



Debt Recovery White Paper

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The backdrop against which this paper is written is one of financial uncertainty. In a climate such as this, maintaining liquid cashflow is crucial to every business. With that in mind I will be taking a look at what the economic future may hold, and how to manage your business' cashflow through it.

In this paper I will be discussing what Credit Management procedures you can put in place in order to maximise your working capital. I will also be looking at Credit Control steps which can be taken by you to recover unpaid debts without the need to instruct solicitors. Finally I will be providing an overview of what steps a Debt Recovery solicitor can take to recover money owed to you.

According to a recent survey conducted by the Institute of Credit Management, 69% of companies in the UK are affected by late payments. Also according to that same survey, 59% of UK Companies reported an increase in the late payments they suffered in 2010. Interestingly, 2010 did not see an increase in companies or for that matter individuals becoming insolvent. Low interest rates and Time to Pay tax deferral agreements by HMRC meant that many businesses were able to survive. Possibly they did this by stretching their credit terms, hence the increase in late payments between companies.

Unfortunately, I believe that 2011 will see a worsening of this situation. On 4th January 2011 VAT increased, albeit by only 2.5%, but still an increase. HMRC has indicated that they will not give any further extensions on Time to Pay agreements. Public sector cuts are looming. It is estimated that 30% of small businesses are reliant on public sector contracts, and 10% of small businesses will fail for total reliance on the public sector if those contracts are taken away. Such contracts include providing services to Councils, NHS Trusts, Schools and Care Facilities. Few businesses will be untouched. Further afield wage inflation in China and the Far East is growing, which will inevitably pass increased costs up the supply chain. Purchasing will become more expensive and customers more scarce. As cashflow becomes tighter, stricter measures need to be taken to ensure that payments which are due are made, and are made on time.

Credit Management

This is ensuring that you are paid on time, with effect from the moment you take on a new customer. Chances are whatever you supply, be it widgets or professional advice, you will be entering into a contract to supply your goods or services. Before you even consider doing business with someone, essential checks should be carried out in order to protect your company. Simple anti-fraud measures such as checking how long your potential client has been established and whether there has been a recent change of address or director, will stand you in good stead in the future relationship. Using Credit Reference Information agencies in order to check the financial stability of your potential customer and obtaining company accounts (if your potential customer is a limited company) are invaluable. Signs such as a company previously being a long-time dormant may give rise for concern. Of course, obtaining proof of identification and the correct trading status should be a given.



Subject to the service or goods which you are providing, and the value of them, it may be wise to consider obtaining a Personal Guarantee from the director that the company will make payment when invoices are raised. If it is your first dealings with a new limited company, or one that you know or have heard is struggling financially, and your potential loss could be significant if payment isn't made, a personal guarantee from the director can offer you significant security. That also serves as a good indicator as to whether or not a company director has any intention of his company paying you. With fraud on the increase, companies can put in an attractive request for goods or services, which you will then supply, but for which they have no intention of paying. If a director is unwilling to give a personal guarantee, ask yourself why they are not willing to guarantee that their company will pay you for your services. Alternatively, seek a payment on account against future invoicing.

Gradient UK has carried out research which has shown that 54% of UK companies have experienced those with whom they do business attempting to change their payment terms without prior consultation over the last twelve months. Making sure that the terms upon which you do business are your terms of business is crucial at the outset of any transaction or provision of goods and services. It is imperative that your customer knows the terms on which they are doing business with you from the outset. There is no substitute for clearly defined trading terms that are brought to their attention before the contract is entered into, and which take priority over any they may want to do business on.

Depending on the goods or services that you supply, if they are a tangible product, you may wish to consider including a retention of title clause in your terms of business to provide adequate provision for you to recover the goods supplied if you are not paid for them.

Absolutely essential is to set out your credit terms. State the number of days within which payment is due, and the interest that you will charge if payment is made late. If payment is not made on time your terms should provide for you to be compensated by the ability to charge interest on late payments. Educating customers so that they know they will be charged extra if they pay late (and then following that up) will pay dividends.

Credit Control

Once the trading relationship is under way the education process should continue. I am always staggered how much time businesses spend trying to match payments to customers when automatic payments are made without an adequate reference. Clear invoicing, subsequent statements of accounts and a written reminder that a reference should be quoted on all payments will save time and therefore money.

For the strictest Credit Control you may wish to start by phoning a customer to check that they have received your invoice and they are happy with the service which you have provided. That phone call can be followed up with a statement of account reminding your customer when payment is due. Ensuring that the customer is happy with the service that you have provided, and eliminating any possible queries at the same time as reminding them when payment is due, will doubtless speed payment.

Being pro-active is essential to Credit Control. A phone call if a payment is not made on time is quite often sufficient. At that stage you may come across excuses and delaying tactics. Over the summer it is not uncommon to be told that the director who signs the cheques is on holiday. It is easy to be floored by an excuse such as this but being prepared with a counter-argument will assist. If you are told that the director who signs the cheques is on holiday ask what provision has been made for



signing salary cheques and paying utility bills. It is unlikely that no provision has been made settling important accounts. Yours is an important account.

