

Coleman & Horowitz Client Memorandum

Discussing Issues of Interest to our Clients

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

COLLECTION TIPS

By The Commercial Litigation Department

The start of a new year may find your company's collections lagging. If your customer's payments have slowed, now may be the time to consider taking steps to recover your overdue receivables. To help your business maximize the recovery of receivables, we recommend the following:

! **For those accounts that have become slow pay, take action to collect the overdue balance.** Call your customer to see why payment is being delayed. Better yet, if you can visit your customer in person, you can see if your customer's business has somehow dropped off. You can then discuss, in person, a repayment plan.

! **Consider charging interest on unpaid balances.** Many businesses have such language in their contracts or invoices but do not charge it thinking that it will cause work for the accounting department. However, it may create an incentive for your customers to pay earlier instead of paying interest. Similarly, if you do charge interest and your customers pay slow because they simply refuse to pay interest, consider giving slow-paying customers amnesty from paying accrued interest.

! **Consider rewarding customers who pay early.** To insure prompt payment, many businesses give their customers a discount -- of 2-5% when payments are made within five days of billing. Just like charging interest, the discount provides an important incentive to pay.

! **When a customer promises payment, but fails to deliver it, offer to pick up**

payment in person. If your customer is out-of-town, yet promises to pay, consider hiring a courier service to pick up the check and mail it to you.

! **Review your accounts to make sure that you have accurate and up-to-date information on your customers.** Update addresses and bank accounts. Check to see if the business has new officers or directors; perhaps your customer has changed owners and your bills are being sent to the wrong location.

! **Review payments as they are received.** In doing so, you may notice that your customer has changed its business form; i.e., from a sole proprietorship to a corporation, from a partnership to a limited liability company, etc. If so, get updated information.

! **Keep copies of checks you receive.** Often, when the debtor claims a lack of payment, a telephone call to their bank -- which can be found on the copies of the checks -- will allow you to determine if your customer may have the funds to pay. In addition, if you have to file a lawsuit against your customer, the information will be useful to your attorney when collecting on any judgment or enforcing any pre-judgment writ.

! **Stop providing supplies or services to your customers who don't pay.** Many companies operate believing that it is better to keep supplying their goods and services and hope for payment instead of demanding the account being brought current before any further services are provided. Although some customers do ultimately pay, the majority do not. More often

than not, most companies understand the need for payment before providing services; after all, they probably demand the same of their customers.

! Remember, you are not a bank. Nevertheless, every time you extend payment terms to a customer, you are providing credit, like it or not. Thus, treat every credit extension the same way a bank does and require performance within terms and, when payment is not paid, take action. Consider suing to recover the money; and remember, the longer you wait to take action, the less likely it will be that you will recover anything.

! Obtain complete information on your customer before you extend credit. Remember that every time you give a customer time to pay, you are giving your customer credit. Thus, unless the only terms you provide are C.O.D., make sure that you receive critical information for *every* customer, *before you make the first sale*. The information should include: full name, address and telephone number of the customer; name, address and telephone number of all principals of the business; if a corporation, the name, residential address, and telephone number of each officer and director; the company's bank, including bank account number; how long the company has been in business; a financial statement from the company; and the names of other vendors the company does business with.

! Get accurate financial information. As noted above, you should obtain financial information on every customer. Many customers are, however, reluctant to give you the information. Whatever the reason, think twice before extending credit to any company that will not share their financial condition with you. After all, you are giving credit, just as a bank would, and certainly your customer would not be able to obtain a bank loan without providing the bank with financial information. Check to be sure that the financial statement is audited, as that assures that some outside party has critically inspected the information. Some companies, however, prepare their own financial information which is taken from their in-house computer. While the

information *may* be accurate, at minimum, the financial information should be reviewed by the company's outside accounting firm.

! If dealing with a publicly traded corporation, obtain the company's 10-K filing. Some publicly traded corporations may be reluctant to provide you with significant financial information. You can, however, obtain a public corporation's 10-K filing either from the company's public relations department, the Securities and Exchange Commission, your stock broker, or on-line from some commercial internet providers. The 10-K will contain important information on the company, including financial information. It may also provide you with information on other goods the company may need from your company that you were not previously aware of.

! Once you obtain information on your customer, verify it. With bank and vendor information, obtain consent from your customer to verify the information. If you have consent from your customer, *make sure that you follow up to verify the information*. You do not want to wait until after you have not been paid to find out that the company does not have a bank account where it said it did, or that it is a slow pay with other vendors. If you have access to Dun & Bradstreet, review the company's payment history ("Paydex"); the report will have other pertinent information on the company.¹

! Go to the company's place of business. Many companies do an excellent job of promoting themselves, and making their company seem much larger and more prosperous than it may actually be. Where geographically possible, take time to visit the company. You will thus have the opportunity to judge for yourself whether the company will be in business long enough to pay for the goods or

¹If you do not have access to Dun & Bradstreet, you may be able to obtain a report from other sources. For example, we at Coleman & Horowitz can obtain Dun & Bradstreet reports from our on-line information services. Remember, however, that Dun & Bradstreet and other commercial reports use information obtained from the company being reviewed and is thus only as accurate as the information given by the company.

services you provided. If the company is located out of town, and the order is received by telephone, check with others in the community where the customer is located about the company's business; and if you are in town, visit the company. Doing so will not only allow you to evaluate the company, it may also solidify a long-term relationship.

