

DIRECTORS' BRIEFING



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Debt recovery

● Most businesses experience some problems getting paid on time by their customers. Good credit control helps to prevent this becoming a serious problem.

However, there are occasions when a customer cannot, or will not, pay. To avoid a bad debt, you may need to use a third party or take legal action to recover the money you are owed.

This briefing explains:

- ◆ The key issues to consider when deciding how to proceed.
- ◆ How debt collection agencies, solicitors and arbitration can help you.
- ◆ Which legal remedies might be the most appropriate.

1 Is it worth a fight?

There are no hard and fast rules about whether to pursue a debt and which approach to take. Much depends on the individual circumstances of the debt and the customer.

A How much money are you owed?

- ◆ In terms of time and money, it may be best to write off very small sums, but the Small Claims Track (see 4) offers a cheap route without the need for solicitors.

B Who is your customer?

- ◆ If it is a customer whose business you value, be diplomatic in your approach.
- ◆ If it is a one-off customer, you can be more assertive.

C Why has the customer refused to pay?

- ◆ Is there any dispute over the goods? If so, resolve it immediately. Otherwise,

the debt will be difficult to recover.

- ◆ Is the customer in cashflow difficulties? If so, try to negotiate a payment on account (part payment) and reschedule the remainder. Confirm this in writing.
- ◆ Are there already outstanding judgments against the customer? If so, the debt may well be irrecoverable. Ask your local court how to check the Register of County Court Judgments.
- ◆ Is the customer bankrupt or in liquidation? If so, the debt is probably irrecoverable.

If the customer does not have a good reason for not paying, you may choose to pursue the debt.

You can use a debt collection agency or a solicitor specialising in debt collection (see 2),

FURTHER HELP

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DIRECTORS' BRIEFING

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serve a statutory demand (see 3) or go to court (see 4 and 5).

2 Debt collectors

Debt-collection agencies (and solicitors who specialise in debt collection) have the time, expertise and resources needed for the job.

A Using a reputable debt-collection agency (or a specialist debt recovery solicitor) is a **fast** method of recovering debts.

- ◆ Your customer will often pay up straight away, either in full or in instalments.

You also save your own time.

B Using an agency is often sensible when you want to **keep** the customer.

- ◆ You are unlikely to keep a customer who has been pursued through the courts.

C **Costs** are normally calculated as a percentage of the money recovered.

- ◆ The commission on the money recovered is typically eight to ten per cent for commercial debts (and three to 15 per cent for consumer collections), though it can vary depending on the size and age of the debt.
- ◆ The percentage commission may be higher for a one-off recovery than if you use the agency for all your unpaid debts.
- ◆ Some agencies charge an annual subscription (often £25 to £100).
- ◆ Some agencies charge a flat fee in the form of vouchers. You buy, say, £400-worth of vouchers, which you send in

Be firm, be reasonable

When it comes to recovering problem debts, the only winners are the debt-collection agencies and the lawyers.

A **Discuss** the situation with your customer.

- ◆ Find out why the debt has not been paid and try to resolve the problem.
- ◆ Explain what steps you intend to take.
- ◆ Try to reach an agreement.

B Before you start any kind of **legal proceedings**, let the customer know.

- ◆ A solicitor's letter makes it clear to the customer that you are serious.

Many customers will pay up immediately, or at least settle out of court.

The customer will probably want to avoid costs, hassle and uncertainty as much as you.

with each invoice to be collected.

- ◆ If you are asked to pay any money in advance, check the agency's record (see E). Rip-offs can, and do, happen.

D The agency can also **instruct solicitors** on your behalf if a customer still refuses to pay up.

- ◆ This will save you time but it may be cheaper to instruct the solicitor direct.

E Make **checks** before using an agency.

- ◆ Is it registered with the Credit Services Association (0191 286 5656 or www.csa-uk.com).

- ◆ What methods does it use?

You could be liable if it uses unlawful methods such as harassment.

F Your **solicitors**, or your accountants, may be able to recommend a good agency or may offer debt collection services themselves.

- ◆ Unless your solicitor specialises in debt collection, this may be expensive.

3 Statutory demands

The other alternative to going straight to the courts is to issue a statutory demand.

A You can only use this for undisputed, **higher-value** debts.

- ◆ This means outstanding debts of more than £750.

B You send a formal demand for payment in a **specified format**.

