

## **EBC position on the Late Payment Directive**

### **About EBC**

Established in 1990, the European Builders Confederation (EBC) is a European professional organisation representing national construction employer associations of micro, small and medium-sized enterprises. EBC is a member and partner of SMEunited, the European association of SMEs, and Small Business Standards (SBS), the European association representing SMEs in standardisation.

The construction sector is of vital importance to the European economy. With 3.4 million enterprises and a total direct workforce of 18 million, the construction sector contributes at around 9% to the GDP of the European Union. 99.9% of the European construction sector is composed of micro, small and medium-sized enterprises.

### **General remarks**

Despite the recast of [Directive 2011/7/EU on combating late payment in commercial transactions](#), unacceptably long payment terms and late payment remain serious and widespread problems in the construction sector. A study commissioned by the European Commission highlights that construction experiences the longest payment duration of all sectors with 72 days (2016). In addition to this, it is estimated that only about 15% of the payments in the construction sector are on time whereas 10% of them are delayed by more than 60 days<sup>1</sup>.

The result of this is a situation, which in particular harms micro, small and medium-sized enterprises (SMEs) by blocking their rather limited time and resources, hampering investment and raising cash-flow issues that may even lead to business closure. A study in the UK indeed observed that late payment is the primary or major factor in one fifth of corporate insolvencies in the construction sector<sup>2</sup>.

There are various reasons for the persistence of unacceptably long payment terms and late payment in the construction sector. Firstly, the sector is very specific concerning its long and interdependent supply chain. A typical construction project often involves a main contractor and various sub-contractors, which again may sub-contract parts of their work. Therefore, late payment accumulates quickly within the value chain. Secondly, 94.1% of the companies in the construction sector are microenterprises. Hence, many business relations are defined by an imbalance of power between enterprises, which often forces micro and small enterprises to accept longer payment terms than they are comfortable with and allows enterprises in a stronger negotiation position to use outstanding invoices as a form of free credit. Thirdly, due to the nature of construction works, disputes over the quality of goods and services are frequent and

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<sup>1</sup> European Commission (2018). Business-to-business transactions: a comparative analysis of legal measures vs. soft-law instruments for improving payment behavior. Retrieved from <https://publications.europa.eu/en/publication-detail/-/publication/c8b7391b-9b80-11e8-a408-01aa75ed71a1>

<sup>2</sup> Construction Excellence (2016). A review of payments within the UK construction industry by CE Funding and Finance Group. Retrieved from <http://constructingexcellence.org.uk/wp-content/uploads/2016/07/Payments-Minefield-%E2%80%93-A-review-of-payment-practices-within-the-UK-Construction-industry.pdf>

while contracts usually cover shortcomings and resulting payment delays, intended delays based on disputes display a serious and too common problem.

However, long payment terms and late payment do not only exist in business-to-business relations. In fact, they also constitutes an extensive problem in contracts with public authorities, which should apply prompt payment terms with their suppliers. Given that public procurement makes up about one third of government expenditures, it represents an important direct source of income for construction enterprises and makes short payment terms and timely payment in public contracts as urgent and essential as in business-to-business relations.

**Following this, EBC calls for the implementation of a zero tolerance policy regarding long payment terms and late payment, proposing a number of changes to strengthen the rules.**

### **EBC proposals**

The study [“Business-to-business transactions: a comparative analysis of legal measures vs. soft-law instruments for improving payment behaviour”](#), commissioned by the European Commission, as well as the feedback from EBC members show that there has only been little progress in reducing payment terms and late payment in commercial transactions since the recast of the late payment directive. Problems lie in the long and interdependent supply chain, the imbalance of power between enterprises as well as the importance of public contracts in the sector, which often force construction entrepreneurs and SMEs to accept uncomfortable contract conditions and payment situations. Therefore, EBC believes it is necessary to establish both, stricter legal measures and soft-law instruments to further improve payment behaviour of enterprises as well as public authorities and proposes the following actions:

#### **Measures at the European level:**

**a. Define an obligatory maximum period of payment not exceeding 30 calendar days for all commercial transactions**

As became visible since the last recast of the late payment directive, long payment terms remain a huge problem, especially for SMEs, as they offer large enterprises a legal way to pay late, circumventing possible sanctions as well as obligations in terms of interest rates. Therefore, EBC believes it is necessary to clearly limit the maximum period of payment to 30 calendar days for all transactions between undertakings and transactions between undertakings and public authorities without the possibility of derogations. This would also make the very controversial term “grossly unfair” obsolete, which currently exists in the Directive to justify very long payment terms.

**b. Make the application of interest a legal obligation from the first day of late payment and apply the statutory interest for late payment in business-to-business relations**

The late payment directive entitles a creditor to interest for late payment without the necessity of a reminder. However, in practice interest rates are either not paid or too low. The former because creditors often fear to damage the business relations and the latter due to the unbalanced power relation, allowing the debtor to dictate terms. The result is that interest rates do not appear to have any influence on the payment behaviour of the debtor. Therefore, EBC believes that it is necessary to make the application of interest a legal obligation as from the first day of late payment. This would make it easier for enterprises

to claim interest, especially in the frame of mediation or arbitration. In addition to this, EBC calls for the application of the statutory interest for late payment in business-to-business relations (as is the case in contracts with public authorities), to ensure that large companies cannot use their dominant position to fix interest rates at an unjustifiably low level.