! **If the company is a corporation, obtain the personal guaranty of the principal shareholder.** One of the benefits of a corporate form is that if the corporation observes corporate formalities (i.e., conducts regular shareholders and board of directors meetings, properly supervises the actions of the officers, is adequately capitalized, etc.), the shareholders, officers and directors are not generally liable for the debts of the corporation. Some corporations, however, may ultimately succeed, but may not have adequate resources to pay. We thus recommend that whenever you can, you obtain the personal guaranty of the principal shareholder(s). A properly drafted guaranty² will permit you to take legal action against the guarantor *and* the corporation for nonpayment of a corporate debt; and if the company files for bankruptcy, the guarantor may be the only source of repayment.

! **Obtain security for nonpayment.** Like a bank, you should ask every customer you can to sign a security agreement. Under a security agreement, if your customer does not pay, you will have the right to repossess your collateral, sell it and, if the repossession and sale are done properly, sue your debtor for the remaining balance due after disposition of the collateral. If your customer files for bankruptcy

and your collateral is not disposed of prior to the bankruptcy, you will be a secured creditor, which is generally better than if you were unsecured.

² We say "properly drafted" because under California law, unless certain rights of a guarantor are waived in writing, you may have to first proceed against the company before you can sue the guarantor. Moreover, care has to be taken in enforcing a guaranty if the debt is partially secured by real or personal property and failing to properly foreclose on the collateral may allow the guarantor to be released from liability.

! **If you learn that your customer is about to go out of business shortly after you have made a delivery, try to take redelivery of the goods.** Rarely, shortly after you have made a delivery, you learn from industry sources that your customer is not paying its debts and may soon close its doors. In those instances, you should immediately notify your customer, in writing (preferably by certified mail or personal delivery) that you deem your company "insecure" (a formal term meaning that you do not believe that your customer will pay its bill) and ask that they provide you with "adequate" assurances that you will be paid. You should also notify your customer that if the requested assurances are not provided within the time specified (you should ask for assurances in no longer than 10 days), that you will reclaim the goods you delivered. If such assurances are not timely made, you may have the right to "reclaim" (repossess) your goods so that you can lessen your losses. You may also have the right to sue your customer for any unpaid goods.

! **If you hope to recover attorney's fees in a lawsuit you file to collect an unpaid debt, add a provision in your agreements and invoices that permits attorney's fees.** California law provides that attorney's fees are recoverable if they are either provided by statute or by contract. (See Civil Code § 1021.) There are very few statutes that permit attorney's fees for a breach of contract suit. If, however, you have an attorney's fees provision in your contract with your customer, or even in purchase orders you send to vendors or invoices, you preserved your right to recover fees. (See Civil Code §§ 1717 and 1021.) We recommend language similar to the following: "In the event that it becomes necessary to take legal action to enforce this agreement, the prevailing party shall be entitled to recover reasonable costs, including attorney's fees."

! **If you intend to preserve your right to recover interest at a rate greater than 10%, include appropriate language in your contracts and invoices.** In the last issue, we recommended that as an inducement to your customers to pay timely, you consider charging interest. California law provides that interest is

recoverable on a debt in a certain sum at the rate of 10% per annum. If, however, you include language in your contract, or invoices, to provide for a different rate, and the charge is only if payment for the goods or services is not timely paid, then interest can be charged at a higher rate; even up to 18% per annum.³

This list is not a complete list of all the steps your company can take to minimize its losses, nor does it guaranty that you will not have losses. It should, however, give you some ideas as to where you can shore up your credit efforts and help you if and when you need to take legal action against one or more of your customers.

Of course, the above is not a complete list of everything your business can do to increase its collections. The list will, hopefully, remind you of steps your company should consider taking to increase cash flow.

The attorneys at Coleman & Horowitz, LLP have extensive experience in collecting overdue accounts including secured and unsecured commercial debts. Whether your debt is small or large, Coleman & Horowitz, LLP can help, and we offer a wide variety of fee options depending on your company's particular needs. If you have any question on collections, or would like to know how Coleman & Horowitz, LLP could help your company, please call either Darryl J. Horowitz or Lucille Goins Dimmick at (559) 248-4820 or by e-mail at dhorowitz@ch-law.com or ldimmick@ch-law.com.

³ Be careful in charging interest at a rate greater than 10% for a loan because the amount of interest recoverable for a loan is limited by law to 10%, unless the loan is made by a financial institution or mortgage company. There are other exceptions, but they will not be discussed here. If, however, you have a question in this regard, please call us.

Coleman & Horowitz, LLP 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.