ACCOUNTANCY EUROPE.

THE LATE PAYMENT REGULATION PROPOSAL – BRINGING FAIRNESS TO BUSINESS TRANSACTIONS

Factsheet

FACTS.

SMES
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HIGHLIGHTS

The European Commission released on 12 September 2023 the Late Payment Regulation (LPR), a legislative proposal to tackle late payments in commercial transactions in Europe. It aims to:

- bring fairness into commercial transactions
- increase supply chains and SME's resilience
- foster a more widespread use of digitalisation
- improve financial literary of entrepreneurs

This document provides a high-level summary of the main provisions and explores the impact on Small and Medium Enterprises (SMEs). The proposal will have a fundamental impact on businesses and affect many SMEs and small practitioner accountants, who should be aware of the proposed changes. Accountants will play a key role in helping SMEs be prepared – and to prepare their own accountancy practice if it falls under the proposal's scope.

INTRODUCTION

The European Commission (EC) argues that late payments have a major impact on SMEs, with one in four bankruptcies occurring due to late payments. According to the EC, the reason is unfair payment terms and conditions that SMEs often accept due to the unbalanced bargaining power between a large or more powerful client (debtor) and a smaller supplier (creditor).

The EC proposed the "Late Payment Regulation'' on 12 September 2023, which revises the Directive from 2011 to address this problem. The revision aims to protect the SMEs against unfair commercial terms and conditions, increase their resilience and foster the use of digital tools.

This proposal will be discussed in the European Parliament (EP) and Council until a final agreement is reached, but it is still on an early stage of negotiations. The final text could be different from the initial proposal by the EC. Once a final agreement is reached, the LPR will enter into force on the day of its publication in the Official Journal of the European Union and will be applicable 12 months after the date of entry into force.

This paper provides an overview of LPR's main provisions, with particular emphasis on the impact on SMEs and aims to make the accounting profession and other relevant stakeholders aware of the key changes.

Accountancy Europe is following the proposal's developments closely and will issue another factsheet once the legislative process is finalised and a final text is approved.

PROPOSAL 'S OBJECTIVE

The EC introduced LPR as it considers the current EU legal framework on late payments inadequate for SMEs to cope with unfair terms and conditions. Several studies and assessments executed by the EC on the effectiveness of the EU legal framework as well as the 2019 Resolution of the European Parliament and the 2021 Opinion of the Fit for Future Platform have confirmed this. The current Late Payment Directive is deemed to be ineffective as it:

1. does not provide suitable means of redress to SMEs
2. does not define the concept of "unfair" practices or clauses
3. lacks preventive measures and effective enforcement mechanisms
4. does not fix a maximum payment term in a business-to-business context

Bigger companies still have the leverage to impose their own terms to SMEs because of the above shortcomings, and due to different rules applied in Member States (MS). Hence, the EC decided to revise the current framework and introduce the Late Payment Regulation which will be directly implemented into national laws.

WHY A REGULATION RATHER THAN A DIRECTIVE?

The EC proposes replacing the current Directive with a Regulation. A Regulation is directly applicable into each Member State's (MS) law, unlike a Directive that has to be separately implemented by national governments into national legislation. In this way, the Regulation contributes to unified obligations as it lays down the same rules across the EU, and thereby ensures a level playing field across the Single Market and benefits in particular businesses that have cross border activities.

The draft Regulation proposes stricter measures to prevent late payments by introducing the following main changes:

1. it sets a maximum payment term of 30 days
2. payment of interest is now compulsory in case of late payment, and is automatically due without the need of a reminder by the creditor

3. additional measures to protect creditors against bad payers e.g. setting out the criteria for unfair contractual terms
4. Member States should set up a designated authority to ensure implementation of the rules
5. use of tools and trainings to increase credit management and digital financial literacy of SMEs

IMPACT ON SMES

Late payments are a significant concern for small companies that need liquidity to support their businesses and fund their way to sustainable transition. Many accounting practices serve SMEs and are SMEs themselves. They should therefore be aware of the LPR to start preparing for the upcoming changes.