Other classic delaying tactics are “the computer is down” and “the cheque is in the post”. Even if the computer is down, a manual cheque will no doubt suffice. If the cheque is in the post you can ask for cheque and postage details. If payment has not been sent they will not be able to provide you with those details. Whatever the excuse, tackling it head on can avoid the invoice becoming an overdue debt.

The Institute of Credit Management has introduced The Prompt Payment Code to which signatories undertake to pay suppliers on time, give clear guidance of suppliers and encourage good practice. It encourages and promotes a prompt payment best practice between organisations, further to which signatories commit to paying within clearly defined terms and to ensuring that there is a proper process for dealing with any issues that may arise. Not only does this encourage timely payment but it also builds stronger relationships between businesses, encouraging safety in the knowledge that payment will be made and confidence in working with a business that values the service that is delivered. Mark Prisk, the Minister of State for Business and Enterprise reports that Experian (the Credit Reference Agency) has delivered research showing that current signatories to the Prompt Payment Code represent over 60% of the total UK supply chain value. By signing up to the Prompt Payment Code and encouraging your customers to do the same can be done online at www.promptpaymentcode.org.uk.

Being prompt is one of the essential keys to good credit control. Although taking action to recover a debt arising from a contract for the supply of goods or services can be left for six years I would strongly advise against it. The sooner an unpaid invoice is chased the sooner it will be paid and the sooner it is injected into your cashflow. Delays in chasing payment can lead to forgetfulness on the part of your customer or at least allow them the opportunity to dream up a reasonable excuse for non-payment. If being paid is important to you, your customer should know about it sooner rather than later.

Crucially, time can see a change in your customer’s financial circumstances. Undoubtedly cashflow will become tighter in 2011. Any rise in interest rates will affect business’ ability to service loans. In the worse case scenario the business goes bust before they have paid you. By delaying collecting overdue invoices you will be increasing the risk that your cash-strapped customer may become insolvent before you get paid.

Not infrequently payment is made, but by a cheque which bounces. Although cheques will be phased out over the next few years they remain strongly in circulation and a common means of payment. If a customer does a bounce a cheque on you it is essential that it is not returned but instead a Notice of Dishonour is issued. There is very little defence available to bouncing a cheque, yet the act of doing so speaks volumes as to the customer’s ability to pay. A Notice of Dishonour demanding repayment (preferably by cash or account transfer) and threatening further action in default will put you in prime position for recovering the money which is due to you.

Debt Recovery

If acting promptly is crucial, taking formal steps to recover unpaid invoices as soon as they fall overdue for payment is essential. Nevertheless, a quick risk assessment before ploughing on will establish whether you are likely to be throwing good money after bad. Assuming that a solid credit management procedure is in place, the



information will be to hand as to whether your (now former) customer is worth pursuing. There are also trade credit insurance policies available to protect you against non-payment by insolvent customers although exploring those goes beyond the realms of this paper.

But what action to take? So often solicitors are told to “just bankrupt them” or “he’s told me they are bankrupt”. This is not the forum to discuss the intricate procedure of obtaining a bankruptcy order or a winding-up order. Suffice to say insolvency proceedings are neither a guarantee of evoking payment or appropriate in many cases. The point is two-fold.

Firstly, it raises the issue of whether your debtor is already insolvent. It is an often used excuse to put creditors off by proclaiming insolvency. As simple as it sounds, do check. The Insolvency Service’s website enables an Individual Insolvency Register Search. If you have been lead to believe that a company has become insolvent, or that is what you are being told when you chase for payment, check the Companies House website. If your debtor is insolvent, you will have the certainty of that knowledge, and you can take your claim for payment to their Insolvency Practitioner. If they are not insolvent, you remain free to pursue them.

That leads onto my second point, which is whether insolvency proceedings can be brought against your debtor and if so, whether it is worth it. The first insolvency step against either an individual or a company is to serve them with a Statutory Demand. That is a prescribed form of document personally served on an individual or a company, which demands payment within 21 days. Put very simply, if payment is not made within 21 days a Petition can be issued and served. A Bankruptcy Petition for an individual or a Winding-Up Petition for a company. There are certain steps which must then be taken until ultimately the Petition is heard by the Court and potentially a Bankruptcy Order or Winding-Up Order made, thus declaring the debtor insolvent.

One essential point to make is that insolvency proceedings cannot be used if the debtor has raised any dispute or valid reason why payment should not be made. Think of it as the debtor “can’t pay” as opposed to “won’t pay”. If there is a dispute, the debtor is at liberty to apply to set aside the Statutory Demand, which can incur significant legal costs if they are successful. But if there is no dispute, and the debtor has simply been putting off making payment, a Statutory Demand with its threat of insolvency can be a swift method eliciting payment.

However, I always urge caution in using Insolvency Proceedings. Insolvency Proceedings are not designed for debt recovery, they are designed to make an individual or a company who cannot pay their debts bankrupt or wound-up as applicable. If they truly cannot pay their debts you are unlikely to get paid even if you obtain an Insolvency Order. I would therefore urge anyone to think carefully about whether it is worth your while, and if the debtor will have any assets that will be liquidated in insolvency from which you will get paid. Once again that highlights the benefit of having a Credit Management Procedure to establish whether or not the debtor would be worth pursuing via insolvency procedures.

