

# The late payment under the EU legislation

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## **Abstract**

*According to Article 14 EC, the European Union shall guarantee the free movement of goods and services. In this regard, it is necessary that the entrepreneurs should be able to do their business throughout the internal market and to recover their receivables in due time. Therefore, that late payment represents an obstacle to the proper functioning of the internal market. The Directive on combating late payment in commercial transactions, Directive 2000/35/EC is placed in the context of maintaining and developing an area of freedom, security and justice. This Directive governs all commercial transactions irrespective of whether they are carried out between private or public entrepreneurs or between entrepreneurs and public authorities, having regard to the fact that the latter handle a considerable volume of payments to business. It should therefore also regulate all commercial transactions between main contractors and their suppliers and subcontractors. This paper explores the legal framework on late payment of trade credit from the European legislation perspective.*

**Keywords:** *late payment, retention of title clauses, overdue debts, commercial transactions, enforceable title*

**JEL Classification:** K12, K33

## **1. Introduction**

The impact of enlargement and globalization on the internal market creates a special context for individuals and companies that operate across borders. The institutions of the European Union have launched a wide-ranging strategy to adapt and harmonize European law to meet these new challenges.

At present there is a gap between the free circulation of goods and services on the one hand and the timely receipt of the corresponding payments on the other. The available statistics<sup>2</sup> revealed that, on average, 21% of all undertakings would export more if their foreign customers were to pay more quickly; and more than 40% of invoices are still unpaid after 60 days. It is often argued that late payment is due to the debtor's financial difficulties and that a high level of statutory interest

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<sup>2</sup> European Business Survey 2000 – Grant Thornton mentioned that one out of four insolvencies is due to late payment. This leads to the loss of 450 000 jobs each year, adding to the high unemployment level in Europe. In addition, outstanding debts worth 23.6 billion euros are lost every year through insolvencies caused by late payment.

would be unable to improve the situation. However, a study<sup>3</sup> shows that only 23% of late payment is due to the debtor having financial difficulties. It is rather cross-border late payment that is cited as the most frequent cause of late payment (35%) coupled with administrative inefficiency (17%), it would seem that 52% of late payment could be reduced by a high level of statutory interest. The figures cited above vary among Member States. “Many payments in commercial transactions between economic operators or between economic operators and public authorities are made later than agreed in the contract or laid down in the general commercial conditions. Although the goods are delivered or the services performed, many corresponding invoices are paid well after the deadline. Such late payment negatively affects liquidity and complicates the financial management of undertakings. It also affects their competitiveness and profitability when the creditor needs to obtain external financing because of late payment. The risk of such negative effects strongly increases in periods of economic downturn when access to financing is more difficult.”<sup>4</sup>

Therefore, late payment represents a veritable obstacle to the proper functioning of the Internal Market and was thus bound to incite the European Commission to take action. In the words of the European Commission’s Enterprise and Industry Directorate: “Companies go bankrupt waiting to be paid. Jobs are lost. Dreams die. Across the European Union, paying suppliers late is common. It costs little and is considered acceptable. But it does great harm. Every year, hundreds of thousands of European businesses have closed waiting for late payments. Small and medium-sized enterprises are particularly exposed to late payment, and businesses selling across borders are especially vulnerable. The late payment culture has to change, and the European Union is equipping business with the tools to make this change happen.” This indicates that a high level of statutory interest combined with rapid recovery procedures tends to be beneficial.

According to the European Parliament, combating late payments in the internal market cannot be sufficiently achieved by the Member States acting individually and should, therefore, be organized at the Community level. This implies that the EU legal order or that of the Member States must make available sufficient legal instruments to creditors allowing them to recover their receivables across Europe within a reasonably short frame. Otherwise, the free movement of goods and services would remain little more than a theoretical possibility.

This legislative effort, which are essential for the correct operation of the Internal Market, ranged among the Directive 2000/35/EC of the European Parliament and of the Council on combating late payment in commercial transactions, entered into force on 8 August 2002 for the then 15 Member States

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<sup>3</sup> R.Schulte-Braucks, S.Ongena, *The late payment directive--a step towards an emerging European private law?*, „European Review of Private Law” no. 4/2003, p. 178.

<sup>4</sup> The recitals from the Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions.

(and the three States of the European Economic Area)<sup>5</sup>; on 1 May 2004 for another 10 European countries and in 1 January 2007 for Bulgaria and Romania. The Directive had been designed to remedy the situation and to ensure that the sellers of goods and the providers of services will have a number of instruments at their disposal which permit them to obtain payment on time.

