlines twelve good credit management practice points¹¹⁹:

- *“Ask all new customers to fill in a credit application form (including payment address, accounts payable department contact and acceptance of terms).*
- *Carry out thorough credit checks on all new and existing customers, including county court judgements, trade references, bankruptcy orders (via the Insolvency Service), bank references, credit circles etc.*
- *Ensure the credit management staff contact accounts payable staff from an early stage and establish a business relationship.*
- *If possible, offer incentives for early payment or request part payment in advance before releasing goods to a new customer. Funds can be held in a secure deposit account until the customer is happy.*

¹¹⁸ AFDCC, Enquete AFDCC sur les délais de paiement (septembre 2005).

¹¹⁹ COFACE UK.

- *Make all customers fully aware of payment terms from the first meeting and ensure they are displayed clearly on account application forms, orders, acknowledgments, invoices and statements.*
- *If appropriate, obtain a credit insurance policy to cover against the risk of default, protracted late payment, political risk etc.*
- *Issue clear and accurate invoices promptly (within 24 hours of delivery) and address them to a named individual.*
- *Deal with account queries promptly.*
- *Ensure computer systems are modern, user-friendly and properly updated and that sufficient resources have been devoted to manpower (a trained collector can manage about 600 accounts). Use a reputable collections agency if this is not possible.*
- *Ask the Credit Manager to establish a collections process for credit control staff, setting priorities for collection, a timetable for chasing accounts and the methods to be used, including phone (the most effective), letter, e-mail and possibly visit.*
- *If legal action is required, consult a solicitor sooner rather than later. Do not bluff. Any threats of legal action must be followed up to avoid perceptions of weakness.*
- *Set targets for DSO, Aged Analysis and cash collected; monitor the results and compare to previous months.”*

In the UK the BPPG launched a national campaign ‘Collect the Cash’ encouraging small businesses to make trade credit management and debt collection their number one priorities. To help smaller businesses on credit management techniques, on the business benefits of monitoring trade credit and getting their invoices settled promptly, the BPPG launched a free guide which shows the practical uses of the late payment legislation for credit management. The guide has been regularly updated over the years and a credit management wall-chart was compiled in 2004. To date more than 200,000 guides and wall-charts have been issued by BPPG.

Further, BPPG regularly conducts surveys on late payments and on how to obtain prompt payments from clients. In one of its surveys it found for example that late invoicing increased the risk of late payment¹²⁰.

¹²⁰ *Tardy invoicing puts businesses at risk from late payment* finds the Better Payment Practice Group, Better Payment Practice Group, Press Release 21.07.2006.

This organisation also proposes assistance to companies that may be exposed to late payments. This includes:

- Online credit management assistance;
- Late payment risk reduction techniques;
- Credit management glossary;
- Cash-flow rules for companies to use¹²¹;
- Regular surveys of payment behaviour;
- Factoring information;
- Interest on late payments calculator;
- Guide to current legislation
- Guidance in choice of collection agency

- **Pressure**

In the UK, the Small Firms Minister sent letters to UK PLC's that have not signed up to the Better Payment Practice Code¹²², encouraging them to show their commitment to prompt payment by becoming a signatory¹²³.

In the UK, PLCs are required by the Companies Act (1985) to disclose commercial bills payment times. It appears however that because such disclosure can be filed together with all other documents related to the annual accounts, it is quasi-impossible to identify which information actually pertains to the payment performance of a company. Pressure is mounting however on finding solutions to ensure that company payment performance is not only available but ascertainable¹²⁴.

- **Goodwill and payment practice codes**

In the UK the BPPG was established to promote a better payment culture.

¹²¹ www.payontime.co.uk

¹²² www.payontime.co.uk

¹²³ Source: Management Accounting: Mar 2000 issue

¹²⁴ See

<http://www.publications.parliament.uk/pa/cm200304/cmhansrd/vo040907/debtext/40907-20.htm>

A payment practice code was developed and is available online¹²⁵. Through the BPPG companies are encouraged to adopt a responsible attitude to paying on time and to abide by four principles:

- “1. Agreeing to payment terms at the outset of a deal and sticking to them;*
- 2. Explaining payment procedures to suppliers;*
- 3. Paying bills in accordance with any contract agreed with the supplier or as required by law; and*
- 4. Telling suppliers without delay when an invoice is contested, and settling disputes quickly”.*

A certificate is given to those who sign up to the code. More than 1500 companies are signatories of this code.

In Spain a similar initiative has been promoted by the “Centro de Estudios de Morosología EAE”¹²⁶ which published the “Ethical Code for the Compliance of Payment Obligations in Commercial Relations”¹²⁷.

- **Government initiatives to strengthen the actions of businesses: the example of France.**

On June 28, 2006, France announced a new policy directed by F. Loos, Minister for Industry and Trade and aimed at improving client-supplier relationships, placing particular stress on the issue of payment periods¹²⁸. This policy followed a large consultation that began on February 1, 2006 in the automobile sub-contracting sector.

The policy includes 5 measures. These are as follows.

- Adoption of an industry-wide good practices charter;

¹²⁵ http://www.payontime.co.uk/whypay/about_the_code.html

¹²⁶ This headed by Professor Pere J. Brachfield, Professor at the Escuela de Administración de Empresas.

¹²⁷ *Código ético de buen cumplimiento de las obligaciones de pago en las operaciones comerciales* at <http://www.foroindeco.com/informes/9-Código%20ético%20pagos%20EAE%20enero%2006.pdf>

¹²⁸ Press Release, 29.06.06.

- Examination of the legislative changes to be undertaken;
- Reinforcement of SME financing opportunities:
 - o Organisation of consultations between the parties to identify the issues and find financing solutions;
 - o Facilitation of debt consolidation using a publicly funded body¹²⁹, OSEO BDPME through a new financial product “AVANCE +” ;
 - o Provide SMEs with information on the financing opportunities at their disposal;
- Help SMEs acquire the most up-to-date communication tools for administrative processes and for internal and external use:
 - o Training and professional advice on accounts receivables management ;
 - o Developing, with public funding, common standards for training, payment methods, and accounts receivables management, and undertaking to facilitate and enhance communications levels between clients and suppliers¹³⁰;
- Re-opening the Observatory of Payment Periods to monitor payment behaviours.
- Educating SMEs on client accounts management including¹³¹:
 - o Organising systematic follow-up procedures;
 - o Anticipating disputes
 - o Using client credit risk techniques
 - o Obtaining and researching information on clients
 - o Evaluating factoring, discounting, and credit insurance.

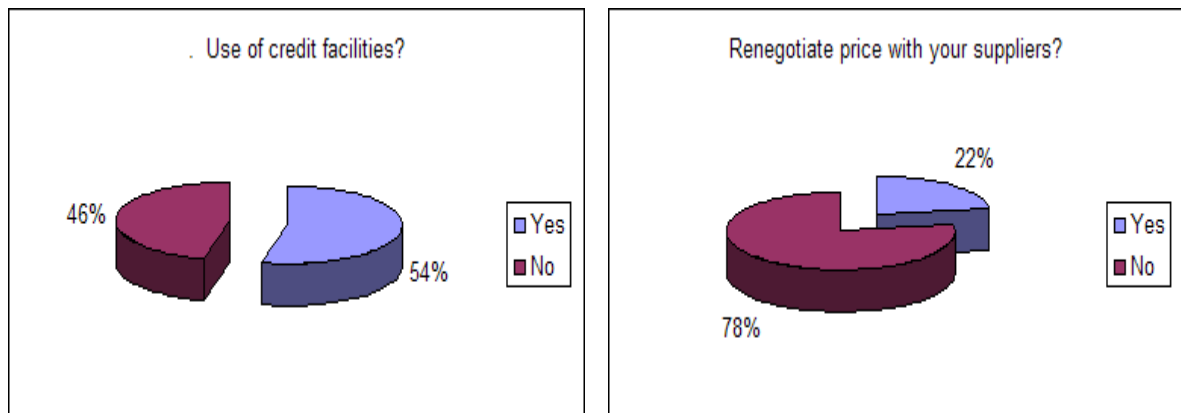
These tools are necessary as the LP Survey shows.

¹²⁹ OSEO was created in 2005 by the French Government. OSEO BDPME, is an affiliate of OSEO that was created to assist SMEs in dealing with debtors and debt recovery.

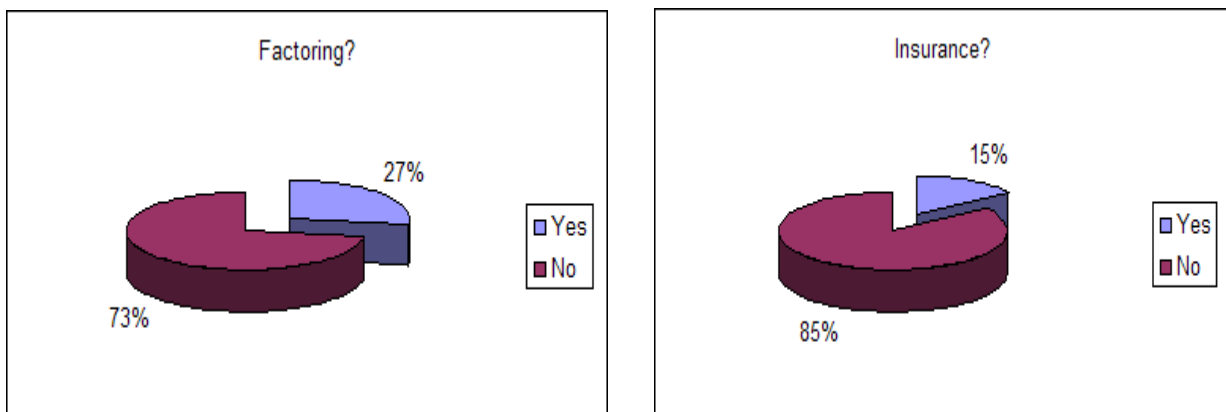
¹³⁰ With support from the State which can go up to 50%, the objective is to develop standards, and software packages for transferring data between customers and suppliers, as well as training modules for this common platform, in particular proposing services relating to the follow-up of dispatch and invoicing using WEB EDI.

¹³¹ Presentation by Fédération Bancaire Française, OSEO BDPME and COFACE.

54% of those surveyed indicated that late payments forced them to use credit facilities. On the other hand, 78% indicated that they have however not renegotiated their prices with their suppliers.



Moreover 73% and 85% indicated that they did not use factoring or insurance as a result of late payments. This indicates that more information on these services should be provided and that SMEs should have better access to them.



- **Government initiatives to strengthen the actions of businesses: the example of the UK**

The UK Government makes a number of interactive tools available to SMEs to facilitate debt recovery¹³². These include the following:

¹³² www.businesslink.gov.uk

- Debt factoring and invoice discounting: the basics ;
- Getting paid on time ;
- Getting paid when selling overseas ;
- Recover debt through court ;
- Avoid insolvency ;
- Recover your debts ;
- Alternatives to bankruptcy ;
- Assess the health of your business.

5.1.7.(c) Enhancing the effect of good practices

- **The need to reinforce the information on late payments**

One UK website provides a “calculator” of interest on late payments whether the interest is based on a contract or on statute¹³³. The calculator takes into account the date the contract was formed, the date payment became overdue, the date of any payment made. This type of calculator should be made available in all Member States.

The website also provides updated information on the current interest rate to be charged.

This information is of great value to SMEs and should be replicated in other Member States.

5.1.7.(d) Limits to good practices codes and the role of representative organisations

Several representative organisations indicate that they do not wish to adopt good practices codes or recommendations, or enforce the Directive’s provision allowing them to go before the courts. Their reluctance is explained by the fact that the European Commission itself, or alternatively national competition authorities, could consider such actions as violations of competition laws.

¹³³ <http://www.payontime.co.uk/calculator/statutory.html>

These fears are not unfounded. Indeed in light of Article 81 of the Treaty:

- A representative organisation or company can include a regrouping of trade associations¹³⁴ ;
- The Commission in the past condemned an agreement on payment periods as a violation of competition law.

The European Commission needs to clarify under which conditions representative organisations may adopt good practices on payment periods.

In the Fedetab case¹³⁵, the European Commission condemned as anti-competitive an agreement between Belgian and Luxembourg tobacco manufacturers belonging to the Belgo-Luxembourg Federation of tobacco industries («Fedetab»). The agreement was aimed at reducing payment periods from 90 days to 15 days. Under the Directive, this type of action would be praised. In the Fedetab case however, the European Commission motivated its decision by deeming that in a sector where no price competition exists, competition in terms of payment periods could play an important part. Could long payment periods be a factor of competitiveness?

According to the Commission :

“86) (e) The decision taken by Fedetab and its members on 23 December 1971 to saddle wholesalers with maximum credit terms reinforced the anti-competitive effect of the other measures taken by them, notably the rule against discounts and rebates. The collective and uniform fixing of terms of payment accorded by the manufacturers to wholesalers directly affected the profit margins of manufacturers, wholesalers and retailers alike, since terms of payment, like rebates and other favours, are reflected in profit margins and, like them, provide a significant opportunity for competition between the various firms operating on a particular market.

(...)

¹³⁴ TPICE, 21 févr. 1995, VSPOB [SPO], aff. T-29/92 : Rec. p. II-289 ; et CJCE, 25 mars 1996, SPOB, aff. C-137/95 P : Rec. p. I-1611

¹³⁵ Déc. Comm. 20 juill. 1978, Fedetab : JOCE n° L 224, 15 août 1978, pt 88

(99) By signing the recommendation, manufacturers undertook to furnish Fedetab, or a body appointed for the purpose, with a list of the wholesalers they supplied ; intermediaries were likewise obliged to supply Fedetab with details of all the purchases they had made in the course of the previous year, so as to facilitate the calculation of their end-of-year rebates. In view of the fact that trade discount rates, end-of-year rebates and terms of payment are all standardized, these practices have the effect of preventing all competition in these three areas between the signatory firms, which are not only fully aware of their competitors' sales policy but are also safe in the knowledge that it is identical to their own.”

A distinction must thus be made between the recommendations which are part of normal functions of representative organisations and those which could be seen as likely to directly or indirectly influence competition within the profession concerned.

The French Conseil de la Concurrence has indicated some flexibility in this respect enabling representative organisations to edict codes of conduct that can include limitations on payment periods¹³⁶. However, it appears unconvinced by the economic benefits of payment periods harmonization¹³⁷. An official and clear undertaking will probably have to be made before any of these organisations work on limiting payment delays. Alternatively, a European Regulation on payment periods may be required.

5.1.8 Conclusion on the economic situation

Since 2002, the year of the Directive's transposition in most Member States, late payments have decreased in the EU. The culture is changing and codes of good practices, information on late payments and better credit management are developing. Payment delays are stagnating and because they are in relative terms more important than late payments, payment periods have only slightly dropped. Based on the statistical information available insolvency numbers have

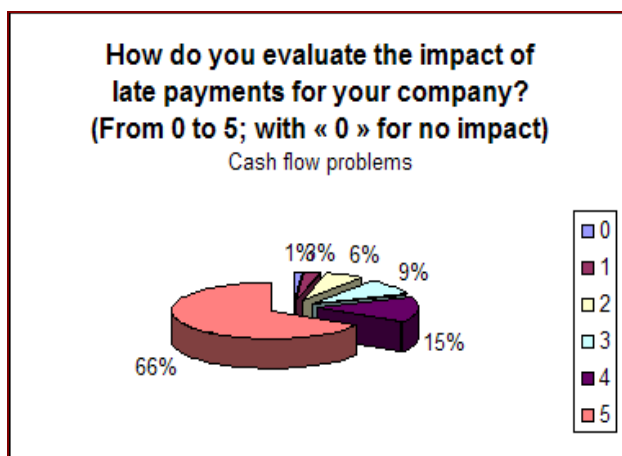
¹³⁶ See Opinion of the Conseil de la Concurrence [n 05-A-17], 22.09.2005.

¹³⁷ See Opinion of the Conseil de la Concurrence, *relatif au recours à la négociation collective en matière de délais de paiement inter-entreprises*, [n 05-A-17], 22.09.2005, at 40.

been generally stable and unemployment levels have dropped slightly. It is still clear however that even though late payment level have dropped, efforts to combat them must continue as companies still suffer from the cost associated with late payments.

In the LP Survey¹³⁸, it appears that the majority of firms (66%) indicated that late payments have an impact on their company operations. Only a very small proportion of those surveyed (1%) indicated that late payments had no impact on their company.

Cash Flow Problems Figure

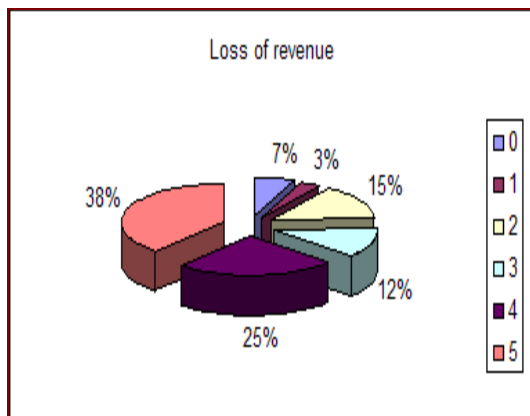


Moreover, according to the companies surveyed, 38% indicated that late payments resulted in a loss in revenue and only 7% indicated that that late payments have no effect on revenue. A good proportion of companies (30%) also indicated that late payments resulted in a loss of growth opportunities.

¹³⁸ See Annexe 2.

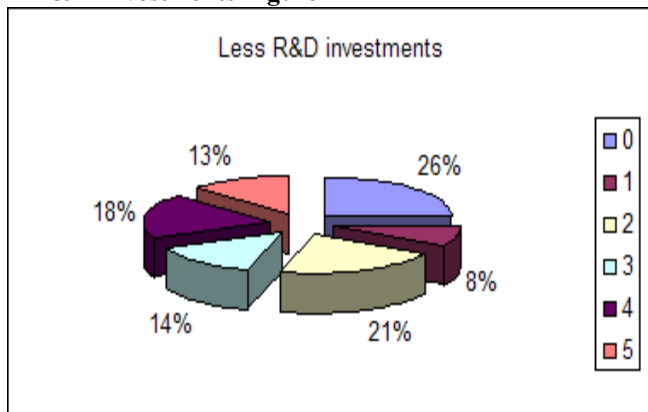
Loss of Revenue Figure

Figure

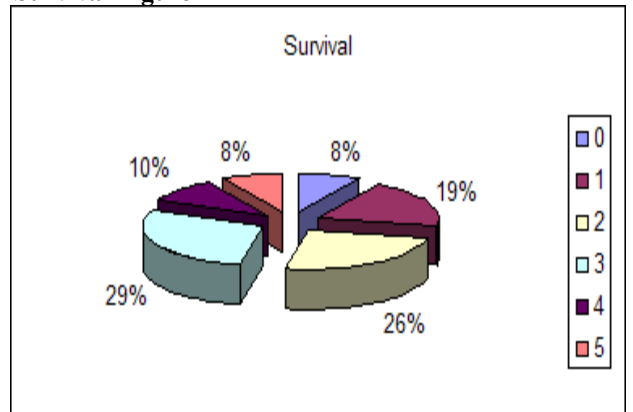


As can be seen from the Less R&D Investments Figure below, 26% of those surveyed indicated that late payments had an impact on research and development investment. At the same time, according to the Survival Figure, a number of firms seemed to be indifferent on the impact of late payments on the survival of the firm.

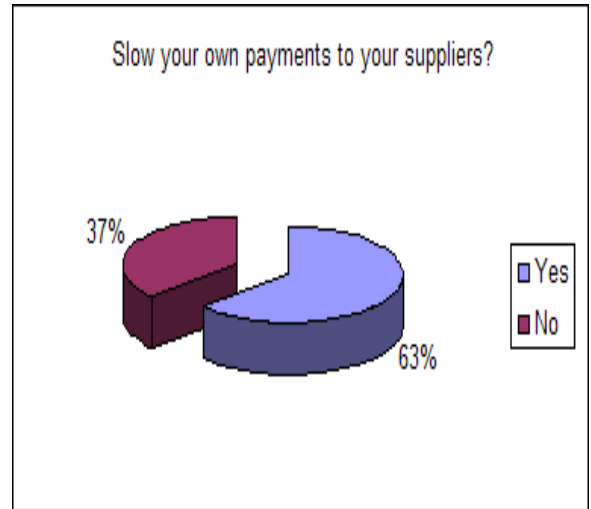
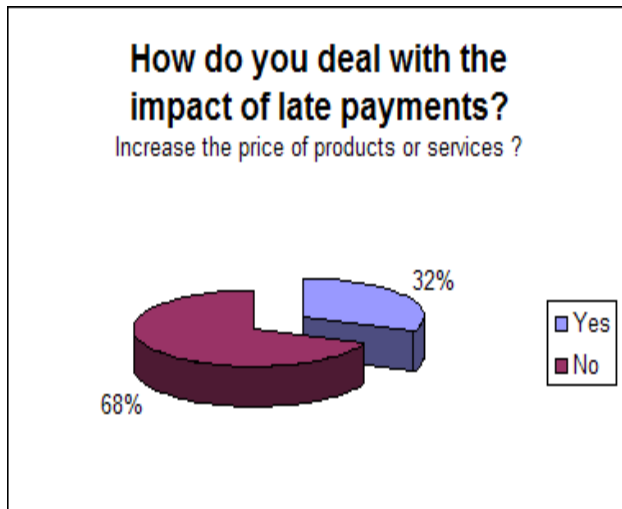
R&D Investments Figure



Survival Figure



Late payments have also had various repercussions on the operations of businesses. Indeed according to the LP Survey, 37% suggested that the Directive has not pushed them into increasing the price on products or services. On the other hand, 63% indicated that late payments have had implications for their payment practices to the extent that they slowed down their own payments to their suppliers. This confirms the vicious circle late payments can start.



5.2 Legal situation

A number of countries have enacted legislation since the August 8, 2002 deadline for implementation. All Member States have now formally transposed the Directive. EU Commission actions against Spain¹³⁹ and Luxembourg¹⁴⁰ have been cancelled following their transposition¹⁴¹. The new Member States have notified the Commission of their transposition measures. Most regulations now conform to the Directive. Some do not appear to conform because either the regulation itself is insufficiently precise to adequately transpose the Directive or it is complex and confusing and interpreted in ways that negate the Directive. The following presents the legal situation based on (i) the information provided by Member States as per their obligation under the Directive, (ii) the information collected by the Team, (iii) the contributions made by different law firms as identified under **Annexe 3**, and Member State regulations.

The evaluation of the conformity of each national law or regulation with the Directive has been organised in a separate report which we communicated to the European Commission. This exercise was necessary before an evaluation of the legal and economic impact of the Directive was possible as such an impact and

¹³⁹ Affaire C-384/03 Commission / Espagne, Requête (JO) JO C 264 du 01.11.2003, p. 23.

¹⁴⁰ Affaire C-479/03, Commission / Luxembourg Requête (JO) JO C 7 du 10.01.2004, p. 26.

¹⁴¹ Radiation du 23/09/2004, Commission / Luxembourg

its proper evaluation are contingent on the existence of adequate transposition measures.

The national measures that were officially notified to the Commission as transposing the Directive as per Member States notification obligations under the Directive are listed in the table below. Although the Team has gone beyond the mere assessment of the regulations below as provided by the Member States by checking them and researching other relevant regulations, any criticism of this Report that is based on a regulation that has not been evaluated by the Team should be directed to the relevant Member State for its failure to notify the European Commission of such regulation.

Country	Legislative act
AT	Zinsenrechts - Änderungsgesetz BGBl I Nr 118/20002 Änderung der Basis - und Referenzzinssatz -VO, BGBl II Nr 309/2002
BE	Loi concernant la Lutte contre le retard de paiement dans les transactions commerciales C-2002/09716 of 2/8/2002
CY	Law No. : 73(I)/2003; Official Gazette of the Republic of Cyprus No. 3736 - 11.7.2003
CZ	Act No. 513/1991 Coll., Commercial Code, as amended, Act No. 40/1964 Coll., Civil Code, as amended, and Act No. 99/1963 Coll., Civil Procedure Act, as amended
DE	Law on the Modernisation of the Law of Obligations (Gesetz zur Modernisierung des Schuldrechts) of 26.11.2001 (Bundesgesetzblatt 2001 Part I, p.3138 Amendments to the Civil Code (BGB): Sections 286, 288(2) and 247.138) with effect from 01.01.2002 Sections 307(1), 449 Code of Civil Procedure Sections 688-703d, Sections 330-347
DK	Act No 379 of 6/6/2002 amending the Act on interest for late payment Order no 601 of 12/07/2002 on out of court recovery costs in connection with late payment
EE	Law of Obligations Act (LO) § 113(1); LO § 113 subsection 1-3; LO § 103 (1); LO 113(1); LO § 113(5); LO § 42, § 5, § 6 subsection 2; LO § 45; LO § 233(1); Code of Civil procedure § 169 (1) and § 170 (3)

EL	Presidential Decree no.166/2003 (Government Gazette no.138/5.6.2003)
ES	Ley 3/2004, de 29 de diciembre, por la que se establecen medidas de lucha contra la morosidad en las operaciones comerciales. BOE 314, 30-XII-2004.
FI	Interest Act (633/1982) as amended by Act 340/2002 (Statutes of Finland 10.05.2002); Act on regulations concerning contractual terms between traders (1062/1993) as amended by Act 341/2002 (Statutes of Finland 10.05.2002) <i>Provisions already in force</i> Chapter 21 of the Code of Judicial Procedure; Recovery of Claims Act, 22.4.1999/513; Ministry of Justice Decision concerning the basis of the amounts of court costs ordered to be paid in accordance with Section 8 c of Chapter 21 of the Code of Judicial Procedure, 14.12.2001/1311; Contracts Act 13.6.1929/228. <i>Note</i> Laws also applicable in Aland
FR	Law 2001-420 of 15.05.2001 Articles 53, 54, 55, 56 (Law on New Economic Regulations); Articles L 441-3; L 441-6; L 442-6; L 470-7 of the Commercial Code Art 1405 et seq of the Civil Procedure Code; Decrees No 2001/210 of 07.03.2001, 2002/231 of 21.01.2002 and 2002/232 of 21.02.2002
HU	Article 301/A of Act IV of 1959 on the Civil Code; Article 200 par. (1) of the Civil Code; Article 301/A par. (3) of the Civil Code; Article 301 par. (1)-(2) of the Civil Code; Article 299 par. (1) of the Civil Code; Article 301 par. (4) of the Civil Code; Article 78 par. (1) of Act III of 1952 on Civil Procedure; Article 301/A par. (5) of the Civil Code; Article 209 of the Civil Code; Article 5 of the Law-Decree No. 11 of 1960 on the Entry Into Effect and Implementation of the Civil Code; Article 368 par. (1) of the Civil Code; Articles 313-323 of the Act on Civil Procedure; Article 688 of the Civil Code point (d); Article 398 of the Act on Civil Procedure

IE	Statutory Instrument 388 of 2002 (implemented under s3, ECA 1972) - 07.08.2002
IT	Decreto Legislativo 9/10/2002 n.231
LT	Law of the Republic of Lithuania on the Prevention of Late Payment in Commercial Transactions, 9.12.2003, No. IX-1873
LU	Loi du 18 avril 2004 relative aux d'avis de paiement et aux intérêts de retard (JO du Grand-Duché de Luxembourg A-N 66, 6 mai 2004, p. 977)
LV	Following Articles of Civil Law (Civillikums) and Civil Procedure Law (Civilprocesa likums) correspond to the Directive 2000/35/EC: Para.1(a) Art.3: Art. 1496, 1652 and 1759 of Civil Law; Para. 1(b) Art.3: Art. 1652, 2035 of Civil Law; Para. 1(c) Art.3: Art. 1651-1668 of Civil Law; Para. 1(d) Art.3: Art. 1765 of Civil Law; Para. 1(e) Art.3: Art. 41, 44, 458 of Civil Procedure Law; Para. 2 Art.3: Art. 1496 of Civil Law; Para. 3 Art.3: Art. 1, 2391 of Civil Law; Para. 4 Art.3: Art. 1, 2391 of Civil Law; Para. 5 Art.3: Art. 76 of Civil Procedure Law; Art. 4: Art. 2033. 2034 Of Civil Law; Art. 5: Chapter 50 of Civil Procedure Law
MT	Part VII of the Business Promotion Act (Cap. 325); Government Gazette 30.1.2001
NL	Amendment to the Civil Code published in the Bulletin of Acts, Orders and Decrees [<i>Staatsblad</i>] (No 545 of 14 November 2002 and No 561 of 21 November 2002)
PL	Act of 12 June 2003 on payment periods in commercial transactions
PT	Decreto-Lei n. 32/2003 (17 February 2003)
Scotland	Late Payment of Commercial Debts Regulations (SI 2002 No 335 - 07.08.2002) amending the Late Payment of Commercial Debts (Interest) Act 1998; Late Payment of Commercial Debts (Rate of Interest) (no 3) Order 2002 (SI 2002 No 336 - 07.08.2002); Late Payment of Commercial Debts (Interest) Act 1998 (Commencement No 6) Order 2002 (SI 2002 No 337) with effect from 07.08.2002
SE	Amendments to:

	<p>The Code of Land Law, chapter 6 section 3</p> <p>Interest Law 1975:635, sections 4-6, section 9</p> <p>Law on General Partnerships and Single Partners 1980:1102, chapter 2 section 6</p> <p>Law on Conditions of Commercial Contracts 1984:292, sections 1,3</p> <p>Law on Company Mortgages 1984:649, chapter 2 section 5</p> <p>Law on Concession Fees in the field of television and radio 1992:72, section 9</p> <p>The Maritime Law, chapter 3</p> <p>Law on deposit Guarantees 1995:1571, section 13</p> <p>With effect from 1/7/2002</p>
SK	<p>Act from 10th of July 2003 which amends and complements act No. 99/1963 Coll. (Civil Trial) as amended and complemented by act No. 328/1991 Coll. About Bankruptcy proceedings as amended; Act No. 513/1991 from 5th November 1991- Commercial Code; Act No. 530/2003 from 28th October 2003 about the Commercial Register and about amendments and changes of some acts; Act No. 99/1963 Civil Trial Code from 4th December 1963</p>
SI	<p>Articles 13, 378, 380 & 520 of Code of Obligations (CO) (OG RS, No 83/2001); Legally Prescribed Default Rate of Interest Act, Art. 2 (OG RS, No 56/2003; 135/2003); Articles 488, 492 & 496 of the Civil Procedure Act (CPA) (OG RS, No 26/1999).</p>
UK (except Scotland)	<p>Late Payment of Commercial Debts Regulations (SI 2002 No 1674 - 07.08.2002) amending the Late Payment of Commercial Debts (Interest) Act 1998;</p> <p>Late Payment of Commercial Debts (Rate of Interest) (no 3) Order 2002 (SI 2002 No 1675 - 07.08.2002);</p> <p>Late Payment of Commercial Debts (Interest) Act 1998</p> <p>(Commencement No 5) Order 2002 (SI 2002 No 1673) with effect from 07.08.2002</p>

5.2.1 Late payments interest (A 3.1.d)¹⁴²

Country ¹⁴³	Relevant provision
AT	§ 1333 (2) BGBI I et FLG n° 27/1999.
BE	Article 2.4 de la loi du 2 août 2002.
CY	Section 6 Law No. : 73(I)/2003.
CZ	Article 369a(1) Act No. 513/1991; Article 369(1) ; Article 517(2) ; Article 1.
DE	288 et 247 BGB.
DK	Section 5(1) et Section 5(3) of the Interest act states.
EE	§ 113 LO.
EL	Article 4 Presidential Decree no.166/2003.
ES ¹⁴⁴	Article 7 of the 3/2004 law , of 29 December 2004

¹⁴² Section based on research conducted by the whole Team and a report prepared by Professor Frederic Leplat and Isabelle Tinel presenting an approximation of Member State regulation with the Directive to the European Commission on August 31, 2006.

¹⁴³ Germany (DE) ; Austria (AT) ; Belgium (BE) ; Cyprus (CY) ; Denmark (DK) ; Spain (ES) ; Estonia (EE) ; Finland (FI) ; France (FR) ; Greece (EL) ; Hungary (HU) Ireland (IE) ; Italy (IT) ; Latvia (LV) ; Lithuania (LT) ; Luxembourg (LU) ; Malta (MT) ; Poland (PL) ; Portugal (PT) ; Czech Republic (CZ) ; United Kingdom (UK) ; Slovakia (SK) ; Slovenia (SI) ; Sweden (SE)

¹⁴⁴ **Note by Juan Ramón Iturriagoitia:** “Regarding to the retail trade, there is a difference relating to the interest rate in case Of late payments. Indeed pursuant to the article 17-5 of the Law7/1996 (amended by law 3/2004) The Law provides however for a second statutory rate applicable to the retail sector. Here the Law provides for very long terms of payments, where the parties are allowed to reduce by agreement the interest rate for late payment to a minimum level that corresponds to the Spanish legal interest increased by a factor of 1,5. Obviously, this is a minimum rate on whose basis the parties may negotiate. In view of the structural composition of the Spanish retail sector, sellers will at best obtain this second statutory interest rate. The retailer sector is simply too dominant for engaging in serious negotiations with its contractual

FI	Section 4 and 12 Interest Act.
FR	Article L. 441-6 Code de commerce.
HU	Section 301/A of the Civil Code.
IE	Section 5 of the Statutory Instrument 388 of 2002
IT	Article 5 Decreto Legislativo 9/10/2002
LT	Article 2 Law on the Prevention of Late Payment in Commercial Transactions
LU	Article 5 de la loi du 18 avril 2004.
LV	Article 1765 of Civil Law ¹⁴⁵
MT	Article 50 (1) of the Business Promotion Act ¹⁴⁶
NL	Art. 6: 120 sub 2 CC
PL	Article 56 of the Act of 29 August 1997.
PT	Article 102 Decreto-Lei n. 32/2003 and Decree 262/99, of 12 April 1999.
SE	Section 9 of The Interest law (1975:635).
SK	Article 369 of the Slovak Commercial Code.
SI	Article 378 of the Code of Obligationa and Article 2 of the Legally Prescribed Default Rate of Interest Act ¹⁴⁷ .

counterparts, i.e. the producers. In any case, we conclude that the Law provides for two different statutory interest rates”.

¹⁴⁵ Article 1765 of Civil Law « *The interest rate shall be precisely stipulated in the document or transaction. If this has not been done, and in cases where the law requires calculation of interest set by law, the interest rate shall be fixed at six per cent per year. Interest shall be calculated only on the principal itself. But if within the term stipulated, interest is not paid for one year or more, pursuant to the demand of the creditor interest set by law shall be assessed on the outstanding amount of interest from the commencement of the term referred to* ».

¹⁴⁶ 50. (1) of the Business Promotion Act: “*The rate of legal interest applicable under this Part of this Act shall be the minimum discount rate in terms of any directives issued from time to time by the Central Bank of Malta under the Central Bank of Malta Act, and prevailing on the relevant reference date increased by six percentage points. The Commercial Code supersedes the Business Promotion Act for late payments with effect from 1 July 2005. A new interest rate is set up in article 26 A of the Commercial Code added by LN. 233 of 2005 which can be read as follows: “interest rate” means the reference rate in force on the first calendar day of the half year during which interest becomes due, plus seven percent (7%)*”.

