

Coleman & Horowitz Client Memorandum

Discussing Issues of Interest to our Clients

Vol. 2, No. 1

Coleman & Horowitz, 499 West Shaw Avenue, Suite 116, Fresno, CA 93704 (209) 248-4820

EFFECTIVE COMMERCIAL COLLECTION TECHNIQUES

By Darryl J. Horowitz

It is an unfortunate fact of business that from time to time one of your customers will not pay for goods or services you provide. It is a frustrating and sometimes helpless feeling that you have knowing that even though you provided a valuable product or service, for reasons beyond your control you are simply not paid. How do you collect your money? What follows are some techniques that will help you effectively collect your receivables.

Obtain Proper Documentation

First, you should obtain good information on your customer. There is nothing more frustrating than selling goods or providing services to a customer that you cannot find when it comes to collection. We, therefore, recommend that for every customer, you obtain pertinent information such as the customer's full name, including all fictitious business names, as well as their current address and prior addresses.

For sales made on an open account basis (that is, on credit), an open account or credit application is a must. The application should require the full name of the debtor; any fictitious business names; if an individual, a social security number, drivers license number, and date of birth; if a corporation, the name, address, and telephone number (both business and residence) of the officers and directors; or, if a sole proprietorship or partnership, the principals of the company.

Bank account information with account

numbers and addresses of branch offices where bank accounts are maintained should be acquired. Trade references are also useful information. Quick phone calls confirming references can aid in rejecting false applications.

You should also request that your customer provide you with a recent financial statement. A statement audited by a Certified Public Accountant is best; at minimum, you should ask for a statement that has been prepared by your customer's accountant. If no financial information is available, be wary; it may indicate a company in distress. Where a company has been in business for a short period of time, there may be insufficient information with which to prepare a financial statement. In this case, you should obtain one from the company's principal(s).

Many publicly held companies are required by federal and state law to prepare annual reports which contain pertinent financial information. These reports are on file with the Securities and Exchange Commission and/or the California Department of Corporations; and most companies will also provide a copy upon request. Obtain an annual report where available and study it carefully. Merely because a company is publicly held does not guaranty it has the financial wherewithal to repay its obligations; observe the number of Chapter 11 bankruptcy filings by such companies in recent years.

Once you get the information, do not just put it in your credit file. Verify all information. Obtain a Dun & Bradstreet report to obtain a

profile on the company. If any of the information cannot be verified, or simply does not add up in your mind, ask for additional information or clarification.

In many instances, sales information is taken over the phone and an order is filled before credit references can be checked. Your company is then at risk and you may be unable to find the debtor if payment is not made. The credit application and follow up is, therefore, a necessity.

Bill Promptly and In An Understandable Format

Of course, the best method of payment is certified funds on delivery. However, this is often impractical and goods are sold on credit. If credit is extended, it is important to fix, as early as possible, the credit terms given (whether it be net 7 days, net 10 days, etc.), and provide your customer with written notice of the terms. You should then enforce your credit terms.

It is also important to bill promptly. Customers are most likely to pay soon after goods are received. Unbelievably, many companies wait several weeks, if not months, to deliver an invoice for a product sold or services rendered. Because of the lapse of time, your customer may delay payment while they investigate what product was purchased or service was rendered. They will have to match up their purchase order with your invoice. Prompt billing of your invoice may cut down the time needed for any such investigation.

The invoice should be clearly written. It should include an invoice number for your internal use for matching payment. It should also include the date goods were sold (or services provided), your customer's purchase order number (so that they may match up the purchase order with your invoice), the cost of each item of goods sold, the date the product was delivered (or service was provided), the total amount charged, and terms for payment. It should also include the payment terms agreed to.

California law permits an interest rate to

be charged for the delayed payments of goods or services. This is known as "time price differential" and generally exempts such transactions from California usury (excess interest) laws. Thus, if you wish to charge a service charge or interest on unpaid accounts, you should clearly set forth the rate conspicuously on your invoice. Your service charge should also be included on your open account/credit application (to advise your customer that service charges will be incurred if timely payment is not made), as well as on any delivery receipt. That will assist you if it is necessary to take legal action to collect on your unpaid obligations, so you can recover interest.¹

Additionally, you should include a provision on recovery of attorneys' fees on your invoice, as well as your open account/credit application. This is an important provision, because California law in most circumstances does not provide for the recovery of attorneys' fees unless it is provided for by agreement or by statute. Generally, for the collection of a trade debt, attorneys' fees over \$660.00 are not recoverable on the collection of a trade debt, unless provided for by agreement. We, therefore, recommend that an attorneys' fees clause be included, which should state words to the following effect:

"If it becomes necessary to take legal action to enforce this obligation, you shall pay us costs incurred in prosecuting any such claim including, but not limited to, reasonable attorneys' fees."