- ◆ The format is set out in the Insolvency Rules. You can get appropriate forms online (eg from Oyez at www.oyez.co.uk).
- ◆ Alternatively, ask your solicitor to organise it. This is a relatively low-cost procedure.

C If the debt is not paid after **21 days** (and you think there is money available), you can petition the court to wind up the company (or make an individual bankrupt). See 8.

- ◆ The prospect of being wound up (or made bankrupt) often has much more effect on debtors than court procedures to recover the money.

4 Small Claims Track

If you pursue a debt for up to £5,000 using the courts, your case will be allocated to the Small Claims Track, part of the County Court. The procedure has opened up rapid and simple

◆ You can launch claims to recover unpaid debts on the Money Claim Online website at www.courtservice.gov.uk/mcol. The website allows you to make claims for fixed amounts of up to £100,000. Judgments by default and warrants of execution can also be requested online.

◆ In the case of overseas customers, you can avoid payment problems by using a Letter of Credit. See **Export finance**, EI 3.

methods for individuals and small firms.

- A** Making a claim using the small claims track is **inexpensive**. County courts are listed in the telephone directory. Your local court can send you the forms to fill in, plus leaflets explaining each stage and the fees involved.
- ◆ A solicitor is not usually required.
 - ◆ The court fees can be added to the amount of your claim. So, too, can interest on the debt from the time it became due. Both should be included at the outset. However, you can only claim very limited solicitors' fees.
 - ◆ Present written evidence that you have tried to resolve the dispute before resorting to proceedings or you may be penalised even if you have a valid claim.
- B** Once the court serves the claim form, your customer (the defendant) can **respond** in one of four ways:
- ◆ Pay the claim.
 - ◆ Admit the claim, or part of the claim.
 - ◆ Ignore the claim by not responding within 14 days. In this case, a default judgment can be enforced.
 - ◆ File a defence to your claim. A defence can include a counterclaim (saying that you owe the defendant money). This usually leads to a hearing (see **D**).
- C** If the defendant suggests a **compromise**

Alternative dispute resolution

Long before a payment dispute ever arises, it is possible to agree a dispute resolution procedure with your customer. This can be written into the contract between you.

- A** The main attraction of this approach is the **flexibility** it provides.
- ◆ You can agree how formal the procedure should be and who should act as the arbitrator or mediator. In this way you can control costs.
 - ◆ Disputes can be resolved more quickly than in court, with less confrontation.
- B** One form of dispute resolution (if the parties agree) is **arbitration**. This involves using a professional arbitrator. Importantly, you can make the arbitrator's decision legally binding.
- ◆ Arbitration is rarely used for debts below £2,000 because of the costs involved.
- For more information, call the Chartered Institute of Arbitrators (020 7421 7444).

of some sort, you can accept the offer or progress to a small claims hearing (see **D**).

- ◆ Agreeing to accept payment in instalments is often advisable.
- D** A **small claims hearing** is an informal meeting between yourself, the defendant and a district judge.
- ◆ This takes place on a fixed date at court.
 - ◆ The judge listens to you, to the defendant and to any witnesses, and reviews the evidence which each of you puts forward (eg invoices, letters, expert opinions).
 - ◆ The judge then tells you his decision and explains his reasoning. He can also explain what to do next.
 - ◆ Provided you submit written evidence and give at least seven days' notice, you do not have to attend the final hearing in person.
- E** If the defendant has agreed in writing to pay the claim, or you have been **awarded judgment** at the hearing, you can then request the court to enter judgment.
- ◆ This records your legal right to the debt, but does not guarantee payment (see **6**).

5 Claims over £5,000

Court claims between £5,001 and £15,000 are dealt with by a fast-track procedure. Claims over £15,000 use the multi-track procedure.

- A** You start proceedings by **issuing a claim**.
- ◆ Claims over £15,000 can be issued in the High Court. Claims for less than this must be issued in the County Court.
- B** It is advisable to use a **solicitor** or barrister to represent you.
- ◆ Obtain good legal advice before proceeding. A trial can be expensive for the defeated party. (See **Suing**, LA 1.)
- C** If the defendant issues a **defence** to your claim, the procedure is more formal and complex than for small claims.
- ◆ Your legal adviser and the court staff can explain what is involved.
 - ◆ You may not wish to proceed further if a defence is issued. But you may have to pay costs if you abandon the claim.
- D** Try to establish the **length of time** it will probably take for the case to go to trial.
- ◆ The courts try to limit this to 30 weeks for fast-track cases.