¹⁴⁷ According to article 378 of Code of Obligations (CO) (OG RS, No 83/2001):

“(1) A debtor that is in delay in performing a pecuniary obligation shall owe penalty interest in addition to the principal.

(2) The interest rate for penalty interest shall amount to 8% per annum, unless stipulated otherwise by a separate act of law.

UK	Section 4 of The Late Payment of Commercial Debts (Interest) Act 1998.
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We note that in Austria § 1334 of the Austrian General Civil Code¹⁴⁸ states that:

“Unless otherwise agreed by the parties, the debtor shall effect his performance without any undue delay after the performance of the creditor at the occasion of the provision of the contractual return, or if the parties have agreed upon such procedure, after the acceptance or inspection of the performance of the creditor, or in case the amount of receivables is not certain after the entry of an invoice or an equivalent request for payment.”

This will need to be reviewed under Article 3.1. (b) of the Directive. Indeed, The General Civil Code (ABGB) does not provide for a default 30 days payment term¹⁴⁹. The law provides that the interest starts running as of the date of maturity as provided in the contract. Because in the absence of a contract there is no date of maturity there may be no ability to charge interest¹⁵⁰.

In Germany, the law provides an interest rate on late payments of 8 percentage points on top of the base rate¹⁵¹. This appears to go beyond the 7 percentage points above the ECB rate. However, with a base rate lower by one percentage

Nevertheless article 2 of the Legally Prescribed Default Rate of Interest Act (OG RS, No 56/2003; 135/2003), sets up the following interest rate:

(1) The legally prescribed default rate of interest is 15,5% per annum.

(2) The interest rate from the previous paragraph of this Article shall be amended by the Government of the Republic of Slovenia if the economic circumstances in the country change”.

Article 382 states that « (2) *If contractual interest is agreed but the interest rate and the time it falls due are not stipulated the interest rate shall be 6% per annum and the interest shall fall due at the same time the principal falls due. Article 2 of the Legally Prescribed Default Rate of Interest Act (OG RS, No 56/2003; 135/2003), sets up the following interest rate:(1) The legally prescribed default rate of interest is 15,5% per annum. (2) The interest rate from the previous paragraph of this Article shall be amended by the Government of the Republic of Slovenia if the economic circumstances in the country change”.*

¹⁴⁸ ABGB, JGS 1811/946 as amended with BGBl I 2006/92.

¹⁴⁹ Comments to the draft law, page 5 and 6 Zinsrechtsänderungsgesetz 2002, BGBl I 2002/118.

¹⁵⁰ A per the questionnaire answered by Benedikt Spiegelfeld Partner of Cerha Hempel & Spiegelfeld law firm. See contact details under Annexe 3.

¹⁵¹ § 247 BGB

point to that of the ECB, the German law is in line with the Directive on the interest rate on late payments¹⁵². This is the case as long as its base rate is consistently pegged to the ECB rate.

Section 6, Article 3(2) of the Danish Interest Act states that, the period of 30 days starts running from the date on which the invoice is raised or from the time of a request for payment. In the opinion of the Danish authorities, this policy is more favourable to the creditor than the Directive.

In Ireland, Article 4.3 of the Irish transposition law provides for an automatic entitlement to interest rather than an automatic payment of interest. In practice this has meant that the interest is only paid when imposed pursuant to a court decision.

In Greece, the Presidential Decree 166/2003 that transposes the Directive into Greek law has left unanswered many practical questions.¹⁵³

5.2.2 *Recovery of costs*¹⁵⁴

Country ¹⁵⁵	Relevant provision
AT	Article § 1333(3) BGBI I
BE	Article 6 of the August 2 2002 Act ¹⁵⁶ .

¹⁵² A per the questionnaire answered by Manon Brindöpke, senior associate of Linklaters law firm. See contact details under Annexe 3.

¹⁵³ A per the questionnaire answered by John C. Kyriakides Senior Partner of KYRIAKIDES GEORGOPOULOS & DANIOLOS ISSAIAS Law Firm

¹⁵⁴ Section based on research conducted by the whole Team and a report prepared by Professor Frederic Leplat and Isabelle Tinel presenting an approximation of Member State regulation with the Directive to the European Commission on August 31, 2006.

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¹⁵⁶ No specific measure.

CY	Section 7 Law No. : 73(I)/2003.
CZ	Article 142(1) to (3) ; Article 143 of Act 99/1963 ¹⁵⁷ .
DE	Article 288 BGB Section 4 ¹⁵⁸ .
DK	Section 9a of the Interest Act.
EE	No Specific Provision
EL	Article 4 Presidential Decree no.166/2003
ES	Article 8 of the 3/2004 law , of 29 December 2004 ¹⁵⁹
FI	Decree 1311/2001 ¹⁶⁰ .
FR	Art. 700 du Nouveau Code de procédure civile ¹⁶¹
HU	Article 299 par. (1) of the Civil Code
IE	Section 9 of the Statutory Instrument 388 of 2002 ¹⁶²
IT	Article 6 Decreto Legislativo 9/10/2002
LT	Article 3 Law on the Prevention of Late Payment in Commercial Transactions
LU	Article 8 de la loi du 18 avril 2004
LV	Article 41, 44, 458 of Civil Procedure Law
MT	Article 54 of the Business Promotion Act superseded by Article 26C (5) of the Commercial Code ¹⁶³

¹⁵⁷ With regard to the recovery of the costs of legal representation, such costs are, under Czech procedural law, paid as a lump sum (usually according to the value of the suit) for the entire proceedings at a particular level (i.e., regardless of what the real costs for legal representation of a party are). Generally speaking, if the attorney-at-law charges his or her fees using an hourly rate, such fees are paid in full if the suit has a high value. In the event of a suit with a low value, even if the suit is fully successful, the amount of payment of the costs of proceedings awarded need not fully cover the costs of the legal representation. DEBT RECOVERY IN THE CZECH REPUBLIC Czerwenka & Partner v.o.s 2006.

¹⁵⁸ Information provided by Gabriele Scheuer R A 2 Division - Civil Procedure Federal Ministry of Justice June 12, 2006

¹⁵⁹ The Law provides for compensation for all relevant collection costs up to a maximum of 15% of the amount of the debt if the debt exceeds 30,000 Euros. If the debt does not exceed 30.000 EUR, the maximum compensation shall be the same as the amount of the debt. Information provided in report by Juan Ramón Iturriagoitia.

¹⁶⁰ Dette < 250 € : 170/240 €

Dette > 250 € : 200/270 €

¹⁶¹ No specific measure

¹⁶² < 1000 € : 40 €

<10.000 € : 70 €

>10.000 € : 100 €

¹⁶³ Article 54 of the Business Promotion Act superseded by Article 26C (5) of the Commercial Code which can be read as follows: “(5) Unless the debtor is not responsible

NL	Article 237-245 Code of Civil Procédure ¹⁶⁴
PL	Article 10 of the Act of 13 June 1967 on the court costs in civil cases
PT	Article 3 Decreto-Lei n. 32/2003.
SE	No specific provision
SK	Article 369, Paragraph 3 of the Slovak Commercial Code
SI	Article 380 of the Code of Obligations (CO) (OG RS, No83/2001)
UK	Section 5A of The Late Payment of Commercial Debts (Interest) Act 1998 ¹⁶⁵

Under German law the court decides *ex officio* on the award for costs. Further, the general rule is that the unsuccessful party shall bear the costs of the legal dispute; in particular, it shall reimburse the winning party their expenses to the extent that these were necessary¹⁶⁶. It is not clear that out-of-court expenses can be claimed and whether lawyer's costs are fully taken into account.

In Finland, the creditor may request reimbursement of all recovery costs. Judges practically always decide in favour of reimbursement of recovery costs. However, the debtor's liability for recovery costs is limited to between 192 and 302 Euros depending on the size and nature of the debts. Exceptionally, this limit can, however, be set aside. The median amount of recovery costs awarded in 2005 was 220 Euros¹⁶⁷. This seems modest when considering all costs that can be related to late payments.

for the delay, the creditor shall be entitled to claim reasonable compensation from the debtor for all relevant recovery costs incurred through the debtor's late payment."

¹⁶⁴ No specific measure

¹⁶⁵ < 1000 £ : 40 £

<10.000 £ : 70 £

>10.000 £ : 100 £

¹⁶⁶ Section 91 ZPO.

¹⁶⁷ Information provided in a report by Jarkko Männistö, LL.M., doctoral student University of Turku, Faculty of Law

The Irish transposition law adds a requirement to the right to claim recovery costs. It imposes that a creditor must state in the contract the amount of recovery costs that will be charged in case of late payment¹⁶⁸.

In Poland, in general the losing party has to reimburse all the legal costs of the winning party. Depending on the category, kind of litigation and duration, the legal costs can vary between € 25 and € 25,000¹⁶⁹.

In Portugal, judges do not generally award recovery costs to the creditor or winning party except for the court costs. The effect of this is accentuated by Article 32 of the Civil Procedure Code that requires representation by a lawyer for debts of more than 3,740.98 €¹⁷⁰.

In Sweden, the creditor can request reimbursement of all recovery costs but the amount that can be reimbursed is fixed by law at 100 €¹⁷¹.

In France recovery costs are only available within the setting of court proceedings.

Pursuant to the Slovak Commercial Code a creditor is entitled to claim reasonable compensation from the debtor for all relevant recovery costs incurred by virtue of the debtor's delay in payment¹⁷².

In England and Wales it is possible use a fast-track procedure in case of a small claim, but the recovery costs awarded will be limited as a result¹⁷³. Fast-track procedures enable the plaintiff to obtain an enforceable title within an acceptable time-frame. However, when using the fast-track procedure the plaintiff forgoes the rights to full reimbursement of recovery costs and in particular right to reimbursement of attorney costs.

¹⁶⁸ Irish report by Isabelle Tinel, following interviews and research implemented by Isabelle Tinel.

¹⁶⁹ Atradius November 2005

¹⁷⁰ Information provided by João Arsénio de Oliveira *Legal Consultant* Legal Policy and Planning Office Ministry of Justice

¹⁷¹ Information provided by Mattias Wahlstedt, Deputy Director, Ministry of Justice

¹⁷² Information provided by Kristína Rúsková and Ondřej Dušek lawyers of Peterka & partners law firm

¹⁷³ House of Commons Constitutional Affairs Committee, The courts: small claims, First Report of Session 2005-06 Report, together with formal minutes, oral and written evidence, published 22 November 2005, Ev 42 (14).

5.2.3 Grossly unfair provisions¹⁷⁴

Country ¹⁷⁵	Relevant regulations
AT	879 (1) (3) GCC ¹⁷⁶ .
BE	l'article 7 de la loi du 2 août 2002.
CY	Section 8 Law No. : 73(I)/2003.
CZ ¹⁷⁷	Article 369(4) Act 513/1991.
DE	§§ 242 and 307 BGB ¹⁷⁸ .
DK ¹⁷⁹	Section 36 of the Agreement act.
EE	Articles § 42, § 45 Law of Obligations Act ¹⁸⁰ .

¹⁷⁴ Section based on research conducted by the whole Team and a report prepared by Professor Frederic Leplat and Isabelle Tinel presenting an approximation of Member State regulation with the Directive to the European Commission on August 31, 2006.

¹⁷⁵ Germany (DE) ; Austria (AT) ; Belgium (BE) ; Cyprus (CY) ; Denmark (DK) ; Spain (ES) ; Estonia (EE) ; Finland (FI) ; France (FR) ; Greece (EL) ; Hungary (HU) Ireland (IE) ; Italy (IT) ; Latvia (LV) ; Lithuania (LT) ; Luxembourg (LU) ; Malta (MT) ; Poland (PL) ; Portugal (PT) ; Czech Republic (CZ) ; United Kingdom (UK) ; Slovakia (SK) ; Slovenia (SI) ; Sweden (SE)

¹⁷⁶ No specific measure

¹⁷⁷ Article 369(4) Act 513/1991.

¹⁷⁸ Limited to « *standards business terms* ». As per Information provided by Manon BRIDOEPEKE from Linklaters law firm.

¹⁷⁹ Section 36 Agreement act.

¹⁸⁰ Articles § 42, § 45 Law of Obligations Act (RT I 2002, 53, 336) and adopted 26 September 2001 (RT I 2001, 81, 487), entered into force 1 July 2002.

“§ 42. *Invalidity of standard terms*

(1) *A standard term is void if, taking into account the nature, contents and manner of entry into the contract, the interests of the parties and other material circumstances, the term causes unfair harm to the other party, particularly if it causes a significant imbalance in the parties' rights and obligations arising from the contract to the detriment of the other party or if the standard term is contrary to good morals.*

(2) *Unfair harm is presumed if a standard term derogates from a fundamental principle of law or restricts the rights and obligations arising for the other party from the nature of the contract such that it becomes questionable as to whether the purpose of the contract can be achieved. A standard term is not deemed to be unfair if it relates to the main subject matter of the contract or to the relationship between the price and the value of the services or goods supplied in exchange.*

EL	Article 5 Presidential Decree no.166/2003.
ES	Article 9 of the law 3/2004.
FI	Section 36 Property Transaction Act.
FR	Article L. 442-6 du Code de commerce.
HU	Article 301/A par. (5) of the Civil Code.
IE	Article 6 of the Statutory Instrument 388 of 2002 ¹⁸¹
IT	Article 7 Decreto Legislativo 9/10/2002.
LT	Article 4 Law on the Prevention of Late Payment in Commercial Transactions
LU	Article 6 de la loi du 18 avril 2004.
LV	Article 1, 2391 of Civil Law.
MT	Article 52. (1) of the Business Promotion Act superseded, as of 1 July 2005, by Article 26C (6) of the Commercial Code ¹⁸²
NL	Article 3 :44(2) and 6 :248(2) of Civi Code ¹⁸³ .
PL	Article 5 et 9 Act of 12 June 2003 on payment periods in commercial transactions.
PT	Article 5 Decreto-Lei n. 32/2003.
SE	Section 1 of the law1984 :292.

§ 45. Requirement to terminate application of unfair standard terms: A person or body provided by law may, pursuant to the procedure provided by law, require that a party supplying an unfair standard term terminates application of the term and that the person recommending application of the term terminates and withdraws such recommendation”.

¹⁸¹ Article 6 of the Statutory Instrument 388 of 2002 applies to contract in which the contract does not specify the date or period of payment.

¹⁸² 52. (1) of the Business Promotion Act superseded, as of 1 July 2005, by Article 26C (6) of the Commercial Code which can be read as follows: “(6) Any agreement on the date for payment or on the consequences of late payment which is not in accordance with the provisions of subarticles (2), (3) and (4) shall give rise to a right to claim for damages if when all circumstances of the case including good commercial practice and the nature of the product are considered, it is grossly unfair to the creditor: Provided that in determining whether an agreement is grossly unfair to the creditor, it shall be taken, inter alia, into account whether the debtor has any objective reason to deviate from the provisions of subarticles (2), (3) and (4). If such an agreement is determined to be grossly unfair, the terms established in this Sub-Title shall apply unless the First Hall of the Civil Court upon the application of any party interested determines different conditions which are fair and which are to apply”.

¹⁸³ No specific measures

SK	Article 265 of the Slovak Commercial Code; Article 3 of the Slovak Civil Code; Article 39 of the Slovak Civil Code ¹⁸⁴
SI	No specific measure
UK	Section 7 (2) and Section 3(4) of The Late Payment of Commercial Debts (Interest) Act 1998 ¹⁸⁵

The Austrian General Civil Code did not require a specific transposition of articles 3.3, 3.4, and 3.5. According to § 879 paragraph 3 of the General Civil Code, grossly discriminatory clauses are unenforceable. The Directive's Articles 3.4. and 3.5 did not require specific transposition measures¹⁸⁶ as such issues are addressed by Austrian competition law, and in particular the antitrust claim under § 14 of the Austrian Anti Trust Code¹⁸⁷.

In Belgium, Article 7 of law C 2002/09716 of August 2, 2002 transposes the Directive. However, it should be noted that the contractual revision authority of the judge is limited to placing the creditor in the position he or she would have occupied in the absence of a contract or the litigated clause. This leaves open the question of damages.

Of noteworthiness is article Article 10 of the law C 2002/09716 August 2, 2002 which creates a cease and desist action in case of grossly abusive contractual clauses¹⁸⁸.

It is only very recently that the Czech Republic has correctly transposed the Directive in this respect¹⁸⁹. As of January 1, 2005, Section 369(a) was inserted in the Commercial Code. This basically transposes Articles 3.3, 3.4 and 3.5 of the Directive. The new section provides that any contractual clause that is grossly

¹⁸⁴ Article 265 of the Slovak Commercial Code; Article 3 of the Slovak Civil Code; Article 39 of the Slovak Civil Code states that “A legal act whose content or purpose are at variance with a statute, circumvent the statute or are at variance with good manners shall be invalid.”

¹⁸⁵ Section 7 (2) restricts the application to contracts terms agreed before the debt is created.

¹⁸⁶ As per information provided by Benedikt Spiegelfeld, Partner of the Cerha Hempel & Spiegelfeld law firm.

¹⁸⁷ (UWG 1984, BGBl 1994/448 as amended with BGBl I 2006/106).

¹⁸⁸ European legal development bulletin/Baker & Mackenzie April 2004.

¹⁸⁹ Under Act N° 554/2004 coll, effective as of 1 January 2005 a new section has been inserted in the Commercial Code: section 369 (a). Articles 3.3, 3.4 and 3.5 are transposed by the article 369 (a) of the Commercial Code. See News 1/2005 Peterka & Partners.

unfair to the creditor may be replaced by the judge using corresponding statutory provision. This also applies to contracts with public entities¹⁹⁰.

Article 3 of the Spanish transposition law does not provide for claims for damages. Nonetheless, the Law clearly stipulates that when the judge determines whether a clause is abusive, he will also take into account whether the agreement mainly serves the purpose of procuring the debtor additional liquidity at the expense of the creditor, and whether the main contractor imposes on his suppliers and subcontractors terms of payment which are not justified on grounds of the terms granted to himself. This rule should in the future curb the abuses of large distribution companies that have used their cash-flow in speculative financial investments.

Courts have the power to evaluate contractual provisions based on Article 1258 of the Civil Code and to modify relevant contract terms, deciding also on the effects of unenforceability in respect to specific provisions. This avoids ending up with a declaration of unenforceability for the whole contract which would deter legal action.

The law also identifies the types of organisations that may take legal action on the grounds that contractual terms drawn up for general use are grossly unfair as described in the previous paragraphs. These are:

- associations, federations of associations and groupings of businesspersons, professionals and farmers, which according to their bylaws represent the interests of their members;
- Chambers of Commerce and Industry; and
- legally established associations of liberal professionals.

Sectors such as the public and retail sectors are excluded from the application of this law. These follow a special regime that to this day does not address the issues described above¹⁹¹.

Section 1 of the Swedish law that regulates commercial contracts¹⁹² does not define the conditions under which grossly unfair clauses can be declared unenforceable. Further, the law is unclear on claims for damages.

¹⁹⁰ See News 1/2005 Peterka & Partners.

¹⁹¹ As per information provided by Juan Ramón Iturriagoitia.

¹⁹² (1984 : 292)

5.2.4 Retention of title¹⁹³

The retention of title clause as adopted in the Directive does not in effect lead to a harmonization of retention of title. As a result, the legal requirements relating to the retention of title vary from state to state¹⁹⁴. However, all Member State regulations recognize the concept of retention of title. Most Member States' regulations pertaining to retention of title extend beyond what is provided for in the Directive¹⁹⁵.

Country ¹⁹⁶	Relevant regulations
AT	No specific provision.
BE	Art. 101 de la loi sur les faillites.
CY	Article 11 Law No. : 73(I)/2003.
CZ	Article 445 Act 513/1991.
DE	§ 449 BGB.
DK	No specific measure.
EE	§ 233 LO.
EL	No specific measure.
ES	Article 10 of the law 3/2004.
FI	No specific measure.
FR	Article 2367 du Code civil.
HU	Article 368 par. (1) of the Civil Code.
IE	No specific measure.
IT	Article 11 Decreto Legislativo 9/10/2002.

¹⁹³ Section based on research conducted by the whole Team and a report prepared by Professor Frederic Leplat and Isabelle Tinel presenting an approximation of Member State regulation with the Directive to the European Commission on August 31, 2006.

¹⁹⁴ J. Michael Milo, Retention of Title in European Business Transactions, Washburn Law Journal, Vol, 43, 24.01.2004, p. 121-139.

¹⁹⁵ Retention of Title in European Business Transactions, J. Michael Milo, Washburn Law Journal, 27.01.2004, p. 137.

¹⁹⁶ Germany (DE) ; Austria (AT) ; Belgium (BE) ; Cyprus (CY) ; Denmark (DK) ; Spain (ES) ; Estonia (EE) ; Finland (FI) ; France (FR) ; Greece (EL) ; Hungary (HU) Ireland (IE) ; Italy (IT) ; Latvia (LV) ; Lithuania (LT) ; Luxembourg (LU) ; Malta (MT) ; Poland (PL) ; Portugal (PT) ; Czech Republic (CZ) ; United Kingdom (UK) ; Slovakia (SK) ; Slovenia (SI) ; Sweden (SE)

LT	Article 5 Law on the Prevention of Late Payment in Commercial Transactions.
LU	Article 567-1 du Code de commerce.
LV	Articles 2033 and 2034 Of Civil Law.
MT	No specific measure.
NL	Article 92a.
PL	No specific measure.
PT	No specific measure.
SE	No specific measure.
SK	Article 445 of the Slovak Commercial Code; Article 443 of the Slovak Commercial Code.
SI	Article 520 (2) ¹⁹⁷ .
UK	No specific measure.

Retention of title works very efficiently in Germany where it is a simple, straightforward protection, but less so in countries like Italy where on public registers, recorded retention of titles will be opposable by third parties¹⁹⁸. Small transactions or transactions that are to be implemented with short delays are excluded from these types of procedures since, registering the retention with the public register takes time, experience, and for foreign creditors, the use of local counsel.

Further, in the Netherlands contractual retention of title is normal business practice. However, once the goods have been sold on to a third party, title is lost.

There are some issues in Italy, it appears, as the European Commission has started an action against Italy for incorrect transposition. The European Commission considers that the requirements of Article 11(3) of Decree No

¹⁹⁷ Article 520 (2) states that « *The reservation of title shall have effect against a buyer's creditor only if the buyer's signature on the contract containing the provision on the reservation of title was notarised prior to the buyer's bankruptcy or the attachment of the movable property* ».

¹⁹⁸ Aparo San Jose Riestra *Credit Insurance in Europe, Impact, Measurement and Policy recommendations*, Centre for European Policy Studies, CEPS Research Report in Finance and Banking, No 31, February 2003.

231/2002 limit the effect of Article 4(1) of the Directive and violate it¹⁹⁹. The European Court of Justice recently decided against an expansive interpretation of the Directive in this respect and considered that the retention of title clause in fact did not impose a requirement on Member States to change their enforceability rules against third parties since the Directive does not regulate their rights and obligations²⁰⁰.

5.2.5 Procedures to obtain an enforceable title²⁰¹

Country	Relevant regulations
AT	No specific measure.
BE	No specific measure ²⁰² .
CY	No specific measure.
CZ	Article 114b(1), (2), (4) and (5) Act 99/1963; Article 153a(3) Act 99/1963; Article 172(1) Act 99/1963.
DE	No specific measure ²⁰³ .
DK	No specific measure.
EE	§ 169 Code of Civil procedure ²⁰⁴ .
EL	No specific measure.
ES	No specific measure
FI	No specific measure.
FR	No specific measure (Article 1405 Nouveau Code de Procivile.°

¹⁹⁹ Case C-302/05: Action brought on 28 July 2005 by the Commission of the European Communities against Italian Republic, OJ C 229, 17/09/2005 P. 0010 - 0010.

²⁰⁰ *Commission of the European Communities v. Italian Republic*, Judgment of the Court, case C-302/05, 26.10.2006 at paragraph 30.

²⁰¹ Section based on research conducted by the whole Team and a report prepared by Professor Frederic Leplat and Isabelle Tinel presenting an approximation of Member State regulation with the Directive to the European Commission on August 31, 2006.

²⁰² Art. 573. Code de l'organisation judiciaire ; Art. 735 Code de l'organisation judiciaire.

²⁰³ Section 688 to 703d of the Code of Civil Procedure and Section 330 to 347.

²⁰⁴ § 169 Code of Civil procedure: "(1) If a court holds a preliminary hearing, it shall be held within two months after the filing of the statement of claim. A court shall summon the participants in a proceeding to a preliminary hearing".

HU	Articles 313-323 of the Act on Civil Procedure.
IE	No specific measure.
IT	Articles 633 et 641 du Code de procédure civile.
LT	No specific measure.
LU	Article 794.
LV	Chapter 50 of Civil Procedure Law.
MT	No specific measure.
NL	No specific measure.
PL	Articles 485 and 486 of Code of Civil Procedure.
PT	Article 7, 8, 10,11 12,12-A Decreto-Lei n. 32/2003.
SE	No specific measure.
SK	Article 172, Paragraph 1 of the Civil Procedure.
SI	Articles 488, 492 & 496 of the Civil Procedure Act (CPA) (OG RS, No 26/1999).
UK	No specific measure.

The prescriptions made by the Directive in terms of time to obtain an enforceable title have had an impact in most Member States both in the specific regulations that have been adopted and in the efforts that have been made to adapt court structure to them. Reforming the judicial system in Member States is not a straightforward exercise. The judiciary is independent to a large extent. Courts have to be able to render justice in a way that is effective, efficient but also mindful of the parties' rights. Forcing deadlines on courts may have the unwarranted effect of "fast-food" type justice where the parties are so limited in the arguments that they can present none are satisfied by the process and all are frustrated.

In order to determine how the Directive was implemented, it was necessary to identify the different procedures that are available to the parties and the relevant statistics.

Statistical information on procedures has been integrated into this section rather than the next one. Section 5.1 which presents the economic situation could also have included this statistical information, but to avoid unnecessary repetitions, the information was only included here.

Statistical information that relates to the efficiency of procedures is not readily available in all Member States, as uncontested claims are not always differentiated from those that are contested, and claims made by companies against private purchasers or between private parties are not always separated out from those made between commercial entities²⁰⁵. The technology to obtain precise statistical results is readily available. However, the means and the will are not always so. Too few Member States are able to give precise updated statistical information regarding the time it takes in their own country to obtain an enforceable title²⁰⁶. The availability of such information is essential and it cannot be stressed too much how crucial a management tool it is both to evaluate compliance with relevant EU regulations, but also to set targets for future improvements or follow up on past errors. Recently, efforts have been made at the European level and at national levels to use new technologies in such a way that the whole justice system becomes part of a wider network enabling efficiencies and local, national and regional statistics to be drawn²⁰⁷.

Moreover, many Member States have in the last few years adopted special procedures aimed at accelerating the process of obtaining enforceable titles in cases of small or uncontested claims²⁰⁸. This shows will and determination to change the situation the Directive seeks to fight following its adoption. Such procedures are known for their efficiency in speeding up the time it takes to

²⁰⁵ « *Des Procédures de traitement judiciaire des demandes de faible importance ou non contestées dans les droits des Etats-membres de l'Union Européenne, Exploitation de l'enquête de la Commission européenne sur Les procédures judiciaires applicables aux demandes de faible importance* », Rapport final: Evelyne Serverin, Directeur de recherche au CNRS IDHE-ENS CACHAN, Cachan, 2001. In the report, table 9 on page 34 shows that barely any statistical information is available and that the little information produced allows only a very general overview.

²⁰⁶ See CEPEJ, 2006 Report on European Judicial Systems, October 5, 2006 at 7.2.

²⁰⁷ See Council Decision of 28 May 2001 establishing a European Judicial Network in civil and commercial matters. See also Report from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the application of Council Decision 2001/470/EC establishing a European Judicial Network in civil and commercial matters (COM/2006/203) and annexes (SEC/2006/579).

²⁰⁸ See CEPEJ, 2006 Report on European Judicial Systems, October 5, 2006 at 7.3.

obtain an enforceable title²⁰⁹. The European Commission itself follows the evolution of these procedures closely²¹⁰.

Further, the LP Survey, research, and the WB Survey include sufficient indicators to show that either concrete steps have been taken by Member States to accelerate procedure in cases of undisputed claims or that no steps were necessary.

The information collected also shows there is no automatic correlation between the length of payment periods and the time it takes to obtain an enforceable title. In some countries, it takes little time in comparison with other countries, to obtain an enforceable title, but payment periods are relatively short. Other countries fall victim to long payment periods when the time to obtain an enforceable title is relatively short.

5.2.5.(a) *The existence of special fast-track procedures for small claims*

In a 2002 report on the small claims procedures of England and Wales, Professor Baldwin concluded that:

“While so much of the civil justice system remains the focus of severe criticism, the small claims procedure continues to flourish. As the results of the research discussed in this report demonstrate, it is well liked by litigants and in large measure retains their confidence. And the interventionist role, which is so important in the satisfactory resolution of small claims, continues to be played with relish by most district judges. The judicial approach that is adopted in small claims has, indeed, proved to be so flexible that it has not been difficult to expand the scope of the small claims track to accommodate claims of much higher values. Although there maybe continuing problems and dilemmas in small claims

²⁰⁹ See European Commission Green Paper on a European Order for payment Procedure and on Measures to Simplify and Speed Up Small Claims Litigation, COM (2002) 746 final, 20.12.2002. See also Commission Proposal for a Regulation of the European Parliament and of the Council Creating a European Order for Payment Procedure, COM(2004)173 final/3, 25.05.2004.

²¹⁰

http://ec.europa.eu/civiljustice/simplif_accelerat_procedures/simplif_accelerat_procedures_fra_en.htm

*that are yet to be satisfactorily tackled, the small claims procedure is widely acknowledged to be the great success story of civil justice in England and Wales*²¹¹.

Many Member States today have such procedures.

Denmark has recently introduced such a procedure via the Administration of Justice Act²¹². This is called “Forenklet inkasso”²¹³. Undisputed claims go directly to the bailiff’s court. Representation by a lawyer before the bailiff’s courts is neither compulsory nor common. No judgement is needed to obtain an enforceable title. The law came in force on January 1, 2005. This procedure is limited to claims under 50,000 Danish Kroner exclusive of interest or recovery costs. Representative organisations may not use it to file suit against grossly unfair provisions²¹⁴.

This procedure is quicker and cheaper because there is no longer a need for a court decision or representation by a lawyer. As a result of this reform, cases filed with Copenhagen’s general courts have dropped by 38% in 2005 compared to the previous year. 53% of cases that go straight to the bailiffs are resolved within 4 months²¹⁵.

In Poland, Article 505 of the Polish Civil Procedure Code provides for fast-track procedures for claims of fewer than 1 million PLN²¹⁶.

The European Order for Payment fills the gap and complements Member States’ procedures for small claims.

²¹¹ Professor John Baldwin in 2002 on “*Lay and Judicial Perspectives on the Expansion of the Small Claims Regime*” (Lord Chancellor’s Department Research Series No 8/02).

²¹² Information provided by Lone Kjær Jacobsen, Head of section of The Danish Court Administration.

²¹³ Simplified Debt Recovery Procedure

²¹⁴ Information provided by Lone Kjær Jacobsen, Head of section of The Danish Court Administration.

²¹⁵ Copenhagen Court statistics.

²¹⁶ Information obtained from SPS Advogados - Sociedade de Advogados, www.spsadvogados.com

5.2.5.(b) *The existence of special procedures for uncontested claims*

In Greece for example, if the debtor has acknowledged the debt, the creditor may request the issuance of a Court Payment Order²¹⁷. This procedure enables the creditor to obtain an enforceable title in under 90 days.

There are no fast-track or summary proceedings as such under the Cypriot legal system. However, the Civil Procedure Rules provide that, where the defendant fails to respond to a writ of summons, the plaintiff may apply *ex parte* for judgment by default. In all cases in which a party seeks to obtain a judgment by default the Court may require that the plaintiff proves the claim. These proceedings may as a result take longer than 90 days²¹⁸.

In Portugal following the Directive a specific expedited procedure was introduced in 2003²¹⁹ for debts originating from commercial transactions, irrespective of their value²²⁰. The procedure was originally established by the Decree-Law 269/98, of the 1st September 1998 but was amended recently to implement the Directive²²¹. The new procedure is a simple, fast, cheap and efficient means of obtaining an enforceable title in undisputed claims²²². This procedure is widely used today mainly because of its speed. An enforceable title can be obtained in 30 days²²³. One of the recent problems encountered with the procedure however is that it has become so popular that the increased number of cases has provoked delays in obtaining an enforceable title. The table below shows this.

²¹⁷ Information obtained through interviews with local law firms as identified under Annex 25.

²¹⁸ Information obtained through interviews with local law firms as identified under Annex 25.

²¹⁹ Information provided by João Arsénio de Oliveira *Legal Consultant* Legal Policy and Planning Office, Ministry of Justice.

²²⁰ See Decree-Law 32/2003 implementing EU Late Payment Directive (35/2000/EC).

²²¹ Amended by the Decree-Law 383/99, of the 23rd September 1999, by the Decree-Law 183/2000, of the 10th August 2000, by the Decree-Law 323/2001, of the 17th December 2001, by the Decree-Law 32/2003, of the 17th February 2003, by the Decree-Law 38/2003, of the 8th March 2003, by the Decree-Law 324/2003, of the 27th December 2003, by the Decree-Law 53/2004, of the 18th March 2004, by the Decree-Law 107/2005, of the 1st July 2005 and by the Law 14/2006, of the 26th April 2006.

²²² Creditors to Benefit from New Late Payment Regime, Miranda Correia, Amendoeira & Associados, 26.04.2004.

²²³ Debt Recovery in Portugal, SPS Advogados - Sociedade de Advogados, 19.02.2004

**New and completed fast track procedures to obtain a judicial or enforceable decision in cases of
undisputed debts
at first instance courts and length of the procedure, in the years 2001 to 2005**

Years	Years				
	2001	2002	2003	2004	2005*
New and completed cases/Length of procedures					
New cases	190 511	232 564	293 958	298 382	251 880
Completed cases	178 210	225 489	271 395	269 666	223 975
Length of the procedures (in months):					
Up to a month	55 450	57 809	53 704	38 252	21 415
From 1 to 2 months	71 021	112 796	121 533	117 362	97 248
From 2 to 3 months	17 648	24 341	38 801	21 544	14 707
From 3 to 4 months	18 583	20 760	32 084	39 194	17 126
From 4 to 5 months	4 069	3 832	11 895	20 589	7 963
From 5 to 6 months	2 852	2 314	4 835	10 450	17 432
More than 6 months	8 587	3 637	8 543	22 275	48 084

* Provisional data gathered in June 2006.

5.2.5.(c) The existence of specific procedures

In some countries other procedures have been developed over the years which run parallel to procedures described above. These procedures are in fact fast, inexpensive and satisfying to those who use them²²⁴.

In the UK for example an online procedure exists for the types of claims covered by the Directive²²⁵. This procedure is extremely efficient and now

²²⁴ House of Commons Constitutional Affairs Committee, *The courts: small claims*, First Report of Session 2005-06, EV (39).