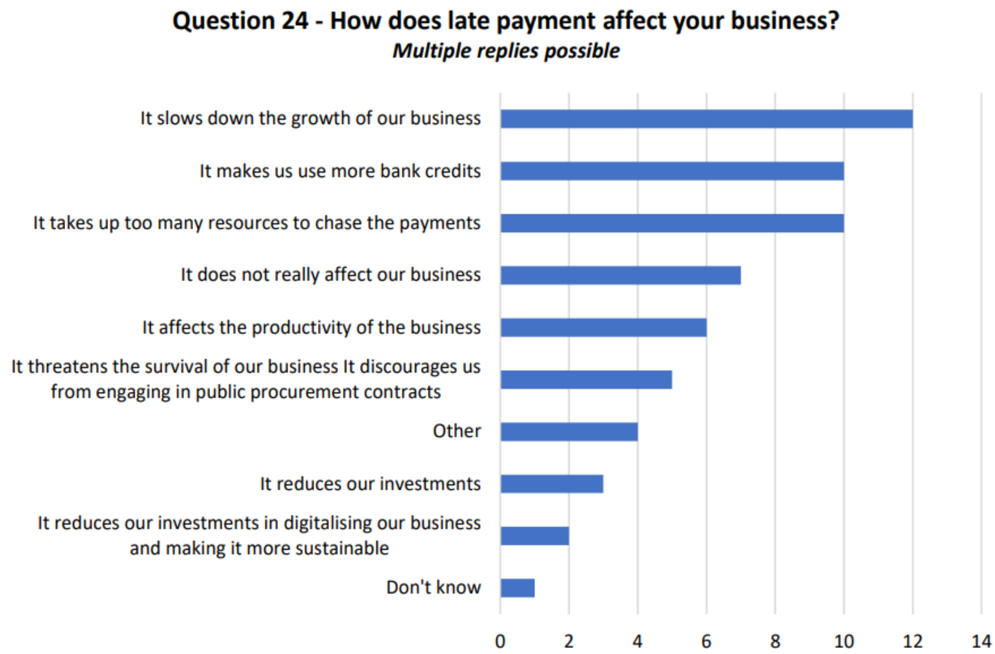
This proposal gives additional rights to SMEs and small accountancy practices where they are creditors. They also put obligations on them where they are debtors and can have a big impact on their balance sheets. For example, SMEs and small accountancy practices that are debtors must ensure that they are able to pay their creditors within a 30-day period.

According to EC, the Regulation is expected to have a big impact on SMEs in the following ways:

1. improved liquidity for SMEs
2. fewer bankruptcies due to improved liquidity
3. saved time, money and resources chasing debtors
4. more opportunities for innovation, to recruit new staff, to grow and expand into new markets
5. a fairer business environment since SMEs will have the proper tools to defend their rights for due payment without having to worry about the uneven bargaining power between them and larger businesses.

HOW ARE BUSINESSES AFFECTED BY LATE PAYMENTS?

The below chart shows different effects of late payment in businesses. For example, late payments slow business' growth and forces them to borrow more from banks. The use of too many resources to chase due payment is another important effect as the chart demonstrates.



Credits: factual summary report to the public consultation of the European Commission

LATE PAYMENT REGULATION'S KEY FEATURES

SCOPE

LPR applies to payments on commercial transactions which are defined as ''the delivery of goods or the provision of services for remuneration'' between:

1. business-to-business
2. business to public authorities – specifically including the design and execution of public works, construction and civil engineering works.

It **does not** apply to business to consumer (B2C) transactions.

PAYMENTS TERMS AND CONDITIONS

PAYMENT PERIODS

The payment period is set to maximum 30 days in commercial transactions from the invoice reception date, provided that the debtor has satisfactorily received the goods or services.

The text does not specify how the invoice reception criterion can be fulfilled. It may be challenging for the creditor to prove that the debtor has indeed received the invoice on a specific date and thereby start the 30-day deadline.

Creditors could prove the receipt date via electronic invoices ('e-invoicing'), for example as proposed in the 'VAT in the digital age' EC proposal. With paper invoices, a form or registered or tracked post will be necessary. Also, certain industries, such as construction services, have a customary invoicing practices (such as self-billing for work done to date) which LPR's provisions could affect.

For agreed payment schedules via instalments, the Regulation mentions that in case of delay of any instalment's payment, interest shall be calculated on the basis of any overdue amount. It does not specify how a contract amount should be split between the instalments - i.e. by equal payments.

The national laws may include provisions for an exceptional procedure of acceptance or verification - due to the nature of the goods or services. However, that process' maximum duration shall not exceed 30 days from the date of receipt of goods or services. After the procedure is finalised, the payment period is set to a maximum of 30 days.

