

ARTICLES - PAGE 1 OF 2

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AVOIDING COLLECTIONS PROBLEMS

By Matthew A. Griffith, Esq.

Businesses often experience difficulties in collecting monies owed to them by their customers and clients as soon as the business first begins offering its goods and services. Every business has experienced some difficulty in getting paid all it is owed, and many business plans are formed with the presumption that a certain percentage of the business' accounts receivable will go uncollected. The problem of collecting accounts receivable is not usually the cause of a business' failure, as more businesses fail from undercapitalization. However, collections problems can prevent a business from growing and will always negatively affect the business' profitability.

There are things a business can do to minimize its risks that an account receivable will become uncollectible. And as is usually the case, preventing the problem from occurring is far less costly than curing the problem once a client or customer fails or refuses to pay you for your goods and services. Whether your business is the sale of pastries, providing rental housing or the construction of high-rise office buildings, the following suggestions, where applicable, should help you increase your collections and avoid much frustration and anguish in the process. Try following these basic collections rules.

GET IT IN WRITING. It may sound elementary, but it is so very important that you memorialize your agreements with customers, clients and other businesses. Any change, termination or other modification of an agreement should also be memorialized. For example, in a construction context, a "Change Order" form may often be used. To avoid a variety of legal and tax trappings, all written documents, including your regularly used forms, should be reviewed by your legal counsel and tax advisors.

GET PAID IN ADVANCE. Easier said than done, but your goods and services are not free. You should require substantial deposits and down payments before you begin ordering parts or using materials. And you should require payment-in-full before you begin performing services or relinquish control of your property. Remember that until your customer has paid you for a good, the customer is not entitled to the fruits of your labor. This rule may best be exemplified by the landlord who demands rent to be paid on the first day of every month during which the tenant will occupy the leased premises. In essence, the tenant pays in advance. But when the tenant fails timely to make the rent payment, the tenant is essentially a trespasser and the landlord should immediately begin eviction proceedings.

ARTICLES - PAGE 2 OF 2

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IF YOU DON'T GET PAID IN ADVANCE, GET SECURITY. Obviously, this rule does not apply to leasing agreements or the simple cash transaction such as the sale of a dozen doughnuts. In larger transactions, particular those involving the sale of moveable personal property and real estate, the seller should demand a security interest in something of value. A mortgage, a recorded land contract, a mechanic's lien and a lien on personal property are familiar examples of security interests. But many people forget that a business can agree to provide services, such as structural repairs to a house, and in exchange receive a security interest in an entirely different property, such as an office building, delivery truck or car owned by the customer. Or alternatively, that same business could require a security interest in the house, office building, delivery truck and car, or some combination thereof. Having a security interest may also improve your chances of recovery in the event the customer files for bankruptcy protection.

IF THE CUSTOMER IS CREDIT RISKY, DEMAND A CO-GUARANTEE. Many businesses extend credit to customers while fearing that the customer is a credit risk. In such circumstances, the customer should be made to provide the signature of a co-guarantor who promises to pay the customer's debt to you in the event the customer does not. Remember, however, that the co-guarantee is only as good as the co-guarantor is creditworthy.

IF YOUR CONTRACT DOES NOT ALLOW FOR COLLECTION COSTS, YOU CANNOT GET THEM. The "American Rule" is that litigants pay their own attorneys' fees. So, if you must retain an attorney to collect a debt, you will pay the attorneys' fees and most other collections costs. The exceptions to the American Rule are the existence of a written contract allowing the recovery of attorneys' fees, a statute allowing such recovery; or the assertion of a frivolous, unreasonable or groundless claim or defense. The easy solution to the American Rule is to include a provision in your contracts allowing YOU to recover your attorneys' fees, collections and court costs. Your customers should not have the same right to recover against you.

THE CHECK IS NEVER TRULY IN THE MAIL. The lesson here is to begin legal proceedings as soon as possible and not to delay in collecting your money or retrieving your property. Equally important, you should read your written agreements to determine whether you are required to provide any notices or demands to the customer before commencing a collections action against the customer. The longer you wait, the more likely the customer will be difficult to locate; the customer will have been hidden his/her assets; or your property will have been destroyed, devalued or transferred to third-parties.

As a final suggestion, consult your attorneys as soon as you suspect difficulty in collecting a debt. Often a stern letter from an attorney on a law firm's letterhead can have a dramatic effect on a delinquent customer. You also should consider consulting your attorneys to review your entire billing and collections processes. Thrasher Buschmann Griffith & Voelkel, P.C. has often assisted businesses whose agreements, leases and other forms were outdated or lacking important provisions which would allow the business to pursue additional remedies against a delinquent customer. If we can help you or your business, please contact this author.

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