²²⁵ <http://www.moneyclaim.gov.uk/>

deals with more claims per annum than any county courts in the UK. The service started at the end of 2001 and dealt with more than 55,000 claims in 2004²²⁶. However, it does not allow claims to be made against Government departments²²⁷. It also limits a claim amount to under £100,000. Furthermore it discriminates against other EU citizens and companies as the service address must be within the UK²²⁸. This does not mean that creditor has to be a UK company. However, a debtor must be a UK resident to come under consideration. More positively the system does enable a complainant to follow the progress of his or her claim online and, where appropriate, request entry of judgement and enforcement by warrant of execution. Payment of fees can be done online by credit or debit card. Finally, if the claim is undefended, the money can be recovered without anyone having to go to court.

In the Netherlands, summary proceedings exist for urgent matters. These are informal with no other written submissions permitted than those called for by the President of the court. Execution of the court order is by way of a bailiff who will seize and sell the debtor's assets, or by attachment of assets in the possession of a third party.

On 20 April 2005, the Estonian Parliament (Riigikogu) adopted the Code of Civil Procedure and the Code of Execution Procedure. It also amended the Courts Act. These codes came into force on 1 January 2006. It is not clear how effective these provisions will be as they have not been fully implemented yet. Their aim however is to increase substantially the efficiency of proceedings and reduce the number of procedure related disputes. Under the new rules it will be possible under certain circumstances to benefit from expedited proceedings and to file claims electronically. The new Code prescribes the rights and obligations of the debtor, claimant and bailiff to use these proceedings²²⁹. Other changes include: (a) reduction from 16 to 4 city courts and a better division of work because judges can move

²²⁶ House of Commons Constitutional Affairs Committee, *The courts: small claims*, First Report of Session 2005-06, EV (29).

²²⁷ https://www.moneyclaim.gov.uk/csmco/guidelines_who_cannot.jsp

²²⁸ http://www.hmcourts-service.gov.uk/onlineservices/mcol/userguide/claimant/can_i.htm

²²⁹ Raidla & Partners, *Estonia: An Up-Date On The Latest Legal Developments In Estonia*, 2005.

around in the four county courts and share the workload, (b) introduction of a small claims procedure (claims up to 20 000 kroner) and a new, accelerated payment order procedure (claims up to 100 000 kroner), (c) strict time limits, (d) separate procedure to determine the amount of legal costs, (e) settling cases is being promoted (reimbursement of 50% of state fees if a court case is settled), (f) witness testimony in written form and through video conference, (g) electronic communication of documents to the court, (h) written proceedings (no hearing) if parties agree to it, (i) interim measures can be requested more easily.

In Sweden, the law provides that an enforcement agency is in charge of making decisions on matters of undisputed debts²³⁰. The proceedings before this agency are expeditious. This agency is particularly efficient as it is also the enforcer of such decisions²³¹. Below is the number of cases filed with the agency over four years.

YEAR	fast-track or summary procedures to obtain judicial or enforceable decision in cases of undisputed debts
2002	666 000
2003	743 000
2004	810 000
2005	856 000

5.2.5.(d) The general procedure

In the Netherlands, judicial procedures remain time consuming, especially where technical issues are involved, often lasting about 18 months from beginning to end. However, for cases involving amounts of less than 5000 Euros, representation by a lawyer is not compulsory.

²³⁰ (1990:746)

²³¹ Information provided by Mattias Wahlstedt , Deputy Director, Ministry of Justice. See also http://ec.europa.eu/civiljustice/simplif_accelerat_procedures/simplif_accelerat_procedures_swe_en_order.htm#1x

In the Czech Republic, the time it takes to obtain a payment order is on average 90 days. The court fee payable upon filing of the action amounts to 4 % of the claimed amount. The legal fees depend on the time spent; the average fee for filing an action is around 400 Euros²³².

5.2.5.(e) Ongoing reforms at Member State and EU levels

In Belgium a draft law has been submitted to be adopted in late 2006 early 2007 to reduce the backlog of current and pending cases in the courts²³³. However, this proposal only formalizes the existing practice of a case calendar with stipulated deadlines for submission of pleadings and exchanges of evidence and the existing practice of judges imposing fines for bringing trivial cases before courts (fines are set between 15 Euros and 2,500 Euros) which in itself does not resolve the existing backlog of current and pending cases. On the positive side, the proposal does oblige parties to submit all written evidence before the final hearing to allow judges to prepare thoroughly for the hearing and question all relevant parties and impose sanctions on judges who do not deliver judgments within the legal time period of 1 month after the hearing. (The maximum sanction is 20% of a judge's monthly salary over a period of 2 months). The risk of such a measure is that judges if not provided with adequate means may be forced into low quality justice. The issue of adequate means given to the justice systems by Member States is not new and in Belgium the issue has taken a constitutional turn with the separation of powers in play. Most recently, the Belgium Supreme confirmed an Appeals Court sanctioning the Belgian State for not providing adequate means to the justice system. The Supreme Court states *in totidem verbis*:

“En attribuant aux cours et tribunaux la connaissance exclusive des contestations qui ont pour objet des droits civils, l'article 144 de la Constitution met sous la protection du pouvoir judiciaire tous les droits civils.

En vue de réaliser cette protection, la Constitution n'a égard ni à la qualité des parties contendantes ni à la nature des actes qui auraient

²³² DEBT RECOVERY IN THE CZECH REPUBLIC Czerwenka & Partner v.o.s 2006.

²³³ The Belgium Supreme Court has in a September 28, 2006 decision confirmed an Appeals Court decision that awarded damages to a person that fell a victim to long judicial delays.

causé une lésion de droit, mais uniquement à la nature du droit faisant l'objet de la contestation.

L'Etat est, comme les gouvernés, soumis aux règles de droit, et notamment à celles qui régissent la réparation des dommages découlant des atteintes portées par des fautes aux droits subjectifs et aux intérêts légitimes des personnes.

En règle, la faute dommageable commise par l'un de ses organes engage la responsabilité directe de l'Etat sur la base des articles 1382 et 1383 du Code civil lorsque l'organe a agi dans les limites de ses attributions légales ou qu'il doit être tenu comme ayant agi dans ces limites par tout homme raisonnable et prudent.

Le principe de la séparation des pouvoirs, qui tend à réaliser un équilibre entre les différents pouvoirs de l'Etat, n'implique pas que celui-ci serait, de manière générale, soustrait à l'obligation de réparer le dommage causé à autrui par sa faute ou celle de ses organes dans l'exercice de la fonction législative.

Ni ce principe ni les articles 33, 36 et 42 de la Constitution ne s'opposent à ce qu'un tribunal de l'ordre judiciaire constate pareille faute pour condamner l'Etat à réparer les conséquences dommageables qui en sont résultées.

En appréciant le caractère fautif du comportement dommageable du pouvoir législatif, ce tribunal ne s'immisce pas dans la fonction législative et dans le processus politique de l'élaboration des lois mais se conforme à la mission du pouvoir judiciaire de protéger les droits civils.

Saisi d'une demande tendant à la réparation d'un dommage causé par une atteinte fautive à un droit consacré par une norme supérieure imposant une obligation à l'Etat, un tribunal de l'ordre judiciaire a le pouvoir de contrôler si le pouvoir législatif a légiféré de manière adéquate ou suffisante pour permettre à l'Etat de respecter cette obligation, lors même que la norme qui la prescrit laisse au législateur un pouvoir d'appréciation quant aux moyens à mettre en oeuvre pour en assurer le respect.

En déclarant le demandeur responsable envers la défenderesse en raison de la faute consistant à avoir " omis de légiférer afin de donner au pouvoir judiciaire les moyens nécessaires pour lui permettre

d'assurer efficacement le service public de la justice, dans le respect notamment de l'article 6.1 de la Convention (...) de sauvegarde des droits de l'homme et des libertés fondamentales", l'arrêt ne méconnaît pas le principe général du droit et ne viole aucune des dispositions que vise le moyen, en cette branche.

(...)

L'arrêt justifie dès lors légalement sa décision que la responsabilité du demandeur est engagée envers la défenderesse.

(...)

Par ces motifs,

La Cour

Rejette le pourvoi²³⁴ ;”

This decision will have important repercussions in the political and legal arenas and hopefully instead of being the object of debate and disputes will also lead to in-depth reform of the Belgium justice system and the recognition that a good justice system needs independence and adequate means. SME victims of late payments can thus look forward to improvements in the time it takes to obtain an enforceable title in Belgium.

The Czech Republic changed its Code of Civil Procedure in 2005 to expedite the process in court²³⁵. As of April 1, 2005, the accent shall be placed on quicker resolution of disputes with the judge at the forefront of the new process. Further, Appeals Courts may only reverse courts of first instance decisions in cases of serious procedural errors or if exceptional circumstances warrant it.

As of January 1, 2006 a new Civil Procedure Code came into force in Estonia. The code organises new simplified procedures for small claims and introduces modern technologies to civil procedure by allowing digital signatures, video conferencing and organising digital case files.

The Finish government has recently proposed law 13/2005 amending the Finnish Execution Act. The draft law aims at avoiding the hardships of insolvency proceedings. To improve the chances of sustaining a business throughout

²³⁴ Extract taken from http://www.droitbelge.be/news_detail.asp?id=353.

²³⁵ As published under Collection of Law of the Czech Republic No. 59/2005.

enforcement of a decision, the draft law limits the amount of business income vulnerable to seizure. If the law is adopted, the time between the judgment being issued and the instant at which the plaintiff obtains payment would increase.

France modified its Code of Civil Procedure on December 28, 2005, with effect from March 1, 2006²³⁶. The objective of the reform is to increase the speed and efficiency of the justice system. Major changes include (a) the adoption of a procedural calendar with deadlines to submit evidence and written arguments²³⁷, (b) the obligation made on parties to invoke procedural issues at the first hearing²³⁸, (c) the simplification of notifications²³⁹, and (d) the ability to communicate certain procedural acts by email²⁴⁰.

In Greece, the court procedures law was modified on September 16, 2005. New timeframes for the treatment of cases have been introduced. No more than 6 or 12 months can elapse between filing the complaint and the final hearing, or between two hearings if a case cannot be decided in a single hearing. The 6 month limit applies to special proceedings (cheques, promissory notes, uncontested claims) and the 12 months timeframe for normal proceedings. This should divide by three on average length of a case. The risk however is that instead of organising just one hearing judges will tend to multiply hearings thus extending the time it takes to get to the final hearing.

Italy reformed its Code of Civil Procedure in late 2005 with regulations that came in force as of March 1, 2006²⁴¹. These laws, guided by objectives of making justice more accessible and efficient, have imposed major changes on judicial proceedings. Important changes are the introduction of procedural deadlines and evidentiary schedules. Further, new time limits are set on parties' activities during the proceedings especially in respect to the time of presentation of evidentiary documents. Finally, proceedings are shortened by the elimination of hearings. However, the period between the notification of the complaint and

²³⁶Décret n° 05-1678 du 28 déc. 2005, relatif à la procédure civile, à certaines procédures d'exécution et à la procédure de changement de nom.

²³⁷ Modifying Article 764 of the Nouveau Code de Procédure Civile.

²³⁸ Modifying Article 771 of the Nouveau Code de Procédure Civile.

²³⁹ Modifying Articles 670 and 670-1 of the Nouveau Code de Procédure Civile.

²⁴⁰ As of January 1, 2009.

²⁴¹ Law 80 of May 14, 2005 and Law 263 of December 28, 2005.

the start of judicial proceedings is increased by 30 days to 90 days and 150 days for summons notified outside Italy²⁴². This will not fare well with creditors who want to be paid. But the Directive does not seek to harmonize notification periods or regulate the rights of the parties in court proceedings.

In Lithuania a new Code of Civil Procedure²⁴³ came into force relatively recently, 2003. One of its primary objectives was to accelerate court proceedings. It is difficult to evaluate at this stage whether this is a success since only two full years have passed since its enforcement.

Poland adopted a new law regarding legal costs on July 28, 2005. This amended the Civil Procedure Code of 17 November 1964. The new law came into force on March 2, 2006. Creditors can now request private bailiffs, who are conferred extensive powers²⁴⁴ to search for a debtor's assets. Prior to this, the creditor had to establish the scale and whereabouts of the debtor's assets by him or herself. The new law also allows bailiffs to sell immovable goods without having to organise a public auction. In the autumn of 2005, a new arbitration law came in effect, which increases the attractiveness of arbitration courts as compared to common courts²⁴⁵. The objective of this is to limit the number of cases that go to court and decongest the court system.

Portugal has amended its Civil Procedure Code in 2005 and 2006 granting the court further powers to expedite the process²⁴⁶.

Slovenia has suffered from court delays and has been condemned for it. First by its own Constitutional Court²⁴⁷. Second by the European Court of Human Rights in the Lukenda v. Slovenia case of October 6, 2005. As a result the government adopted on December 12, 2005 a project, the Lukenda Project, to reform the judicial system and absorb the case backlog. Amendments to the Code of Civil Procedure are due to be adopted in 2007.

²⁴² Article 163-bis of the Civil Procedure Code.

²⁴³ Law of February 28, 2002 No IX-743 which came into force on January 1, 2003.

²⁴⁴ Bailiffs have authority to request information from public administration authorities, tax authorities, pension authorities, banks or brokerage houses.

²⁴⁵ (Journal of Laws no 178, item 1478).

²⁴⁶ Laws 11276/2006 and 11277/2006.

²⁴⁷ Case no. U-I-65/05 of 22 september 2005.

Slovakia amended its enforcement laws (part of the Code of Civil Procedure²⁴⁸) as of January 1, 2006. The main changes are aimed at shortening court proceedings and enforcement of decisions. Previously creditors had been able to choose between enforcement by the courts and enforcement out of court. Under the new rules, in all civil and commercial matters except cases involving minors, creditors out of court enforcement is the principle. Further, the new rules impose a strict time-table on the parties. Evidence submissions are strictly confined to the evidence period. Facts established before the first degree judge are binding on the appeals court. Finally, the use of ADR is actively promoted so much so that court fees have been increased to encourage parties to use mediation and/or arbitration.

The United Kingdom has recently substantially amended its rules of civil procedure. The changes are incorporated in the 42nd Update which enters into force as of October 2, 2006. The changes include clarifying the Court's case management powers, improvements to online money claims, the promotion of alternative procedures for claims and guidelines on small claims and fast-track procedures. Finally, telephone hearings are facilitated.

5.2.5.(f) Statistical information obtained based on the late payments survey and questionnaire (LP Survey)

The LP Survey shows that legal action is rarely undertaken. In a majority of case the debts are disputed. Most respondents confirmed that it took more than 90 days to obtain an enforceable title. Only 29% of respondents stated that they had to pay full recovery costs.

5.2.5.(g) World Bank survey on contracts enforcement for late payments in commercial transactions

The World Bank has conducted surveys in the last few years on doing business in more than 150 countries²⁴⁹. One of these surveys, which is the only one of

²⁴⁸ Act No. 99/1963 Coll.

²⁴⁹ <http://www.doingbusiness.org/>

its kind, relates to judicial procedures in cases of payment default in commercial transactions²⁵⁰ (“WB Survey”). The WB Survey was conducted in 2003, 2004 and 2005 and includes 22 countries of the EU²⁵¹.

The WB Survey is particularly relevant to this study given its subject matter, the years covered and the countries involved²⁵². Even more relevant is the case study used as a basis for the WB Survey. The hypothesis for the case study is as follows.

In a commercial transaction for goods, a creditor sues a debtor over an unpaid debt²⁵³ based on the assumptions that

*“The debt value equals 200% of the country’s income per capita,
The plaintiff has fully complied with the contract (that is, the plaintiff is 100% right),
The case represents a lawful transaction between businesses residing in the country’s most populous city,
The bank refuses payment for lack of funds in the debtor’s account,
The plaintiff attempts to recover the debt by filing a lawsuit or going through an administrative process, if such a process is available and preferred by creditors,
The debtor attempts to delay service of process but it is finally accomplished,
The debtor opposes the complaint (default judgment is not an option),
The judge decides every motion for the plaintiff,*

²⁵⁰ <http://www.doingbusiness.org/ExploreTopics/EnforcingContracts/>. As stated the study looks at “the efficiency of contract enforcement by following the evolution of a payment dispute and tracking the time, cost, and number of procedures involved from the moment the plaintiff files the lawsuit until actual payment”.

²⁵¹ Luxembourg, Cyprus and Malta are not included.

²⁵² The author of this Report did not check or evaluate the validity of the World Bank Study results since it was not the object of this Report. As with other sources of information, the author uses these results in as far as they emanate from a reputable institution. The author is aware that some of the results of the WB Survey have been put in doubt but because the use of the WB Survey in this study is limited to the general trends that can be observed (the Directive does not address the same issues) any questionable result would not in itself change the general conclusion. Finally, it should be noted that the more specialists from different countries participate in these surveys (I do not believe that the WB refuses contributions) the more satisfying will the results be.

²⁵³ The debt is unpaid because the cheque sent to the creditor by the debtor is refused by the bank for lack of funds.

*The plaintiff attempts to introduce documentary evidence and to call one witness,
The debtor attempts to call one witness.
Neither party presents objections,
The judgment is in favour of the plaintiff,
There is no appeal.”*

Based on this, the WB Survey seeks to determine the time required for the creditor to be paid starting from the moment the plaintiff files the lawsuit in court until enforcement of the enforceable title. This includes the service of process duration, days when actions take place and waiting periods between actions until the issuance of the judgement and actual enforcement.

The situation is thus one where because of a defective payment the creditor seeks a judicial decision with a view to obtaining enforcement against the debtor. This is a situation the Directive addresses. However, a number of elements differ between the scope of the Directive and the case presented in the WB Survey.

The Directive’s scope is limited to the cases where there is:

- 1/ An undisputed claim;
- 2/ A debt resulting from a commercial transaction, whatever its amount;
- 3/ An undisputed procedure;
- 4/ No discrimination between EU creditors;
- 5/ An enforceable title able to be obtained within 90 calendar days of the lodging of the creditor’s action; and
- 6/ No enforcement delay for the title, a procedure excluded from the scope of the Article.

The stated amount in the WB Survey is within the Directive’s scope as the Directive allows for any amount. It is all the more relevant that with a debt value equalling 200% of a country’s income per capita, most small claims procedures will not apply²⁵⁴. Thus the results presented by the WB Survey are

²⁵⁴ Small claims procedures include all fast-track procedures put in place by Member States in the last few years to deal with claims that are usually below 4000 Euros.

particularly interesting because it covers the regular procedures of obtaining an enforceable title rather than just the small claims ones which by definition will be fast and in compliance with Directive objective.

Enforcement delays are excluded from the Directive's scope when they are included in the WB Survey. However, the WB Survey results separate out the time it takes to obtain an enforceable title from the time it take to enforce it. As a result the WB Survey is relevant.

However, where the WB Survey and the Directive differ substantially is in the fact that in the WB Survey the claim is disputed when in the Directive it is not. The Directive's aim is to fight the unfairness of a situation where, even though no dispute exists in relation to a claim, the creditor is not able to obtain payment. On the other hand, the WB Survey highlights the most common situations which arise in contracts enforcement (disputed claims) and how long it takes to deal with them. In that respect the WB Survey is in itself relevant to the Directive's limitations. This is discussed in Chapter 6. However, this also highlights the limitations on the usefulness of the WB Survey in respect to late payments procedures as contemplated by the Directive. The WB Survey concerns disputed claims. The Directive excludes them.

However, because procedures in case of undisputed claims will naturally be longer than those in cases of disputed claims, by deduction any country's result in the WB Survey that show procedures that are shorter than 90 days will indicate that the country in question respects the 90 days prescribed by the Directive. In this respect the WB Survey will be relevant.

The WB Survey is thus partially relevant to describe the present situation in the EU with regard to late payments procedures to obtain an enforceable title.

It appears from the statistics provided by the WB Survey that seven countries are below the 90 day threshold set by the Directive. These are the Netherlands, Latvia, Lithuania, France, Greece, Denmark and Belgium. This information however could not be verified by the interviews conducted under this Study. If when special procedures exist, the 90 day threshold is attainable, absent special procedures the 90 day goal is seldom met. In Greece for example, interviews show that an enforceable title may be obtained only after 3 to 4 years. Finally

5% of those who participated in the LP Survey confirmed that in a suit where they were the defendant, the plaintiff obtained an enforceable title within 90 days.

5.2.6 Related EU measures

5.2.6.(a) Measures relating to insolvencies

The Insolvency Regulation²⁵⁵ was a normal regulation to follow the Directive. The Directive is not just concerned with late payments or long payment periods, but also with the absence of payment. Hence the provisions on retention of title.

5.2.6.(b) Measures relating to procedures

The Directive has clearly highlighted the need for changes in Member States civil procedures so that they are more adapted to the structure of the Internal Market. The discussions alone the Directive triggered during its adoption process had an impact on future discussions relating to harmonization of civil procedures. Interestingly, commercial claims were always included in these.

As stated earlier, the Directive is a precursor in the field of EU harmonization of civil procedures. Various instruments have been devised and adopted either to follow up on the Directive, or based on experience derived from the Directive's provisions in the area²⁵⁶.

The Conclusion of Tampere the European Council is a clear follow-up on the Directive whereby the European Commission is, basing its action on Article 65, to devise special common procedural rules for simplified and accelerated cross-border litigation on small consumer and commercial claims, including uncontested claims²⁵⁷. It also provides that alternative dispute resolution procedure should be created by Member States, and that decisions be recognized and enforced without *exequatur*, in particular in respect to commercial claims.

²⁵⁵ Regulation (EC) No 1346/2000. Council regulation of 29 May 2000 relating to insolvency proceedings, OJ L 160, 30.6.2000.

²⁵⁶ Many instruments revert to the Directive or the original proposal for the Directive. See Tampere Council, 15/16 October 1999, EU Bull. 10-1999, pp. 7-15, at §29;

²⁵⁷ See Tampere Council, 15/16 October 1999, EU Bull. 10-1999, pp. 7-15, at §30;

Other regulations or regulation proposals are follow-ups on the Directive with the interesting feature that they take the actual form of Regulations²⁵⁸.

The most recent regulation in this field is the one creating a European enforcement order for uncontested claims²⁵⁹. This regulation lays down minimum standards to ensure that judgments, court settlements and authoritative decisions on uncontested claims can circulate freely within the EU. This Regulation carries the abolition of *exequatur* for that specific order. The Regulation applies in civil and commercial matters. It is not clear however whether it applies to public entities within the definition of the Directive. Enforcement procedures are governed by the law of the Member State of enforcement that obtains where the debtor is located. The creditor must supply minimal information to the competent authorities in the enforcing Member State. These include a copy of the judgment, a copy of the European enforcement certificate and a translation of the enforcement certificate where necessary. The imposition of a translation was not necessary as the enforcement order certificate could have been made out as a multilingual document as it concerns amounts which are numerals recognized in the same form in all Member States. No security, bond or deposit may be required.

This regulation complements the Directive as it provides an efficient tool to prolongue the Directive effect in the field of enforcement.

Closer to the Directive's objective is the proposal for a regulation for a European payment order procedure²⁶⁰. This creates a swift and simple mechanism enabling creditors in cross-border situations to collect pecuniary claims. Its aim is to tackle the issue of mass recovery of cross-border uncontested claims through national courts. Even if some Member States have devised special summary

²⁵⁸ The Council Regulation (EC) no. 1348/2000 of 29 May 2000 regulates the service in the Member States of judicial and extrajudicial documents in civil or commercial matters, OJ L 160/37, 30 June 2000, Regulation no. 1348/2000 of 29 May 2000; European Regulation (EC) no. 1206/2001 of 28 May 2001 on cooperation between the courts of the Member States in the taking of evidence, in civil or commercial matters, OJ L 174/1, 27 June 2001, Regulation no. 1206/2001 of 28 May 2001.

²⁵⁹ Regulation (EC) No 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims.

²⁶⁰ COM(2006) 57 final, Amended proposal for a Regulation of the European Parliament and of the council creating a European order for payment procedure, 07.02.2006. See also COM(2006) 374 final, Communication from the Commission to the European Parliament, concerning the common position of the Council on the adoption of the Regulation of the European Parliament and of the Council creating a European order for payment procedure, 04.07.2006.

proceedings within the structure of ordinary civil procedure to cope with uncontested claims and even if these have proved to be a valuable tool to ensure the rapid and cost-effective collection of claims that are not the subject of a legal controversy, cross-border disputes are more complex and difficult to resolve through these procedures. As a result a Regulation was proposed to deal specifically to the challenges brought by cross-border claims. This regulation should be adopted before the end of 2006. It fits within the Directive's scope although it is more limited than that of the Directive as it only concerns cross-border cases.

Instruments for either debt collection or enabling enforcement, garnishments and the transparency of assets, or proposals for alternative dispute resolutions are reflected upon at the European level in a spirit similar to that which originally led to the adoption of the Directive²⁶¹.

5.2.7 Identification of good commercial practices

Examples of sound commercial practices and codes of good conduct were collected. It clearly appears that the code of good conduct is a preferred tool to combat late payments. The persons contacted and others who answered the Questionnaire indicated that charters or codes of good conduct negotiated within a sector would be better adapted to ensure the effective implementation of the principles laid down in the Directive. The reasons for this are as follows:

- 1/ A negotiated agreement between the parties is more likely to be implemented;
- 2/ A negotiated agreement facilitates the acceptance of late payment interest; and
- 3/ Different practices concerning late payments exist in each sector because of the distinctive structures which characterise them.

Additionally, it appears that sales contracts and provisions of services contracts integrate the tools proposed by the Directive. Many such contracts in the

²⁶¹ M. Freudenthal, *The Future of European Civil Procedure*, vol 7.5 ELECTRONIC JOURNAL OF COMPARATIVE LAW, (December 2003), <<http://www.ejcl.org/ejcl/75/art75-6.html>>

different Member States incorporate provisions on late payments interest as provided by national legislation. Further, payment periods of 30 days appear more and more in contractual provisions.

5.2.8 Contractual payment periods

Studies, statistics and interviews show that contractual periods have not increased since the adoption of the Directive²⁶². Many contracts, whether public or private, request payment within 30 days and this is established by reference to the Directive or transposition measures. Payment periods in the public sector remain worse than those in the private sector, with some payment periods reaching 150 days. Average payment periods in the public sector are 60 days. Average payment periods in the private sector are 40 days. Payment periods across sectors differ significantly, with the services sector having shorter payment periods, and specific industrial sectors longer payment periods. Further, payment periods between Member States also differ, with public sector average payment periods of 30 days in some countries, and 120 days in others²⁶³.

In Estonia for example a public agency stated that as a state-owned company, *“do not have problems with late payments and therefore, we pay our suppliers on time, usually 21 or 30 days after receipt of invoice”*. In Finland answers generally confirmed: *“usually payment term of 30 days net after successful delivery of goods or services”*. Similar answers were obtained from the Netherlands, Sweden, Slovenia and the UK. In Ireland, public agencies contacted declared that: *“The legislation requires all state agencies to pay invoices within a specified period (currently I think 33 days) and if not paid by then the state agency is required to calculate interest due and add this to the payment when it is finally made”*. In France, hospitals state that they make payment within 50 days. In Malta, hospitals have payment periods of 150 days. Late payments trigger a late payment interest of 3%. In Greece, precise numbers were

²⁶² See *Application of the Directive on Late Payments in the Construction Sector*, FIEC, 12.12.2005.

²⁶³ More than 700 public institutions were contacted to obtain relevant information on their payment practices. These institutions were contacted randomly based on a database compiled by the Team from agencies that participate in public procurements in the EU. Answers were obtained for all Member States mainly from local government entities, hospitals, public road construction entities. As most respondent wish their name and other information to remain confidential, the information provided herein is limited to general statements.

unavailable. However, the following answer was provided: “payments in Public Works are made according to paragraphs 9 and 10, of the article 5, of the Law 1418/84, as it was amended by the article 18 of the Law 1947/91 and replaced by the paragraph 6 of the article 2 of the Law 2229/94, in correlation with the article 40 of the Presidential Decree 609/85. As far as it concerns the interest rate of overdue payments (that is paid in case of a delay, which the Contractor is not responsible for), it is calculated according to the paragraph 4 of the article 4 of the Presidential Decree 166/03”.

The table below presents an attempt at synthesizing the results obtained for public contracts²⁶⁴.

COUNTRY	PAYMENT PERIOD	LATE PAYMENT INTEREST
AT	60 days	YES
BE	60 days for works 50 days for deliveries	YES directive rate precisely
CY	15 to 30 days except in case of acceptance periods in case of complex transactions	NO compensation for late payments
DK	30 days	YES
EE	10-30 days	YES
EL	Payments in Public Works are made according to paragraphs 9 and 10, of the article 5, of the Law 1418/84, as it was amended by the article 18 of the Law 1947/91 and replaced by the paragraph 6 of the article 2 of the Law 2229/94, in correlation with the article 40 of the Presidential Decree 609/85.	YES
ES	60 days	Legal interest plus 1.5 percentage point
FI	30 days	YES
FR	50 days	YES
HU	30-60 days	YES default interest plus collection action against contracting authority's bank account.

²⁶⁴ By no means are these tables a reflection of practices in Member States. To establish this a full study on contractual practices should be organised. These tables merely give an overview of what can be found in contracts and may provide insights on how companies deal contractually with the issues that interest us here.

IE	33 days	YES
LT	90 days	
LU	31 - 60 days	YES
LV	15 - 30 days	0,1 -0,3 % per day
MT	Generally 60 days Public hospitals: 150 days	2% point over CBM 3% for public hospitals
NL	30 days	NO
PT	15 and 30 days	YES Late payment compensation paid
SE	30 days	YES SCB rate plus 8 % point
SI	30 days	YES legal interest
UK	30 days but can be delayed for many reasons including invoice form etc...	

The table below presents an attempt at synthesizing the results obtained for private contracts.

COUNTRY	PAYMENT PERIOD	LATE PAYMENT INTEREST	COMPENSATION	RETENTION OF TITLE
AT	30 days	Between 5 and 12% Base rate ACB or EURIBOR	5-10 Euros per reminder letter	Until payment in full
BE	30 days	10-12%. Minimum of 150 Euros. 1% per month.		YES
CY	30-60 days	1.5% per month		
CZ	30-60 days	0.05% per day		
DE	10-20 days	5-8% point on top of base rate		Until payment in full
DE	20-30 days	Reference to Late Payment Interest Act		
EE	30 days	2% per month		
EL	30-120 days	YES		
ES	30 days	1% per month		
FI	30 days	Interest Act	YES	YES
FR	30-60 days	7% point on top of ECB		YES

HU	30-60 days	20%		
IE	30 days	2% on invoiced amount 10.25% by reference to commercial protection act 1997 and EU Directive 2000/35		
IT	30-120 days	10-30%		
LT	30 days	2% per month		
LU	30 days (default)	1% per month		
LV	30 days (default)	2% per month		
MT	30 days	4% point over CBM	2%	YES
NL	30 days	1% per month Minimum 500 Euros	YES Payment of legal-cost based on flat-fee of 15% of invoice	
PT	90 days	1% per month	YES Payment of collection costs based on flat-fee of 15% of invoice with minimum of 140 Euros	
SE	15-30 days	YES LATE PAYMENT INTEREST ACT	YES SCB rate plus 8 % point	YES SCB rate plus 8 % point
SK	15 - 30 days	0.07% per day		
SI	30 days	YES legal interest	YES for dunning letters	YES
UK	30 days	2% per month 8% point on top of lending rate	Yes between 15 and 150 Euros Reference to statutory compensation rate	YES until paid in full

Member States have been active in promoting an entrepreneurial spirit that in fact enhances a culture of good commercial practices²⁶⁵. In Sweden, a national competence centre for the development of SMEs was created. In the Netherlands, insolvency regulations were modified to protect SMEs. In Spain, the use of ICT to facilitate SME creation and development has been enhanced. In the UK, the Think Small First Campaign has changed the way ministries interact with SMEs. Going further, Finland has started an “entrepreneurship program” for primary schools to promote entrepreneurial behaviour. Austria and Germany have developed similar programs.

Summary of Chapter 5: The Present Situation²⁶⁶

- Late payments in Europe have dropped from around 16 days in 1995 to 12.8 days in 2006.
- SME competitiveness should benefit although trade-credit is also an important component that should not be disregarded.
- Payment periods have stabilized.
- Insolvencies numbers have dropped.
- Unemployment is stabilizing.
- Intra-EU trade is steadily increasing.
- Credit management has improved.
- Member States have transposed the Directive.
- Many Member States have started SME specific actions aimed at improving the business environment and business practices.
- Good practices codes and charters have developed
- Action of representative organisations has been limited by competition law violations concerns
- Many Member States have started to reform their judicial systems.

²⁶⁵ *Perpective de l'OECD sur les PME*, 2002, p. 19.

²⁶⁶ This and following chapter summaries should not be used to draw conclusions from if read in isolation. Rather they should serve as a guide for readers to locate those sections in the text of most interest to them. These summaries provide a little more information than a table of contents.

6 THE IMPACT OF THE DIRECTIVE

The impact of the Directive is presented through three Chapters. These are previous chapter, which describes the present situation, this chapter, which presents the impact of the Directive *stricto sensu* and Chapter 7, which presents the impact of the Directive through the relevance, coherence, usefulness, and effectiveness of its provisions.

Following the Directive, SMEs and, more precisely, creditors, are conferred a number of rights by Member States. These rights are aimed at helping them fight late payments, strengthen their operations and provide them with the degree of security likely to foster cross-border transactions within the EU.

The Directive has had a legal impact on regulations on payments in the EU. It has also had an impact on contractual relationships, on good practices and on business culture.

The Directive has had an economic impact on late payments throughout the EU. Its impact on payment delays is less noticeable. Its impact on insolvencies and unemployment is not clear, firstly because of the lack of reliable economic studies, and second because the Directive has not been in force for long enough for an impact assessment to provide relevant results.

6.1 The Legal impact

The expected legal impact has been described in Chapter 4, in which the Directive's provisions have been described in detail.

Most firms interviewed stated that the measure most helpful to them was the introduction of interest on late payments. This is confirmed by other studies²⁶⁷. This is also the measure that is most clearly implemented by Member States²⁶⁸.

²⁶⁷ "*Late Payment and Credit Management in the Small Firm Sector: Some Empirical Evidence*", Michael J Peel, Nicholas Wilson and Carole Howorth, Cardiff Business School, CMRC Leeds University Business School and Nottingham University Business School, Revised July 1999.

²⁶⁸ Report submitted by Jean Albert to the European Commission on information on and approximation of legislation, 31 August 2006.

Contracts often use the statutory late payment interest as a reference, either adopting it as is or adding to it some extra percentage point²⁶⁹.

6.1.1 Actual legal impact on late payments and payments delays

There is no doubt that the Directive has had a legal impact. Implementation legislation has been adopted in most Member States and late payments have dropped, as shown in Section 5. However, even though late payments may have dropped, their levels remain unsatisfactory in many countries. The legal impact in practice may thus not meet expectations. In Greece for example, payment periods in the health sector have dropped by more than half since the adoption of the implementation law. But this is not enough as they remain at 330 days, and all payments are made after the due date²⁷⁰.

6.1.1.(a) The application of the principles recognized in the Directive to all commercial transactions between undertakings.