PUBLIC PROCUREMENT AND PAYMENTS TO SUBCONTRACTORS

For public works contracts, contractors must provide evidence to contracting authorities that they have paid their direct subcontractors in line with the Regulation's conditions and within the set deadline. In case of late payment, the contracting public sector body must notify its MS's enforcement authority without delay.

LATE PAYMENT INTEREST TERMS AND CONDITIONS

In case of late payment, the debtor must pay interest to the creditor, and it will be automatically due without the creditor needing to send a reminder. The right to obtain interest for late payment cannot be waived if the creditor fulfilled the contact properly and the debtor received the invoice.

LPR does not specify what constitutes 'proper contract fulfilment' since the definition changes per member state according to the applicable contract law.

In case of late payment, the Regulation introduces a flat fee compensation amount fixed at EUR 50 for recovery costs – which the debtor must pay automatically to the creditor. Like with interest, the right of the creditor to this amount cannot be waived and the creditor may also be entitled to additional compensation for any recovery costs that occurred due to the debtor's late payment.

The Regulation states that the fixed EUR 50 amount is per ‘every single commercial transaction’. A single invoice could contain multiple transactions (for example, if it amalgamated several single orders and deliveries on a single invoice) so it is possible that a single invoice paid late could result in multiple compensation payments.

As with the Directive, the interest rate is based on the European Central Bank’s (ECB) rate plus 8%. For example, if the ECB rate is 4%, the interest rate on late payment would be 12%.

COMBATTING UNFAIR CONTRACTUAL TERMS

The Regulation lays down the contractual terms and practices that shall be considered void and are detailed in Article 9. To sum up, the creditor must:

- respect the set deadline of 30 days period for payment
- not limit the debtor’s right to receive interest for late payment, and
- Not deliberately delay processing the invoice

Member States shall put in place effective means to combat unfair terms. They shall also allow creditors to be officially represented before the Courts via an organisation with a legitimate interest in representing them.

DESIGNATION AND POWERS OF ENFORCEMENT AUTHORITIES

LPR mentions that “each Member State shall designate one or more authorities responsible for the enforcement of this Regulation (‘enforcement authority’)’’. The enforcement authority shall ensure compliance with LPR’s provisions and shall cooperate with enforcement authorities from other MS to provide mutual assistance in case of cross border investigations.

Enforcement authorities shall have the power to:

1. conduct investigations based on a complaint or on their own initiative
2. request all the necessary information from debtors and creditors
3. proceed with unannounced on-site inspections in case of investigation
4. enforce creditor’s right to receive interest for late payment by the debtor, and
5. impose or start proceedings, impose fines and other penalties and require the debtor to terminate the infringement

COMPLAINTS AND CONFIDENTIALITY

In case of wrongdoing by the debtor, creditors or organisations officially representing creditors can address complaints to:

- the enforcement authority in the MS where they are established, or
- the enforcement authority of the MS where the debtor is established.

The complaint processing can also be treated confidentially. However, the creditor must explicitly ask for confidentiality and must identify any information that it would like to keep confidential.

The enforcement authority must inform the complainant ‘’within a reasonable period of time’’ how the complaint will be dealt with and whether there are sufficient grounds to further investigate the matter. In case there are sufficient grounds to proceed, a full investigation must be carried out. The enforcement authority should require the debtor to stop the illegal practice in case of proven wrongdoing.

ALTERNATIVE DISPUTE RESOLUTION

MS shall promote the voluntary use of effective and independent alternative dispute resolution mechanisms, in addition to the enforcement authorities’ powers and the creditor’s right to submit a complaint. This encourages fast, efficient, cost effective and private dispute settlement between the two parties.

DIGITAL TOOLS USE AND FINANCIAL LITERACY ENHANCEMENT

MS are encouraged to use digital tools to ensure proper enforcement of LPR and make sure that SMEs have in their disposal those digital tools for timely payments. Credit management tools and financial literacy training should also be available and accessible to SMEs.

However, the text does not specify which digital tools SMEs can use or how those tools can help SMEs ensure timely payments.

CONCLUSION

As stated earlier, the LPR is for the time being only a proposal and the final law's provisions may differ from what is described in this paper. However, SME accountants should already be aware of the incoming big changes, to prepare their own practices as well as their SMEs accordingly.

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