◆ All businesses can charge other businesses interest on overdue bills at the Bank of England base rate plus eight per cent. If you intend to claim interest, it is best to confirm it in writing. But carefully consider the impact of claiming interest on an overdue bill to a regular, valuable customer. See **Interest on late payments**, FI 17.

"Before pursuing a debt, the first consideration for any creditor should be whether it is going to be cost-effective to pursue. Far too often, creditors are left with judgments they cannot enforce and legal bills that far outweigh the value of the debt. Creditors should ask their lawyers to look at both the commercial and legal issues."

*Teja Picton Howell,
Picton Howell solicitors*

- ◆ In extreme circumstances, it can be two years before a multi-track case is heard.

- E** Whichever party loses is likely to end up paying the court fees and most of the **legal costs** of both parties.
- ◆ Even if you win, you will probably have to pay part of your own legal costs.
 - ◆ If you cannot show that you first tried to settle the dispute out of court, the judge may order you to pay your own costs.

Due to the cost, hassle and timescales of a trial, it is common for both parties to agree on an out-of-court settlement before the trial begins.

6 Still no payment?

If your claim is successful (see **4** and **5**), you are awarded judgment by the court. If the defendant still refuses to pay up, or falls behind in payments, you can attempt to enforce judgment through the court (see **7**). Just because you have been awarded judgment does not guarantee success.

- A** Often, the reason the defendant did not pay in the first place was **lack of funds**.
- ◆ There may be no valuable assets to sell either.
- B** The defendant may be able to **appeal** against the judgment.
- ◆ This could delay payment. At worst, the judgment could be cancelled or altered.

7 Enforcing judgment

There are four main methods of enforcing judgment. In each case, you complete a form and pay the court a fee to start the process. The fee is added to the amount of your claim.

- A** The most common method is to use a **Warrant (or Writ) of Execution**. This is effective if the defendant has assets (eg goods on his premises) which can be taken and sold for a significant sum.
- ◆ The court will send bailiffs to collect the money you are owed.
 - ◆ Alternatively, the bailiffs can seize suitable goods to sell at auction.
Bailiffs are prohibited from taking basic domestic items (eg clothes), items which defendants need for their jobs (eg tools, car) or rented items (eg television).
 - ◆ Judgments for debts over £600, which are registered at the High Court, can be enforced by sheriffs. Sheriffs have a much

higher success rate than bailiffs.

- B** If the defendant's bank account is in credit, consider using a **Third Party Debt Order**.
- ◆ The bank (or building society) is ordered to put aside the amount of your claim from the funds in the defendant's account. The defendant is offered a hearing.
- C** If the defendant is employed, consider using an **Attachment of Earnings Order**.
- ◆ The defendant's employer is ordered to deduct the amount from the defendant's wages and pay it over.
- D** If there is no easier way to obtain the money, consider a **Charging Order**.

This prevents the defendant from selling the assets which you charge (usually a house or stocks and shares) without paying you the money you are owed. Usually, the defendant is an individual rather than a limited company.

If you are unsure how best to enforce judgment, you can obtain an order for the defendant to attend court for an examination which will investigate their ability to pay.

8 Insolvency procedures

Winding-up is the procedure whereby a company is forced to cease trading and its assets are sold in order to pay off creditors. The equivalent for an individual is bankruptcy.

- A** These procedures can be used to enforce payment if the debt is **more than £750**, and is not in dispute.
- B** Unless you have personal guarantees, or your customer's debts are secured against a property, you are an **unsecured creditor**. As such, you share money left after secured and preferential creditors have been paid.
- ◆ Secured creditors include banks and organisations owed loan repayments.
 - ◆ Employees are the main preferential creditors.
 - ◆ Should any money remain, unsecured creditors are paid in proportion to the amount of money owed to them.
 - ◆ How much you receive will depend on how much money is realised by liquidation as well as the total number of claims and how much each is owed.
 - ◆ If a customer has few assets and little money left in the bank, you might not receive anything at all.

EXPERT CONTRIBUTORS

Thanks to **Kate Beddington-Brown** (Institute of Credit Management, 01780 722900); **Martin Richards** (Kaltos solicitors, 020 7278 1817); **Andrew Corke** (Lester Aldridge Fast Track solicitors, 01202 786300); **David Greene** (Edwin Coe solicitors, 020 7691 4000); **Teja Picton Howell** (Picton Howell solicitors, 020 7813 3333).

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