In 2011, that Directive was replaced by Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions (the Directive 2011/7/EU).

This paper presents the main features of this Directive from a European perspective.

## 2. Background

The main goal of the directive is to combat the late payment for goods or services within the European Union, by laying down common minimum requirements consistent with the principles of subsidiarity and proportionality.

The Directive 2011/7/EU covers all commercial transactions between undertakings, or/and between undertakings and public authorities, where the public authority is the debtor, to the extent that these transactions are not regulated by the legal provisions regarding public procurements. Therefore, the provisions of this Directive do not govern commercial transactions where the public authority is the creditor; or the transactions with consumers, or to transactions with undertakings undergoing insolvency proceedings.

According to the Directive 2011/7/EU, *commercial transactions* are “transactions between undertakings or between undertakings and public authorities which lead to the delivery of goods or the provision of services for remuneration”.

Furthermore, the Directive defines the most important concepts<sup>6</sup>:

- *public authority* is any contracting authority<sup>7</sup>;
- *undertaking* means any organization, other than a public authority, acting in the course of its independent economic or professional activity, even where that activity is carried out by a single person;
- *interest for late payment* means statutory interest for late payment or interest at a rate agreed upon between undertakings, due for damages if it is grossly unfair to the creditor;
- *statutory interest for late payment* means simple interest for late payment at a rate which is equal to the sum of the reference rate and at least eight percentage points;

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<sup>5</sup> H. Neudorfer, *Request No.036 “Methods of implementation in the Member States of Directive 2000/35/EC on combating late payment in commercial transactions”*, addressed by the Office of the Committee for European Integration (OCEI), p. 1

<sup>6</sup> Art.2 from the Directive 2011/7/EU.

<sup>7</sup> Contracting authority is defined by Directive 2004/17/EC, (art. 2(1), point (a)) and Directive 2004/18/EC, (art. 1(9)).

- *amount due* means the principal sum which should have been paid within the contractual or statutory period of payment, including the applicable taxes, duties, levies or charges specified in the invoice or the equivalent request for payment;
- *reference rate* means either of the following:
  - (a) for a Member State whose currency is the euro, either:
    - (i) the interest rate applied by the European Central Bank to its most recent main refinancing operations; or
    - (ii) the marginal interest rate resulting from variable- rate tender procedures for the most recent main refinancing operations of the European Central Bank;
  - (b) for a Member State whose currency is not the euro, the equivalent rate set by its national central bank;
- *retention of title* as the contractual agreement according to which the seller retains title to the goods in question until the price has been paid in full;
- *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 installments, which permits the creditor to have his claim against the debtor collected by means of forced execution. It also includes a decision, judgment or order for payment that is provisionally enforceable and remains so even if the debtor appeals against it.

The Directive only defines the term “enforceable title”, it does not attempt to regulate the various procedures for forced execution of such a title, for example: warrants of execution, attachments of earnings, or administration orders, nor does it attempt to regulate the conditions under which forced execution of such a title can be stopped or suspended.

Finally, the Directive defines the *concept of manifest abuse*. When a contract clause or practice concerning the date or payment period, the rate of interest for late payment, or compensation for recovery costs, is grossly unfair to the creditor, the judge presiding over the chamber of the District Court dealing with commercial matters, or the judge who replaces him, may order the cessation of the use of such contractual clause or practice.

The novelty is that Directive 2011/7/UE has introduced criteria for determining whether a contractual clause or practice is grossly unfair to the creditor. To determine whether a contractual clause or practice constitutes an abuse to the creditor, “all circumstances of the case shall be considered, including:

- *any gross deviation from good commercial practice, contrary to good faith and fair use;*
- *the nature of the product or service, and*

- *whether the debtor has any objective reason to deviate from the statutory rate of interest for late payment.*<sup>8</sup>

In addition, the Directive 2011/7/UE establishes a presumption of manifest abuse when a contract clause or practice excludes the payment of interest for late payment or excludes compensation for recovery costs.<sup>9</sup>

### 3. General principles of Directive 2011/7/EU

The Directive covers 8 main areas:

- A right to claim interest payable from the day following the date or the end of the period for payment fixed in the contract;
- A right to claim interest automatically after 30 days following the event specified, without the necessity of a reminder, if the date or period for payment is not fixed in the contract;
- A level of interest set at the European Central Bank base rate (or equivalent rate set by its central national bank if the Member State is not participating in the third stage of Economic and Monetary Union) plus at least 8%;
- A right to claim reasonable compensation from the debtor for all relevant recovery costs incurred as a result of the debtor's willful late payment;
- Adequate and effective means to prevent the continued use of contract terms which, after consideration of all circumstances of the case, may be considered grossly unfair;
- The opportunity for organizations officially recognized as or having a legitimate interest in representing small and medium sized enterprises to take action according to the national law if an agreement is considered grossly unfair;
- The recognition that a 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 seller before the delivery of goods.

