

# Collecting Accounts Receivable & Business Debts

## **Introduction:**

The Legal Aspects of Credit and Collections

To succeed, businesses must be paid promptly and in full. With the help of their lawyers, business owners and managers can collect promptly and protect their rights regarding credit and collections.

This pamphlet reviews the legal aspects of credit and collections, including credit checking; collection letters, and collection lawsuits. It covers collection techniques that apply to consumer accounts and commercial accounts—debts owed by individuals and by companies.

## **Adopting Policies and Procedures to Improve Collections**

Carefully written credit and collection policies improve collections. Your policies should cover procedures for using credit applications, handling billing, sending collection letters and making collection phone calls. Your lawyer can help your company write credit and collection policies that will expedite payment of receivables and comply with debtor protection laws.

## **Using Credit Applications to Help Collections**

Start with well thought-out credit applications. The application should contain crucial customer information—the name, address and phone number of the customer, the owners of corporate clients and credit references. Complete names and addresses will ease collecting delinquent accounts. Customers are willing to supply this information up front to avoid having to pay cash.

You can word the application so that your company has the right to collect interest when accounts are paid late and attorney fees if incurred. A credit application can also ask for personal guarantees of the individual behind corporate customers or the guarantees of the customer's partners or spouse. This enables you to collect the debt from these other individuals if the customer does not pay it.

## **Writing Effective Collection Letters**

When payment of a bill is late, companies ordinarily send a letter asking for prompt payment and requesting an explanation of why the bill has not been paid. If the customer does not respond to the collection letter, a follow-up telephone call to the customer usually follows. Your lawyer can help you write collection letters that get customers to pay without unduly offending them. A script prepared by your lawyer for collection phone calls can encourage payment without violating the law.

## **A Lawyer Can Help You Collect Without a Lawsuit**

When your company cannot collect business debts from a customer, your lawyer can send a letter to the customer on law firm stationery demanding payment and warning of legal action if the debt is not paid. Such a letter lets customers know that you intend to pursue your legal rights to collect the debt and is often enough to cause the customer to pay in full.

In some instances, the customer may respond to the letter by explaining why the debt remains unpaid. The customer may have a justifiable claim for a bill reduction due to a product defect or late delivery. Or the customer may want to pay, but lacks the money. Initiating communication at the earliest possible time may uncover information about something you are doing wrong and help you with other customers. Your lawyer can help you to resolve matters without a lawsuit by settling any disputes and arranging payment schedules. Your lawyer may also suggest that delinquent customers sign promissory notes, furnish collateral, and provide personal guarantees of payment.

## **When a Lawsuit Is Unavoidable**

Sometimes a lawsuit is the only way to collect a debt. Your lawyer may recommend a lawsuit after attempting to collect with a demand letter and investigating your customer's ability to pay. For example, you may have to sue a solvent customer who refuses to pay without justification or who fails to respond to your lawyer's letter and follow-up phone call. If the customer is out-of-state and is not subject to jurisdiction of your state's courts, your lawyer may recommend referring the matter to a lawyer in that state. Be sure your credit and collection policy names the employee responsible for working with your lawyer so that critical time is not lost.

Commencing suit may cause the customer to pay. In other cases, the customer may ignore the lawsuit, or

hire a lawyer to defend it. If the customer fails to pay after commencement of the lawsuit, your lawyer will take the necessary action to continue it, such as motions, discovery of information and, if necessary, trial. If the customer does not have a valid defense, the action should result in a court judgment in your favor.

### **Collecting Your Judgment**

The judgment may not be the end of the procedure. After obtaining a judgment, your lawyer will help you collect it. The first step may be the filing of a copy of the judgment with the county clerk to obtain a "lien" against any real estate owned by the customer. If the debtor still doesn't pay, your lawyer may find other assets of the customer which the sheriff can sell to pay your judgment.

In appropriate cases, your lawyer can help you to "pierce the corporate veil" and collect assets from a corporation's shareholders. If the customer has transferred assets to others to avoid paying the judgment, your lawyer may help you cancel these transfers, sell the assets and collect your judgment.

### **Recovering Your Merchandise**

You may have a legal right to reclaim merchandise when a customer fails to pay immediately after it is delivered. Particularly, when a customer declares bankruptcy, your lawyer can help you act promptly since you can lose your right to reclaim the goods if you fail to demand recovery within ten days or if the goods are sold by the customer.

Before selling to a customer whose financial condition is doubtful, ask your lawyer to help you take action to protect your right to collect. Your lawyer may suggest precautionary measures, such as taking a security interest, or utilizing collateral, or keeping legal title to the merchandise until you have been paid in full.

### **Handling Full Payment Checks**

Sometimes a customer pays an account with a check for less than the amount due on the account and writes "Payment in full" on the back of the check. Your company's credit and collection policies should instruct employees to contact your lawyer before depositing such "payment in full" checks. In some cases, your legal rights can be preserved by endorsing the check with the words "without prejudice". In other situations, your right to pursue the unpaid balance of a customer's debt will be lost if you deposit the check, regardless of how you endorse it. Your lawyer can analyze the facts, advise whether you should return the check or cash it, and recommend steps to collect the unpaid balance.

### **Legal Fees In Collection Matters**

Your lawyer can help you find a mutually agreeable basis for legal fees for services in collection matters. For some cases, it may be appropriate to pay a contingent fee based on a percentage of the amount collected. In other cases, a flat rate or hourly fee might be best. Sometimes your lawyer may suggest a combination of fee arrangements, like a contingent fee combined with a "lump sum" suit fee if it becomes necessary to file a lawsuit. Once you agree on a fee arrangement, your lawyer may follow-up with a letter to confirm it.

### **Conclusion**

Your lawyer can help you collect more quickly and avoid "writing off" uncollectible bills, your lawyer will help you implement legally effective credit and collection policies, keep you out of lawsuits with out-of-court settlements, and act as your advocate when lawsuits are unavoidable.

#### **1 Credit procedures**

- A. Credit applications
- B. Credit reports
- C. Credit approval

#### **2 Credit Terms**

- A. Interest
- B. Attorney fees
- C. Remedies for default

#### **3 Contract forms**

- A. Sales confirmation
- B. Sales agreements
- C. Service agreements

#### **4 Installment sales**

- A. Payment schedule
- B. Retention of title
- C. Chattel mortgage
- D. Insurance

#### **5 Collection procedures**

- A. Billing
- B. Monthly statements
- C. Follow-up letters
- D. Follow-up phone calls
- E. Referral to collection lawyer

#### **6 Accounting and recordkeeping**

D. Master agreements

- A. Review of receivables
- B. Adjustment of reserves for bad debts
- C. Review of disputed accounts
- D. Review of litigated accounts

**7 Special problems**

- A. Full payment checks
- B. Reclaiming goods from insolvent customers
- C. Filing proof of claim for bankrupt customers

This pamphlet provides general information. Laws develop over time and differ from state to state. This pamphlet does not provide legal advice about specific legal problems. Let us advise you about your particular situation.

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