This provision should be clear and conspicuous.

If Payment is Not Timely Made, Take Prompt Action

Most businesses will produce an accounts receivable aging on a regular basis, not less than every 30 days. If you do not have a system in

¹You should also note that if no interest rate is specified in your contract, you may be entitled to recover a prejudgment interest rate of 10% if your debt is for an ascertainable amount. See Civil Code Section 3289.

place that provides such reporting, you should do so immediately. It will provide you with a ready snapshot of who owes you, how much, and for how long.

Once you have this information, review it on a regular basis, not less than every 30 days. Many companies have found success in reviewing their accounts receivable report weekly, if not every 15 days. By doing so, you can readily determine who is and who is not paying within terms. For those who are not paying within terms, it is important to take prompt action to contact the customer. In doing so, you may find that the failure to pay is wholly innocent. The customer may not have received your invoice/billing statement or may have simply misplaced it. Similarly, the customer may have been displeased with the goods or services provided and may not wish to confront you with their dissatisfaction; rather, they instead decided to take no action, including not paying your bill. By contacting your customer, you might not only get payment, but might be able to take the steps to keep your customer satisfied, and thus receive further orders from your customer.

Do not merely send a letter as your first contact with your customer. Give them a friendly call, which will be less sterile than a letter (which is simply a form letter for many companies). When you speak with your customer, get a commitment as to when payment can be expected. Then, put that date on your calendar so that if payment is not received, you can follow up with your customer.

If your customer proposes a repayment schedule, confirm the terms of the repayment schedule in writing; you may also want to consider including a return envelope with your confirmation letter to make it easier for your customer to make payments to you. In addition, if your customer promises payment on a certain date, and your offices are located in the same city as your customer, offer to pick up the check in person. This shows your customer that you are serious in collecting the debt and forces your customer to make a decision as to whether or not payment will be made. If your customer is not in the same city, you may offer to have an air

express company, such as Federal Express, pick up the check. Many express mail services will, at no additional charge, make three attempts to pick up a package.

If payment is not paid to you as promised, you will then know that stronger collection efforts are needed. If payment is received, no further intervention will be needed, and your collection problems for that customer are over.

If No Payment After Polite Demands, Take Stronger Measures

Most of your customers, after gentle nudging, will make payment voluntarily without the need of stronger measures. However, when an account becomes over due 45-60 days, it is time to take prompt action. Oftentimes, repeated promises to pay will merely serve as an excuse to delay payment and there is often nothing behind the promises to pay. Remember, the longer the debtor holds the money, the longer you will not have the use of it. Many debtors use this to their advantage in the hopes of obtaining a discount knowing that once a debt is 90 days or older, many creditors will do almost anything to get some of the money. The secret is, therefore, to take steps before it gets to that point.

There are numerous alternatives available to most trade creditors. One option is the collection agency. There are generally two types of collection agencies available: a national forwarding agency, and a local credit and collection agency. Though some national agencies will accept small local accounts, they generally handle larger national accounts. Smaller local agencies handle more local accounts.

In most instances, collection agencies will work on a contingency fee arrangement whereby they agree to take a percentage of the amounts recovered. If there is no recovery, there is no fee. Some agencies will even advance litigation costs for their customers, while others will require the customers to pay in the event suit is ultimately filed. In any event, make sure the agency is licensed and bonded. Ask for and

check references.²

Another option is referring the matter to an attorney experienced in the handling of commercial collections. It is important to find an attorney who is experienced. Any competent attorney may be able to obtain a judgment, but an experienced commercial collection attorney will also know how to recover collateral before and after trial. The experienced attorney may obtain a prejudgment writ of attachment (to permit a levy of assets prior to a judgment to secure an unsecured business obligation over \$500.00).

By hiring an experienced commercial collection attorney, you will not have to train the attorney as to the nature of a trade obligation and the defenses to a trade debt that a debtor may claim. In addition, the attorney may need to prepare paperwork for a repossession of goods.³ For example, the debtor may raise defenses like the goods delivered were defective, even though there was no complaint of the goods upon delivery; or that a payment was not entered into the creditor's computer system for goods returned, which the creditor has no record of having received; etc.). The experienced attorney will know how to counter these defenses.