As stated before, the Directive applies to commercial transactions between undertakings²⁷¹ or between undertakings and public authorities²⁷² which involve the provision of goods and services for payment. This has been transposed in Member States' legislation. However, some courts have failed to implement this properly. France is an example of this failure. A French Court of Appeal has very recently ruled that commercial transactions between undertakings excluded the professions (lawyers, doctors, notaries, dentists...). The Directive is absolutely clear on this issue; the legislator's intent also. The professions are included. The implementing French law may have been unclear, but it was the duty of the French judges, especially at the Court of Appeal level, to, without giving the Directive a horizontal effect, clarify the law by reference to it. It

²⁶⁹ Report submitted by Jean Albert to the European Commission including examples of contracts and contractual provisions as collected, 31 august 2006.

²⁷⁰ Following interviews conducted with equipment providers to the health industry and in particular the very helpful Hellenic Association of Scientific and Medical Suppliers.

²⁷¹ The Directive defines an undertaking as meaning "any organisation acting in the course of its independent economic or professional activity, even where it is carried on by a single person"; this includes professionals but not consumers.

²⁷² Public authorities are defined by reference to the four Directives on Public Procurement 92/50/EEC, 93/36/EEC, 93/37/EEC and 93/38/EEC already in force. Article 1 of Directive 93/38/EEC states that public authorities "*shall mean the State, regional or local authorities, bodies governed by public law or associations formed by one or more of such authorities or bodies governed by public law.*"

appears that the French judges felt no need to so or even refer the case of the ECJ²⁷³.

6.1.1.(b) The right in case of an undisputed invoice to claim interest by default 30 days after due date

This right can now theoretically be exercised in all Member States. This being the case, the Directive has had the expected impact. However, in practice, the right is not always exercised. This has limited the practical impact of the Directive. First, creditors are reluctant to use this right. Many creditors do not wish to offend their clients, especially when amounts are small. Most companies interviewed prefer to work with companies that are flexible in respect to payment terms. Second, this right is not always recognised. In Greece for example, public organisations do not accept the extra invoices sent to them for interest on late payments. They are not paid, and as a result are rarely issued to debtors²⁷⁴.

6.1.1.(c) The right to automatic interest

This right can now theoretically be exercised in most Member States. This being the case, the Directive has had the expected impact.

6.1.1.(d) The absence of a reminder necessary to claim interest

By default, no reminder is necessary to charge interest on a late payment. This has been implemented in Member States and many countries have had to make specific changes in their regulations to accommodate this. However, in practice most companies interviewed send reminders before charging interest.

²⁷³ Decision of the Douai Court of Appeal of October 2006. Interestingly the decision involved a member of the Team who did not fail to point out the relevant legislation. The costs of bringing the case to the Cour de Cassation, France's highest court, are such that the Court of Appeal's decision will be final.

²⁷⁴ Following interviews conducted with equipment providers to the health industry and law firms and in particular the very helpful Hellenic Association of Scientific and Medical Suppliers and the law firm of KYRIAKIDES GEORGOPOULOS & DANIOLOS ISSAIAS.

6.1.1.(e) The default interest rate should be the ECB's rate²⁷⁵ plus seven percent at least

Most Member States have implemented this provision.

Its impact is noticeable in practice even against public institutions. In the cases in the UK that involved payment delays by the government to companies that assisted in fighting the foot and mouth epidemic, companies were awarded millions of pounds in late payment interest²⁷⁶. Similar cases led to similar decisions in Scotland where Sheriff James Roy Smith ruled that Wallets Marts Castle Douglas Limited should receive £267,322 plus interest accrued over the previous three years from the Scottish Executive for work carried out during the 2001 foot and mouth epidemic²⁷⁷. Courts readily award late payment charges to debtors.

However, its impact may have been limited out-of-court. First, SMEs are not always organised to charge and calculate interest rates on late payments. Second, calculating the interest on late payments does not seem to be as straightforward as it appears. Many interviewees have stated that they find it difficult to calculate the interest. Many do not know what the ECB rate is or how to find it. Third, companies remain reluctant to charge interest to their clients not wishing to risk losing an important source of work²⁷⁸.

Once the legal proceedings stage is reached, a point of no return, charging interest is easier. First because once a court action is started, any relationship with the customer is over and there is nothing to lose by asking for the interest. Second, before they go to court, SMEs usually ask for advice from lawyers. As professionals, lawyers will point out that they may be entitled to interest.

²⁷⁵ Or rate set by national central bank for Member States not participating in the Economic and Monetary Union third stage.

²⁷⁶ <http://www.fpb.org/Yb50UNto5IMmUA.html>

²⁷⁷ Court Reference No : A105/01, 10.05.2004.

²⁷⁸ We used the term “work” here rather than “income” because a client is much more than an income. It is a chance for many companies, an activity, a reference, an account, sometimes a supplier, often a recurring business relationship...

6.1.1.(f) Option for a payment delay of 60 days left to Member States for categories of contract (Article 3.2)

A useful instrument seldom used.

Country ²⁷⁹	Option
AT	
BE	
CY	
CZ	
DE	
DK	
EE	
EL	
ES ²⁸⁰	✓
FI	
FR ²⁸¹	✓
HU	
IE	
IT ²⁸²	✓
LT	
LU	
LV	
MT	

²⁷⁹ Germany (DE) ; Austria (AT) ; Belgium (BE) ; Cyprus (CY) ; Denmark (DK) ; Spain (ES) ; Estonia (EE) ; Finland (FI) ; France (FR) ; Greece (EL) ; Hungary (HU) Ireland (IE) ; Italy (IT) ; Latvia (LV) ; Lithuania (LT) ; Luxembourg (LU) ; Malta (MT) ; Poland (PL) ; Portugal (PT) ; Czech Republic (CZ) ; United Kingdom (UK) ; Slovakia (SK) ; Slovenia (SI) ; Sweden (SE)

²⁸⁰ Produits frais et les denrées périssables continuera à être celui déjà exigé de 30 jours

²⁸¹ Article L. 441-7 du Code de commerce.

²⁸² Art. 4.3 and 4.4 Decreto Legislativo 9/10/2002.

NL	
PL ²⁸³	✓
PT	
SE	
SK	
SI	
UK	

Few countries have used this provision. As a result it has not had a great impact.

The fact that this provision has been seldom used is a confirmation that the provision on grossly unfair provisions is ineffective. Many contracts include 60 day payment periods with no compensation whatsoever in case of late payment except for the normal statutory interest.

This provision would only become effective, if a contract that included a 60 day payment period were considered grossly unfair.

6.1.2 Actual legal impact on retention of title

All Member State regulations recognize the concept of retention of title. This was so even prior to the Directive. Most Member State regulations go further than what is provided for in the Directive²⁸⁴.

As a result, the Directive's impact is uncertain because Member States did not take specific measures to transpose it believing that the Directive required no change in national regulation. Since the Directive does not *stricto sensu* impose harmonization of the requirements relating to the retention of title among

²⁸³ Article 5 « *In cases where the period for payment fixed by the parties to the agreement is longer than 30 days, the creditor may claim legal interest from the 31st day following his fulfilment of the non-pecuniary obligation and the delivery to the debtor of the invoice or the bill concerned until day of the actual payment, but not however later than the due date for payment relating to the pecuniary obligation* ».

²⁸⁴ *Retention of Title in European Business Transactions*, J. Michael Milo, Washburn Law Journal, 27.01.2004, p. 137.

Member States²⁸⁵, it has had little or no legal impact. Recently, the European Court of Justice decided that that the Directive did not impose harmonisation on rules regarding the enforceability of retention of title clauses against third parties and went further to state that the Directive does not “*harmonise all the rules relating to late payments in commercial transactions*”²⁸⁶.

Further, any legal impact of the Directive would be limited to payment periods in commercial transactions involving goods. It would also have been limited to specific goods. As observed by EUCOMED the retention of title provision affords no protection to sellers of medical devices to hospitals²⁸⁷. Other instruments have to be used to ensure that sellers of medical devices are paid on-time since they, for obvious reasons, cannot retake possession of their life-saving machines.

6.1.3 Actual legal impact on procedures

Chapter 5 describes in great detail the reforms that have been undertaken since the adoption of the Directive. Their number and magnitude are significant. Many precisely address late payment claims.

As stated in Chapter 5, the WB Survey is relevant to a certain extent in describing the present situation in the EU regarding late payment procedures to obtain an enforceable title. This does not mean that the results of the WB Survey are relevant to determine whether the Directive has had an impact on judicial procedures. However, a ripple effect on disputed claims may be expected if the Directive has an impact on procedures relating to undisputed claims. Observing an improvement in the former could lead to improvements in the latter, themselves due to the Directive. For example, fast-track procedures created to facilitate obtaining an enforceable title in cases of undisputed claims, may free the courts of the extra work load. In this case the WB Survey results could be relevant. Its relevancy is increased because it was conducted in 2003, 2004 and 2005 and includes 22 countries of the EU²⁸⁸.

²⁸⁵ *Retention of Title in European Business Transactions*, J. Michael Milo, Washburn Law Journal, 27.01.2004, p. 139.

²⁸⁶ See also *Commission of the European Communities v. Italian Republic*, Judgment of the Court, case C-302/05, 26.10.2006 at paragraphs 22 and 23.

²⁸⁷ *EUCOMED situation summary and guidance for members on the late payments directive*, EUCOMED, 13.12.01, p.7.

²⁸⁸ Luxembourg, Cyprus and Malta are not included.

The WB Survey shows improvements in Slovenia, Lithuania, Poland, Finland, the Czech Republic, the Slovak Republic and Germany.

The impact on countries such as Portugal has been remarkable. Prior to the Directive, the average procedure time was 180 days. In its transposition legislation, and although the Directive did not require this, Portugal decided to introduce a specific expedited procedure for debts originating from commercial transactions, irrespective of their amount²⁸⁹. The new procedure which is in fact an injunction proposes a simple, fast, cheap and efficient means of obtaining an enforceable title in undisputed claims²⁹⁰. Basically, the creditor only needs to provide minimum information by filling in a form and submitting it to a court office. The debtor is then notified and has 15 days to settle or contest the debt. The injunction will become an enforceable title after 15 days if the debtor fails to respond. This procedure is widely used today mainly because of its speed. See Section 5.2.5(b) above.

An enforceable title can be obtained in 30 days²⁹¹.

The Directive, by the rights of claim it creates following its transposition in Member States' legislation, implies a substantial increase in the number of claims being pursued. As a result, Member States with judicial back-logs not only have to face a prospective increase in the number of claims but an obligation to enhance judicial efficiency. The fact that so many Member States have enacted new legislation to enhance the efficiency of judicial procedures is a sign of the very positive effect of the Directive.

These trends to increase procedural efficiency will not have an immediate impact. They should however change the reluctance of creditors to go to court to obtain an enforceable title²⁹².

²⁸⁹ See Decree-Law 32/2003 implementing EU Late Payment Directive (35/2000/EC).

²⁹⁰ *Creditors to Benefit from New Late Payment Regime*, Miranda Correia, Amendoeira & Associados, 26.04.2004.

²⁹¹ *Debt Recovery in Portugal*, SPS Advogados - Sociedade de Advogados, 19.02.2004

²⁹² *The Quasi-judicial Role of Large Retailers: An Efficiency Hypothesis of their Relation with Suppliers*, Benito Arruñada, Barcelona, January 13, 2000, p. 21.

6.1.4 Actual legal impact on the right to recovery costs

The impact of the Directive in this respect has been limited due to the absence of a definition of “relevant recovery costs” in the Directive. The reference therein to judges as awarding costs has limited it further. As a result, Member States have limited the definition of reimbursable costs and often constrained their recognition to a right or a claim to be made within the context of court proceedings.

The impact on the right to recovery costs has thus been mitigated by the fact that the Directive is not clear on what Member State transposition obligations are in this area. As a result, some Member States such as the UK and Ireland have regulated recovery costs in an extensive way, using fully the option given to Member States to fix recovery cost reimbursable amounts depending on the debt amount²⁹³. Other Member States have considered that the right created was not automatic and that it was a **right to claim** costs of recovery before the courts, which their systems already provided for. This is the case in France where recovery costs are not reimbursable unless within the framework of court proceedings. So no change was made in this respect. In countries like Portugal where judges are reluctant to award recovery costs other than those directly related to court proceedings, this provision has had no impact²⁹⁴.

6.1.5 Actual legal impact on grossly unfair contractual clauses

In the information on contractual practices that were collected for this Report, the only contracts that included grossly unfair clauses within the meaning of the Directive were those concluded in some countries between public adjudicators and private parties²⁹⁵. Public contractors impose longer payment periods without proper compensation.

²⁹³ Although the fixed amounts are very low considering the cost of going to court in the UK. One must assume that the reimbursables are relevant in procedures that allow of the absence of representation by a lawyer.

²⁹⁴ Following interviews conducted with lawyers and in particular the very helpful contribution from Filipa Pinto, Litigation Department, SPS Advogados - Sociedade de Advogados.

²⁹⁵ Report submitted by Jean Albert to the European Commission including examples of contracts and contractual provisions as collected, 31 august 2006.

Representative organisations have not used this practice for fear of violating competition laws and because many of these organisations represent sectors that include both suppliers and customers.

Further, some laws prevent these organisations from acting in cases of single contracts. They may only sue against general contracts that apply to whole sectors, which should actually create competition law issues.

As a result, the objective of the Directive which was to promote representative organisation actions before the court to have grossly unfair provisions annulled has failed.

SMEs do not wish to offend customers whose business they depend on to survive...a higher priority than prompt payment.

Finally, fast and cheap procedures have been devised for undisputed claims. There are currently no fast, efficient and cheap procedures for claims relating to grossly unfair provisions.

6.1.6 *The related legal impact*

The Directive's impact on other European proposals is clear. As stated earlier, the Directive is a first attempt to harmonize areas that were up until the Treaty of Amsterdam mainly within the scope of Member State competence. However, since the Directive, European action in some areas has never been so brisk. The Treaty of Amsterdam is partly responsible. But so is the Directive, due to the specific inroads it makes and because the measure itself and the problems it addresses are constantly referred to.

The Directive is a foundational basis for the European Commission's proposal for a regulation creating a European order for payment procedure²⁹⁶. The proposal's preamble under paragraph 5 states "*The swift and efficient recovery of outstanding debts over which no legal controversy exists is of paramount importance for the economic operators in the European Union as late payments constitute a major reason for insolvency threatening the survival of businesses,*

²⁹⁶ Proposal for a Regulation of the European Parliament and of the Council Creating a European Order for Payment Procedure, COM(2004)173 final/3, 25.05.2004.

particularly small and medium-sized ones, and result in numerous job losses”. This echoes the prescriptions of Article 5 of the Directive.

6.1.6.(a) Dissemination of legal information

Representative organisations, factoring companies, credit insurance organisations and governments have been instrumental in the diffusion of information on combating long payment delays.

Organisations such as EUCOMED have promoted the creation of national associations designed to provide legal information in the field of late payments and payment periods for the health sector²⁹⁷.

6.1.6.(b) Development of good practices code

Sections 5.1.7 and 5.2.7 of this Report show that the Directive has triggered broad reflection on good commercial practices and how to build a prompt payment culture.

6.2 The economic impact

The most immediate and expected economic impact of the Directive is a halt in the upward movement of payment periods. This should be followed by a stabilization or a drop in payment period levels at the European level and decreases in average payment periods in countries that had excessive payment periods.

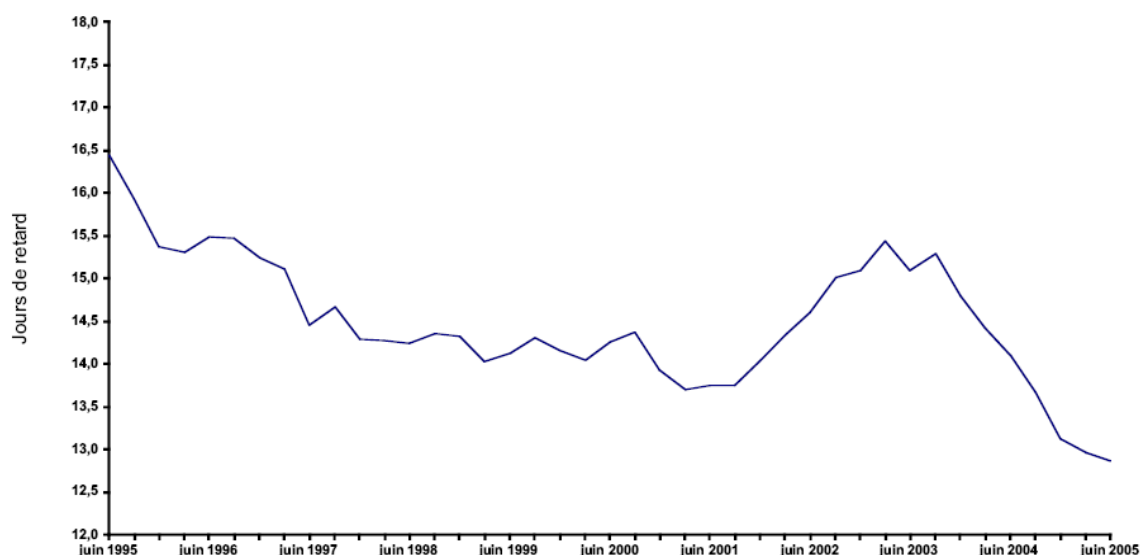
In the mid-term, the expected economic impact is a significant drop in late payments from public institutions and an effective harmonization of payment periods in the EU at around 30 days, meaning a substantial economic gain for SMEs.

Other economic impacts that could be expected in the longer term are drops in insolvencies across the EU, resulting in turn in fewer job losses.

²⁹⁷ 2003/2004 Report, EUCOMED.

6.3 The actual economic impact

One can conclude that the Directive has had the first expected economic impact. Late payments have dropped. The figure below is clear.



Source: *Altares/Dunn and Bradstreet France, 2005.*

However, the statistics also show that constant action is necessary to ensure that the impact is continuous. In the late nineties payment periods shortened due to talks, debates and actions taken in the field of late payments by different Member States and at the EU level. However, actions seem to have dropped in intensity immediately after the adoption of the Directive which in effect may have been a disappointment for many who had worked on a more ambitious text. But by the end of 2002 and the beginning of 2003, both the transposition of the Directive by Member States, the action by the European Commission against non-complaint Member States and renewed interest in the issue of long payment periods gathered momentum and had a positive effect. However, efforts need to be renewed as 2004 and 2005 marked a small regression.

Evaluating the economic impact of the Directive requires an assessment of the extent to which the Directive has led to a reduction in the negative phenomena associated with late payments, and to a consequent increase in economic welfare.

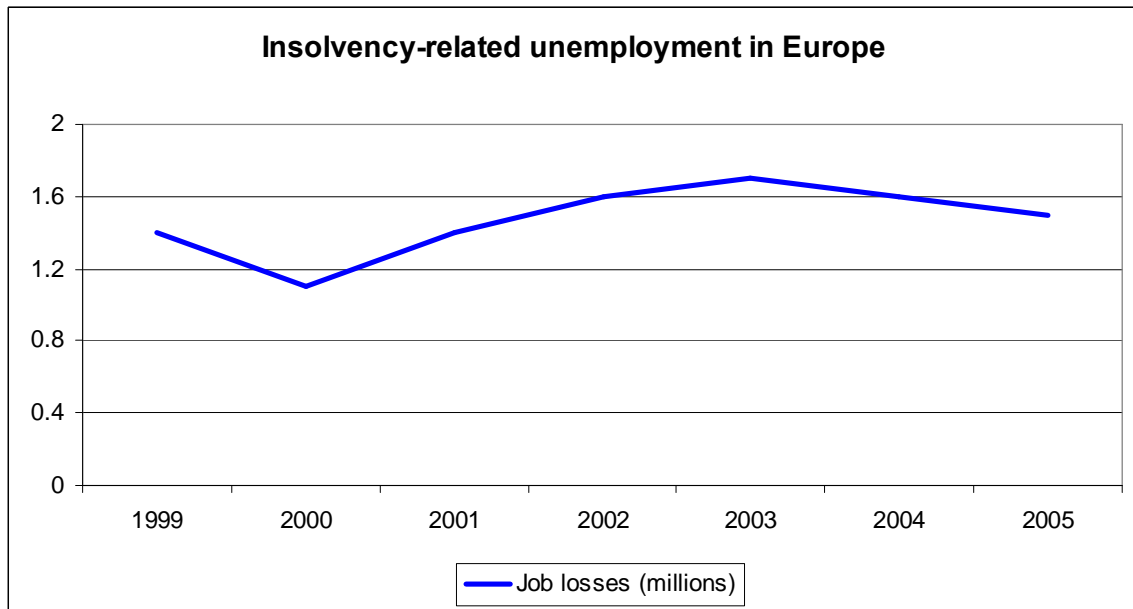
In practice, the achievement of this aim is limited by a number of considerations. Firstly, the phenomenon of late payments and the beneficial effects of their elimination or reduction can only be measured imprecisely through available indicators, including length of payments and the volume and value of late payments. In different countries with different economic and legal systems, the optimum levels of these variables may differ, as would the positive implications of changes in them. This complicates the derivation of conclusions from the historical developments of these variables.

Secondly, the phenomena associated with late payments are conditional on a number of factors apart from the possible effects of the Directive. These include developments in the economic cycle, legal and cultural conditions, and developments in the financial services industry, as well as changes in fiscal and other economic policy approaches. It may well be that the phenomena associated with late payments have taken a positive turn in spite of the Directive, owing to other contributing factors, or because of it. Likewise, degradation of conditions may be ascribed to the Directive itself and to other factors. The disentanglement of these effects from the effects of the Directive can be accomplished in theory but this would necessitate long data series, especially if such effects are to be analysed on a country-by-country basis. A sufficiently long data series is currently not available as information relating to the period post the implementation of the Directive is limited to a maximum of three years with an average of only two years.

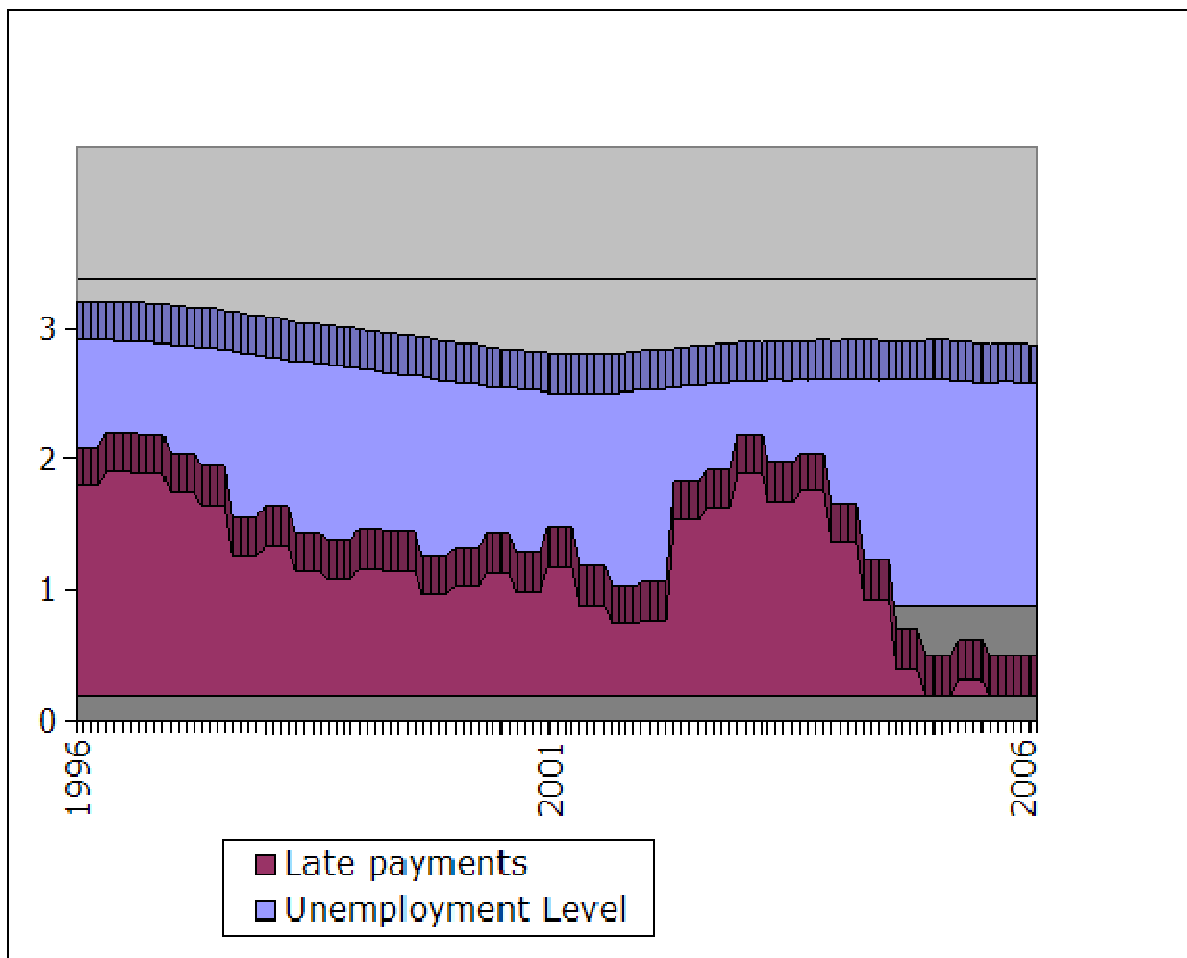
Thirdly, the Directive may have long term effects which have not yet been realised in the three years since its implementation. These would include changes in cultural perceptions and business attitudes towards late payments, which are already present in different countries as the LP Survey shows and will spread to other countries in the longer term. These effects can at this stage only be hypothesised, as data regarding their magnitude is not available.

From the information available, it is possible to conclude that the Directive has had an impact on late payments. Not only has their progression been stopped but a reversing trend is perceptible. However its impact on payment delays is not as clear. Payment delays have been constant over the last few years. In this respect the Directive has stopped a situation of increasing payment delays.

However, there is no reversing trend in sight. Its impact on insolvencies and unemployment is not perceptible as yet, even if the figures below show positive parallels in that all show a downward trend since 2003.



Source: Creditreform Economic Research Unit



6.3.1 Surveys

6.3.1.(a) Assessing the effectiveness of the Directive by means of evaluating surveys

In order to assess the effectiveness of the implementation of the Directive 2000/35/EC in combating late payments in commercial transactions, the LP survey was carried out among companies (i.e. artisans, SMEs, large companies, professionals), state owned entities (i.e. any entity that implements public procurements) and representative organisations (i.e. syndicates, industry representatives) from the 25 EU member states.

-Companies

The LP Survey results indicate that just under a third of respondents knew about the existence of the Directive 2000/35/EC, with an additional 45% having just learnt about the Directive. Almost 60% of the respondents stated that the

Directive met their expectations in the fight against late payments. However, just over a fourth of the respondents argued that it did not.

70% of the companies surveyed claimed that they believed that the Directive and national implementation measures had a positive effect on SMEs. However respondents did not believe that existing regulations on commercial practices or existing regulations on judicial procedures and commercial practices were successful. 78% of the respondents had not noticed a reduction in late payments in the last few years. 63% did not think that changes in late payments were due to the adoption of the Directive and the resulting new national regulations.

Respondents claimed that they did not think that to date the Directive and the related implementation measures had caused an increase in the number of litigations. Neither did the majority believe that the measures would result in an increase in the future.

Just over a fourth of respondents seemed to have little knowledge about which national legislations implement the contents of the Directive. However, a large proportion, 43%, said that the transposition measures were sufficient, with just 13% replying to the contrary. Three-quarters of the respondents claimed that they did not have sufficient access to information relating to regulations aimed at fighting late payments. Companies surveyed stated that they expect assistance from NGOs or industry associations in fighting against late or delayed payments. Important information, ranked in descending order of importance, was deemed to be the following: general information, publication of bad debtors, advice on debt collection procedures and options, legal advice, representative function before the courts, training, and others.

Over 50% of respondents claimed that they were able to legally charge interest on late payments; however, almost 40% stated that they were unable to do so. Only 13% claimed that they were able to legally obtain reimbursement of costs incurred in recovering money related to late payments.

This probably explains the statistics showing that in some countries too many companies fail to charge interest on late payments. In a study conducted in 2005 by Professor Glais for the French Government, almost all of the representative

organisations participating in the study estimated that less than 10% of their members charged interest on late payments. In Germany however 54% of companies invoice late payment interest to their clients²⁹⁸.

More than half of the respondents stated that they could legally provide for retention of title until payment is made. Although almost 40% of the respondents claimed that there are legal means available to eliminate grossly unfair provisions in contracts, and, more specifically extended payment delays, 40% stated that they were unable to do so. However, almost two-thirds of the companies surveyed claimed that there were legal means which would enable them to obtain an enforceable title against a late paying debtor within 90 days of the filing of an undisputed claim. Respondents were almost equally divided about whether or not there are good commercial practices that can be easily implemented to avoid late payment issues.

More than 80% of respondents think that the maximum payment delay of 30 days should be imposed by regulation.

Almost three-fourths of the companies surveyed never charged late payment interest to their clients and 80% had never been sued for late payment. 95% of the respondents disputed the debt, but less than half had to pay damages. However, almost a third of the respondents had to pay the creditors' recovery costs, such as banking and legal expenses. Unfortunately, 86% said that this did not change their payment practices. Over half of the respondents claimed that they had never sued a client for late payment. Of those who did, only a small proportion obtained payment of interest and/or damages.

-Representative organisations

In responding to the LP Survey, it emerged that 4 out of 5 of members of representative organisations had complained to their organisations on the question of late payments. These complaints usually concerned (in decreasing order of importance) excessive payment delays imposed by clients, an increase in the duration of contracts and thus payment delays, an increase in the number of late payments and an increase in the size of late payments.

²⁹⁸ CSA/Eurofactor study transmitted to the European Commission on August 31, 2006.

More than 4 out of 5 representative organisations stated that they were aware of the national regulations which implement the concerns of the Directive. However, more than two thirds of the respondents claimed that the Directive does not meet the expectations of their members. This could be due to the fact that most replied that their country's regulations do not efficiently implement the principles developed in the Directive and that these measures are insufficient.

Almost 90% of the representative organisations surveyed claimed that during the last three years, their organisation communicated information to its members on questions relating to late payments as well as recommendations on the subject of contractual payment delays. Nearly all representative organisations are aware of the number of litigations in their country that concern late payments. Almost 60% of the representative organisations surveyed organised conferences and seminars on the subject of late payments and the principles described in the Directive during the last five years. However, more than two thirds of the respondents stated that they did not provide their members with model payment clauses and do not have a code of good commercial practice. Neither are they in contact with their members' suppliers and clients with respect to late payment issues.

Almost 4 out 5 respondents claimed that less than 10% of their members applied late payment interest. Almost all of the representative companies surveyed stated that their organisation advised its members on the importance of including the interest penalties for late payments on their invoices.

83% of the respondents claimed that they noticed differences in the area of late payments in respect to commercial transactions between companies located in the same country and companies located in different countries of the EU.

-State-owned entities

The LP Survey of state-owned enterprises indicates that over two thirds of the respondents are aware of the Directive 2000/35/EC and that this Directive led to changes to national regulations. Two thirds of the respondents were also aware of the national regulations that implement the contents of the Directive.

The suppliers of state-owned entities could legally charge them interest on late payments, as well as claim recovery costs in case of late payments made by state-owned entities. 54% said that their suppliers could legally include a retention of title clause in contracts signed with them. 60% of the respondents claimed that there are recourses against grossly abusive contractual clauses and in particular those that tend to extend payment delays. Almost 85% of respondents stated that there were no national measures that give incentives for timely payments.

The majority of state-owned enterprises said that they have never been sued for late payments, but the majority of those who were generally lost to the plaintiff. This did not encourage them to change their practices in respect to late payments and neither did it generally change their relationship with the supplier.

Almost all respondents stated that no accelerated legal procedures exist to obtain an enforceable title in case of late payments. Over half of the respondents felt that they did not have sufficient access to information related to regulations aimed at fighting late payments.

Almost two-thirds of the respondents do not agree that a maximum payment delay of 30 days should be imposed by regulation. 90% stated that they were not prepared to contribute financially to a system implementing a good debtor quality label.

-Telephone survey carried out by The International Research Center (CRI-IRC) in the context of the LP Study.

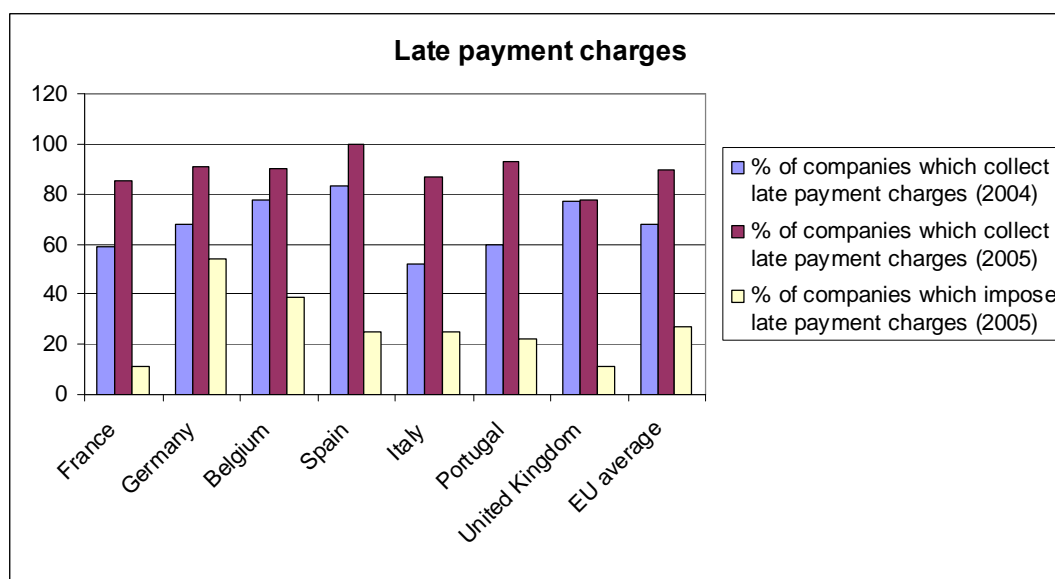
More than two-thirds of the respondents to the telephone survey carried out by CRI-IRC said that they have problems with late payments. Interestingly, 85% and 62% did not know what law applies to combating late payments in commercial transactions for both public and private contracts, respectively. Almost three fourths could not identify their legal rights in case of a late payment by a client, but more than half stated that these rights were insufficient, while 69% said that they do not exercise these rights in practice. 69% said that they do not charge automatic late payment interest or reminder fees and they criticized the court procedure to recover debts as being a slow one. On a positive note, more than two-thirds of respondents said that they had noticed a decrease in payment

delays in the last few years and 59% said that they had noticed a decrease in late payments. This confirms the finding on the drop in late payments. The online survey however does not provide the same result. An explanation for this may lie in the fact that during the telephone survey, interviewees were reminded that the question only concerned late payments and not payment delays.

Eurofactor survey

According to the Eurofactor Survey, the practices pertaining to late payment charges are variable: it is frequent practice in Germany and in Belgium (respectively 54% and 39% of the companies impose a charge for payment after the due date); however this practice is a lot less common in the countries of Southern Europe (25% of companies in Italy and in Spain, 22% in Portugal) and even less common in France and in the United Kingdom (11%). However, when late payment charges are imposed, these charges are collected in most cases.

