



PREVENTATIVE COLLECTION DOCUMENTING YOUR CREDIT TRANSACTION

By Darryl J. Horowitz

In many instances, having information regarding a particular customer will make the difference in whether you will or will not be successful in the collection of the debt if payment is not made. This section will discuss some practical solutions to avoid the pitfalls of lack of information.

- **Take steps to avoid a problem before it begins.** Most clients will contact counsel only after they have experienced an unpaid obligation, not before. As is the case with many legal problems, however, the time to take steps to avoid a potential loss is before the problem arises. The place to start is to realize you have to be proactive. Some suggestions follow.
- **Remember, your company is not a bank.** Nevertheless, every time your company extends payment terms to a customer, you are providing credit, like it or not. Thus, treat every credit extension the same way a bank does: obtain adequate and accurate information before credit is extended, 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 a customer before credit is extended.** Remember that every time your company gives a customer time to pay, it is giving the customer credit. Thus, unless the only terms that are provided are C.O.D. (cash on delivery), make sure that your customer obtains accurate critical information for every customer, before the first sale is made. The information should include:
 - ✓ The full name, address, and telephone number of the customer;
 - ✓ The 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, your company should obtain financial information on every customer. Many customers are, however, reluctant to give you the information. Whatever the reason, your company should think twice before extending credit to any company that will not share its financial condition with them. 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.

Where a financial statement is provided, check to be sure that it 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 your client 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. It is also available via the internet through many services, including AOL Financial, EDGAR (the SEC's repository of required filings), etc.

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 which you were not previously aware of.

- **Once information is obtained from the customer, verify it.** With bank and vendor information, your company should obtain consent from your customer to verify the information. If you obtain consent, it is important to make sure that the information is verified. After all, you do not want to wait until after a problem has arisen to discover that the company does not have a bank account where it said it did or that it is a slow pay with other vendors. Information on a company's payment history and other financial information can be obtained from commercial sources. One such source is Dun & Bradstreet, from whom your company can obtain a report which includes a review of the company's payment history ("Paydex"); the report will have other pertinent information on the company.

- **Have your client visit the customer'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, you should take time to visit the company. You will then have the opportunity to judge for yourself whether the company will be in business long enough to pay for the goods or services they provided. If the company is located out of town and the order is received by telephone, you should check with others in the community where the customer is located about the company's business; and if your customer's representative is in town, the representative should then visit the company. Doing so will not only allow your client to evaluate the company. As a side benefit, it may also solidify a long-term relationship.

- **If the customer 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 guaranty 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, your company should, whenever possible, ask your customer to offer collateral to assure repayment of the obligations and, to confirm the security interest, sign a security agreement. Under a security agreement, if the customer does not pay, you will have the right to repossess the defined 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 the customer files for bankruptcy and the collateral is not disposed of prior to the bankruptcy, you will be a secured creditor, which is generally better than if your client is unsecured.

- **If you learn that a customer is about to go out of business shortly after a delivery has been made, repossess the goods if possible.** Sometimes, shortly after your company has made a delivery, you learn from reliable industry sources that the customer is not paying its debts and may soon close its doors. In those instances, your client should enforce its rights of reclamation, as provided under the Commercial Code. (See Commercial Code § 2702(b).) In doing so, you should immediately notify your customer, in writing (preferably by certified mail or personal delivery) that your company deems itself “insecure” (a formal term meaning that your client does not believe that the customer will pay its bills as they become due) and ask the customer to provide “adequate” assurances that payment will be received. You should also notify the customer that if the requested assurances are not provided within the time specified (the demand should ask for assurances in no longer than 10 days), you will “reclaim” (repossess) the goods previously delivered. If such assurances are not timely received, you will then have the right to “reclaim” (repossess) the goods, and the value of the repossessed goods may be used to reduce the amount owed by the customer. If properly reclaimed, you may also have the right to sue its customer for any unpaid goods.

- **Make sure that accounts are reviewed to make sure that your client has accurate and up-to-date information on its customers.** Many companies obtain financial information when the account is opened and then rarely update the information. You should, however, regularly update the financial information, including, but not limited to, addresses and bank accounts. You should check to see if the business has new officers or directors; perhaps your customer has changed owners and its bills are being sent to the wrong location. Remember, information on many businesses can now be reviewed via the internet. They include:

- ✓ <http://kepler.ss.ca.gov/list.html>: For searching corporations and LLC's;
- ✓ <http://www.cslb.ca.gov>: For searching contractors;
- ✓ <http://www.dre.ca.gov>: For searching real estate agents and brokers;

- ✓ <http://www.insurance.ca.gov/docs/index.html>: For searching insurance agents and brokers.

- **Make sure that payments are reviewed as they are received.** In doing so, your company may notice that the customer has changed its business form; i.e., from a sole proprietorship to a corporation, from a partnership to a limited liability company, etc. Changes in bank accounts or signatories on the account may be observed. If so, get updated information.

- **Keep copies of checks received.** Often, when the debtor claims a lack of funds, a call to their bank -- which can be found on the copies of the checks your customer has made -- will allow you to determine if your customer may have the funds to pay. In addition, if you have to file a lawsuit against the customer, the information will be useful to you 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, companies understand the need for payment before providing services; after all, they probably demand the same of their customers.

- **If you hope to recover attorneys' fees in a lawsuit filed to collect an unpaid debt, make sure all agreements, including invoices, include an attorneys' fees provision.** California law provides that attorneys' 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, an attorneys' fees provision is included in your client's contract, even in purchase orders sent to vendors or invoices, attorney's fees may be recovered. (*Ibid.*, see also Civil Code § 1717.) Language similar to the following should be sufficient to preserve the right to recover fees: "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 attorneys' fees."

- **If you want to recover interest at a rate greater than 10%, make sure that appropriate language is included in the contract.** California law provides that where a contract is silent as to the amount of interest recoverable, interest is recoverable at the rate of 10% per annum. (See Civil Code § 3289 (b).) 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 a service charge can be charged at a higher rate, up to 18% per annum.

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

This article was written by [Darryl J. Horowitz](#). Darryl is the managing partner at Coleman & Horowitz, LLP, where he works in the firm's litigation department and represents clients in complex business, construction, banking and real estate litigation, consumer finance litigation, commercial collections, casualty insurance defense, insurance coverage, and alternative dispute resolution. He has been named a Northern California Super Lawyer® (Thomson Reuters) in business litigation from 2006-2020, a Top 100 Northern California Super Lawyer® (Thomson Reuters) from 2015-2019, has received an AV®-Preeminent rating from Martindale-Hubbell and a perfect 10.0 rating from Avvo. He is a member of the Fresno County, Los Angeles County and American Bar Associations, the Association of Business Trial Lawyers (former President and Board Member). Darryl can be reached at dhorowitz@ch-law.com or (559) 248-4820, ext. 111.

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