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Accompanying document to the

Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on combating late payment in commercial transactions (Recast)

SUMMARY OF THE IMPACT ASSESSMENT

{COM(2009) 126 final}
{SEC(2009) 315}

Agenda planning or WP reference: 2009/ENTR/006. This document commits only the Commission's services involved in the preparation of the impact assessment and does not prejudge the final form of any decision to be taken by the Commission.

The Impact Assessment Board delivered its opinion about the draft impact assessment on 17 December 2008 [D(2008)10479]. All recommendations made by the Board were taken into account and the impact assessment was amended accordingly.

1. PROBLEM DEFINITION

Directive 2000/35/EC was adopted in order to combat late payment in commercial transactions. According to the Directive, a late payment interest may be charged when the payment is not made within the contractual or legal deadline. The directive provides for a statutory rate but allows the parties to agree otherwise. It becomes payable from the day following the date or the end of the period for payment fixed in the contract, or 30 days following the date of receipt by the debtor of the invoice or an equivalent request for payment if the payment period is not fixed.

Despite the Directive, late payments in commercial transactions are still a widespread practice in the EU. They do not only occur frequently in transactions between businesses: surveys also show that, in general, the payment periods in the public sector are longer than the payment periods in private sector contracts.

The roots of late payments in commercial transactions and the corresponding passive attitude of many creditors are diverse:

(1) The market structure: the level of competition within a market, the market power of market participants and the corresponding fear of harming commercial relationships with clients are important factors determining whether creditors accept or refuse late payment and whether debtors seek an extension of the period of trade credit. The position of a creditor in a specific market will have a large impact on his attitude vis-à-vis late payment and on his fear of damaging his commercial relationship with the client. For debtors, the main reasons for timely payment in commercial transactions are often related to commercial or professional repute or mutual trust in long-term commercial relationships.

(2) The business cycle: changing macroeconomic conditions are another cause of late payment. A business cycle downturn is likely to cause more late payments as firms delay paying their invoices. Also, firms suffer from a reduced ability to generate cash from their operations, and banks may reduce credit to firms. However, improvement in economic conditions may also provoke an increase in late payment for certain firms presented with more investment opportunities and, consequently a greater need to find funds.

(3) Access to finance and budgetary constraints: The availability of credit, monetary policy, the flow and nature of credit information, the liquidity position of the firm and the availability of financial resources from banks may also affect late payment, particularly for businesses for which bank credit is a

substitute for supplier financing. Many debtor enterprises and public authorities consider late payment an efficient and cheap way to finance their own businesses and activities. For public authorities, late payments to creditors are also an easy, but unjustified, way to overcome budgetary constraints by postponing payments to the next budgetary period.

(4) The internal organisation of creditors and debtors: the financial management practice of debtors (including public authorities) and the credit management practice of creditors as well as their product and service quality and after-sales service are important factors in (avoiding) late payment. Creditors in commercial transactions, and especially SMEs, do not necessarily have appropriate credit management systems for preventing or managing late payments.

(5) The absence of effective and efficient remedies: notwithstanding Directive 2000/35/EC, many businesses, and in particular SMEs, do not charge interest when entitled to do so. For some creditors, the cost of taking action against late payment is not justified by the financial benefits. In many cases, the expenses of the extra-paperwork cannot be recovered. Chasing late paying clients or charging interest for late payments generates administrative costs that many businesses wish to avoid. Furthermore, the final amount of the statutory interest due from a debtor can only be calculated on the day that the creditor is actually paid so the latter must await payment before he can know exactly the amount of interest that he could charge. In addition, the costs of charging interests before the actual date of payment would outweigh the financial benefits in most cases. All these reasons make that the risk of negative consequences in case of late payment on the side of the debtors is too low to achieve a tangible improvement in payment behaviour. This is particularly deplorable in case of public administrations, which do not face the same financing constraints as businesses. In addition, several key provisions of the Directive are unclear or difficult to implement in practice. For instance, diverse interpretations are conceivable for the calculation of the applicable interest rate, the definition of “relevant recovery costs” and the possibility of compound interest.

Late payments in commercial transactions have important effects:

- Late payment represents a significant cost to creditor enterprises. In general, late payment strains cash flow, adds financial costs, squeezes investment opportunities and fuels uncertainty for many creditor businesses and in particular, SMEs, especially in times of limited and expensive access to finance. The result is that their competitiveness and solvency are often compromised.

- Debtor companies and public authorities paying late get free trade credit.

- Late payments have a negative impact on intra-community trade. In most Member States, businesses perceive selling goods and services to businesses and authorities in another Member States as entailing a higher risk of late payment. Among other reasons, the risk of late payment discourages enterprises from selling products and services in other Member States since it increases uncertainty and the cost of doing business. Very long payment periods in public procurement contracts and late payment by public authorities also discourage economic operators to participate in public procurement procedures. This discouragement reduces the capacity of public authorities to get best value for tax payers' money.