Figure 32

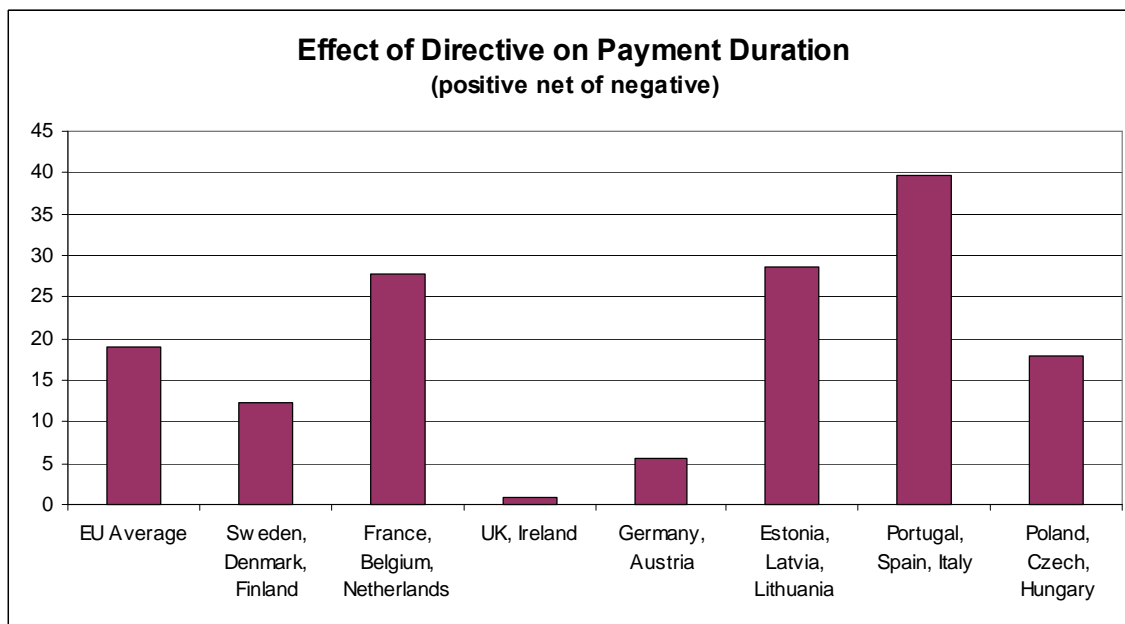


Source: Eurofactor Survey

European Payment Index

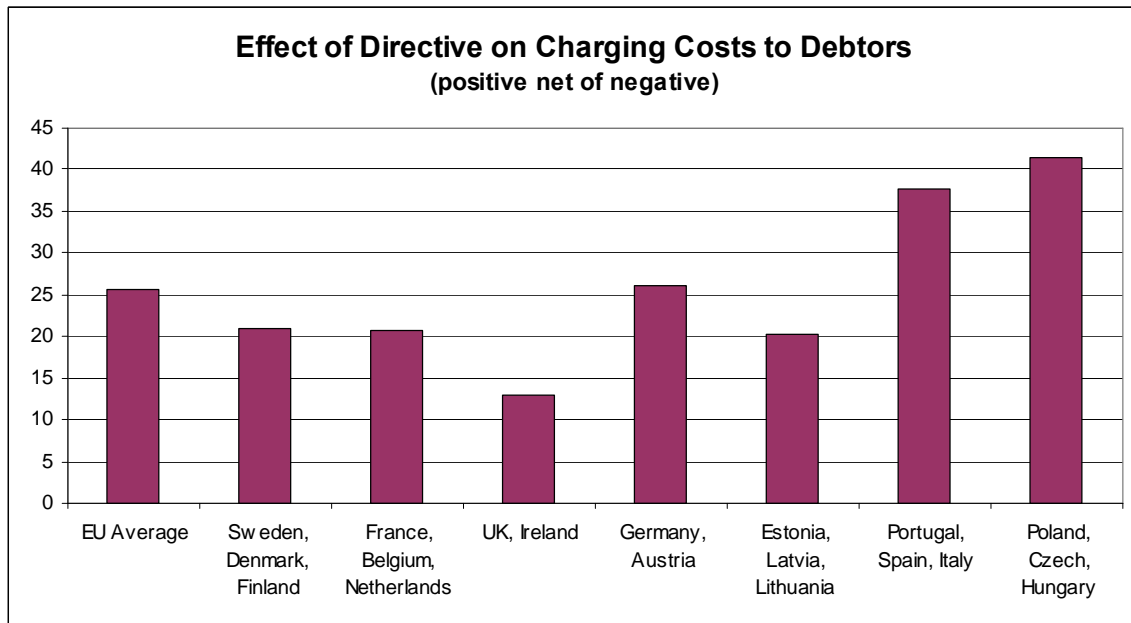
The European Payment Index 2004 Spring Report provided information on the expectations of surveyed business people concerning the effects of the Directive on the actual payment duration and the practice of charging of debtor costs and interest on late payment.

The figure below, shows that almost one fifth of respondents believe that the Directive successfully reduced payment duration. Respondents from Portugal, Spain and Italy believe it was most successful, while those from the UK and Ireland believe it was least successful. This coincides with other findings that indicate the greatest progress was recorded in countries such as Spain, Portugal and Italy and that the progress was less apparent in countries that had implemented late payment fighting measures prior to the adoption of the Directive.



Source: European Payment Index 2004 Spring Report

The figure below shows the expectations of surveyed business people concerning the effects of the Directive on the practice of charging of debtor costs and interest on late payment. The figure indicates that a fifth of respondents from the EU as a whole believe that the effect was positive. Respondents from Poland, Czech Republic and Hungary as well as Portugal, Spain and Italy were the countries which rated the Directive as successful in this respect. Respondents from the UK and Ireland had the smallest percentage of respondents replying that the Directive was successful.



Source: European Payment Index 2004 Spring Report

NB: Greece, Cyprus, among worst performers are not included in this table for lack of precise information.

Other

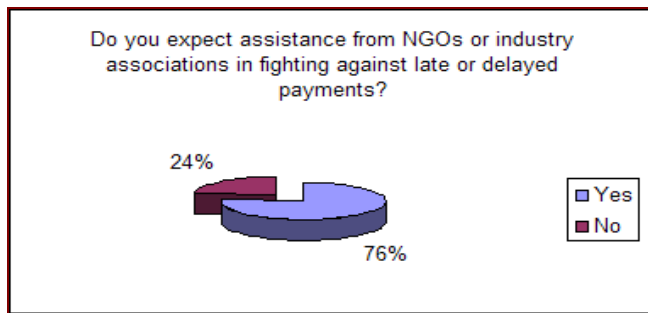
Comments on the success or otherwise of the Late Payments Directive from Grant Thornton:

“EU action to accelerate payments had some initial success, but it is disappointing to note that in France and the UK, no further progress has been made in recent years, and the gap vis-à-vis Germany remains wide”.
Sue Palmer, Grant Thornton International.

“France’s average payment period is still relatively high compared to other countries but some progress has been made compared to previous years thanks to stronger rules triggering interest on late payments. The progressive recovery of the economy could further decrease the average payment period”. Jean-Luc Carpentier, Grant Thornton France.

6.4 Other impact

The LP Survey confirms that there is an expectation that representative organisations will assist in this area.



6.5 The general impact of the Directive

The expected short term impact of the Directive has been realised. The Directive has generally been implemented correctly by Member States. Late payments increases have been stopped and late payment levels have even dropped in the last three years throughout the EU. Late payments are not considered a normal cost of doing business anymore. Payment delays have generally stopped increasing. They have not dropped, however, an effect which could have been expected and is a clear expectation in the longer term. At this stage no impact is expected on insolvencies and unemployment but a steady drop in late payments over a number of years combined with a drop in payment delays should contribute favourably to SME health and employment in the EU. This general conclusion does not mean that the situation is satisfactory in every Member State, or that the disparities the Directive aims to fight have disappeared, or that current levels of late payments and rights granted in Member States should be taken for granted. The UK example shows that combating late payments is a constant effort. The legislative changes in Italy and Greece show that constant monitoring is important. A European Regulation may be appropriate and timely to ensure positive long term effects.

6.6 The Limits to the Directive's impact

6.6.1 *Multidisciplinary and novel character of the Directive*

As stated above the Directive is one of the first EU regulations to affect property law and civil procedure, both fields previously falling within the realm of sovereign Member States.

The tools used in the Directive have seldom been used in the past at the European level. Accordingly the Directive constitutes a breakthrough at a European level for dealing with matters that had previously been national monopolies. As with any such action, the breakthrough itself has an impact because it sets a precedent and opens doors. However, not unlike other European regulatory breakthroughs used through Directives, the local practical impact is hardly felt immediately.

The Directive is the first attempt at harmonizing judicial procedures; harmonizing or reforming judicial procedures is no meagre task. Member States have tried many a time to reduce delays in judicial procedures. In many Member States courts are overloaded with cases and poorly financed. Imposing procedural deadlines implies reforming the whole European justice administration.

6.6.2 *Knowledge that creditors have of the tools at their disposal*

The LP Survey indicates that creditors are not always aware of the tools at their disposal to fight late payments²⁹⁹. As stated earlier SMEs and especially micro enterprises have to be actively informed of the new regulations which seek to assist them in combating late payments. The information on late payment regulations is not always easily accessible and its flow is not constant. Between 2000 and 2002 many representative organisations published information on the

²⁹⁹ See Annexe 2.

issue of late payments advising their members of their rights³⁰⁰. After 2002, the information flow lightened. Often a few articles and studies are published whenever a new regulation implements the Directive³⁰¹. There is rarely any follow-up. Regulatory impact assessments are seldom performed. This is problematic given the number of companies created every year in the EU³⁰² and the fact that young companies are the most vulnerable to cash-flow problems. The LP Study triggered a new wave of information as the media, representative organisations, chambers of commerce and European Information Centers were contacted to disseminate information on the LP Survey³⁰³. This should be renewed regularly through the creation of systematic information processes that target newly created companies.

6.6.3 How creditors deal with long payment periods

In this section we have concentrated on how SMEs as creditors deal with long payment periods. This section was written because in the course of interviews and research it has become apparent that if long payment periods were mainly due to debtor behaviour, they were also at least partly due to creditor behaviour³⁰⁴.

This point is important when measuring the impact of the Directive because many of the tools that the Directive creates are only useful if employed and if those that they are designed for have the capabilities to actually use them. The Directive does not impose contract terms. The Directive does not impose the billing of interest in case of late payments. The Directive does not impose reporting of bad debtors. Nor does it impose litigation in cases of late payment. The Directive provides the debtors with a number of tools that they may or may

³⁰⁰ *Late Payments: The Cheque is in the Post*, Daniel Windaus - REL Consultancy Group - 13 July 2004

³⁰¹ See for example, *Creditors to Benefit from New Late Payment Regime*, Contributed by Miranda Correia, Amendoeira & Associados, 26.04.2004; Cyprus Mail: News Articles in English, 26.06.03; Economic Bulletin, Banco de España, 00.01.05.

³⁰² In Sweden alone 30658 companies were created in the first half of 2006. See *Surge in number of new companies in Sweden*, at http://www.sweden.se/templates/cs/News_14911.aspx, 13.07.2006.

³⁰³ List of organisations and media contacted as provided to the European Commission on August 31, 2006.

³⁰⁴ *Main changes in average days for payment of sales invoices 2003 to 2006*, The Grant Thornton International Business Owners Survey.

not use, so its impact is thus limited by the debtors' will, ability and capacity to deploy these tools.

As stated by Clive Lewis, Head of SME Issues at the Institute of Chartered Accountants in England and Wales, "*Good credit management from day one can mean the difference between the failure and the realisation of an entrepreneur's business dream*"³⁰⁵. This implies that business failure that is a consequence of late payment has causes also in how credit is managed. This is confirmed by recent studies³⁰⁶.

SMEs alone are fragile entities, but together can be considered the economic power-house of the EU.

SMEs, especially micro and small enterprises, are not well equipped to deal with late payment issues because they have to deal with these issues alone on a day-to-day basis. Studies show that micro and small enterprises are ill-equipped to use some of the instruments proposed by the Directive. Many studies show that micro and small enterprises pay little attention to working capital. Some do not hold cash books or keep debtor/creditor records, and a strong majority fails to produce budgets³⁰⁷. These studies also show that credit management is related to company size. The points outlined below identify some of the reasons given by SMEs for not dealing efficiently with accounts receivables:

6.6.3.(a) The absence of formalized structures within the firm's organisation devoted to financial management

Often in SMEs there is no dedicated person in charge of financial management. Most often the owner is in charge of signing in clients, expenditures and billing.

³⁰⁵ *New Credit Management help for Start Ups*, Better Payment Practice Group, Press release, 24.08.2004.

³⁰⁶ *Enquête sur les délais de paiement*, AFDCC, 09.2005. See also *La lutte contre les délais excessifs et les retards de paiement en France: de récentes avancées significatives*. Professeur Michel Glais, 08.2006, p.4.

³⁰⁷ Bank of England, *Finance for Small Firms - A Third Report*, HMSO, London, 1996; Winborg, J., *Finance In Small Businesses*, Licentiate Thesis, Department of Business Administration; Lund University, Sweden, 1997; Peel, M.J. and Wilson, N. (1996), "*Working Capital and Financial Management Practices in the Small Firm Sector*," *International Small Business Journal*, Vol.14, No.2, pp.52-68; Nayak, A. and Greenfield, S., '*The Use of Management Accounting Information For Managing Micro Businesses*' in *Finance and The Small Firm* eds Hughes and Storey, Routledge: London, 1994.

No one is really in charge of overall financial management, and especially not of debt collection processes.

Financial management or management of legal issues does not generally have dedicated staff as it is considered unproductive.

6.6.3.(b) A reluctance to deal with accounts receivables

- Many SME work forces concentrate on commercial capacity (obtaining clients) and production capacity (providing the product or service to the client). Minimal workforce is dedicated to administrative tasks and most administrative time spent is allocated to dealing with red tape. There is no time for accounts receivable management.
- Many SMEs feel that they should not be spending time managing accounts receivables anyway.
- Many SMEs feel that they are treated unjustly if payments are late after work or services have been correctly performed or provided.
- Many SMEs are geared to understand that even when work or services are well performed or provided, payment may not be made on time.
- Because there is often no separation between commercial management and invoices management, emotional tensions often worsen the situation: “why should I beg for payment when the work has been done?”
- Many SMEs lack the resources to organise accounts receivables management.
- Many SMEs lack the structure to organise accounts receivables management.
- Many SMEs lack systematic or rationalized processes to efficiently manage accounts receivables.

6.6.3.(c) Insufficient expertise in contracts negotiations

- Most SME owners are not sophisticated in legal matters.
- Most SME owners negotiate and sign only the basic commercial terms of a contract or order form.
- When there is a full contract those who read all its clauses are rare.

6.6.3.(d) Insufficient time for negotiating contracts

- SME management does not usually want to spend too much time negotiating contracts.
- SME management usually has few ideas about how to negotiate a contractual clause or what the financial value of a clause may be³⁰⁸.
- SME management is usually happy to sign a contract as soon as possible and start the job.
- Contracts and contractual clauses are usually seen as un-productive components of doing business.

6.6.3.(e) Reluctance to “offend customers”³⁰⁹

- SMEs usually have a limited number of customers.
- Some customers represent more than 50% of an SME’s revenue.
- The relationship is often personal.
- SMEs hesitate before sending the first follow-up letter, let alone regular communications which may detail interest charges for late payments.

6.6.3.(f) Reluctance to structure credit management

SMEs;

- Usually have few customers and gaining new customers is the hardest part of the business.
- Lack resources to pay for marketing campaigns.
- Lack resources to run credit checks on customers.
- Lack resources to subscribe to credit insurers and banks.
- Are reluctant to ask new customers for references when often they feel that they should be the ones providing references.
- Given the importance of a new customer, often prefer not to investigate them, turning a blind eye and hoping for the best rather than losing business³¹⁰.

³⁰⁸ *Nearly a quarter of businesses do not confirm their credit terms in writing*, Survey conducted by Better Payment Practice Group in 2004, Press Release, 07.01.2004.

³⁰⁹ *Application of the Directive on Late Payments in the Construction Sector*, FIEC, 12.12.2005. p. 3.

³¹⁰ *63% of Businesses never check the creditworthiness of new customers*, Survey conducted by Better Payment Practice Group in 2004, Press Release, 09.02.2004.

6.6.3.(g) Poor assets and account receivables management

SMEs often demonstrate;

- Absence of understanding of the need for management of accounts receivables.
- Absence of belief in the usefulness of accounts receivable management.
- Reluctance to pay for credit insurance and factoring.
- Lack of resources to use external accounting services with receivables management.
- Reluctance to pay collection agencies because of the effect on the client relationship.
- Reluctance to pay collection agencies in general.
- Absence of knowledge of the processes that can be easily be put in place or IT solutions.
- Absence of resources dedicated to IT solutions in this area³¹¹.

6.6.4 The behaviour of Member States and public institutions

6.6.4.(a) Setting the example

When governments or public institutions create exceptions for themselves, whether legal or unofficial, they foster a business environment which reflects their own behaviour³¹². The most edifying cases in this area are those that involved the late payments made by UK Secretary of State for the Environment, Food and Rural Affairs to companies that assisted in dealing with the foot and mouth epidemic³¹³.

Governments have extraordinary powers of collection. They also hold within their jurisdiction a set of captive clients. As a result they are in a position in which they can easily set examples of good business practices whenever they

³¹¹ *Perpective de l'OECD sur les PME*, 2002, p. 24.

³¹² See *Third survey of the management of customer accounts in Europe*, Eurofactor, 2005, p. 15.

³¹³ See *Ruttle Plant Hire Limited v. The Secretary of State for the Environment, Food and Rural Affairs*, IN THE HIGH COURT OF JUSTICE QUEEN'S BENCH DIVISION TECHNOLOGY and CONSTRUCTION COURT, 29.09.2004 at <http://www.bailii.org/ew/cases/EWHC/TCC/2004/2152.html>

act as clients to private companies. However, the opposite often happens. Governments in many countries are the worst debtors³¹⁴.

They are also difficult contractors, providing little chance for SMEs to contract with them. Public institution contracts are often complex and eliminate micro and virtually all SMEs by demanding guarantees and numerous annual balance sheets while setting stringent financial requirements. They also provide for late interim payments on extended contracts and unjustifiably long approval periods which often lead to extra delays in payment.

Whatever the reasons, the result is that public contractors pay later than private ones³¹⁵. Payment delays in public administrations are twice those in the purely private sector.

Consequently, this behaviour on the part of public institutions limits the impact of the Directive as it creates a business environment that is not respectful of SMEs or their constraints, and can even be disdainful of regulation and its spirit. It is hardly acceptable for regulators to set a default payment period of thirty days, justifying it as reasonable, and then implement for public contracts a policy of sixty days, even if such a policy is available under the law.

The reason why some governments and public institutions were, and to a certain extent still are reluctant to adhere more fully to Directive principles may be due to a perception that it is impossible to implement them in so short a time. In general, prior to the Directive public institutions were reluctant to deal with late payments or long payment periods. They recognized the extent of the problem and understood that they were partly to blame for its effect on SMEs. But for public institutions late payments were mostly a feature of bureaucracy along with lengthy standardized procedures, faceless decision making processes and relative opacity, rather than being due to wilful opposition³¹⁶. Studies show that payment periods

³¹⁴ The OECD Observer, n. 2009, 12.97/01.98.

³¹⁵ *SMEs under threat from late payments*, INTRUM JUSTICIA, 2005, p. 11.

³¹⁶ Except in some cases: ie Walletts.

can be reduced substantially by changing management techniques and payment processes³¹⁷. This takes time.

As a result, dealing with late payments implied vast reforms which would involve far more than the adoption of a new law. Thus, there would have been a dichotomy between the necessity for shorter payment periods in the interest of SMEs and the reality of a situation that would take a long time to change. As it happened, the Directive came at a time when many Member States were streamlining their administrations, “decentralising” and generally implementing the subsidiarity principle at a national level.

However, the Directive came too early to ensure that public institutions were ready to set the example.

6.6.4.(b) The lack of incentives given by the Directive to public institutions

The public sector is responsible for increases in late payments in across-the-board averages. The situation will not improve in the next few years as governments with an aging population scramble to find new sources of revenue and fight huge public deficits.

The situation is not new, either, as this 2005 statement by a US company to its shareholders shows:

“Credit Risks. We are particularly subject to credit risk from our European customers. Our European product sales to government owned or supported customers in Greece, Italy, Portugal and Spain are subject to significant payment delays due to government funding and reimbursement practices. Historically, receivables had tended to accumulate over a period of time and settled as large lump sum payments as government funding became available. If significant changes were to occur in the reimbursement practices of European governments or if government funding becomes unavailable, we may not be able to

³¹⁷ French Central Bank Bulletin n 145, 01.2006.

collect on amounts due to us from these customers and our results of operations would be adversely affected”³¹⁸.

In addition to this, as noted by the European Commission, the behaviour of administrations constitutes barriers to the Internal Market³¹⁹. Their use of discretionary powers or heavy and non-transparent procedures all favour slow treatment of invoices. Further, those in charge of enforcing regulations are themselves often part of the same administrations³²⁰.

The Directive is ill-equipped to give incentives to public institutions for prompt payment. Interest rates on late payments are not a real incentive for paying on time when a public institution is funded by tax-payers' money. Because this is not a genuine incentive public institutions can stretch payments and litigate cases over years, hoping that the creditor might go bankrupt before it can collect. Moreover, when there is a pool of creditors there is all the more incentive not to pay, as the chances that only very few will survive the lengthy legal procedures are high.

In addition the Directive itself provides that governments may identify sectors to which the Directive will not apply.

Finally, in the construction and health sectors, which are known for their long payment periods, it has become apparent that not only are administrations insensitive to interest rates on late payments, but the retention of title provision is not effectively enforceable³²¹. It is difficult, for example, for a seller of medical devices to hospitals to demand that such devices be removed and sent back to it, especially if they are used for life support operations.

³¹⁸ <http://biz.yahoo.com/e/050804/gild10-q.html>.

³¹⁹ REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT ON THE STATE OF THE INTERNAL MARKET FOR SERVICES, presented under the first stage of the Internal Market Strategy for Services, 30.07.2002, COM(2002) 441 final, p. 7.

³²⁰ In France for Example DGCCRF is in charge of making sure that the late payments regulations are enforced. DGCCRF is part of the Ministry of Finance.

³²¹ *EUCOMED situation summary and guidance for members on the late payments directive*, EUCOMED, 13.12.01, p.7.

6.6.4.(c) The resistance of Member States to harmonization

As stated above, the Directive seeks to harmonize fields of the law that previously effectively belonged to the realm of Member States.

As a result, some resistance was expected. The content of the Directive itself was heavily amended by the Council, limiting the impact of the final text³²².

Further, transposition by Member States of regulation that encroaches on new areas, meets natural resistance from administrations not accustomed to implementing EU regulation.

The Directive was adopted on June 29, 2000³²³. The final date for its transposition was August 8, 2002³²⁴. In February 2003, the European Commission initiated second stage proceedings against Spain and Luxembourg for their failure to notify the Commission of their transposition of the Directive³²⁵. Further, this study shows clearly that many transposition legislations did not adequately or completely transpose the Directive. It was finally only in December 2004 that the Spanish transposition legislation went into force³²⁶. Some countries are still adopting regulations to transpose the Directive.

Further, in 2004, Greece adopted a year-long regulation that forced on creditors to concede public hospitals a discount on current invoices and relinquish any rights to interest on late payments³²⁷. This regulation terminated automatically before the European Commission could take any action.

³²² COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT *pursuant to the second subparagraph of Article 251 (2) of the EC-Treaty concerning the Common position of the Council on the proposal for a European Parliament and Council Directive combating late payment in commercial transactions*, SEC/99/1398 final - COD 99/0099.

³²³ Directive 2000/35/EC, OJ L 200, 8.8.2000, p. 35.

³²⁴ Article 6 of the Directive.

³²⁵“*Late Payments: Commission to refer 2 Member States to the Court of Justice*”, see European Commission press release, IP/03/999, 11.07.2003.

³²⁶ Ley 3/2004, de 29 de diciembre, *por la que se establecen medidas de lucha contra la morosidad en las operaciones comerciales*. BOE 314, 30-XII-2004.

³²⁷ ΝΟΜΟΣ 3301/22.12.04 Συμφωνίες παροχής χρηματοοικονομικής ασφάλειας, εφαρμογή των Διεθνών Λογιστικών Προτύπων και άλλες διατάξεις.

Finally, Italy's interpretation of the Directive has been particularly restrictive. It is beyond dispute that Italy's closure of hospitals to avoid having to pay overdue debt and related interest sends the wrong message to public and private companies.

6.6.4.(d) The need to reform the judicial systems of Member States

Member States have to acknowledge that as commercial transactions between them increase, so does the potential for late payments and disputes. Increasingly, disputes involve a growing number of entities from at least two Member States or entities operating within a single Member State but originating from outside it. Member States' legal systems created for and attuned to handling mainly local disputes between local parties may well be ill-adapted to these changes. To deal fairly with parties originating from more than one Member State new structures and procedures have to be put in place. Otherwise the number of commercial transactions in the Single Market will peak artificially, because of obstacles that take the form of legal and administrative barriers³²⁸.

The European order for payment does answer this concern to a certain extent but it falls short of being an efficient instrument for the future. It is limited to small claims. In a few years it will not be equipped to handle large scale commercial transactions. Further, it does not take into account that the Single Market will generate more and more people from different states who are unable to adequately defend their rights in the Member States in which they have elected to live and establish themselves. Finally, Member States are already arriving at limited interpretations of the measure's scope³²⁹. It is doubtful that the regulation will be construed as allowing creditors to obtain payment orders against public entities, let alone enforce them. In short, the European order for payment is a step in the right direction but not an answer

³²⁸ "Facing the Challenge - The Lisbon Strategy for Growth and Employment", Report from the High Level Group chaired by Wim Kok, November 2004, p. 26.

³²⁹ See Dr Birgit Grundmann, the Head of the Civil Law Directorate of the German Federal Ministry of Justice as cited in "The German order for payment procedure (Mahnverfahren)", Grozdana Šijanski and Jimmy Barber, <http://www.iuscomp.org/gla/literature/sijanski.htm>, 2006.

to late payment problems in the EU. It should not be construed by Member States as a reason not to reform their systems.

6.6.5 Access to financing

As stated by Fred von Dewall, General Manager and Chief Economist, ING Group, *“the New Basel Capital Accord, and the forthcoming new Capital Adequacy Directive, has sparked concerns that higher capital charges will further curb lending to SMEs. In this respect, the new regulatory banking framework could also worsen the effects of the long payment delays which typically undermine SMEs’ commercial transactions. In fact, cash unbalances due to late payments might cast additional doubts on small firms’ creditworthiness and, as a consequence, hamper their access to credit”*³³⁰.

SMEs interviewed stated that if they generally had more access to capital they would be less vulnerable to late payments by creditors, and they themselves would not pay their own invoices late. Banks are generally reluctant to lend to SMEs and even more so to micro enterprises³³¹. The level of guarantees requested by banks on loans effectively equates to a total absence of risk on the bank’s part³³². As a result, few SMEs actually have access to capital.

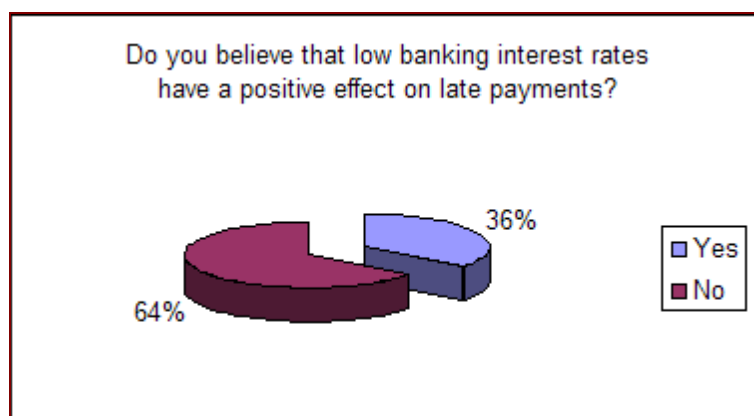
Further, it should be noted that were access to financing easier and cheaper, companies would finance their working capital through loans rather than through late payments or payment delays.

³³⁰ *“Facing the Credit Squeeze - effects of the capital adequacy and the late payments directive on SMEs”*, Round table organised by CEPS and Intrum Justicia, November 30, 2004, http://www.euractiv.com/29/images/CEPSBasell%20MinutesRoundtable_tcm29-141413.pdf.

³³¹ See Professor Von Liechtenstein’s comment in *“Facing the Credit Squeeze - effects of the capital adequacy and the late payments directive on SMEs”*, Round table organised by CEPS and Intrum Justicia, November 30, 2004, http://www.euractiv.com/29/images/CEPSBasell%20MinutesRoundtable_tcm29-141413.pdf.

³³² This example comes from an interview with a micro-enterprise in France, which requests a loan representing 5600 Euros. The micro enterprise has for two years had 20000 Euros invested at the bank in the bank’s own bonds. To lend 5600 Euros, the bank requests a security in 5600 Euros of the 20000 Euros invested in bonds and proposes charging the micro-enterprise a hefty interest rate for the loan. The bank’s proposal thus makes no sense to the enterprise which actually needs 25000 Euros to invest in its development.

Almost two-thirds of the respondents to the LP Survey believe that low banking interest rates have a positive effect on late payments.



Long payment periods or trade credit are a way to finance all companies regardless of size, and the importance of trade credit is directly related to the lack of incentive banks have to finance business undertakings³³³. No wonder companies prefer paying late as “*a means of refinancing as opposed to applying for bank loans*”³³⁴.

Difficult access to financing thus has two consequences. It fosters long payment periods. It limits the growth, competitiveness and survival chances of SMEs.

6.6.6 The Scope of the Directive

As discussed in Chapter 5, the WB Survey highlights the most common situations that arise in contracts enforcement and how long it takes to deal with them. Following the WB Survey, the most common situation in business transactions appears to be the one in which the debtor will somehow dispute the claim, at least to gain time and avoid paying late payment interest. This has been confirmed by interviews conducted for this study.

One feature the Directive does not address is the definition of a disputed claim. Many creditors have “undisputed” claims until they either threaten to or actually

³³³ Banks find it more profitable to sell services to individual customers than to take risks on businesses. It should be noted that in the last ten years banks have been able to sell services to individual customers that previously they could not or had not.

³³⁴ *SMES under threat from late payments*, INTRUM JUSTICIA, 2005, p. 13.

file a suit. Do these last minute challenges to the creditor's claim fall within the scope of the Directive or not? It appears that they do not, which means most claims actually fall outside the scope of the Directive's main provisions.

6.6.7 Floors and Ceilings in terms of Late Payments

6.6.7.(a) Floors imposed by the Directive

There are a number of floors under which late payments levels will not drop. These are due to the Directive itself or related to economic efficiencies.

The first floor is a legal one and is directly imposed by the Directive. The Directive in its Article 6(3) provides that: *"...In transposing this Directive, Member States may exclude: (c) claims for interest of less than EUR 5"*.

The floor that this provision imposes is the number of days the creditor will have to wait after the due date of an invoice for the interest to reach 5 Euros so that it can then start effectively charging interest. This will obviously depend on the interest rate and the amount owed. If the interest rate I is 11% per annum non-compounded and the amount A owed is 1,000 Euros, the number of days overdue N before the creditor can claim interest is:

$$N = 5 \times 365 / (A \times I) = 16.59 \text{ days}$$

Thus, the floor imposed by the Directive for debts of 1000 Euros is 16.59 days. A smart debtor will pay on day 16 after payment is overdue, and therefore in the absence of a contract on the 46th day. (30 days default payment delay + 16 days overdue but unsanctioned).

If the Directive aims at deterring late payments, the interest should be imposed on the first day of a payment being overdue. This is not the case for debts of 1,000 Euros. The Directive effectively only imposes interest to be paid on the first overdue day N (with $N=1$) for debts of over:

$$A = 5 \times 365 / (N \times I) = 16,591 \text{ Euros}$$

The Directive's provision on interest will deter all late payments assuming the interest rate is appropriate, on debts of at least 16,591 Euros.

For purposes of this Report this floor has been labelled the FIDI³³⁵.

6.6.7.(b) Floors related to the Directive

There is another associated floor imposed by the Directive and that is the one dictated by the Directive's ambiguity on reimbursement of recovery costs. As stated previously the expected impact of the Directive on recovery costs, especially out of court costs, can only be minimal and has been so in most Member States. This is an issue because it in fact creates a floor under which interest on late payment will serve the purpose of compensating for the costs of recovery rather than representing credit granted unwillingly to the debtor.

If one assumes that the cost C of sending reminder or dunning letters to a debtor is 20 Euros (including special tracking postage/return receipt letter, labour cost, equipment etc), that the interest rate I is 11% per annum non compounded and that the debt amount A is 1,000 Euros, the number of days N before an overdue payment starts to compensate a creditor for the unwilling credit provided to debtor shall be:

$$N = C \times 365 / (A \times I) = 66.36 \text{ days}$$

Although not made clear in the language of the Directive, in the matter of automatic reimbursable recovery costs, the deterring³³⁶ impact of the Directive on a debtor only starts after 66.36 days of overdue payment.

In the example set out above it is clear that a creditor has no incentive to invoice a client for a late payment of 60 days on an amount of 1,000 Euros, as the administrative burden and the business cost of invoicing the client is greater than the compensation provided by the Directive.

For the purposes of this Report this floor has been labelled the IRCF³³⁷.

³³⁵ Floor on Invoicing Debt Interest as defined by Jean Albert for purposes of this Report.

³³⁶ Provided the interest rate is high enough.

³³⁷ Interest Offset by Recovery Cost Floor as defined by Jean Albert for purposes of this Report.

6.6.7.(c) Psychological floor

Interviews have shown that one of the major reasons why creditors do not charge interest is that they do not wish to offend clients. Payments made ten days after the due date will not lead to interest invoicing. In fact, interest invoicing will be considered only after official reminders or even court proceedings. Interest invoicing also depends on the type of client/supplier relationship. The more the client is anonymous and small in size, the earlier and more automatic will interest invoicing be. The amount of late payment interest also contributes to the psychological floor. If a minimum penalty of 250 Euros were to exist for late payments, the creditor would reassess the business relationship against the penalty.

6.6.7.(d) Economic/financial floor

In the absence of automatic out-of-court recovery costs, there is a floor under which late payment levels will probably not drop, partly because of the economics of payments and partly due to the fact that the Directive does not appropriately address late payments of a few days duration for small amounts.

6.6.7.(e) Legal/Economic/Financial ceilings

There are ceilings that limit payment delays and late payments. A regulation that will impose a maximum 30 day payment delay will fix the ceiling for payment delays at 30 days. If a high penalty for late payments is imposed on the first day of lateness, the payment delay ceiling will extend to late payment and include payment periods. The Directive does not create such a fixed ceiling. It draws the existing ceiling closer to 30 days but enables this to be a moving ceiling. As a result payment periods have decreased slightly reflecting the letter of the Directive, but disparities between Member States persist.