According to Article 1, the Directive is limited to payments made as remuneration for commercial transactions and does not regulate: the debts that are subject to insolvency proceedings instituted against the debtor, including proceedings aimed at debt restructuring.

Article 3 stresses the key aims of the Directive:

#### 1. Harmonization of payment periods for public authorities across the EU

In commercial transactions between commercial enterprises and public authorities, the latter are obliged to pay for the goods and services that they procure within 30 days or, in very exceptional circumstances, within 60 days.

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<sup>8</sup> *in terms of the payment periods referred to in Article 3, paragraph (4); Article 4, paragraph (3) subparagraph 1; Article 4, paragraph (4); and Article 4, paragraph (5), or from the lump sum referred to in Article 5, paragraph (1)."*

<sup>9</sup> Paragraph (2) of Article 6.

## 2. Contractual freedom in commercial business transactions

In commercial transactions between commercial enterprises, the creditor shall demand the interest for late payment from the day following the date or the end of the period for payment fixed in the contract.

- if no credit period has been agreed, the interest can run automatically without the necessity of a reminder - 30 days following the date of receipt by the debtor of an invoice or an equivalent request for payment;
- if the date of the receipt of the invoice or the equivalent request for payment is uncertain – 30 days after the date of the receipt of the goods or services;
- if the debtor receives the invoice or the equivalent request for payment earlier than the goods or services - 30 days after the receipt of the goods or services;
- 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 acceptance or verification takes place - 30 days after this latter date at the following.

## 3. Entitlement to claim interest

Businesses can claim interest on late payments as well as charge a fixed €40 to compensate for recovery costs. Businesses can also claim all further reasonable recovery costs. Besides the right to payment of a lump sum to cover internal recovery costs, the creditor must also be entitled to reimbursement of other recovery costs incurred as a result of late payment by the debtor. These costs should include, in particular, any costs incurred by the creditor to a lawyer or a debt collection company

## 4. Increase to statutory interest rate

Businesses can claim interest at a rate 8% above the European Central Bank's reference rate.

The Directive merely introduces a minimum requirement: EU member states can continue with, or introduce, more stringent measures should they wish.

Moreover, the Directive states that the creditor should be entitled to claim reasonable compensation from the debtor for all relevant recovery costs incurred as a result of the latter's late payment (additional administrative costs, costs incurred when the creditor passes the debt onto a third party to facilitate recovery, such as a debt collection agency or solicitor). Such recovery costs must respect the principles of transparency and proportionality as regards the debt in question. In this regards, Member States may fix maximum amounts to cover the recovery costs for different levels of debt.

For certain categories of contracts, Member States may fix the period after which interest becomes payable to a maximum of 60 days provided that they either

restrain the parties to the contract from exceeding this period or fix a mandatory interest rate that substantially exceeds the statutory rate.<sup>10</sup>

The Directive aims to prohibit abuse of freedom of contract to the disadvantage of the creditor. Factors constituting such an abuse include agreements which serve to procure the debtor additional liquidity; or main contractors imposing terms of payments on their suppliers and subcontractors which are not justified on the grounds of the terms granted to them. Therefore, the member states should ensure that an agreement on the date of payment; or the consequences of late payment (i.e., the rate of interest) that is not in line with the provisions outlined in Article 3.1 (b) to (d) and Article 3.2 should not be enforceable or should give rise to a claim for damages.<sup>11</sup>

In determining whether an agreement is grossly unfair to the creditor, it will be taken into account, amongst other things, whether the debtor has any objective reason to deviate from the provisions of outlined Article 3.1 (b) to (d) and Article 3.2. In this scenario, all circumstances of the case, including good commercial practice and the nature of the product, must be considered before deciding whether the agreement is grossly unfair to the creditor. If such an agreement is determined to be grossly unfair, the statutory terms will apply, unless the national courts determine different conditions that are fair.

Article 3.4 of the Directive confirms that member states should 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 with the meaning of Article 3.3.