2. OBJECTIVES

Any Community initiative aiming at tackling the issue of late payment must ultimately:

- Be conducive to the achievement of the broader and overarching competitiveness goals enshrined in the renewed **Lisbon Partnership for Growth and Jobs**[1]**;**

- Significantly reduce administrative burdens on business, promote their cash flow and help more people to become entrepreneurs, in accordance with the principles of the **Small Business Act**[2];

- Facilitate the smooth functioning and the completion of the **internal market** via the elimination of related barriers to cross-border commercial transactions.

The initiative provides also an important impetus to overcome the current economic crisis by contributing to the implementation of the **European Economic Recovery Plan**[3] and promoting businesses' cash flow in order to reinforce the competitiveness of European enterprises in the long term.

Concretely, this translates into the following twin operational objectives:

(1) Confront debtors with measures that successfully discourage them from paying late; and

(2) Provide creditors with measures that enable them to fully and effectively exercise their rights when paid late.

3. POLICY OPTIONS

Besides the baseline option, the following options were examined:

– Option 2a (non-legislative): The organisation of awareness raising activities targeted at businesses;

– Option 2b (non-legislative): The organisation of awareness-raising activities targeted at organisations representing SMEs;

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1 Commission Communication: Working together for growth and jobs. A new start of the Lisbon strategy - COM(2005) 24.

2 According to the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - “Think Small First” - A “Small Business Act” for Europe, COM(2008)394final of 25 June 2008, the facilitation of SMEs' access to finance and the development of a legal and business environment supportive to timely payments in commercial transactions is one of the 10 principles to guide the conception and implementation of SME policies both at EU and Member State level.

3 COM(2008) 800, 26.11.2008.

– Option 2c (non-legislative): Publication of information on bad debtors;

– Option 3a (legislative): Full harmonisation of payment periods;

– Option 3b (legislative): increasing the ”margin” interest rate;

– Option 3c (legislative): the abolition of the threshold of €5;

– Option 3d (legislative): the introduction of a “Late Payment Fee”;

– Option 3e (legislative): the introduction of a “Late Payment Compensation”;

– Option 3f (legislative): Strengthen the role of representative organisations.

Several options, such as the repeal of Directive 2000/35/EC, the creation of a European Fund aimed at providing finance to SMEs at no cost and based on accounts receivable were discarded at an early phase of the screening of the options.

4. ANALYSIS OF IMPACTS

It should be noted that, for some important aspects of the three first problem causes set out in section 1, the EU does not necessarily have the power to act. Certain problems related to the structure of national or regional markets should be dealt with by Member States while, as regards the business cycle, most of the economic policy levers are in the hands of the Member States so that no overall solution for all problem causes can be found at EU level.

Moreover, the Directive is an optional instrument for economic operators in so far as it does not oblige them to claim interest for late payment. The directive also operates in a field where many other factors could influence the payment performance in B2B transactions. The regulatory landscape applicable to the payment process and judicial claims to obtain payment for commercial transactions in cross-border cases within the EU is being reshaped by new EU rules that recently entered into force or will soon apply. It is hard to account for interconnection and spill-over effects in the baseline scenario. Thus, it is only possible to provide indicative quantitative estimates of the possible economic and social impacts of any given option. Therefore, the analysis is mainly qualitative. It should be noted that none of the options would have an environmental impact or third country implications.

Some causes of problems where the EU does not have the power to act will nevertheless influence the uptake of certain options. For instance, the market structure and the position of an economic operator in a market will determine to a large extent his willingness to take action against a late paying debtor and to run the risk of damaging a business relationship which might be worth several thousand Euros. For this reason, while it is possible to qualitatively estimate the impact of the different options it is difficult to make a reliable forecast on the overall economic effect of the proposal and hence impossible to assess quantitatively the direct social impacts.

The policy options are assessed in the light of the baseline option in terms of their effectiveness, efficiency and consistency:

General comparison of options			
Option	**Effectiveness**	**Efficiency**	**Consistency**
Option 2a (non-legislative): The organisation of awareness-raising activities targeted at businesses	**No**: no impact on debtors and minimal impact on creditors	**No**: requires too many resources for a very uncertain result.	**Yes**: trade-offs across other domains could not be identified.
Option 2b (non-legislative): The organisation of awareness-raising activities targeted at organisations representing SMEs	**No**: objectives are unlikely to be achieved.	**Yes**: fairly low budgetary cost for the EU. No other costs.	**Yes**: trade-offs across other domains could not be identified.
Option 2c (non-legislative): Publication of information on bad debtors	**Doubtful**: possible preventive effect on creditors but many practical drawbacks for its implementation	**No**: very high administrative costs for businesses.	**Yes**: trade-offs across other domains could not be identified.
Option 3a/1 (legislative): Harmonisation of payment periods between businesses	**Yes**: likely to lead to less late payments by shortening contractual payment periods.	**No**: Considerable compliance and adjustment costs.	**No**: loss of contractual freedom by removing the ability of companies to compete through payment periods offered to clients. This could in turn put more pressure on other aspects of contract negotiation where larger companies can still exercise significant influence over small company suppliers
Option 3a/2 (legislative): Harmonisation of periods of payment by public authorities to businesses	**Yes**: fear of damaging the commercial relationship with the client should not exist in contracts concluded with national authorities which are required to follow standard and transparent procedures. Moreover, the payment period is normally not a negotiable item of a contract awarded by a public authority. However, a sufficiently high sanction in case of late payment needs to be foreseen.	**Yes**: budgetary impact for national authorities would remain fairly limited compared with the additional liquidity that earlier payment by public authorities would generate for businesses.	**Yes**: trade-offs across other domains could not be identified.

Option 3b (legislative): increasing the "margin" interest rate	**Doubtful**: stakeholders seem to be satisfied with the current "margin" interest rate. Businesses are already entitled to negotiate a higher interest rate in the contract or to include a higher rate in their commercial conditions. The current rules allow Member States to provide for a higher minimum "margin" rate in their national legislation.	**Doubtful**: this option could strengthen the position of bigger or more powerful businesses since it would reinforce the bargaining position of firms that ask for a discount for early payment.	**Yes**: trade-offs across other domains could not be identified.
Option 3c (legislative): the abolition of the €5 threshold	**Yes** for small transactions if accompanied by other measures that would make it economical to collect the outstanding amounts.	**Yes**, especially for SMEs. No budgetary, transaction and compliance costs could be identified.	**Yes**: trade-offs across other domains could not be identified.
Option 3d (legislative): the introduction of a "Late Payment Fee"	**Yes**: it would permit businesses to recover the transaction costs of claiming the payment and charging interest for late payments so that only purely commercial arguments would prevent creditors from charging interest.	**Yes**. Costs (mainly transaction costs) are redistributive. No budgetary or compliance costs.	**Yes**: trade-offs across other domains could not be identified.
Option 3e (legislative): the introduction of a "Late Payment Compensation"	**Yes**: strong deterrent effect on debtors proportional to the size of the claim since the costs incurred by the debtor would exceed the savings that he would otherwise obtain from free trade-credit. It also constitutes a strong incentive to creditors to claim the payment and the interest.	**Yes**. Costs (mainly transaction costs) are redistributive. No compliance costs. The budgetary costs are justified in view of the damage inflicted on business and proportional to compliance.	**Yes**: trade-offs across other domains could not be identified.
Option 3f (legislative): Extending the role of representative organisations	**Doubtful**: these organisations may not have the resources to cope with the administrative charges and the financial risks of litigation on late payment. They may also be prevented from bringing an action because of a conflict of interest, for example when the organisation has as members both the	**Yes** if measures are taken to reduce the cost of bringing an action and the associated financial risks (options 3c, 3d and 3e).	**Yes**: trade-offs across other domains could not be identified.

	creditors and the debtor.		

The above impact analysis shows that, as regards B2B transactions, options 3a/2, 3c, 3d and 3e meet the criteria of effectiveness, efficiency and consistency. The other options fail in respect of at least one criterion:

Ranking the options			
Option	**Effectiveness**	**Efficiency**	**Consistency**
RECOMMENDED CHOICE			
Option 3a/2 (legislative): Harmonisation of periods of payment by public authorities to businesses	**Yes**	**Yes**	**Yes**
Option 3c (legislative): the abolition of the €5 threshold	**Yes**	**Yes**	**Yes**
Option 3d (legislative): the introduction of a "Late Payment Fee"	**Yes**	**Yes**	**Yes**
Option 3e (legislative): the introduction of a "Late Payment Compensation"	**Yes**	**Yes**	**Yes**
OPTIONS WHICH ARE NOT RECOMMENDED			
Option 3b (legislative): increasing the "margin" interest rate	**Doubtful**	**Doubtful**	**Yes**
Option 3f (legislative): Extending the role of representative organisations	**Doubtful**	**Yes**	**Yes**
Option 3a/1 (legislative): Harmonisation of payment periods between businesses	**Yes**	**No**	**No**
Option 2a (non-legislative): The organisation of awareness raising activities targeted at businesses	**No**	**No**	**Yes**
Option 2b (non-legislative): The organisation of awareness raising activities targeted at organisations representing SMEs	**No**	**Yes**	**Yes**
Option 2c (non-legislative): Publication of information on bad debtors	**Doubtful**	**No**	**Yes**

The only option likely to impose significant administrative costs on business is option 2c. A rough indication of these costs for this options amounts to 25,300 million euro for SMEs and 86.1 million euro for large enterprises.