There are economic and financial ceilings beyond which payment delays and late payments represent credit risk rather than payment culture or normal business practice. Companies specialised in credit risk assessment and rating such as

Atradius, Creditreform and Dun and Bradstreet have identified credit limit indices which determine the risk of bankruptcy of a debtor based on the length of payment periods. The longer the payment periods the more likely a debtor is to be insolvent. A sound payment period ceiling will be fixed significantly below an insolvency risk floor.

6.6.8 Sectors prone to late payments - the example of the health sector.

To a certain extent payments are a sector problem rather than a general issue. Some sectors send late payments averages to record highs, and will continue to do so until a ceiling is reached.

Regulations like the one proposed by the Directive have had and will have little or no impact on these sectors as they require substantial reforms. They are and will continue to be chronically under-funded³³⁸.

The aging of the European population inevitably means increased costs for the health and social care systems of Member States, systems which are on the brink of collapse in some countries as funding gets more and more difficult³³⁹.

With the increased needs of aging populations and decreasing working populations, the health care and social sectors in some Member States are more than likely to cause further increases in the late payments general average throughout the EU in the years to come. This will be the case whatever regulation is put in place, unless these sectors undergo major reforms, expectations change, and perceptions of appropriate health care and social care change³⁴⁰. Another option is that these sectors be excluded from late payment statistics altogether.

³³⁸ *Italy Medical Technologies Issues*, Italian example see Advamed, January 2005.

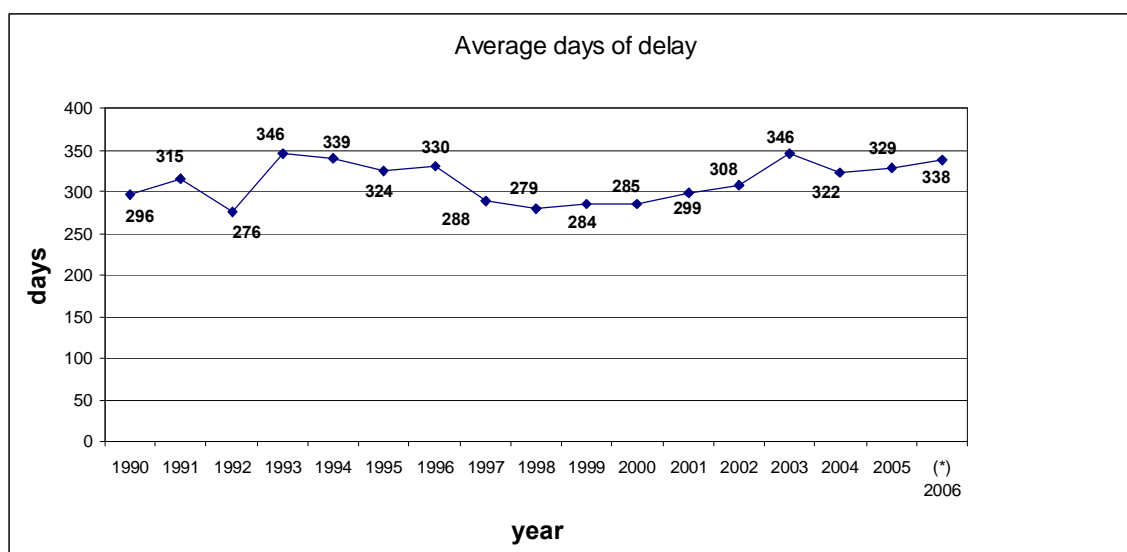
³³⁹ *Conference on the Appraisal of Investments in Health*, Proceedings of the European Investment Bank (EIB) and World Health Organisation (WHO) Luxembourg 17-18 June, 1999.

³⁴⁰ *Conference on the Appraisal of Investments in Health*, Proceedings of the European Investment Bank (EIB) and World Health Organisation (WHO) Luxembourg 17-18 June, 1999, p. 114.

6.6.8.(a) Example of Italy's health sector

Late payments in the Italian health sector run into the billions of Euros³⁴¹. Italy's general poor track record in the area of late payments and payment periods is mostly attributable to the public sector, and within this sector the health sector³⁴².

The following figure shows the average number of late payment days by the Italian National Health System to its suppliers. It shows that over the period 1990 through 2006, the average periods of delay were over 300 days. The figure shows that after falling in the late nineties, the average rose gradually as of 1999. After dropping by 22 days in 2004, the average days of delay increased. In 2006, it is estimated that the average days of delay by the Italian National Health System to its suppliers stood at 338 days³⁴³.



Source: *'Il Sore 24 Ore Sanita'* Year IX number 21.

Further, payment periods in the health sector vary greatly from one region to another with averages between 550 and 650 days in Lazio, Molise and Campania³⁴⁴. Payment terms range from 120 to 220 days on average over the

³⁴¹ *The Italian NHS financial crisis and late payments*, Centro Studi Biomedica, No 19, March 2005.

³⁴² *Italy Medical Technologies Issues*, Eurofactor Barometer for 2006, p. 6 and Advamed, January 2005.

³⁴³ It is unclear whether this takes into account the hospitals declared bankrupt by the Government.

³⁴⁴ *Italy Medical Technologies Issues*, Advamed, January 2005, p. 3.

territory. This means that late payments themselves represent up to 400 days. Payment terms range from 120 to 220 days on average over the territory. This means that late payments themselves represent up to 400 days. Statistics do vary from one source to another. But all confirm that the national average in the public health sector is around 300 days³⁴⁵. Essentially this means that total payment periods in the public health sector have increased steadily in the last fifteen years³⁴⁶. They have peaked even as recently as early 2006. When financially moribund hospitals cannot deal with their debts any more, the government closes them down and creditors are left with no payment at all³⁴⁷. Given the choice between very late payments or no payments at all, many creditors choose the former. But is it really a choice?

6.6.8.(b) Example of the Czech Republic health sector

Hospitals here are regular late payers³⁴⁸ and when contractors have threatened to shorten payment delays, hospitals have threatened to change suppliers. Further, the under-funded state owned health entity General Health Insurance Company is also responsible for important late payments to doctors³⁴⁹ and dentists³⁵⁰. The situation is worsening with payment periods of a year or more³⁵¹.

³⁴⁵ *LATE PAYMENTS IN EUROPE FOR IVDS*, EDMA, 2005, p.3. Advamed, *Italy Medical Technologies Issues*, January 2005, p. 3. *The Italian NHS financial crisis and late payments*, Centro Studi Biomedica, No 19, March 2005, p. 12.

³⁴⁶ *The Italian NHS financial crisis and late payments*, Centro Studi Biomedica, No 19, March 2005, p. 11-12.

³⁴⁷ *The Italian NHS financial crisis and late payments*, Centro Studi Biomedica, No 19, March 2005, p. 5.

³⁴⁸ Article published on February 14, 2006 on <http://www.radio.cz/en/news/75852>.

³⁴⁹ The Directive applies to doctors and dentists as they are independent professionals. Article published on May 4, 2006 on <http://www.radio.cz/en/article/77584>. Doctors organised a one day strike against late payments. See article published on October 5, 2005 on

<http://homepage.mac.com/milankalus/blogwavestudio/LH20041220192517/LHA20051005162608/index.html>.

³⁵⁰

<http://homepage.mac.com/milankalus/blogwavestudio/LH20041220192517/LHA20060128200502/index.html>

³⁵¹ *LATE PAYMENTS IN EUROPE FOR IVDS*, EDMA, 2005.

6.6.8.(c) Example of the Greek health sector

In Greece, the government tried to deal with late payments, and more precisely with interest on late payments, by changing the law. The situation had become untenable for hospitals. Payment periods between 2002 and 2004 averaged 320 days representing 2.7 billion Euros³⁵². Hospitals needed to continue to function and be provided with goods and services but could not pay their late invoices. The situation was made even worse by the Presidential Decree 166/2003 transposing the Directive. The interest rates that creditors could charge on late payments could on their own cause hospitals to go bankrupt. On December 23, 2004, law 3301/04 was published³⁵³. Article 7 of this law created a special system for Greek public hospitals in respect to any and all debts owed since January 1, 2002. This law was supposed to last one year³⁵⁴. It stated that creditors of public hospitals not only had to grant hospitals a 3.5% discount on their outstanding invoices, but also declared that interest rates would not be applicable to such invoices. This law obviously violates Directive 2000/35 and creates an exception to the Presidential Decree 166/2003 transposing the Directive.

6.6.8.(d) Example of the Portuguese health sector

Average payment periods in Portugal seem to be improving although they remain high at more than 200 days. The statistics provided are not closely representative but do give an overview of the issues³⁵⁵.

6.6.8.(e) Example of the Maltese health sector

Contractual payment periods for hospitals are 150 days³⁵⁶. Further, in case of late payment a 3% penalty is provided. However, this percentage seems to be a fixed penalty and not one that is tied to the number of overdue days.

³⁵² *LATE PAYMENTS IN EUROPE FOR IVDS*, EDMA, 2005.

³⁵³ ΝΟΜΟΣ 3301/22.12.04 Συμφωνίες παροχής χρηματοοικονομικής ασφάλειας, εφαρμογή των Διεθνών Λογιστικών Προτύπων και άλλες διατάξεις.

³⁵⁴ Law 3301/04, Article 7 (4).

³⁵⁵ *LATE PAYMENTS IN EUROPE FOR IVDS*, EDMA, 2005, p.3.

³⁵⁶ Report prepared under the supervision of Professor Lino Briguglio and Jean Albert presenting a statistical analyses of payments behaviour, insolvencies and unemployment on a per country basis and submitted to the European Commission on August 31, 2006.

This means that for a hospital that has not paid within the normal payment delay, the incentive is to pay as late as possible.

However, a recent study showed that the Directive had and still has a positive financial impact on the Maltese pharmaceutical sector traditionally prone to long payment periods³⁵⁷. Both the liquidity and profitability of companies is expected to improve considerably following its implementation.

The rationale of interviewees is that companies' liquidity position is strengthened due to the interest threat made to clients, thus persuading them to pay within a reasonable time period. This improves the timing and predictability of cash inflows resulting in a shorter debtors' collection period. The *Cash in hand* figure in the Balance Sheet rises outstandingly due to three factors: faster conversion of trade debt into cash, interest and compensation receivable. This improves the *Current ratio* as well as drastically increasing the proportion of current assets in liquid form. Consequently, firms are in a better position to meet their current obligations, and at the same time, reduce the need for short-term borrowings.

Companies also experience a substantial rise in their profitability. This is attributable to the extra revenue generated from the receipt of interest and compensation payments in respect of overdue debt. This extra income contributes to reducing the financial strain placed on companies, as a result of excessive payment periods and late payments.

It is up to businesses, however, whether or not to make use of the Directive's provisions. If the culture of late payment needs changing, to a great extent it is for businesses themselves to lead the change. The government can pave the way by introducing new legislation which can assist businesses in overcoming this problem and by setting the example. However, SMEs need to use the rights conferred upon them for such measures to be effective.

³⁵⁷ Source: Caruana D., (2005). *The Financial Impact of the EU Late Payment Directive 2000/35/EC on the Maltese Pharmaceutical Sector*, unpublished dissertation, University of Malta.

6.6.8.(f) The health sector abroad

Late payments in the health sector are not just a feature of the EU. The same problem exists in the US, but because it is a private system public authorities are more likely to intervene and fine health insurance providers for their late payments³⁵⁸.

The lack of impact of the Directive in such sectors may warrant a different type of action altogether, either at Member State level or EU level³⁵⁹. In this sense the Directive has revealed that late payments and the Single Market will continue to be affected by a lack of reform in sectors which obviously need it³⁶⁰.

Italy, the Czech Republic, Greece, Malta and Portugal are not the only countries to experience these problems, and the health sector is not the only one affected.

6.6.9 *Industries prone to long payment periods - Retail suppliers example.*

6.6.9.(a) Retail suppliers example

Large retailers have adjusted their payments to suppliers based on the turnover period for specific products and the resulting reordering process. Accordingly, suppliers of perishable goods are paid quasi-immediately, whilst suppliers of packaged food, drugstore items and household goods are paid within 90 days and textile products up to 180 days³⁶¹. Large retailers thus take lower risks as they generally pay for items they purchase based on sales. It is the suppliers however who assume that risk, and in effect are always

³⁵⁸ See [http://www.sfgate.com/cgi-](http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2001/09/26/BU152711.DTL&type=business)

[bin/article.cgi?file=/chronicle/archive/2001/09/26/BU152711.DTL&type=business.](http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2001/09/26/BU152711.DTL&type=business)

³⁵⁹ Centro Studi Biomedica, *The Italian NHS financial crisis and late payments*, No 19, March 2005, p. 12.

³⁶⁰ *Conference on the Appraisal of Investments in Health*, Proceedings of the European Investment Bank (EIB) and World Health Organisation (WHO) Luxembourg 17-18 June, 1999, p. 14.

³⁶¹ *The Quasi-judicial Role of Large Retailers : An Efficiency Hypothesis of their Relation with Suppliers*, Benito Arruñada, Barcelona, January 13, 2000, p. 10.

paid at least one delivery late. This is because supplier payment time coincides with the next order and delivery, and this gives retailers extra bargaining power.

6.6.9.(b) Construction sector

In the construction sector a similar conclusion was attained after a recent survey by the European Construction Industry Federation which stated that “the Directive has not been an efficient instrument for combating late payments in the construction sector”³⁶².

The worst case scenario seems to occur when the construction sector meets the public sector. Payment periods for implementation of public construction contracts range from 5 to 6 months for contracts with central public authorities to 2 years when they are local public authorities.

6.6.10 *The lack of Information*

Calculating the interest rate on late payments with no basis other than the ECB bank rate is inevitably confusing, especially when all a small company owner knows about that rate is that it changes regularly. Many businesses interviewed stated that they did not know how to calculate the interest, and that this was one reason for not applying a late payment interest on the invoice. The chances are that interest rate calculations would lead to a dispute on the invoice. The ECB website itself is confusing, and although some countries such as the UK have provided very informative tools to calculate late payment interest³⁶³ other countries have provided little in the way of assistance in this area.

6.6.11 *Competition law*

As previously stated, many representative organisations interviewed indicated that they had no desire to make any recommendations, or define codes of good practices, or even use their right to sue for grossly unfair clauses. These

³⁶² *Application of the Directive on Late Payments in the Construction Sector*, FIEC, 12.12.2005. p. 3.

³⁶³ <http://www.payontime.co.uk/calculator/statutory.html>

respondents were hobbled by the fear that any such action would be considered anti-competitive as stated under Article 81 of the EU Treaty and following the Fedetab decision of 1978. The French Conseil de la Concurrence has indicated some flexibility in this respect, enabling representative organisations to draw up codes of conduct that can include limitations on payment periods³⁶⁴. However, it appears unconvinced by the economic benefits of payment periods harmonization³⁶⁵. An official and clear undertaking will probably have to be made before any of these organisations work on limiting payment delays. Alternatively, a European Regulation on payment periods may be required.

6.6.12 Statute of limitation on debt recovery

Some legislation limits the time a creditor has to recover debts owed. In the Netherlands for example, debts die after 5 years if not paid and if no proceedings have been started.

This limitation does vary depending on the circumstances and can be restricted to 3 years or extended to 20³⁶⁶.

In Poland the statute of limitation is two years and once this has expired both the principal and the interest on late payments are lost³⁶⁷.

6.6.13 Economic cycle as a limit on the Directive's impact

It is often contended that changes in late payments could be due to economic cycles. More specifically, it is thought that when economic activity is buoyant, late payments will be low, and that when economic activity is weak, late payments will be high.

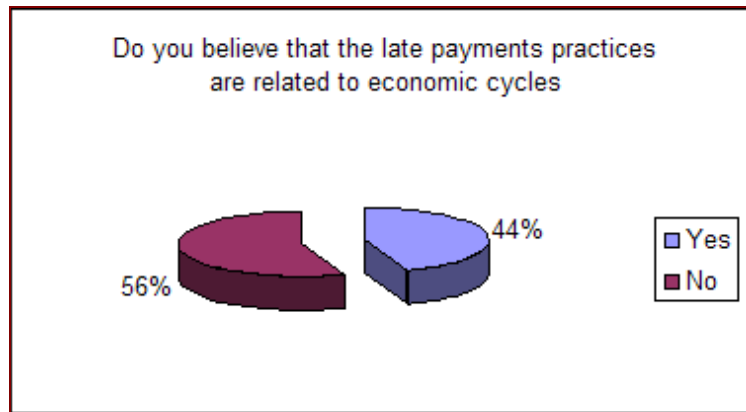
In the LP Survey, over half the respondents said they believe that late payment practices are unrelated to economic cycles.

³⁶⁴ See Opinion of the Conseil de la Concurrence [n 05-A-17], 22.09.2005.

³⁶⁵ See Opinion of the Conseil de la Concurrence, *relatif au recours à la négociation collective en matière de délais de paiement inter-entreprises*, [n 05-A-17], 22.09.2005, at 40.

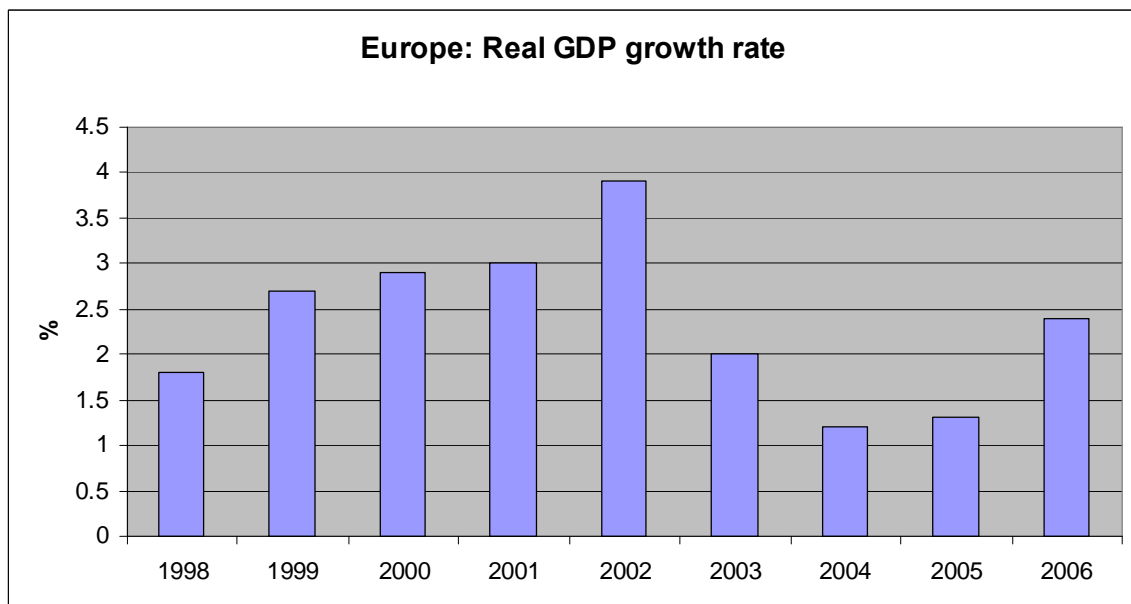
³⁶⁶ See www.moretonsmith.com/legalservices.html.

³⁶⁷ <http://www.legalweek.com/ViewItem.asp?id=24229>. See also decision of the Supreme Court of January 26, 2006 that states that interest follow the principal.



This is not in contradiction with the view that economic cycles influence company payment behaviour but merely indicates that growth may not lead to better payment practices.

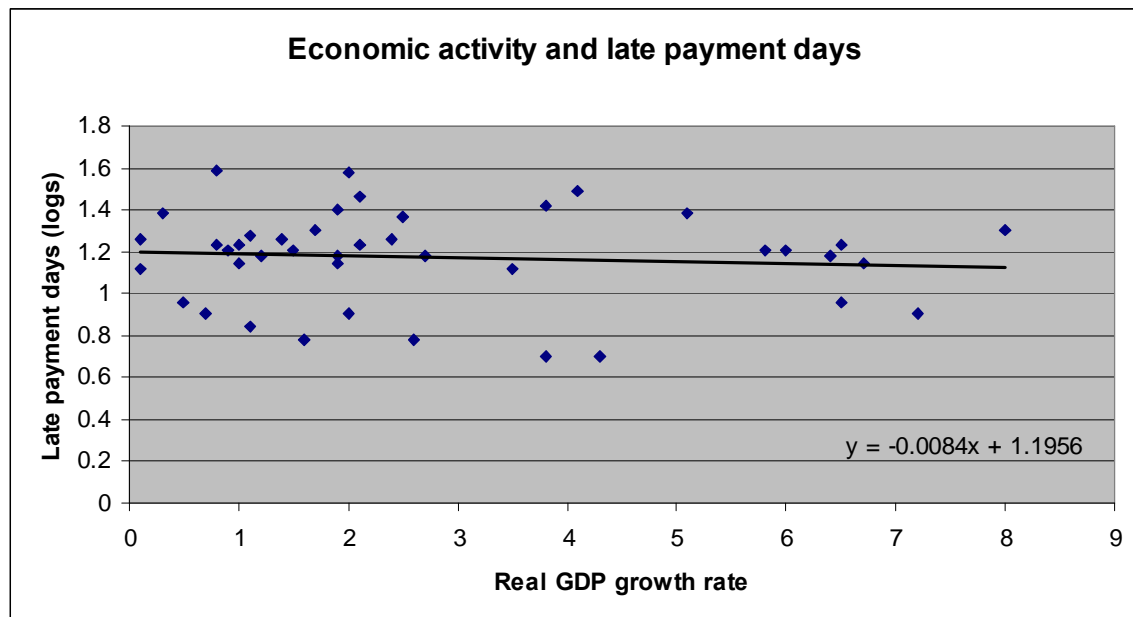
Economic activity has been rather weak in the EU in recent years. In fact, as the figure below shows, after increasing till 2002, the real GDP growth rate dropped. Although it rose in 2006, the real GDP growth rate was still lower than the 2002 figure. If payment behaviour negatively paralleled growth, this would imply that late payments may have experienced a greater reduction since 2002 had there been greater economic activity.



Source: Eurostat

Indeed the figure below indicates that economic activity is negatively related to late payment days. The chart is a scatter diagram of cross sectional data for late payment days and real GDP growth, for a number of EU states during the period 2003 and 2004. Data for late payment days is from the European Payment Index,

while the real GDP growth rate is from Eurostat. Possibly, a stronger relation could have been perceived had a longer time series been available.



Source: Eurostat, European Payment Index

To conclude, although it appears that economic cycles may have an influence on payment behaviour it is not clear that late payments are positively affected by growth and negatively affected by slowdowns. A more complete study on this may show that strong growth may substantially increase late payment levels. On the one hand in periods of growth company resources are stretched. On the other hand in such period credit management is less of a priority; generally the quick cash-flow turn-around provides a more constant stream of working capital with lenders/investors more able to inject cash. If late payments were a feature purely of economic downturns, regulation sanctioning late payments too strongly may provoke strings of insolvencies for companies that need trade credit facilities to survive. However, the fact that late payment days may be negatively related to growth highlights the need for regulation in this area as these periods do not lead to the same risks³⁶⁸.

³⁶⁸ In growth periods the generalized use of trade credit may fuel further growth. However, growth fuelled on trade credit is a blessing in disguise as any downturn or slowdown could create domino-bankruptcies.

Summary of Chapter 6: The Impact of the Directive³⁶⁹

- Late payments in Europe have dropped substantially after 2002 but are not altogether eliminated.
- Payment periods have stabilized but have not dropped.
- Insolvency numbers have dropped but this is not specifically attributable to late payments improvements.
- Unemployment is stabilizing but this is not specifically attributable to late payments improvements.
- Strong disparities in the lengths of payment periods still exist in the EU.
- Information on late payments regulation and the tools available to fight slow payers is not sufficiently disseminated.
- Public contractors do not set a good example in the fight against late payments and excessive payment periods.
- The Directive contains inherent limits that mean its impact will fall short of eliminating late payments and limiting long payment periods.
- Member States have started reforms but some sectors will continue to impact negatively late payments and long payments periods.
- Member States have started important reforms of their judicial systems in order to shorten the time it takes to obtain an enforceable title in cases of undisputed debts.
- Good practices and charters have been adopted to change the business culture.
- Late payments and excessive payment periods are now generally considered abusive and a breach of contract.

³⁶⁹ This and following chapter summaries should not be used to draw conclusions from if read in isolation. Rather they should serve as a guide for readers to locate those sections in the text of most interest to them. These summaries provide a little more information than a table of contents.

7 RELEVANCE, COHERENCE, USEFULNESS AND EFFECTIVENESS OF THE TOOLS PROPOSED BY THE DIRECTIVE

7.1 Interest rate

Charging an interest rate on late payment is relevant in the context of combating late payments, compensating for credit unwillingly provided, deterring the practice of paying late and free-riding on the working capital of other companies.

Article 3 provides a coherent, clear, step-by-step method of determining the chargeable interest.

80% of the interviewed companies which considered the Directive to be a useful piece of legislation also considered that the most useful measure in the Directive was the interest on late payment provision. Many companies have stated that the Directive was mostly useful because by forcing Member States to provide legislation on a statutory interest rate for late payments, it normalized the inclusion of late payment interest in contracts. Thus, such a clause is negotiated less today and accepted more as a boiler-plate provision. Often, late payments contractual interest is higher than statutory interest rates³⁷⁰.

However, as it stands Article 3 is effective only to a certain extent. The Directive provisions on recovery costs limit Article 3's effectiveness. As stated under Section 6.5.7 the provisions of the Directive on late payment interest are useful only beyond a certain amount or number of days late. As a result the Directive is useful only to the extent that it will reduce the length of late payments to the IRCF. The Directive's effectiveness concerning the provision on interest decreases as the late payment average nears the IRCF.

³⁷⁰ See Chapter 5.

The fact that there is no clear definition of recovery costs, no mention of their automaticity and no method to calculate them all add to the uncertainty. Out-of-court and in court recovery costs need to be clearly defined and structured so they can be reimbursed. Interest rate on late payment should not be compensating for the cost of recovery. Under IRCF, the estimated cost of out of court recovery is 20 Euros which is basically the cost of sending reminders. If this is not recognized as an automatic recovery cost that can be invoiced by the creditor before going to court, it essentially means that it is the interest rate that is supposed to compensate for late payment. In that case the provision of the Directive on interest rates will lack efficacy as its aim is not reimbursement of out of court recovery costs.

Further, the Directive does not insist that Member States take measures to demand interest on late payments representing less than 5 Euros. Thus, the Directive's effectiveness is limited further by FIDI.

Interviewees also stated that the interest rate was set too low. Many interviewees considered the interest to charge ridiculous and that they would consider charging interest only in case of litigation. They stated that charging interest on bills paid ten or fifteen days late was inefficient and often counterproductive. Further, the rate of interest does not seem to be a deterrent to debtors who consider it a low price to pay for a breach of contract³⁷¹.

Finally, many interviewees stated that although the Directive was clear on interest rates that could be charged, it was not always easy to determine what interest rate to charge under national laws as they could not easily determine the current ECB rate and did not know whether the interest rate could be compounded. This is accentuated by the fact that companies find it difficult to calculate the actual interest owed. In a recent poll conducted in the UK by the Better Payment Practice Group, more than half of UK companies surveyed did not know how to calculate late payment interest³⁷². This highlights the extent of the problem for Europe as the UK is one of the countries that has communicated

³⁷¹ *Directive 2000/35 on combating late payments in commercial transactions*, European Legal Forum, Zaccaria Alessio, 2001.

³⁷² *Half businesses need guidance on calculating late payment interest*, Better Payment Practice Group, 31.07.2006, at http://www.payontime.co.uk/news/31_07_06.html.

most on late payment interest legislation and is the only country that provides an online late payment interest calculator. Further, the date at which a payment is considered late for purposes of calculating the starting date of the interest due is sometimes difficult to determine. Recently, a German court referred a case on this issue to the ECJ³⁷³. As a result companies avoid charging interest because they do not want to (i) make a mistake that could be used to dispute the invoice or (ii) offend the client further.

The general conclusion is that the interest on late payments provision is relevant, coherent, useful and effective to “reverse the trend” as stated in paragraph 16 of the Directive’s preamble and confirmed by the statistics and interviews, but that it is not sufficient to both “reverse this trend and to ensure that the consequences of late payments are such as to discourage late payment”.

Most companies interviewed confirmed that a 30 day default payment period was adequate and reasonable. Studies generally confirm this. Companies interviewed also found that the 30 day default payment period was useful as a guideline for contracts and that contract payment periods of 60 days or 90 days that may have been considered normal prior to the Directive are now part of specific commercial efforts consented by the supplier. Many companies consider that the Directive would have been more effective if it had imposed a general period of 30 days to make payments special conditions related to the specificity of the goods or services. As shown in the LP Survey only 35% of companies pay their invoices within 30 days. In France for example a law has been adopted in 2006 limiting payment periods to 30 days in the transport sector³⁷⁴. This was seen as a necessary measure to assist a sector that hails from abusive payment practices. However, this initiative is opposed by some representative organisations that point to the risk of loss of international competitiveness if there is no flexibility on payment periods.

³⁷³ *Deutsche Telekom AG v. 01051 Telecom GmbH*, Higher Regional Court of Cologne referred to the European Court of Justice under Case C-306/06.

³⁷⁴ Loi 20 2006-10, L 443-1 du Code du Commerce.

7.2 Recovery costs

The costs associated with the recovery of debts are often important and can play in the late debtor's favour if the creditor may not recover them.

Providing for the reimbursement of reasonable recovery costs is relevant in the context of combating late payments, and encouraging cross-border commercial transactions by facilitating access by creditors to procedures aimed at obtaining payment of debt. The coherence of the Directive's provision in this area is however not satisfactory. First, the expression "recovery cost" is not defined in the Directive. Article 3(1)(e) does not state what recovery costs are "relevant". Anything and everything can be recovery cost. Some companies interviewed claimed that the cost of sending a dunning letter should be reimbursed under the recovery cost provision. Others declared that "recovery costs" should be limited to those related to the "recovery procedures" as provided under Article 5. Second, there is no mention that recovery costs should be automatic. Third and confirming the previous point, paragraph 17 of the Directive adds to the confusion by proposing the possibility of offsetting such costs against the interest rate. It states that "*the reasonable compensation for the recovery costs has to be considered without prejudice to national provisions according to which a national judge can award to the creditor any additional damage caused by the debtor's late payment, taking also into account that such incurred costs may be already compensated for by the interest for late payment.*" Basically the courts are free to appreciate the scope of such costs, the reasonableness of the compensation and whether the interest on late payment is inclusive of them. This is not the intent of the Directive. The interest rate for late payments is supposed to deter debtors and compensate for the forced credit imposed on the creditor. It is not supposed to include recovery costs. Preamble paragraph 17 does not mention contractual interest but only "the interest for late payment".

A restrictive interpretation of this provision by Member States would effectively lead to the idea of recovery costs disappearing to the benefit of an all-encompassing "interest" on late payment.

The way Member States have implemented this provision reflects the range of interpretations that can be made of it, extending from a very restrictive one whereby no action need be taken except that of allowing a debtor to claim

compensation before the courts, to a much broader concept whereby the debtor can claim automatic recovery costs including the costs of dealing with a late paying debtor, filing costs in the courts, attorneys' costs and relevant enforcement costs.

Although the provision lacks coherence, it has been useful. The UK for example has defined an automatic recovery cost fee. This is shown in the table below:

Size of the unpaid debt	To be paid to the creditor
Up to £999.99	£40
£1,000 to £9,999.99	£70
£10,000 or more	£100

Ireland has followed a similar path. In this the Directive's provision that declares "*Member States may, while respecting the principles referred to above, fix maximum amounts as regards the recovery costs for different levels of debt*" is both useful and efficient. It is all the more useful that the UK has interpreted it precisely to mean that costs should not hinder recovery. As presented in the WB Study the cost of obtaining an enforceable title and of enforcing it represents 17.2% of the value of the debt in the UK and on average 11.8% in the EU³⁷⁵. For this reason, the table above only concerns the out-of-court costs. Court costs including attorney's fees, service costs and procedural costs are included in similarly graded tables. The UK's legislation has had the desired effect, which is that companies are more willing to go to court to obtain payment. In a recent survey it was found that almost one third of UK companies had been to court in 2005 to obtain payment of debts owed³⁷⁶. It appears however, that although recovery costs are possible, when debts are relatively large, companies cannot go to court without risking bankruptcy during the process and before recovering anything, because of the magnitude of legal proceedings related costs in the UK.

Spain has opted for a different solution, but based on the same option offered by the Directive. It provides that recovery costs are to be reimbursed fully unless

³⁷⁵ See www.doingbusiness.org under "*enforcing contracts*".

³⁷⁶ Three in ten companies have been to court to collect outstanding debts in the last year, The Better Payment Practice Group, Press Release, 12.01.2006.

the debt exceeds 30,000 Euros, in which case such reimbursement may not represent more than 15% of the amount of the debt.

Recovery costs are not meant to be compensated by the interest on late payment. These are different instruments aimed at different problems encompassing different goals. Both the granting of recovery costs and imposition of interest seek to deter late payments, but where recovery costs typically aim at facilitating recovery of late payments, interest on late payments aims at making sure that the debtor does not get a free ride on the creditor's working capital. As distinct instruments, they remain complementary to one another. Interest without reimbursement of recovery cost would basically mean that the purpose of the interest on late payment would be diverted to compensating for the costs related to the recovery of the payment.

Therefore, for the Directive to be coherent, it would need to clearly distinguish both, and not allow national judges to offset one against the other or define the types of recovery costs that fall within its scope. It could also include formulas based on the UK and Spanish models or on the IRCF.

Finally, the European Court of Justice has recently confirmed that the Directive's scope may be limited further. In a case referred to it by a Spanish Court it considered that the Directive did not impose that expenses related to representation costs by lawyers be considered as part of recovery costs³⁷⁷.

7.3 Grossly abusive clauses

In many business transactions imbalances between the parties' respective powers are common and in some they are reflected in contractual terms and conditions between the parties. Some contracts provide for terms and conditions that are grossly unfair to one party. The form that grossly unfair terms can take can be written or oral but also behavioural. These grossly unfair terms are those that the Directive aims at eliminating in so far as they concern payment periods.

³⁷⁷ Case C-235/03, QDQ Media SA v Alejandro Omedas Lecha, 10 March 2005, [2005].

7.3.1 *Power and grossly unfair clauses?*

Abuse risks arising from the lack of bargaining power have been disputed³⁷⁸. However, the existence of grossly unfair clauses in a contract is a sure sign of a lack of bargaining power in one party and the abuse of the situation by the other. The existence of a very lucrative free ride on others' cash flow by large retailers is confirmed every year when these companies report their earnings. This is not just a feature of retailers³⁷⁹.

The reported earnings of large distribution companies in Spain show that the earnings portion that derives from financial operations surpasses that generated from these companies' core business, i.e. the retail business.

Grossly unfair clauses are prevalent in public contracts, the retail sector and the construction sector. In public contracts, especially in the health sector, clauses allowing for payment periods of 90 to 150 days are not uncommon as confirmed by interviews with public agencies. This is generally confirmed by studies collected and described before. Not only do these clauses exist but little compensation is provided for the late payments that may follow these long payment periods.