If Insolvency Procedures are not appropriate, what solicitors call a Letter Before Action should be sent as swiftly as possible to the debtor. There are certain protocols that must be adhered to in order to rely on that letter if you have to go to Court. Essentially the debtor must be aware of the amount which you are claiming, how it is arrived at, what they can do if there is a query or dispute, how to make payment and a timescale within which they should respond. I would suggest enclosing copy documents at this stage such as copy invoices or a statement of



account, as appropriate. Crucially, advise the debtor what will happen if payment is not made. If you propose to issue Court proceedings for non-payment, it is expected that such action is spelt out so that the penalty for non-adherence is transparent. In my opinion approximately 75% of debtors pay on the receipt of a Letter Before Action.

Sometimes however, there is no alternative but to pursue payment of an unpaid debt via the Court. Usually the County Court. The process is relatively user-friendly and has been designed so that businesses can bring their own proceedings as opposed to instructing solicitors. That said, there are many pitfalls which I would wish for you to avoid. Whilst it may sound obvious, suing the correct person can be easier said than done. Time over clients have not established exactly by whom they are owed payment e.g. Fred Smith t/as FS Building Supplies or Fred Smith Limited t/as FS Building Supplies or FS Building Supplies Limited. If a claim is issued against the wrong party it will be non-effectual and a waste of time and costs. The claim will have to be withdrawn, Court fees thrown away and time wasted.

Careful thinking about exactly what is being claimed is also required. As simple as it may sound a claim is not simply for an invoice – an invoice only evidences damages due as a result of a breach of contract. It is important that the Court and of course the debtor understands exactly what is being claimed, and that it is set out the agreement to pay which the debtor has broken. A claim for interest should also be made at this stage. The Court is generous, and allows 8% interest on a debt from the date on which you issue your claim. Even better, the Late Payment of Commercial Debt (Interest) Act 1998 will give you 8% over the Bank of England Base Rate. That is a statutory default interest provision which you can rely on and use when chasing unpaid debts right from the date upon which they become overdue, even if a claim for interest is not included in any terms of business. Compensation is also available up to £100.

Here at Mayo Wynne Baxter we offer a fixed fee debt recovery service. That gives you the certainty of knowing how much it will cost you at each step of the way. It is our philosophy that our clients should always know how much they will have to pay to chase a debt, not only so as to avoid an adverse effect on their own cashflow, but also to make a commercial decision as to whether pursuit is financially viable.

Legal folk law states that only 1% of claims which are issued actually have to go to trial. There is therefore much to be said for casting aside any fear of Court Proceedings and using them as an effective debt recovery tool.

Effective Debt Recovery entails obtaining a Judgment against the debtor and enforcing it as swiftly as possible. As ever it is easy to be wise after the event, however obtaining sufficient Credit Management information at the outset of the client relationship does enable a Judgment to be enforced more effectively and the cash therefore recovered sooner. The efficiency of instructing a County Court Bailiff or High Court Sheriff to enforce a Judgment by levying on goods belonging to the debtor will be determined very much by whether the debtor has any assets. If the debtor is a sole trader or a partner in a firm, only then is it possible to apply for a Judgment against them individually and enforce it against them personally. If the debtor is a Limited Company, there are very few opportunities to pursue a Director of that company personally.

However, if Judgment is obtained against a Limited Company for a debt, it still remains an option to serve that company with a Statutory Demand, making it extremely difficult for the company to deny liability once a Judgment has been



obtained against it. That said, as I refer above, Insolvency Proceedings are not a guaranteed form of eliciting payment.

The ways and means of enforcing a Judgment are varied, and should be the subject of separate advice not for this paper. However at Mayo Wynne Baxter we make sure that all your options are explained to you, and the most appropriate method taken.

With careful Credit Management and Credit Control, the need for debt recovery should be minimised. If you do find yourself in a position of having to take matters further, good Credit Management will stand you in good stead to recover monies quickly.

Sometimes however, through no fault of its own, a business will suffer an adverse effect on its cashflow due to bad debts. If this does happen it is still essential to be pro-active. For many the thought of calling in an Insolvency Practitioner sounds a death knoll. However that need not be the case. Calling in an IP early can lead to a restructuring of a company's debt with its bank, landlord, HMRC or other creditors. Taking early advice from a Rescue and Recovery Expert can save jobs and reverse a business' decline. Statistics show that insolvencies rise after a recession compared with during a recession. To save a company becoming one of those statistics, directors should take action quickly if it has become apparent that bad debts sustained by the company have affected cashflow to a severe degree.

If you are in any doubt as to what you should do in relation to putting a Credit Management procedure into place, managing your Credit Control or taking Debt Recovery action, you should not hesitate to seek our professional advice. Our legal advisers will happily talk you through the process and advise you on the best way forward, without charge. Straightening out your book debts may be the best cashflow injection your business has had in months.

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