**c. Define an obligatory maximum duration of 30 calendar days to ascertain the conformity of services or goods, starting from the day of the finished service or received good**

Payment in the construction sector is less straightforward than in other sectors, because the conformity of the works undertaken needs to be ascertained before invoicing can take place. The late payment directive allows the procedure of acceptance or verification to take a maximum of 30 calendar days from the date of the receipt of the goods or services, unless otherwise stated in the contract and provided it is not grossly unfair. However, both, enterprises and public authorities appear to increasingly use the approval period as a tool to purposefully delay their payment obligations. The result is that construction SMEs have to wait extremely long for the payment of their services without the possibility to take legal action (30 days or more for the verification and at least additional 30-60 days for the payment). Hence, EBC asks for a maximum duration of 30 days to ascertain the conformity of services or goods and to delete the possibility to agree upon a longer period or any other form of derogation, because enterprises and public authorities can use this to purposefully prolong the verification period and with it, their payment period.

**Measures at the national level:**

**d. If the main contractor exceeds the maximum payment period of 30 calendar days, ensure subcontractors can directly claim payment from the contracting authority as foreseen in the Public Procurement Directive**

A construction project usually involves a large amount of enterprises and rather long supply chains, often significantly delaying payment, especially at the end of the value chain. Hence, Directive 2014/24/EU on public procurement explicitly allows subcontractors to claim due payment directly from the contracting authority. However, this tool is rarely used by public authorities although it can play an important role in better protecting the subcontractor, who knows that he can obtain, with reasonable certainty, the total amount agreed with a limited maximum delay. Moreover, this encourages the main contractor to pay on time, knowing that the contracting authority will easily be able to refer to him in case the subcontractor declares late payment. Therefore, EBC believes the provision should be applied in all situations in which the payment of the main contractor exceeds the maximum payment period of 30 calendar days, given the main contractor verified the proper execution of the works. Similar legislation is already in place in [France](#).

**e. An improved enforcement of legislation on late payment, including the imposition of proportionate administrative sanctions in case of a violation**

A central problem with late payment is that as long as enforcement remains weak, companies imposing unfair practices tend to see no need to change their behaviour. Hence, EBC considers better enforcement key and supports concrete measures, such as proportionate administrative sanctions, to increase compliance with the legislation. The experience of France, which introduced the Hamon Law in 2014 enabling the administration to directly sanction bad payers, shows that tight controls and better enforcement through penalties is possible (SMEs not engaged in a serious misconduct may receive a

warning or an injunction to improve their payment behaviour, in the first instance). The around 230 sanctions in France per year<sup>3</sup> moreover show the importance to strengthen enforcement of late payment legislation. A specifically positive aspect of administrative sanctions is that public authorities directly impose them in the case of a payment legislation breach, which allows enterprises to avoid direct action against the debtor.

### **f. Allow enterprises to hold back tax payments on services and goods delivered until payment for them is received**

Construction enterprises have many financial burdens to carry even if payment arrives late, such as VAT on the works undertaken or services delivered. In order to decrease burdens for SMEs, EBC proposes that Member States exempt enterprises from paying taxes on the works undertaken or services delivered, until payment is received. A good example for this is Poland, which introduced a new law based on a proposal by the Ministry of Entrepreneurship and Technology that includes the principle that small entrepreneurs<sup>4</sup> pay VAT on the works undertaken or services delivered only after having received the respective payment.

### **g. Set-up and promote mediation and adjudication measures at the regional and local level**

EBC believes that mediation and adjudication measures can play an important role in solving payment disputes, because they offer a rather low-cost forum for the resolution of disputes. However, it is important to establish certain common conditions. Firstly, the mediation or adjudication measures should be in the hands of Member States to avoid possible conflicts of interests of e.g. business associations. Secondly, mediation or adjudication measures should be established at the regional and local level in order to encourage in particular micro and small enterprises to make use of them. Finally, the respective facilities should have specially trained staff with knowledge about construction works, in order to ensure that also disputes (whether purposefully or for valid reasons) over the quality of goods and services are properly addressed.

### **h. Increase support for credit management education and training**

Effective credit management can reduce the risk of default, shorten average collection periods and thus helps to maintain the cash flow of enterprises. Indeed, construction SMEs often lack knowledge on effective credit control techniques, compared to larger companies, and have difficulties to find education and training focusing on entrepreneurs rather than employees specialised in accounting. Adding to this are limited resources and time. Hence, EBC believes that Member States should encourage better knowledge on credit management by fostering the development of specific online and/or in-person courses e.g. by professional associations, and by establishing financial support to enable construction SMEs and craftsmen to participate in them.

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<sup>3</sup> European Commission (2018). Business-to-business transactions: a comparative analysis of legal measures vs. soft-law instruments for improving payment behavior. Retrieved from <https://publications.europa.eu/en/publication-detail/-/publication/c8b7391b-9b80-11e8-a408-01aa75ed71a1>

<sup>4</sup> Small enterprises refers to those enterprises that did not exceed the equivalent of EUR 1.2 million in revenues in the previous tax year