7.3.2 *Should the Directive address this?*

It is appropriate for the Directive to address this as there is no reason to believe that grossly unfair provisions will suddenly disappear from contracts. To the contrary, setting a default payment period and interest rate for late payments

³⁷⁸ *The Quasi-judicial Role of Large Retailers : An Efficiency Hypothesis of their Relation with Suppliers*, Benito Arruñada, Barcelona, January 13, 2000. Powerful retailers, who can change contractual clauses, and act as judge and party in their relationship with suppliers are said to be constrained by market forces that impose on them to be reasonable and fair in their business dealings with suppliers/creditors. The argument is limited however, because the author fails to analyse (i) why generally legal systems are opposed to parties being both judge and party, (ii) whether the reputation factor used to explain fairness and reasonableness on the part of retailers is important in a market where suppliers compete intensely for contracts with retailers, (iii) why annual contracts may be a means used by retailers to keep renegotiating prices to their advantage, (iv) true market conditions including competition amongst suppliers and the fact that retailers are themselves directly or indirectly competing against their own suppliers, and (v) the difference in behaviour between large quasi-monopolistic retailers and small ones. The author also fails to provide evidence of the absence of grossly contractual clauses and instead focuses on payment terms.

³⁷⁹ *A practical guide to cash-flow management*, Finance Wales, 2004. p. 13.

can lead to an increase in grossly unfair contractual provisions. Fighting late payments calls for a limitation on the ability of the powerful party to contractually circumvent part of or all of the Directive's objectives.

7.3.3 Does the Directive address this with appropriate tools?

The Directive falls shy of providing an answer on this issue. Paragraph 19 clearly identifies the Directive's limit. It states: "*this Directive does not affect national provisions relating to the way contracts are concluded or regulating the validity of contractual terms which are unfair to the debtor*". Fundamentally this means that the *status quo* in respect to unfair contractual terms can remain, and Member States do not have to act on it. In the absence of a horizontal effect for the Directive, judges may if they so wish, and based on the powers national laws confer upon them, decide that grossly abusive contractual terms are not validly enforceable.

Further, in the chronology of business relationships, creditors will seek to have contractual terms questioned in the case of a late payment or non-payment. Those who sign a contract or agree orally and then turn around and sue on it are rare. Because creditors most often sue when the debtor is late in paying or does not pay, creditors will be reluctant to argue that the contract was grossly unfair and risk it not being enforceable at all, which is one of the options provided for in the Directive to remedy a grossly unfair situation. Further, as long as they are paid creditors will not sue to recoup damages for a clause that will impose longer payment periods. It does not appear practical in that sense. Its only use will be in the context of a law suit in case of default payment or very late payments to enable the creditor to obtain more interest on late payment if the court shortens an excessively long payment period, or to obtain damages on top of interest on late payment and reimbursement of relevant recovery costs. It is not however appropriate to eliminate grossly unfair provisions *stricto sensu*.

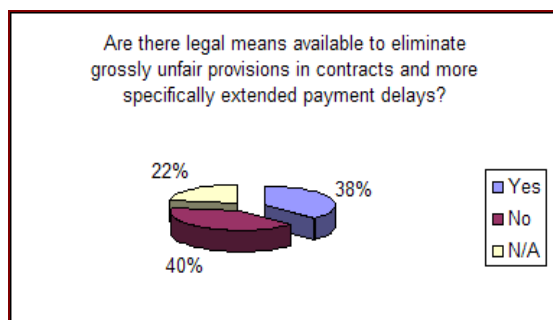
Most regulations already grant judges the power to invalidate grossly abusive clauses. In Spain for example, the law does not provide for a specific claim for damages, but the judge has always had the power to invalidate a clause. Article 1258 of the Civil Code enables the judge to modify the contract and decide on the effects of the unenforceability. This rule intends to provide the parties to

the litigation a final solution to their case and avoid ending up with a simple judicial declaration of unenforceability.

However, the Spanish transposition legislation does stipulate that when the judge determines whether a clause is abusive, he or she will also take into account whether the agreement mainly serves the purpose of procuring the debtor additional liquidity at the expense of the creditor and whether the main contractor imposes on his suppliers and subcontractors terms of payment which are not justified on the grounds of the terms granted to himself. This rule could curb the abuses of large distribution companies that have used their cash-flow in speculative financial investments.

7.3.4 What is the evidence of the Directive's effectiveness...?

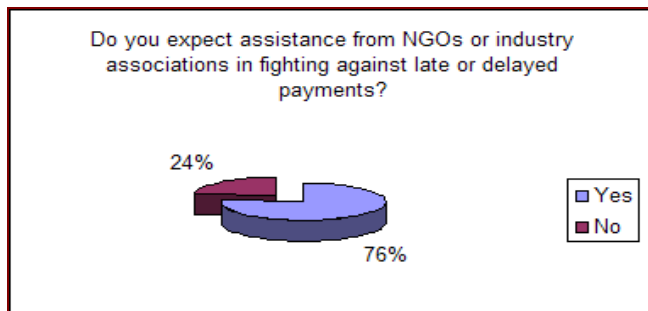
There is no direct evidence of this because as stated above it does not impose any transposition obligations on Member States. The Directive has thus been effective within its scope. It has generally been ineffective in respect to grossly unfair provisions as shown by the LP Survey and other studies. Most people who indicated N/A in fact had no idea how and when to action the grossly unfair provisions of the Directive.



However, there is indirect evidence that in some Member States, representative organisations and institutions have taken it upon themselves to define and implement better practices in business relationships. These initiatives have however been limited by issues relating to competition law as described previously.

7.3.5 *Grossly unfair clauses and representative organisations?*

The LP Survey shows that representative organisations are expected to assist in fighting late payments. In this respect the Directive provision granting representative organisations the right to act for their members is appropriate, useful and relevant. As stated before it enables representative organisations to act in lieu of creditors in an attempt to avoid a creditor-debtor confrontation over payment.

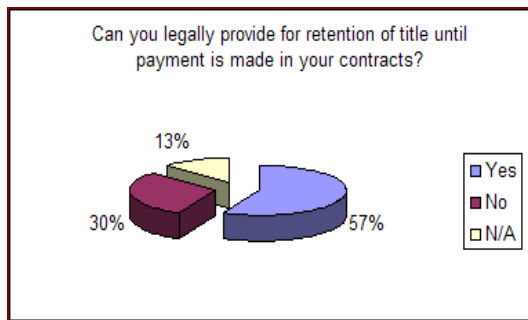


It does not appear to have been very effective however. There do not seem to have been specific actions before the courts by representative organisations requesting the annulment of grossly unfair clauses. Further, the issue of competition law violations remains a sword of Damocles hanging over those representative organisations who venture into bringing court actions to limit the contractual freedom of companies. Finally, many representative organisations represent both suppliers and clients in a particular sector. Their action is thus limited by their own membership structure.

However, the Directive has been effective as many representative organisations now feel invested with a specific mission to resolve late payment problems for their members.

7.4 Retention of title

As shown in the LP Survey, most SME owners feel that this right is at their disposal.



This shows that the retention of title is effective. However, is it appropriate in the field of late payments?

The retention of title is not appropriate in the area of payment delays and late payments but rather in case of insolvency proceedings. Practically such a clause is useful to limit risks of default. To a lesser degree it is relevant to extremely long late payments, which are rare, but not long payment delays. Further, and probably because it is not directly related to late payments and did not literally seek it, the retention of title provision in the Directive has not been efficient in terms of harmonizing Member State requirements for its validity.

The retention of title is aimed at obtaining not quicker payment, but rather funding. Basically, the seller retains property over the goods until he or she is paid. This may have a counter-effect in respect to the Directive's intent, which is to foster prompt payments. In retention of title clauses, the buyer can always argue that the transfer of property being effective upon payment, the goods do not have to be paid for, which corresponds to the historical use of the mechanism³⁸⁰.

Moreover, in practical terms, ensuring that goods be send back on application of the retention of title clause is much longer and more costly than obtaining payment, except in cases of insolvency or insolvency related proceedings. This is another reason why a retention of title clause is not relevant as such in fighting late payments, and certainly not in fighting payment delays.

Credit insurance organisations may require that retention of title clauses be included in contracts in order to insure them. Further, the retention of title

³⁸⁰ *Retention of Title in European Business Transactions*, J. Michael Milo, Washburn Law Journal, Vol, 43, 24.01.2004, p. 127.

clause may be useful when one wishes to sell a debt to a debt collection agency as it increases the value of the debt, but limits the risk of default. But even though these may be valid reasons to try and harmonize retention of title in the EU, they were not those used to justify the existence of a provision on retention of title in the Directive.

The retention of title clause as it stands in the directive largely means that states must recognize it when it is provided for in a contract. However, it does not shed any light on the type of enforcement it should facilitate, set any limit on Member State requirements or define the legal constraints that should apply to it given that each Member State has developed its own requirements in this area.

This has led to difficulties in its interpretation. These difficulties have been illustrated in a European Commission case brought recently against Italy before the European Court of Justice. The European Commission considers that Article 4 of the Directive imposes on Member States that they do not place any conditions on a retention of title clause in a contract for it to be opposable by third parties³⁸¹. The European Commission considers that the retention of title would be meaningless if it were not enforceable against third party creditors of the debtor. As a result the European Commission considers that the requirements of Article 11(3) of Decree No 231/2002 limit the effect of Article 4(1) of the Directive and violate this article.

The European Court of Justice did not confirm this interpretation considering that the rules on enforceability of the retention of title clauses against third parties did not fall within the scope of the Directive³⁸².

This reasoning as such may present some limitations. Since it does not focus on the spirit of the Directive but rather on its precise wording, it leaves Member States with the option to curtail the Directive's effect by creating indirect obstacles to the Directive's implementation. Obstacles that would not affect *stricto sensu* the rights addressed by the Directive. For example, tax regulation as described under Section 8.1.1 can render the Directive completely ineffective. But then again the Directive does not seek to harmonize tax regulation and the

³⁸¹ Case C-302/05: Action brought on 28 July 2005 by the Commission of the European Communities against Italian Republic, OJ C 229 , 17/09/2005 P. 0010 - 0010

³⁸² *Commission of the European Communities v. Italian Republic*, Judgment of the Court, case C-302/05, 26.10.2006 at paragraph 30.

power of Member States to define tax regulations. Similarly in respect to the right to obtain an enforceable title within 90 days for undisputed claims, one could imagine new rules granting debtors more than 90 days to actually dispute a debt or third party creditors to intervene in the action. Does the Directive regulate the procedural rights of all parties to a litigation? It does not seem so. Plenty of examples can be used.

It would have been preferable for the ECJ to elaborate on the scope of the Directive and provide an analysis of the legislative intent behind the Directive as described hereunder.

The European Commission's position was understandable. However, in respect to the retention of title and for reasons explained below the Directive does not require the argued level of harmonization. Does it require for example that Member States change their regulation which states that in case of on-sold goods the retention of title clause is not enforceable against third party *bona fide* purchasers? No, it seems.

Although this was not argued by Italy nor used by the ECJ in its decision³⁸³, it is clear from the drafting history of the Directive and the legislative intent, that the legislative intent is minimalist in respect to Article 4 of the Directive. The European Commission itself deplored this³⁸⁴ when the Council restricted the scope of the retention of title clause, expressly deleting language that evoked enforceability and specifically deleting the sentence "*Member States shall provide for the retention of title to be enforceable against third parties, even in the case of bankruptcy of the debtor or in the case of any other procedure recognised as being similar under the legislation of the Member States*"³⁸⁵. What should the consequence of this deletion be on the interpretation of Article 4 as it stands?

Although the LP Survey shows optimism on this, the retention of title is not always effective to fight late payments. First, it only concerns goods and not services. This is a major amputation of its effectiveness. Second, it cannot

³⁸³ Commission of the European Communities v. Italian Republic, Judgment of the Court, case C-302/05, 26.10.2006.

³⁸⁴ Communication from the Commission to the European Parliament pursuant to the second subparagraph of Article 251 (2) of the EC-Treaty concerning the Common position of the Council on the proposal for a European Parliament and Council Directive combating late payment in commercial transactions, SEC/99/1398 final - COD 99/0099.

³⁸⁵ Amended Proposal for a European Parliament and Council Directive Combating Late Payment in Commercial Transactions, 1998 O.J. (C 374) 4, 10-11.

apply to all goods or works. As stated by EUCOMED, “*the medical technological industry has ethical obligations to continuously make its products available to patients*”³⁸⁶. This is obviously a limit on the impact of the retention of title provision to limit late payments.

The original proposals for a retention of title provision would have had more effect or at the least have led to fewer difficulties in interpreting it.

In any case the question is now dealt with through a regulation³⁸⁷.

7.5 Obtaining an enforceable title in 90 days

The Directive creates a number of rights. It was important as a last resort that creditors could go before competent authorities to have these rights enforced and that the procedures themselves did not render these rights meaningless. The Directive provision on obtaining an enforceable title within 90 days is thus clearly relevant. Interviewees have confirmed that an interest on late payment without the legal means to enforce it is worthless. This has been confirmed in studies and articles³⁸⁸.

It was thus relevant for the Directive to provide that measures be taken to enable a creditor to obtain an enforceable title within a limited time period.

The Directive appropriately deals with the unfairness of undisputed claims relating to late payments. However, these are rare³⁸⁹. Further, it is too easy for debtors to “dispute” such claims and the WB Survey shows that businesses are not as interested in the undisputed claim as much as they are in the disputed one and how long it takes to resolve it. The Online Survey and Telephone Survey confirm this. Many interviewees stated that since the Directive, more claims

³⁸⁶ *EUCOMED situation summary and guidance for members on the late payments directive*, EUCOMED, 13.12.01, p.7.

³⁸⁷ *Retention of Title in European Business Transactions*, J. Michael Milo, Washburn Law Journal, Vol, 43, 24.01.2004, p. 125.

³⁸⁸ See *Directive 2000/35 on combating late payments in commercial transactions*, European Legal Forum, Zaccaria Alessio, 2001, p. 3. See also “*Facing the Credit Squeeze - effects of the capital adequacy and the late payments directive on SMEs*”, Round table organised by CEPS and Intrum Justicia, November 30, 2004, p. 7.

³⁸⁹ *DEBT RECOVERY IN BELGIUM*, Law Firm Van Dievoet, Jegers, Van der Mosen & Partners

were disputed by debtors. The disputes are usually trivial and include such items as formal errors in the invoice. The JDM and Ruttle cases involving UK public entities are edifying. In these case the UK Secretary of State for the Environment, Food and Rural Affairs disputed invoices clearly in an attempt to delay payment or avoid payment altogether³⁹⁰. The Courts found for the complainant³⁹¹ but the legal procedures almost led to the complainant's bankruptcy. Some companies have tried to remedy this by including clauses in the contract which set a specific time limit for contesting the invoice at the expiry of which the invoice is deemed undisputed³⁹². This type of clause is not always accepted by the other party.

The information collected also shows that there is no automatic correlation between the length of payment periods and the time it takes to obtain an enforceable title. In Finland for example, obtaining an enforceable title takes more time than in France when in terms of payments periods France clearly lags behind Finland³⁹³. On the other hand there is a correlation between Italy's long payment periods and the excessive time it take to obtain an enforceable title there³⁹⁴. This tends to suggest that procedures to obtain an enforceable title do play a role in curbing excessive payment periods, but that they are not always instrumental in reducing them to the levels prescribed by the Directive.

Has it been effective? It has generally been effective. Many countries have recently adopted new procedures that aim at and result in faster, cheaper and more efficient procedures. Some issues remain. In Spain for example, the actual transposition law contains no procedural rule related to the enforcement of the creditor's rights. Hence, the only procedures that can be used by creditors are those which existed prior to the adoption of the Law. Far from shortening

³⁹⁰ *Ruttle Plant Hire Limited v. The Secretary of State for the Environment, Food and Rural Affairs Defendant*, High Court of Justice, Queen's Bench Division, Technology and Construction Court, 29.09.2004, at <http://www.bailii.org/ew/cases/EWHC/TCC/2004/2152.html> and *JDM Accord Limited v. The Secretary of State for the Environment, Food and Rural Affairs Defendant*, High Court of Justice, Queen's Bench Division, Technology and Construction Court, 16.01.2004, at <http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/TCC/2004/2.html&query=jdm&method=all>

³⁹¹ The trial, which lasted 12 weeks, found Defra had acted illegally and was in breach of contract.

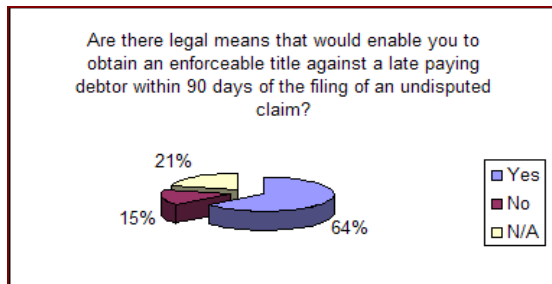
³⁹² "payment is due 30 days at the latest after receipt of the invoice. The invoice shall be deemed accepted unless dispute within the 30 day period to pay the invoice".

³⁹³ See www.doingbusiness.org under « enforcing contracts.

³⁹⁴ See www.doingbusiness.org under « enforcing contracts.

payment periods this factor lengthens them, because the transposition law facilitates debt recovery and compensates for collection expenses but has not been accompanied by a reform of enforcement procedures.

The LP Survey confirms a general improvement in respect to procedures.



7.6 Conclusion

The Directive has had a positive impact globally on late payments rather than on payment delays.

As a whole, the Directive is a relevant, coherent useful and effective tool to combat late payments. However, some of its provisions lack one or more of these characteristics. This may have led to a less than satisfactory impact on payment periods themselves, in particular in some sectors such as the public, transport³⁹⁵, construction and retail sectors.

In the construction sector a similar conclusion was attained after a recent survey by the European Construction Industry Federation which stated that “*the Directive has not been an efficient instrument for combating late payments in the construction sector*”³⁹⁶. The organisation went on to state that the survey that it conducted did not lead to the observation that the introduction of the Directive meant to significant reductions of payment periods. It explained this by considering first that the Directive was not always implemented adequately but also that the specificity of the sector meant that payment periods were rarely based on agreed monthly invoice values. This finding should however be tempered with the Dun and Bradstreet finding that sees a very positive evolution

³⁹⁵ *Les comportements de paiements des entreprises en Europe*, Bilan 2005, Dun and Bradstreet, p. 13.

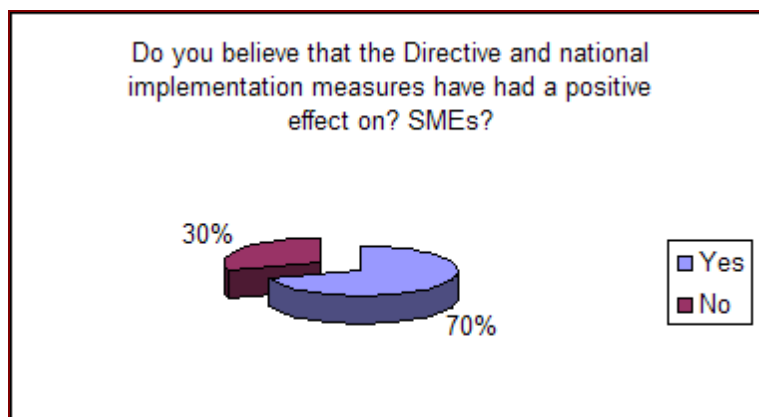
³⁹⁶ *Application of the Directive on Late Payments in the Construction Sector*, FIEC, 12.12.2005. p. 3.

in the construction sector in the last year with the strongest drop in late payment levels over all sectors³⁹⁷.

The public sector is globally a good payer³⁹⁸. This is explained by the strong disparities between payment habits both at the EU level, with Germany paying on time and Portugal paying late, and at the Member State level with the Portuguese central government seldom paying late and local government seldom paying on time. One of the features of “decentralisation” is that in this specific instance implementation takes more time to reach the branches.

Although, some of the Directive’s provisions have not been universally effective, as anticipated other aspects of the Directive have increased its effectiveness. For example, in many instances SMEs, even where they have invoiced late payment interest without collecting it, have triggered earlier payments from debtors and a change in the culture of late payments³⁹⁹.

Generally the effect of the Directive is seen as rather positive as shown in the LP Survey.



³⁹⁷ *Les comportements de paiements des entreprises en Europe*, Bilan 2005, Dun and Bradstreet, p. 13.

³⁹⁸ *Les comportements de paiements des entreprises en Europe*, Bilan 2005, Dun and Bradstreet, p. 13.

³⁹⁹ *Third survey of the management of customer accounts in Europe*, Eurofactor, 2005, p. 15.

Summary of Chapter 7: Relevance, Coherence, Usefulness and Effectiveness of the Tools Proposed by the Directive⁴⁰⁰

- The penalty for late payment should be a real deterrent if the objective is to fight late payments.
- The interest on late payment provision in the Directive is relevant and useful but not a sufficient deterrent to be effective.
- The automaticity of interest on late payment is relevant, coherent, useful and effective.
- The 30 days statutory default payment period should be extended to contracts for the Directive to be effective against long payment periods and disparities between Member States.
- The effectiveness of the provision on recovery costs is limited by the absence of a definition for “relevant recovery costs”.
- The possible confusion between recovery costs and interest on late payment limits the expected impact of the Directive.
- The attribution of a role and function to representative organisations in the fight against late payments and in particular grossly unfair clauses is relevant, coherent and useful especially since they can act as a buffer between sensitive clients and suppliers that do not wish to offend.
- The potential for competition law violations by representative organisations has limited the effectiveness of the provision.
- Further, many representative organisations represent sectors rather than debtors or creditors and as a result cannot use the Directive’s provisions.
- Grossly unfair clauses should be addressed by the Directive but the provision on grossly unfair clauses is limited by the absence of a definition and the power conferred on Member States and courts in this respect.
- The retention of title provision is not relevant in the fight against late payments or in limiting excessive long payment periods.
- The provision that requires that an enforceable title be obtained within 90 days in cases of uncontested claims is relevant, coherent, useful and effective but it should extend to pre-trial procedures and enforcement for greater coherence and effectiveness.
- All of the tools provided by the Directive except possibly the retention of title clause are relevant and useful in the fight against late payment.
- The Directive as a whole could benefit from greater coherence and this is one of the reasons for limited impact expectations and effectiveness.

⁴⁰⁰ If this summary is read on a stand-alone basis no conclusion should be drawn from it. As such the bullet point summary’s purpose is to guide the reader to the section or chapter he or she may be most interested in reading. It is thus a little bit more than a table of content.

8 RECOMMENDATIONS

Based on the LP Survey results, the interviews conducted and the previous Chapters in this Report, recommendations can be proposed to further enhance the Directive's impact.

As stated earlier new instruments and initiatives have already been adopted or proposed to complement the Directive. For example, Regulation 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims facilitates free movement of decisions and out-of-court settlements concerning uncontested claims by making it no longer necessary, prior to recognition and enforcement of decisions, to use an intermediate procedure in the Member State of enforcement. This Regulation has been in force since 21 October 2005⁴⁰¹. Another example is the European Commission Green Paper on a European order for payment procedure and on measures to simplify and speed up small claims litigation⁴⁰².

The following recommendations are made in no specific order.

8.1 The fiscal treatment of late payments

8.1.1 *Easing the tax burden of the late payment victim*

As stated previously the interest rate on overdue payments can not as it stands act as a deterrent on late payments. Further, it tends not only to complicate invoicing and accounting, thereby adding costs, but its tax consequences are of themselves a deterrent to charging such interest. VAT is chargeable on interest and is commonly considered a business income. VAT may even be due as soon as the late payment interest is invoiced. This not only adds red tape and costs, but also cuts the actual interest charged by the tax rate. By charging interest not only does the creditor risk offending a client. He or she will also incur further costs in these cases.

⁴⁰¹ Official Journal L 143, 30/04/2004 P. 0015 - 0039. See at http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/L_143/L_14320040430en00150039.pdf

⁴⁰² COM(2002) 746 final.

The interest rate on late payment thus needs to be substantially higher to act as a deterrent against late payments, while its tax treatment needs to be addressed specifically to encourage creditors to use it.

It is interesting to note that when it is charged, interest is a business income, but when it is not charged it is not accounted for as a loss that would give a right to a tax credit. As a result Member States do not consider that companies actually incur a loss or an expense as a result of late payments, as they do not allow for the reflection of such loss or expense in company returns. Late payments could be evaluated clearly and considered an expense similar to any expenses incurred to find or keep clients.

8.1.2 *Sanctioning the debtor responsible for late payment*

The LP Survey shows that creditors are in favour of the non-deductibility of VAT or imposition of fines on late payers. An automatic minimum amount constituting a real deterrent should be invoiced to Debtors on the first day after the expiry of the contractual payment delay. This could be called the Late Payment Fee (“LPF”). This minimum amount can be proportionate to the debt but should be both statutory and automatic. It should be sufficiently substantial to act as an effective deterrent. The LPF could take the form of a percentage of the total amount owed or a fixed maximum amount based on different levels of debt. The fee should be clear and easy to calculate. The LPF should only sanction the first day of lateness. Any late payment days that follow should be subject to further sanctions similar to the current late payment interest rate but higher, and calculated in such a way that the interest is automatically compounded.

8.2 Placing invoice payments in escrow

The escrow system is based on a third, trustworthy party acting as an intermediary in the transaction. The intermediary receives the debtor’s payment and holds it, and notifies the seller to deliver the products or render the service. Once the intermediary receives the invoice from the creditor and the acceptance from the debtor, the intermediary forwards the payment to the creditor. The

COD⁴⁰³ system is not very different to escrow. The advantage of escrow is that its role and function can be adjusted to suit the nature of the goods provided or services rendered, and it allows more time for acceptance of goods or services. The role of the intermediary may include participation in the acceptance process. In case of a disputed claim escrow could even take on the role of an arbitrator. Interest generated on the moneys deposited through escrow would benefit the debtor.

An option could be given to creditors stipulating that a contract that would not include an escrow agreement would by default bear relatively high interest rate.

The use of an escrow account is a remedy against late payments for companies that claim that they wish to pay after inspection or acceptance of the goods. It would not be a good system where companies rely on trade-credit to do business. It would however ensure that companies that buy goods or services are actually able to pay for them.

8.3 European fund

Long payment periods constitute an important cost to the EU. This cost is the result of the combination of a lack of access to financing and the payment behaviour of large companies and public institutions. The creation of a European fund or bank whose role would be to provide financing at no cost to SMEs based on account receivables could solve part of the problem. Such a fund or bank would be compensated by the penalties on excessively long payment periods or late payments. SMEs would thus have access to late payment financing and large companies or public institutions would have to deal with the European Fund in respect to the penalties. The balance of power would thus be appropriate to ensure that all are paid what is owed.

The European Investment Bank could be conferred such a mission. It may fall within the scope of its objective which is to “contribute towards the integration, balanced development and economic and social cohesion of the Member

⁴⁰³ Collect on Delivery.

Countries”. It would not coincide with the EIB’s mission *stricto sensu*, but the EIB could fulfil its mission of long term investments to foster EU integration, by setting up a “trade-credit fund”. It is currently contributing to the health public sector reforms (although it is not clear how extensively) and thus already participating if not directly, at least indirectly in curing the late payments and excessively long payments period epidemic in that sector⁴⁰⁴.

8.4 Appropriate interest rate for late payment

The current default interest rate as set by the Directive aims at compensating the creditor for loss of interest on moneys or for having to finance cash flow externally by using credit from financial institutions. This is not the objective that was set in the 1997 Commission Report. Nor does it answer paragraph 16 of the Directive’s preamble which states *“late payment constitutes a breach of contract which has been made financially attractive to debtors in most Member States by low interest rates on late payments and/or slow procedures for redress. A decisive shift, including compensation of creditors for the costs incurred, is necessary to reverse this trend and to ensure that the consequences of late payments are such as to discourage late payment”*.

The LP Survey shows that 64% of companies have “committed” late payments. For 48% of respondents, more than 50 percent of invoices are paid late and for 70% of them clients pay late.

If the Directive is to fight late payments and resulting breaches of contract, it must include provisions that deter them rather than provisions that compensate their victims or transform SMEs into credit organisations with neither the power that official credit organisations have nor their knowledge. Companies interviewed confirmed that they do not wish to become credit organisations. A survey conducted in the UK confirms that companies consider that late payment legislation should be used as a deterrent⁴⁰⁵. In the LP Study, 81% of companies consider that late payments have a worse effect on cash flow than long payment delays.

⁴⁰⁴ See EIB Press Release of 03/11/2006, *350 millions d’EUR de la BEI pour la modernisation et l’innovation aux hôpitaux de Marseille*.

⁴⁰⁵ *More businesses see late payment legislation as a deterrent*, Better Payment Practice Group, Press Release, 16.11.2004.

The Directive's provision on interest on late payment is not an adequate deterrent and does not compensate appropriately for a breach of contract. It is not even adequate to compensate for the trade credit unwillingly granted.

First, the FIDI and IRCF constitute a serious impediment on the Directive's effectiveness.

Second, seven percentage points per annum above the BCE rate does not adequately compensate SMEs since overdraft credit is more expensive. Most studies conclude that it only partly compensates for margin losses attributable to the lateness of the payment. This rate barely pays for the administrative burden of following up on the debt. A 5,000 Euro debt late by twenty days at 11% interest per annum non-compounded would produce a 30 Euro interest which is subject to VAT and taxed as income. Is this outcome worth potentially offending a customer?

Third, it is not the required deterrent to fight late payments. The objective of the Directive should not be to compensate but to deter. This invites measures that will give debtors very strong incentives to always pay on time, with the creditor seldom having to use those measures.

Fourth, it does not repair a breach of contract.

Deterring overdue payments means defining a minimum exactable on the first day payment is due and adding thereto a compounded daily rate. These should be sufficiently important that the creditor's invoice will be dealt with by the debtor within the payment delay period, either to be disputed or paid.

The interest rate should be higher than the combination of interest rates and penalties that Member States charge in case of fiscal late payments. This is because Member States have enforcement means that SMEs lack.

Finally, limits on payment disputes should be clearly defined too. A payment should be disputed within the payment period time frame.

8.5 Contract law

The Directive does not seek to harmonize contractual provisions. It provides that by default an interest rate is due on late payment and that payment is considered late after 30 days. Contracts may provide for a different interest rate and different payment periods so long as they are not grossly unfair to the creditor. As stated before contracts will often include excessive payment delays provisions and seldom will SMEs go before courts to have such clauses annulled and replaced by fairer ones. The mere fact of going to court will delay payment by years - the Directive imposes no time limits to resolve claims concerning abusive practices - and SMEs cannot afford payment delays that would result from a lengthy court procedure. At the EU level a more harmonized law on contracts would inevitably facilitate intra-trade exchanges and resolve some of the issues posed by late payments⁴⁰⁶. It could impose the condition that with some exceptions concerning validation or acceptance of services or goods, that commercial contracts have a maximum payment period of 30 days. It could also impose a fixed contractual late payment interest rate. This would enhance legal certainty throughout the EU as the basic provisions on payment periods and sanctions for late payments would not have to be negotiated and discrepancies in laws, enforcement and payment culture would be eliminated.

8.6 Director responsibility and corporate governance

Many companies tend to hide behind the excuse of heavy bureaucracy and multiple decision making procedures as the reason for late payment.

These excuses are not acceptable to the creditor as they are external and beyond an aggrieved party's control. However, heavy bureaucracy and multiple decision making procedures are not beyond the debtor's control. They are not a *force majeure* issue and those responsible for the creditor's predicament should be held accountable.

⁴⁰⁶ COM(2003) 238 final page 9.

When an invoice is not paid on time, the creditor should thus be able to file an action against the company and against the directors of the company based on civil liability.

Director liability for late payment will give the desired incentives both to private companies and to public institutions. When companies fail to pay their taxes, the liability is not merely limited to that of the entity but extends to the directors. The same principle should apply in case of late payments given that the balance of power between the creditor and the debtor is so often related to the inability of the creditor to place pressure on the debtor.

Finally, with many laws today enabling creditors to file for insolvency proceedings against debtors, good corporate governance means there is a duty on the part of directors to act responsibly with respect to payments to creditors. Enhancing good corporate governance includes ensuring that those who manage large companies act responsibly. Beyond the threat of insolvency actions and interest accruing fair treatment of business partners is also an element of good corporate governance⁴⁰⁷.

8.7 Developing programs to assist SMEs in credit management and financing management

To a certain extent late payments can be prevented using measures that would enhance SME capabilities. Business failure that is a consequence of late payment also has causes in how credit is managed⁴⁰⁸. SMEs as already stated above often have limited resources to deal with administrative and legal issues. Programs could be developed and technologies used to enhance SME capabilities in

⁴⁰⁷ *“In its broadest sense, corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interest of individuals, of corporations and of society. The incentives to corporations and those who own and manage them to adopt internationally accepted governance standards is that these standards will assist them to achieve their aims and to attract investment. The incentive for their adoption by states is that these standards will strengthen their economies and encourage business probity.”*—Sir Adrian Cadbury, Foreword to Corporate Governance and Development, Global Corporate Governance Forum, Focus 1, 2003;

⁴⁰⁸ This affirmation derives from a statement made by Clive Lewis, head of SME Issues at the Institute of Chartered Accountants in England and Wales and available on http://www.payontime.co.uk/news/start_ups.html.

evaluating clients and account receivables management⁴⁰⁹. The positive effect of good credit management on prompt debt collection is clear⁴¹⁰.

8.7.1 *Knowing the client*

Before accepting work from a client, credit or company financials checks should be performed. This can be a task that businesses are reluctant to perform because of what a new client can mean to them. SMEs would often rather not know. However, knowing helps prevent future difficulties and it helps define the client relationship from the start.

8.7.2 *Enhancing management capabilities*

As stated earlier, one of the reasons for late payments is related to accounts receivables management. Many SMEs need active support in financing management which includes:

- Preparing cash flow projections to determine the amount of finance required and the period of time the finance will be required for;
- Discussing with financial institutions and international sections of banks the different financing facilities that may be available;
- Determining buyer credit and payment method policies
- Developing credit checking, credit risk and exchange risk minimisation procedures
- Establishing an accounting system to keep track of and recover payments from buyers

8.7.3 *Use of technologies*

Technologies exist that can assist SMEs in managing accounts receivables⁴¹¹. The implementation of technology is a difficult and expensive process and

⁴⁰⁹ See for example the program launched in 2004 in the UK called *Credit Management for Start Ups*, at http://www.payontime.co.uk/start_up/introduction.html.

⁴¹⁰ *Enquête sur les délais de paiement*, AFDCC, 09.2005.

⁴¹¹ See “*Better Payment Practice Group offers advice on using the internet to improve payment times*”, Press Release 22.09.2004

few SMEs take advantage of it⁴¹²; however for the majority of business the benefits of implementation greatly outweigh the costs through reduction of payment delays and also reduction in staff time wasted by tasks that can be automated.

Through the use of technology and Enterprise resource planning applications various benefits arise:

Credit Control:

- Automatic order holds triggered by a credit limit or possibly delinquency condition.
- Accurate customer profiles including risk rating and payment history to evaluate appropriate payment terms⁴¹³. Through the use of these profiles it is easier to increase customer satisfaction as it is possible to quickly access previous transactions involving the consumer. Customers' time is saved by ready access to files to locate information.

