

The Business Journal

Serving Sonoma and Marin counties

Santa Rosa, CA • 707-579-2900

REPRINT

Small Business Week Special Report • Vol. 8, No. 3; May 16, 1994

Eight steps to achieving success in the collection of bad commercial debts

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The pace of economic growth, both for a nation and a single company, is directly related to the extension of credit. While successful commercial debt collection can make a difference in the financial performance of a large corporation, the very survival of a small business enterprise absolutely depends on it.

In every endeavor, the key to success lies in the creation of a plan of action and the vigilant implementation of that plan. In the context of the collection of bad commercial debts, an appropriate plan would necessarily entail the following steps:

- *Do not under any circumstances extend credit to a debtor who does not have the ability to repay the obligation incurred.* While this simple offering may seem superficial, it is the rule broken most often by those within commercial enterprises who are empowered to extend credit. The financial wherewithal of the debtor should always be tested through a credit application and multiple reference verification. Furthermore, every effort should be made to impress upon salespeople the fact that a million-dollar sale on credit, without payment, can be career-ending.

- *Obtain as much information as possible about the prospective debtor and its financial affairs in advance of the extension of credit.* Once a debt has gone bad, recovery depends largely upon the ability to locate the debtor and identify its assets. Therefore, background information on the debtor company and, in most cases, its principals should be assembled at the time the credit application is completed. At a minimum, you should obtain information pertaining to the applicant's business licenses, drivers' licenses, Social Security numbers, and banking relationships. All information should be maintained in permanent, regularly updated files. An annual credit renewal application will ensure that information is kept current.

- *Provide for the cost of credit and the expense of collection.* Every prospective debtor should sign a credit application containing a provision to the effect that, if you have to file a lawsuit to collect the debt, you will be en-

titled to recover your expenses of litigation, including attorney's fees and other recoverable costs. While a court's decision to award attorney's fees can oftentimes be subject to impulse, the amount of interest to be awarded is always the result of simple calculation. Therefore, your credit application – and your invoice form – should provide for the recovery of interest on late accounts. Interest on overdue commercial accounts is not subject to the usury law, and late charges assessed at the rate 18% per annum have been found to be recoverable, making late charges the commercial creditor's best hope of being made whole.

- *Make sure that the basis of the claim is well-documented.* The capability of establishing the basis and validity of the claim is indispensable if litigation is required. At trial, shoddy bookkeeping can be a creditor's Waterloo. As such, commercial transactions should always be memorialized through written agreements, purchase orders, invoices, confirmations, and the like.

- *Take timely internal action.* Once a debt exceeds established aging guidelines, a written demand for payment should be sent to the debtor. The demand should be clear and concise and should identify a fixed period for payment. If a response is not promptly forthcoming, a single follow-up phone call should then be made to the person responsible for payment to verify the debtor's whereabouts and glean any other information that might aid in collection of the debt. For instance, you may learn that the debtor is anxiously expecting payment on a recent sale, or, in the alternative, that the debtor "is experiencing great financial difficulty," "has closed bank accounts," "is insolvent," or "is considering filing bankruptcy." Detailed written notes from the conversation should be taken, including identification of the debtor's representative by name and a description of his or her job title or other evidence of authority to speak for the debtor. This information may prove indispensable if a lawsuit becomes necessary to collect the debt.

- *Promptly engage the services of an expert.* Notwithstanding your best efforts, some debts go bad and must be referred out for

collection. Commercial collection is an area requiring special knowledge, training, and skill, and not every lawyer is equipped to handle such cases. Therefore, you should engage an attorney who is thoroughly familiar with the collection process. Money should never be wasted on endless letters that, in essence, plead for payment. A creditor's resources are conserved and the prospect of recovery on the claim is increased when a lawsuit is immediately filed and prosecuted effectively.

- *Take advantage of the pre-trial asset attachment remedy.* The pre-trial remedy of attachment is a court-ordered procedure through which a creditor may secure its claim with the debtor's assets prior to trial. Attachment allows an unsecured commercial creditor to instruct the county sheriff or marshal to seize and hold a debtor's assets during the pendency of the lawsuit, irrespective of the solvency of the debtor or the existence or non-existence of any so-called great or irreparable injury.

In addition to certain other requirements, to obtain this remedy you must demonstrate that the lawsuit involves a contract claim against a partnership or corporation or a contract claim against an individual that arises out of his or her conduct of a trade, business, or profession. In this regard, it is important to obtain information from sole proprietors at the credit application stage concerning the nature and purpose of their business enterprise. Individuals should acknowledge in writing that your goods or services are being used by them in their business operations.

You must also establish the probable validity of the claim by demonstrating that it is more likely than not that you will succeed at trial. In this regard, you must support the attachment application with statements under oath and accompanying documents showing that your claim is meritorious. If you have been true to your collection plan, your lawyer will have as much detailed information about the debtor and the debt as necessary to obtain the attachment remedy.

- *Be willing to assist in the rehabilitation of the debtor.* In most situations in which a past-

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due debt is undisputed, the debtor probably has other past-due accounts, as well, and is experiencing pressure from a number of creditors. Recognizing this, the goal then is to get paid as much as possible as soon as possible without forcing the debtor into the abyss of insolvency and bankruptcy. Early in the process, you should always consider either a payment arrangement that provides for payment of the entire debt, together with

costs, attorney's fees, and interest, over some reasonable period of time, or a discount of the claim in exchange for a lump-sum payment.

The most disconcerting aspect of being in business is selling goods or rendering services and then not getting paid. A collection plan and adherence to it are a creditor's best defense against bad commercial debts.

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Reprinted from the February 14, 1994 issue of *The Business Journal*, 5510 Skylane Blvd., Suite 201, Santa Rosa, CA 95403. 707-579-2900.