Article 3.5 takes this issue one step further and requires such means to include the right for representative action to be brought in behalf of creditors. Under this provision, organizations that are officially recognized as or having a legitimate interest in representing SMEs should have the right to take action under national law, before the courts, or competent administrative bodies as a means of preventing the continued use of grossly unfair terms as defined under Article 3.3. This article refers specifically to representative claims taken forward in the interest of small and medium sized enterprises, as these companies are defined by EC Law. "Small and medium-sized enterprises"(SMEs) are defined in Annex 1 to Commission Regulation (EC) No 70/2001 of 12th January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises. In summary, SMEs are economic entities which have fewer than 250 employees and have either an annual turnover not exceeding €40 million, or an annual balance sheet total not exceeding €27 million, and conform to the criterion of independence which in general limits the ownership of such enterprises by other enterprises, falling outside the definition of small and medium-sized enterprises, to 25% of the capital or voting rights.

The Directive does not detract from a creditor's right to sue for damages nor does it prejudice national provisions according to which a national judge can

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<sup>10</sup> Art.3.2. of the Directive 2011/7/EU.

<sup>11</sup> Art.3.3. of the Directive 2011/7/EU.

award the creditor any additional damage caused by the debtor's late payment. In these circumstances, a judge would take into account whether or not incurred costs had already been compensated for by the interest for late payment.

Article 9 covers retention of title clauses. It explains that member states must provide, in line with the applicable national provisions designated by Private International Law, that the seller retains title to goods until they are fully paid for if the retention of title clause has been explicitly agreed between the buyer and seller before delivery of the goods. In addition, member states may adopt or retain provisions dealing with down payments already made by the debtor.

This provision reflects the need for the contractual parties to agree freely on the retention of title clause, retains member states discretion to limit recourse to retention of title in some circumstances, and ensures that creditors are in a position to exercise an agreed retention of title clause on a non-discriminatory basis throughout the Community.<sup>12</sup>

According to the Article 10 the Member States must ensure that an enforceable title can be obtained, irrespective of the amount of 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 procedures are not disputed. This provision should be carried out by Member States in line with their own national legislation, regulations and administrative provisions, which shall apply the same conditions for all creditors who are established in the European Union.

The 90 calendar day period does not include periods for service of documents, or any delays caused by the creditor, such as periods devoted to correcting applications. In addition, this Article will not affect the provisions of the Brussels Convention on jurisdiction and enforcement of judgments in civil and commercial matters.

Article 12 confirms that Member States should bring into force the laws, regulations and administrative provisions necessary to comply with the Directive before 16 March 2013, and they must inform the Commission when they have done so. However, Member States may maintain or bring into force provisions that are more favorable to the creditor than the provisions necessary to comply with the Directive.

#### 4. Conclusions

The Directive supports the aim of improving payment periods across Member States. If implemented correctly in all Member states it should regulate all cross-border commercial transactions irrespective of whether they are carried out between private or public undertakings. The size of the business is also irrelevant so it does not place a particular emphasis on any particular part of the business community.

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<sup>12</sup> Gerard McCormack, *Retention of Title and the EC Late Payment Directive*, „Journal of Corporate Law Studies”, vol.1, issue 2, 2001, p. 38.



On the issue of representative claims, the impact of the proposed reforms is wide ranging to the extent that representative claims will apply to all, in a non-discriminatory fashion. Representative claims are less likely to increase litigation against small businesses since by their very nature such businesses are less likely to have impacted a large number of people.

It should also be noted that the European legislator calls on Member states to encourage the use of mediation and other alternative modes of conflict resolution, in order to facilitate compliance with the provisions of this Directive for combating late payment in commercial transactions. The improved access to justice to the extent that SMEs would be able to appoint a representative to act upon their claim. Additionally, there exists the potential for cost savings through efficient use of resources instances of individual claims against one party may be aggregated through a representative claim.<sup>13</sup>

In Romania the EU Directive on combating late payment in commercial transactions (2011/7/EU) has been implemented by the Law no.72/2013 regarding the measures on combating delay in payment due under contracts concluded between professionals and between them and the contracting authorities, published in Official Gazette nr.182 from April, 02, 2013.

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<sup>13</sup> In its communication of 25 June 2008 COM (2008) 394, entitled "Think Small First: Priority to the SMEs - A Small Business Act for Europe," the Commission stresses the importance of facilitating the access of small and medium enterprises (SMEs) to financing and developing a legal and business environment supportive to timely payments in commercial transactions. It should be noted that the public authorities have a particular responsibility in this regard.

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