Collection Capabilities:

- Accurate aging of invoices and subsequent automated collection letters and or statements of account with message capabilities so that they can, if necessary be also be sent to the customer on demand.
- Automated and accurate creation of unearned discounts and late payment fees, with the given allowance for possible grace periods and the generation of notice to customers.
- Automatic 'look-ahead' capabilities that can inform the company and the customer of an upcoming contract expiration date.

⁴¹² Perspective de l'OECD sur les PME, 2002, p. 24.

⁴¹³ See the XSellence software proposed by companies such as Graydon.

8.8 Redefining SMEs

SMEs as defined by the European Commission include a very broad range of businesses, many of which are those “debtors” that the Directive targets⁴¹⁴. A company that has an annual turnover of 50 million Euros cannot be compared in its dealings with late payments to a company that has a 500,000 Euro turnover. Micro sized companies need the kind of protection afforded consumers. Small companies need a similar level of protection but they can be expected to have in-house lawyers and accountants to set up procedures and manage accounts receivables and collection. Medium sized companies are appropriately protected by the Directive and are savvy enough to negotiate appropriate contract terms.

Similarly, the cash flow issues that micro and small enterprises have cannot be compared to those of medium sized enterprises. Medium sized enterprises have the collateral to back loans that micro enterprises lack.

As a result, in many instances SMEs should not be considered as a group but rather defined as sub-categories with different rights and obligations applicable to them. Consumer protection laws could be very appropriate for categories of companies that are the size of, have the power, and behave like consumers. On top of this, such companies should be assisted in debt collection management as described in 8.6. Finally, structures similar to legal aid but applied for accountants could be developed. An “accounting aid system” or “accounting aid society” could be sponsored to assist companies.

8.9 Transparency

It is virtually impossible today to obtain for the EU precise statistical information on the administration of claims relating to undisputed debts. The technological means exist to provide, at little cost, regularly updated court statistics on this subject matter. The reason it is not done is (i) lack of funding, (ii) inappropriate use of technology to generate precise statistics, (iii) fear of the result. However, effective knowledge and acknowledgement of a situation usually has a beneficial

⁴¹⁴ Defined under the Commission Recommendation of May 6, 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.5.2003, p.6.

effect in the long term and would in passing enable a clear assessment as to the Directive's impact on judicial procedures⁴¹⁵.

Information on accounts receivables is not available. Companies, however small, need to manage their accounts receivables efficiently. Too often they avoid doing so until it is too late. Requiring of companies that they provide detailed information in their annual returns on accounts receivables status may assist them in acknowledging a situation and dealing with it. It would also identify those companies that are late payers and warn other companies against working with them.

8.10 Reputation

8.10.1 Compulsory reporting of late payments

Compulsory reporting of late payments by firms would serve two purposes. First it would enable companies to have clear updated statistics on late payments in Europe which would in turn enable quicker action. Second, it would allow identification of those who are responsible for paying late, which would ultimately have a corrective effect.

8.10.2 Disseminating information on companies that pay late or employ grossly unfair practices

This would involve the creation of European ombudsmen⁴¹⁶. One ombudsman at least per country would deal with these issues. Their power would largely be limited to that of a traditional mediator with the right to publish opinions in national and European publications. Mechanisms could be defined to preserve complainant anonymity. Specific powers of discovery could be conferred on ombudsmen facilitating collection of evidence. This last

⁴¹⁵ It is not possible for most Member States today to report on the time it takes to obtain an enforceable title.

⁴¹⁶ As of April 2006, a *Financial Ombudsman* is available in the UK to resolve credit disputes between borrowers and lenders. This could be extended to late payments related disputes.

See

http://www.direct.gov.uk/Nl1/Newsroom/NewsroomArticles/fs/en?CONTENT_ID=4016017&chk=zAZ86v.

recommendation derives from the European Commission's own experience with late payments⁴¹⁷. The potentially bad publicity that mediator opinions might visit on companies and public institutions would in the view of the author of this report deter many from abusing their power.

8.11 The initial text of the Directive

As stated before the Directive is a multidisciplinary novel regulation. As such it has achieved what it set out to do, to combat late payments. However, it hasn't eliminated late payments, substantially reduced payment delays nor harmonized them substantially in the EU. This may be related to the limited time it has been in force. It may also be related to its provisions. The Directive was based on Article 95 of the EC Treaty. This limited the broadness of its scope. Today, article 65 of the Amsterdam Treaty may provide the EU with a sufficient basis for more efficient action to curb late payments and long payment periods in commercial transactions.

8.11.1 Interest rate

The present interest rate structure is too low to deter late payments. The original proposal of the European Commission was better adapted to resolving this issue.

Alternatively, if the interest rate is aimed at compensating for trade credit, it should be applicable 30 days after the due date, whether or not there is a contract that provides for a longer payment period.

8.11.2 Obtaining reimbursement of recovery costs

It is recommended a common regulation should include the recovery costs concept. In it, a punitive element to discourage late payments should be emphasised. The collection costs should be fully compensated otherwise SMEs will not benefit from this provision. If there's an agreement between parties to reimburse all the costs the national courts should obey the contract. If there is no agreement: all the court fees should be reimbursed and in respect

⁴¹⁷ "Letter from the European Ombudsman opening the inquiry", December 3, 1999.

to the lawyer's fees and extrajudicial costs a uniform rate should be set, such as 10% (or less) of the claim with a minimum of 200 Euros. An emphasis should be placed on avoiding reimbursement of the extra-judicial costs twice.

8.11.3 Grossly unfair provision

Such a provision cannot replace the more straightforward 30 days payment period on all contracts. It is clear that the provision could have gained in effectiveness had it been more precise as in the original proposal. Its use is limited though for the reasons stated herein.

8.11.4 Obtaining an enforceable title

Originally the proposal for the Directive included a special debt-collection procedure. This was similar to the German *Mahnverfahren*⁴¹⁸. The advantages of this were its simplicity, flexibility, affordability and speediness⁴¹⁹. However, this did not receive the Council's approval and Article 95 of the Community Treaty was not seen as a sufficient basis for such an action.

Today, the Directive could be amended to include the same provision but based this time on Article 65 of the Treaty of Amsterdam.

Further, the initial proposal imposed a 60 day period for obtaining an enforceable title. This was then changed to 90 days. The change to the 90 day period was justified on the basis that debtors needed to be given time to respond⁴²⁰. This does not appear to be a valid justification. First, the use of software and online systems mean that procedures have dramatically shortened in the last few years⁴²¹. Second, 60 days to obtain an enforceable title was always sufficient to take into account response time. Basically the response time does not need to be long if the objective is to determine the procedure that will be followed. In the German order for Payment procedure, the respondent has fourteen days to respond. If they do, the

⁴¹⁸ See "*The German order for payment procedure (Mahnverfahren)*", Grozdana Šijanski and Jimmy Barber, <http://www.iuscomp.org/gla/literature/sijanski.htm>, 2006.

⁴¹⁹ *The Future of European Civil Procedure*, M. Freudenthal, vol 7.5 ELECTRONIC JOURNAL OF COMPARATIVE LAW, (December 2003), <<http://www.ejcl.org/ejcl/75/art75-6.html>>

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⁴²¹ See "*The German order for payment procedure (Mahnverfahren)*", Grozdana Šijanski and Jimmy Barber, <http://www.iuscomp.org/gla/literature/sijanski.htm>, 2006.

issue moves beyond the scope of the Directive as it then becomes one of a disputed claim or procedure. In cases where there is no response the judge has ample time to issue an enforceable title so as to be within a 60 day limit⁴²².

Therefore the Directive could not only be amended to include a 60 day procedure to obtain an enforceable title, but it could also, based on Article 65 of the Treaty of Amsterdam include the original debt-collection procedure.

The proposal for a European order for payment procedure does not resolve this question because of its limited scope as it only concerns cross-border cases⁴²³.

8.11.5 Retention of title

The retention of title provision as it stands in the Directive has had no impact. Its ambiguity has even led to difficulties in how it should be interpreted. The original text was clearer.

8.12 Debt collection agencies, factoring and credit insurance

Companies that provide services aimed at limiting SMEs' exposure to late payment or payment default are essential. They enable SMEs to concentrate on their core business and outsource some administrative and organisational tasks. These organisations and more specifically debt collection agencies are not limited in their role as debt collectors. They have for many developed credit management expertise and play a fundamental role in advising SMEs on how to manage credit and enhance timely collection.

Debt collection agencies, factoring companies and credit insurers appear to be thriving in the EU with some present in most Member States.

⁴²² See "*The German order for payment procedure (Mahnverfahren)*", Grozdana Šijanski and Jimmy Barber, <http://www.iuscomp.org/gla/literature/sijanski.htm>, 2006.

⁴²³ COM(2006) 57 final, Amended proposal for a Regulation of the European Parliament and of the council creating a European order for payment procedure, 07.02.2006. See also COM(2006) 374 final, Communication from the Commission to the European Parliament, concerning the common position of the Council on the adoption of the Regulation of the European Parliament and of the Council creating a European order for payment procedure, 04.07.2006.

The fact that these organisations are thriving may indicate that the Directive has failed. Is the aim of the Directive not to enable companies to obtain prompt payment...by themselves and without incurring extra costs?

Further, it does not appear that debt collection costs, credit insurance costs and factoring costs would fall within the scope of reimbursable recovery costs under the Directive. If these organisations are thriving, the cost of doing business for SMEs has increased.

However, as stated earlier these organisations are much more than insurance, lending or collection organisations; they enable businesses to concentrate on their core activities and they provide services that do not compete with the Directive, but rather enhance its effect. Advising SMEs on credit management or implementing credit management strategies for SMEs complements positively the Directive's objectives.

Finally, although outsourcing credit management and credit collection involves a cost for SMEs, the efficiencies gained are such that the cost is in fact limited and may even constitute a saving. These organisations have developed an expertise in tasks relating to credit management and collection. In countries where labour costs are high, outsourcing such tasks may prove cost efficient.

As stated before in this Report, at the time of the adoption of the Directive some suggestions were made that the Directive may be unnecessary if debt collection agencies adequately supply services to assist SMEs in obtaining prompt payment. It appeared however, that these organisations were not sufficiently developed in all Member States, with some Member States prohibiting or limiting their activities, to ensure that they could have the required impact on long payment periods in the whole of the EU.

The multiplication and expansion of debt collection agencies in the EU in the last few years may mean that a European regulation regulating them to facilitate their expansion or even the Directive itself may not be needed.

Evaluating whether or not a European regulation controlling debt collection agencies may be needed is beyond the scope of this study, but a study should probably be conducted on this issue. This would involve (i) a review of all relevant existing laws in every country to identify whether they are suitable or not, (ii) interviews with debt collection agencies to determine best practices and on a practical level what improvements need to be made, (iii) interviews with companies to gather their opinions on collection agencies and under which circumstances they would use them, (iv) a survey of the extra costs incurred by companies and the extent to which these are balanced by efficiency gains.

As regards to the continued usefulness of instruments such as the Directive, as stated above debt collection agencies are more than the collection arm of SMEs. They are credit management and collection advisers and managers. As such they enhance the Directive’s purpose and objectives and contribute to its greater impact. Both are thus instruments that complement each other for the benefit of SMEs.

8.13 Harmonizing time frames for enforcement of enforceable titles

The information provided below outlines the extent to which enforcement in itself can be a real deterrent for creditors thinking about undertaking legal actions. If debtors do not respond to dunning letters there is little reason to believe that they will respond to a decision against them. Once there is a decision against them, they might as well wait for it to be enforced. This response is especially understandable given the time it takes to enforce a decision and the difficulties that can arise in finding and seizing debtor assets. Member State enforcement authorities need the powers to enforce enforceable titles expediently⁴²⁴.

Country ⁴²⁵	Enforcement of enforceable title in days
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⁴²⁴ This is not addressed by the European Order for Payment.

⁴²⁵ Germany (DE) ; Austria (AT) ; Belgium (BE) ; Cyprus (CY) ; Denmark (DK) ; Spain (ES) ; Estonia (EE) ; Finland (FI) ; France (FR) ; Greece (EL) ; Hungary (HU) Ireland (IE) ; Italy (IT) ; Latvia (LV) ; Lithuania (LT) ; Luxembourg (LU) ; Malta (MT) ; Poland (PL) ; Portugal (PT) ; Czech Republic (CZ) ; United Kingdom (UK) ; Slovakia (SK) ; Slovenia (SI) ; Sweden (SE)

AT	90
BE	60
CZ	90
DE	55
DK	28
EE	20
EL	90
ES	49
FI	60
FR	29
HU	90
IE	45
IT	270
LT	70
LV	120
NL	20
PL	160
PT	120
SE	21
SK	110
SI	360
UK	56

Source World Bank/IFC survey 2005.

Although this study does not question the quality of the participants in the World Bank study, it does however note that some time-frames for enforcement seem very optimistic. It should thus be considered herein as the most optimistic statistic and as such is revealing of the problems faced by creditors at best. The best possible scenario is a deterrent against legal action by creditors. A more realistic scenario which is based on interviews undertaken in the course of the LP Study with lawyers specialized in debt collection in France, for example,

produces data that is substantially different. Based on these interviews the average time for enforcement of an enforceable title would be no less than 100 days in France. Interviews show that banks are usually slow in responding to enforcement agents. In France for example, a bank will take an average of 30 days to actually pay out from the debtors account and will also only pay from what is left after deduction of its own bank charges on the operation. A creditor with an enforceable title thus ranks second to a bank, regardless of the fact that it does not hold such a title. This is confirmed for other countries by the very recent CEPEJ study which shows that it takes enforcement authorities in the Czech Republic, Greece and Hungary more than thirty days just to notify a judicial decision to a party⁴²⁶.

In some Member States the problem has been acknowledged and the issue is being addressed⁴²⁷. This is the case of the UK where new measures are discussed. Professor Baldwin stated in a 2005 submission that: *“In my own research on this question, only a minority of the claimants who succeeded at small claims hearings received payment from the other party in full and in the time specified in the court order. A substantial minority received nothing at all. Nor are the court-based enforcement options very effective in securing payment. In my view, ineffective enforcement procedures undermine the credibility and integrity of the civil courts—and the credibility and integrity of small claims—more than any other factor”*⁴²⁸.

Enforcement agents should be able to fine organisations that fail to implement enforcement orders in a timely manner.

Defining time constraints for enforcement steps or actions would not only broaden the impact of the Directive’s objective but also give greater meaning to the European Order for Payment.

⁴²⁶ Report of the European Commission for the Efficiency of Justice, CEPEJ, European Judicial Systems, Edition 2006, October 5, 2006.

⁴²⁷ House of Commons Constitutional Affairs Committee, The courts: small claims, First Report of Session 2005-06 Report, together with formal minutes, oral and written evidence, published 22 November 2005, p.13.

⁴²⁸ House of Commons Constitutional Affairs Committee, The courts: small claims, First Report of Session 2005-06 Report, together with formal minutes, oral and written evidence, published 22 November 2005, E53, 16(v).

The European Enforcement Order for uncontested claims resolves this issue as far as the scope of the Directive is concerned⁴²⁹. However, further harmonization is necessary to include cases of contested claims. Once an enforceable title is obtained in the EU, enforcement should be simple, fast and affordable.

Finally, not enough countries have systems to automatically measure and publish the timeframes of enforcement procedure in civil and commercial affairs. The first step to guarantee efficiency in this area may be to implement the tools that will highlight inefficiency.

8.14 Increasing asset transparency and facilitating garnishment of accounts

As stated previously, debtors can often rely on slow procedures and the difficulties of locating their assets to strengthen their belief that creditors will possibly not take legal action to obtain payment.

As stated in a recent study conducted for the European Commission, other mechanisms can assist in facilitating if not timely, at least efficient enforcement of claims⁴³⁰. This would include the creation of a “European Asset Declaration” and of “A European Protective Order for Cross-Border Garnishment”⁴³¹. The objective behind these in the context of the Directive would be less to use them than to place debtors in situations which make them feel that creditors have at their disposal sufficient means to force fast and indemnified payment.

⁴²⁹ Regulation (EC) No 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims, Official Journal L 143 , 30/04/2004 P. 0015 - 0039.

⁴³⁰ Study No. JAI/A3/2002/02, “*On Making More Efficient the Enforcement of Judicial Decisions Within the European Union: Transparency of a Debtor’s Assets, Attachment of Bank Accounts, Provisional Enforcement and Protective Measures*”, Prof. Dr. Burkhard Hess, Director of the Institute of Comparative and Private International Law, 2.18.2004.

⁴³¹ Study No. JAI/A3/2002/02, “*On Making More Efficient the Enforcement of Judicial Decisions Within the European Union: Transparency of a Debtor’s Assets, Attachment of Bank Accounts, Provisional Enforcement and Protective Measures*”, Prof. Dr. Burkhard Hess, Director of the Institute of Comparative and Private International Law, 2.18.2004, p. 141

8.15 Limiting the number of steps necessary to lodge a claim

The WB Bank Survey shows that there are often many steps to complete before being able to lodge a claim to obtain an enforceable title and enforce it in case of late payment. The reluctance of SMEs to file claims is also related to the ease or difficulty of using the legal process. A maximum number of steps should be imposed to file a claim, obtain an enforceable title and enforce it.

It should be noted that the WB Survey presents the MINIMUM number of steps required to handle the case from filing the case to actual enforcement of judgement in each country

The average for the EU has been calculated for comparison purposes.

Country	Steps to obtain enforceable title and enforcement
Europe	22.2
OECD	19.5
AT	20
BE	27
CZ	21
DE	26
DK	15
EE	25
EL	14
ES	23
FI	27
FR	21
HU	21
IE	16
IT	18
LT	17

LV	20
NL	22
PL	41
PT	24
SE	23
SK	27
SI	26
UK	14

Source World Bank/IFC survey 2005.

8.16 Developing European Alternative Dispute Resolution (“ADR”) mechanisms

The European Union has reflected on the advantages of ADR mechanisms to resolve issues such as those involved in undisputed commercial claims⁴³².

Online alternative dispute resolution systems are becoming essential to speed up procedures, unburden court systems and answer the needs of the Single Market. The ADR system put in place to resolve domain name disputes relating to the EU is an example of the possibilities offered by ADR⁴³³. The Czech Arbitration Court⁴³⁴ manages the first system that resolves disputes online in all EU languages in a speedy and efficient way⁴³⁵. The procedure is organised online from beginning to end. The complainant is provided with a login and password. So is

⁴³² See Green paper on alternative dispute resolution in civil and commercial law, COM/2002/0196 final, April 2002. See Commission recommendation of 4 April 2001 on the principles for out-of-court bodies involved in the consensual resolution of consumer disputes, L 109, 19.04.2001, p. 0056 - 0061. See also Commission Recommendation of 30 March 1998 on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes (Text with EEA relevance), L 115, 17/04/1998 P. 0031 - 0034;

⁴³³ See Regulation (EC) No. 733/2002 of the European Parliament and of the Council of 22 April 2002 on the implementation of the .eu Top Level Domain and Regulation (EC) No. 874/2004 of 28 April 2004 laying down public policy rules concerning the implementation and functions of the .eu Top Level Domain and principles governing registration.

⁴³⁴ The Prague-based Arbitration Court attached to the Economic Chamber of the Czech Republic and Agricultural Chamber of the Czech Republic is a not-for-profit organisation founded in 1949. The Czech Arbitration Court was appointed by EURid on 12 April 2005 to provide alternative dispute resolution for .eu domain name disputes.

⁴³⁵ See www.adr.eu

the defendant. The list of arbitrators includes specialists from all Member States able to decide in all languages (summary provided in English). The case administrators are also competent in all EU languages. Procedures follow precise time schedules and most decisions are rendered within three months. The only drawback is the cost of arbitration which is 1990 Euros for a single panelist (1000 Euros for the arbitrator and 990 Euros for the Court). As this is a new procedure, fees integrate initial set-up costs. Once these are paid for and efficiencies gained from experience, working costs will decrease. Further, the assumption is that a dispute exists between the parties. With undisputed claims, the costs could be adjusted and represent a fraction of the current pricing and so could the time taken to obtain a decision. Such a system could thus be a model for a dispute resolution mechanism involving late payment claims.

Some countries are actively promoting the use of ADR in the resolution of small claims or collection issues. This is the case of the UK which in 2005 started a telephone service providing information on mediation for problems related to small claims and business disputes⁴³⁶.

8.17 The definition of an undisputed claim

As stated earlier, it appears that more and more debtors start disputing invoices when they are served with dunning letters or as soon as a court action is filed. First, debtors should be allowed only a limited amount of time to dispute an invoice following its supposed reception. Second, a debtor should not be allowed to dispute a claim before a court unless he or she can demonstrate either (i) that an invoice has been disputed prior to its due date, (ii) that such an invoice was never received or (iii) that it has no business relationship with the creditor and that the invoice was tainted by fraud⁴³⁷. Any debtor that disputes a claim *mal fide* should be heavily sanctioned.

⁴³⁶ <http://www.direct.gov.uk>

⁴³⁷ More and more companies send bogus invoices to customers or invoices for services that were either not performed or ordered and then threaten suit to make them pay. They even start to charge interest on late payment and dunning letter costs.

8.18 Promoting the use of new technologies

New technologies have an important function to play in fighting late payments. First, they can be used to integrate late payment interest and recovery costs automatically into invoices. Studies confirm that use of software and credit management techniques contribute to more prompt payments by debtors⁴³⁸. Second they can assist debtors in their management of payments, limiting late payments due to administrative failings. The drop in payment periods of 8.5 days in the last 15 years is attributed to changes in payment processes in large companies⁴³⁹. Some of these changes are the result of the Directive. Third they can assist creditors in managing accounts receivables and debt collection procedures. Fourth, they can assist courts and competent administrative bodies in ensuring that enforceable titles are obtainable within reasonable time frames.

Member States need to adopt policies that encourage and assist the use of technologies by SMEs⁴⁴⁰.

In 2001, the UK started its first online court service. In 2004 it was dealing with 55,000 claims a year⁴⁴¹. Similarly the German order for payment procedure is now available online⁴⁴².

8.19 Commission information on the Directive

8.19.1 Information on the Directive

The LP Survey has shown that the Directive is not well known and that late payment regulation was not well known either. The relevant figures are reproduced hereunder. The 32% of N/A responses in respect to national regulations implementing the Directive is attributable to the absence of knowledge of the Directive rather than the lack of knowledge of national

⁴³⁸ *Enquête sur les délais de paiement*, AFDCC, 09.2005.

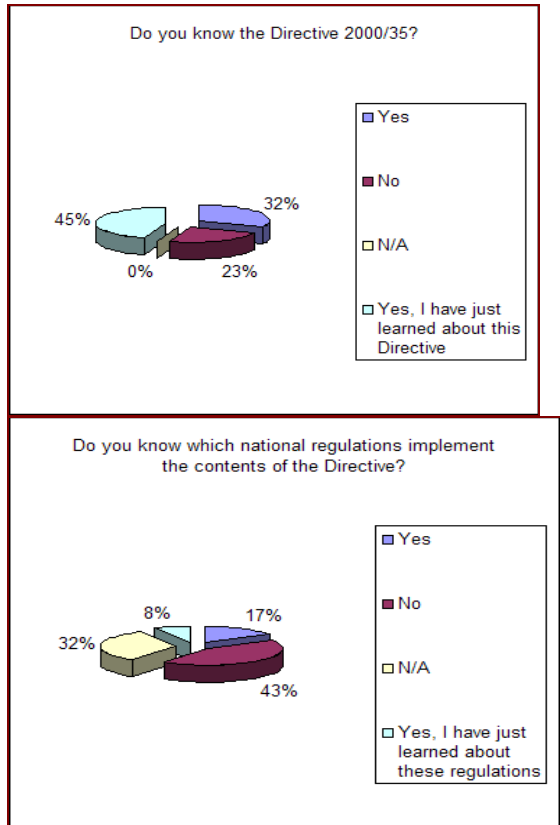
⁴³⁹ French Central Bank Bulletin N 145, 01.2006.

⁴⁴⁰ *Perspective de l'OECD sur les PME*, 2002, p. 24.

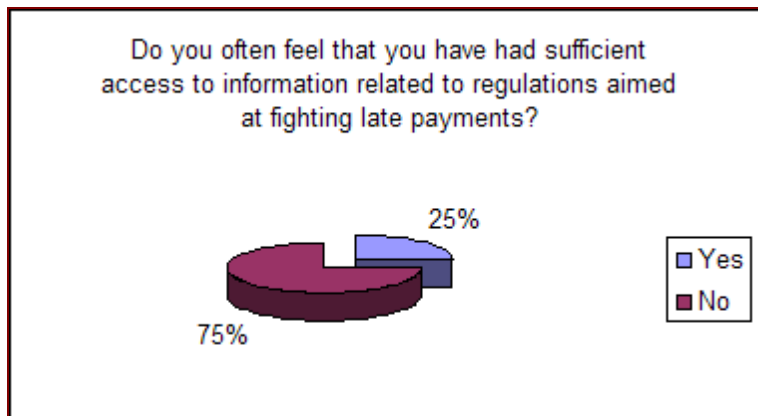
⁴⁴¹ House of Commons Constitutional Affairs Committee, *The courts: small claims*, First Report of Session 2005-06 Report, together with formal minutes, oral and written evidence, published 22 November 2005, EV29.

⁴⁴² See *The German Order for Payment Procedure (Mahnverfahren)*, Grozdana Šijanski and Jimmy Barber, 2006, at <http://www.iuscomp.org/gla/literature/sijanski.htm>

measures that deal with late payments. Interviews confirmed that although interviewees did not always know of the Directive, they often knew that national regulations allowed them to charge interest on late payments.



Regardless of the above explanation, as stated earlier, information on late payments regulation is not easily accessible from a practical standpoint. There are few continuous campaigns organised. The UK is a rare example of a Member State that has provided complete, easily accessible information on late payments on a continuous basis since 1998. Information on the issue in many countries is scarce and when it does exist it is limited to a specific event such as the adoption of the transposition regulation. This is not enough as SMEs are created all the time. As the LP Survey shows, it is not enough for legal professionals alone to know of the regulations.



The European Commission could provide more information on national legislations, how they work and how to calculate interest on late payments in each Member State.

8.19.2 Interpretation

As stated under Section 7, the nature and extent of the “recovery cost” and “retention of title” provisions are not clear.

Some of the Directive’s provisions appear limited in scope giving Member States significant leeway in their implementation. However, some of these provisions could be interpreted as having a much broader scope. Basing its approach on the language and legislative history of the Directive, the European Commission should clearly define what it views the scope of each provision to be, and the expected level of harmonization. The short guide provided by the Commission on its website helps users understand the goal of the Directive and provides a presentation of the tools proposed to achieve these goals. However, it does not give detailed guidelines to Member States on the scope of these tools. Examples would also assist enforcers and limit the number of complaints about Member State implementation or enforcement as some complaints are based on exaggerated interpretations of the Directive’s provisions.

8.19.3 Calculating late payments interest

More websites such as the one proposed in the UK should exist to assist in calculating late payment default interest⁴⁴³. Companies are worried that a

⁴⁴³ <http://www.payontime.co.uk/calculator/statutory.html>.

mistake in their calculation will lead to a dispute on the whole invoice and possibly later or even no payment.

8.20 Late payments, grossly unfair clauses and unfair commercial practices

Companies should not use grossly unfair clauses in their contractual arrangements with smaller companies, nor should they pay late. A variety of suggestions have been made to support the Directive's action in this area and expand it, two of which have been retained here. The first one involves legal measures based on unfair commercial practice laws applying consumer protection type legislation to micro and small companies⁴⁴⁴. The second one involves more actions based on competition regulations.

8.20.1 *The French example constitutes an interesting model*

Regulation to secure "fair" competition includes provisions that require producers to present price lists for their products in a non-discriminatory manner, meaning that all clients must be offered identical terms for similar services, including unit price and any volume discounts. Other regulations to secure "fair" competition include a prohibition of "abusively" low prices (which includes the sale of own-label goods at below cost). To further the negotiation process, a commission for commercial practices has been created to supervise the commercial relations between producers and retailers.

According to article L442-1 of the French Commercial Code, it is forbidden to subject a trading partner to terms of payment which are manifestly unfair in the light of good commercial practice, or deviate, with no good reason, from the time limit.

⁴⁴⁴ See Directive 2005/29/EC on Unfair Commercial Practices which is currently limited to harmonising EU rules on business-to-consumer commercial practices, OJ L149/22, 11.06.2005.

The following acts committed by any producer, trader, manufacturer or other perpetrator render them liable and entail the obligation to redress the prejudice caused:

- applying to an economic partner, or obtaining from an economic partner, discriminatory prices, terms of payment or terms and conditions of sale or purchase which are not justified by any real quid pro quo, thus creating, for that trading partner, a competitive disadvantage or advantage,
- obtaining, or seeking to obtain, from a trading partner any advantage unrelated to a commercial service effectively rendered or which is manifestly disproportionate to the value of the service rendered,
- taking unfair advantage of a trading partner's dependence on him or of his own purchasing power or selling capacity by subjecting him to unjustified trading conditions or obligations,
- obtaining, or seeking to obtain, an advantage as a precondition for the placing of orders without providing a written undertaking concerning a proportionate volume of purchases and, if appropriate, a service requested by the supplier which is the subject of a written agreement,
- prohibiting the other contracting party from transferring the debts it holds against him to a third party.

8.20.2 *The Czech and Slovak examples*

According to Professor Dr Cees van Dam⁴⁴⁵, to a certain extent only the position of SMEs is protected by the general rules of competition law, particularly the rules prohibiting the abuse of a dominant position.

Another example: the Czech Republic and Slovakia prohibit abuse of a dominant position to the detriment of other competitors or consumers. This is stated in the Act on the Protection of Economic Competition (PEC), (§ 11 (1) Czech PEC and § 8(6) Slovak PEC). This provision is considered a general

⁴⁴⁵ UNFAIR COMMERCIAL PRACTICES An analysis of the existing national laws on unfair commercial practices between business and consumers in the new Member States, http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/ucp_general_report_en.pdf

clause for the reason that it prohibits any form of misuse of a dominant position to the detriment of any other competitors or consumers.

8.20.3 The European Law

Directive 2005/29/EC⁴⁴⁶ concerning Unfair Commercial Practices does not protect SMEs.

The Unfair Commercial Practices Directive's scope excludes national laws on unfair commercial practices, which harm only competitors' economic interests or which relate to a transaction between commercial undertakings. This Directive seeks to protect consumers. According to Article 3 §1, "This Directive shall apply to unfair business-to-consumer commercial practices, as laid down in Article 5, before, during and after a commercial transaction in relation to a product".

8.20.4 Competition law

As stated before, competition law can limit the impact of the Directive insofar as the Fedetab case has shown.

The European Commission needs to clarify its position on rights of companies or representative organisations to impose or agree on payment periods. On the one hand, it appears that long payment periods have a negative effect on SME competitiveness. On the other, differences in payment periods may be a sign of competition in a market. The French Conseil de la Concurrence appears unconvinced by the fullness of the economic benefits of payment periods harmonization⁴⁴⁷. This could be counterbalanced by a WTO Panel decision which sees in standardization of such terms as "enhancing" the potential to increase the efficiency of a whole sector, thereby increasing the

⁴⁴⁶ Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the Internal Market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council.

⁴⁴⁷ See Opinion of the Conseil de la Concurrence, *relatif au recours à la négociation collective en matière de délais de paiement inter-entreprises*, [n 05-A-17], 22.09.2005, at 40.

likelihood of more transactional transparency and greater competition opportunities⁴⁴⁸.

In order to avoid the legal uncertainty created by a potential action under Article 81 of the EU Treaty, the European Commission should either create an exemption, or clearly state that agreements on payment periods are generally pro-competitive when they aim at reducing such periods. Alternatively, a European Regulation on payment periods may be required.

Competition law can also be used to promote the Directive. If late payments or long payment periods are considered abuses, any firm that is in a dominant position in the market and uses such practices could be sanctioned for violating competition law. Companies have tried this⁴⁴⁹. However, it appears that even if competition law were applied in cases of late payments and long payment periods on the basis of a violation of Article 82, it would not be applicable to public institutions. National competition regulations may provide more appropriate answers on this.

⁴⁴⁸ *Japan - Measures Affecting Consumer Photographic Film and Paper*, Report of the Panel, WT/DS44/R, 31 March 1998.

⁴⁴⁹ T-319/99

Summary of Chapter 8: Recommendations⁴⁵⁰

- Resolving incoherencies between taxation and late payment charges.
- Providing sanctions that are a real deterrent for debtors responsible for late payments and an appropriate interest rate on late payment.
- Harmonization of payment periods to eliminate disparities in this area in the Single Market.
- Providing escrow facilities to ensure on time payment.
- Creating European fund for trade-credit arbitrages.
- Increasing good corporate culture by making directors responsible for late payments.
- Developing and promoting credit and financing management programmes.
- Studying the role and function of debt collection, factoring and credit insurance organizations in fighting long payment periods.
- Promoting the use of new technologies for both debtors and creditors.
- Redefining SMEs and protecting the more vulnerable through consumer protection-type regulations.
- Increasing corporate transparency by making compulsory the filing of clear accounts receivables management, that identify late payers.
- Increasing transactions transparency by limiting the length of payment periods either generally or by sector.
- Increasing asset transparency and facilitating garnishment of accounts.
- Pursuing judicial reforms to limit the time and steps it takes to lodge a claim and obtain an enforceable title and enforcement, and limiting opportunities to dispute a claim once an action has been filed.
- Expanding the use of ADR systems with a European dimension that use the latest technologies and provide services in all EU languages.
- Providing more information on European instruments such as the Directive, including more interpretative guidelines.

⁴⁵⁰ If this summary is read on a stand-alone basis no conclusion should be drawn from it. As such the bullet point summary's purpose is to guide the reader to the section or chapter he or she may be most interested in reading. It is thus a little bit more than a table of content.

CONCLUSION

Late payments are steadily decreasing across Europe and have done so since the end of 2002. This does not mean that late payments are not a problem any more. To the contrary, in the first place they are decreasing but are not disappearing. Second, payment delays have not decreased but merely stabilized. Third, the level of late payments in some countries remains well above acceptable levels and disparities between Member States are substantial. Fourth, efforts need to be maintained in fighting them as legislation alone will not guarantee that they will completely disappear or that they will consistently decrease.

Statistics show that the late payment situation in the UK has worsened slightly in the last year or so, even though it is an improvement on 2002. However, of all the countries in Europe, the UK is one of the most active in trying to address the issue and in communicating on it. It is not exactly known why the situation has deteriorated lately, but given the efforts made in the past by not-for-profit organisations, the media, representative organisations and the government, the latest result is surprising.

This is a clear indication that efforts need to be renewed constantly and that no improvement can be taken for granted.

As intra-EU trade grows, so will late payments and disputes. However, the dynamics of cross-border transactions are different from those of local transactions. In these transactions people know each other, or speak the same language, or have the same cultural heritage, or know how to negotiate terms or resolve slight misunderstandings⁴⁵¹. In cross-border transactions misunderstandings or poor handling of other parties are more likely, and as a result late payments and/or disputes are also more common. This is why most businesses operate locally. To enhance the likelihood of a continuous increase in cross-border commercial transactions, European institutions need to step in with measures that will follow-up on the Directive's first attempt at intervening in areas that were previously reserved for Member States.

⁴⁵¹ For these reasons, the UK's main trading partner remains the US.