Experience also assists the attorney in collecting the judgment once judgment has been entered. Commercial collection attorneys have

²It is important to check references because, as your agent, your company may be held liable if the agency violates credit and reporting laws. If violated, your customer may have a claim against your company for damages, and damages awarded for such claims are often substantial.

³For a secured debt, repossession of the collateral (if it can be resold) is recommended. If the debtor will not permit a voluntary repossession, redress through the Court may be necessary. In addition, under the Uniform Commercial Code, where goods have been sent to a debtor, and you thereafter learn that the debtor may not have the money to pay you or may be on the verge of bankruptcy, you may have rights to reclaim your property. This is known as reclamation, and an attorney may assist you in preserving your rights to reclamation. Where you have no security agreement, this is very important if you were to repossess your goods and resell them to reduce your losses.

experience in structuring settlements to assure that timely payment is made and, if it is not, that prompt steps are taken to enforce the settlement.

Based upon the amount to be collected, experienced commercial collection lawyers will work on either an hourly or contingent fee arrangement. Generally, however, the contingency fees charged by collection agencies are less than those charged by attorneys. Thus, if the debt can be collected quickly by an agency, you may, in the long run, save money because you only have to pay a small contingency or a small price per letter (if you are using an agency that provides a demand letter service).⁴ If the agency is not able to obtain results with demand letters and follow-up telephone calls, the agency will then refer the matter to an attorney. Most reputable agencies have an established relationship with attorneys within their local area and, for placement of cases outside their area, will refer to a law list. A law list is a directory of attorneys who agree to accept commercial collection matters on a pre-set, contingent fee basis.

A detriment to using a collection agency is that there is generally a delay before the matter is referred to an attorney. Please remember that for most creditors, a claim will not be referred to an agency until it has aged 60-90 days. The agency will then take steps within their own company to collect the debt (e.g., demand letters and follow-up telephone calls) to collect the debt, and may not refer the matter to an attorney for another 30-60 days. Thus, if a debtor makes up his mind not to pay, and the matter is referred to an agency, it may take up to six months to get the matter into the hands of an attorney. By then, the debtor may be out of business or, due to the length of time, it may not make economic sense

⁴Some commercial collection agencies offer programs where, for a set fee, they will send a pre-set number of demand letters to the debtor requesting that payment be made directly to the creditor. Few, if any, follow-up measures are taken (such as a collector phoning the debtor after the demand letter is sent) to assure that payment is made; the only service is the demand letter. Then, if the demand letters are ignored, the creditor can make the decision to hire the agency to take further steps for an additional fee.

to take legal action against the debtor.

Where the dollar amounts are high (over \$10,000.00), it makes sense to employ an attorney to take immediate legal action. In this regard, you may wish to refer the matter directly to your collection agency with instructions for them to refer it to an attorney. There will, however, be somewhat of a delay in doing so, and there may be no cost savings to you. Many attorneys will handle commercial collection claims on a contingent fee basis, and many will also advance costs (to be reimbursed either from any recovery or directly from a client once a decision is made to take no further action). You may, therefore, be able to have a lawsuit on file within only a few days after sending it to the attorney.

Conclusion

Whichever avenue you take, it is important to remember that while most of your customers will pay timely, for those who do not, it is important to take prompt action. Regularly

review those accounts receivable statements and follow up on the aged receivables. Those funds are, after all, yours.

[Note: Coleman & Horowitz has available an article entitled "Commonly Asked Questions Regarding Collections." If you would like a copy, please call us at (209) 248-4820.]

This article was prepared by Darryl J. Horowitz, a litigation partner at Coleman & Horowitz emphasizing business, construction, real estate, environmental and personal injury litigation, commercial collections, casualty insurance defense, insurance coverage, and alternative dispute resolution. He is a member of the Fresno County Bar Association, the American Bar Association, the Consumer Attorneys of California, and the Fresno Trial Lawyers Association. If you have any questions regarding the subject of this article, please contact Mr. Horowitz at (209) 248-4820, or by E-mail at "DJHLAW @ AOL.COM."

Coleman & Horowitz provides legal counsel to the business community in the areas of commercial and corporate law, real estate litigation and transactions, personal injury litigation, environmental regulations, casualty insurance defense, insurance coverage, tax, probate and estate planning. This Legal Brief is intended to provide the reader with general information regarding current legal issues. It is not to be construed as specific legal advice or as a substitute for the need to seek competent legal advice on specific legal matters. This publication is not meant to serve as a solicitation of business. To the extent that this may be considered as advertising, then it is herewith identified as such.