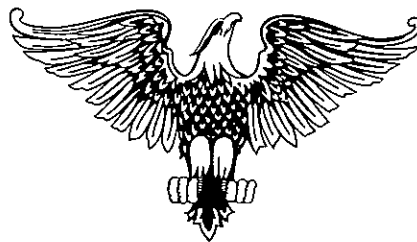


**LEGAL
ASPECTS
OF
COLLECTING
AN
ACCOUNT
RECEIVABLE**



by Richard G. Baumann

The American Lawyers Quarterly takes pride in presenting this pamphlet as an introduction to the legal aspects of collecting a commercial claim, with the hope that it will be both informative and helpful to those who are embarking on such an undertaking for the first time, as well as offering a concise review for lawyers and collection agents who are experienced in the field.

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The Attorney's Initial Efforts. When an attorney has a case referred to his office for collection, he should immediately acknowledge the claim in writing to the client or forwarder. Upon receiving a claim on behalf of a creditor, the attorney will first attempt to collect the money amicably without the necessity of the institution of a lawsuit. The attorney will make demand upon the debtor by advising the debtor in writing that the law firm has been retained by the creditor, and also by attempting to contact the debtor by telephone. On occasion, personal visits are made to the debtor's business premises so that the attorney can discuss the matter directly with the debtor; at that time, the attorney can also "check out" the premises to ascertain whether the debtor entity appears to have sufficient assets (physical inventory, machinery, or equipment on the premises) to satisfy the claim.

Whether by telephone conversation, personal interview, or with the assistance of a paralegal's investigation, the attorney will attempt to determine what the debtor entity has in the way of assets and liabilities, and what outstanding security interests the debtor may have, so he can write a knowledgeable report and make proper recommendations to the creditor or forwarder. He will also attempt to resolve any disputes amicably. If possible, when a debt is acknowledged or confirmed by a debtor but the debtor is unable to make a lump sum payment, the attorney will try to arrange a payout program, subject to client's approval, backed up by a signed promissory note or stipulation for judgment. An initial report or recommendation is then submitted to claimant; this usually occurs within two weeks to thirty days from the receipt of claim. If the attorney is unable

to obtain a voluntary payment or a payment schedule, and he believes suit will be effective in bringing about collection of the claim, he will then submit suit requirements to the creditor. An attorney will not file any legal proceeding without written authorization from the claimant. If suit is deemed necessary, the attorney will request court costs, a suit fee or retainer, an affidavit and other supporting documentation to substantiate the claim, before the suit is drafted.

What Will an Attorney Need in the Way of Court Costs? While costs and procedures differ materially from state to state, attorneys will usually request sufficient sums to cover expenses for such things as the filing fee, service of the summons and complaint, costs for the entry of judgment, writ of execution, abstract of judgment, the marshal's or sheriff's costs, and jury fees if a jury has been requested. These costs must be advanced by the creditor, and may be recoverable if the creditor gets a judgment against the debtor. At the conclusion of any case the prevailing attorney will submit an accounting of cost expenditures to the court and those costs will be included, together with interest, in the amount of the judgment granted by the court.

All monies advanced for costs are trust funds. Thus, at the conclusion of the case, a full accounting should be furnished to the client. The unexpended portion will be refunded in full, as will any costs recovered from the debtor. Recovered costs are deemed to be the property of the claimant and are not subject to attorney's commissions. Where monies are collected in excess of the principal amount of a judgment, the excess funds should first be allocated as a recovery of court costs. Only when

costs have been recovered in full should additional monies collected be deemed interest and subject to commissions, unless specifically prohibited by local statute.

What Is a Suit Fee? A suit fee is a charge by the attorney for the filing of the suit and following through with the litigation on the creditor's behalf. It is usually determined by a combination of factors like: What will the attorney have to do in the way of drafting legal documents or rendering of legal opinions? What is the attorney's past experience with the debtor? What is the nature of the action which is being undertaken? How large is the size of the claim? What is the dispute of the debtor and what is the attorney's appraisal of the validity? What is the expectation of going through a trial? The ultimate collectability of the claim may also be a determining factor in the amount of the suit fee. In the instance an attorney definitely recommended that a client not institute a suit but, as a matter of principle, the client has decided to go forward in any event, the attorney in order to assure himself of adequate compensation for his services will have to charge a retainer or increase his suit fee knowing that an ultimate recovery may be negligible.

A suit fee is not earned by the attorney until such time as the suit has been filed with the court. The mere preparation of the complaint and supporting documents is not sufficient to earn a suit fee. However, it is not actually necessary to have served the debtor or to recover a judgment before the attorney is entitled to take the suit fee. Most suit fees are non-contingent and advanced by the creditor at the time that the costs are submitted to the attorney for the commencement of suit. The term "non-contingent suit fee"

means that it is money "up front" and has nothing to do with the actual collection of the account. It is a fee for the legal work. In other words, the attorney is entitled to the suit fee regardless of the outcome of the case.

As a rule of thumb, you can expect attorneys to request a suit fee ranging from five to ten percent of the amount of the claim. In some instances attorneys may make their suit fee totally contingent upon collection or they may hedge a little bit by making a portion of the suit fee non-contingent up front with the balance of the suit fee contingent upon collection. In still other situations an attorney may waive suit fee entirely but request an increased commission contingent upon collection.

What Papers Are Necessary to Commence a Suit? Initially an attorney will usually require that the creditor submit all documentation that substantiates the claim, like an affidavit from the creditor, invoices and a statement of the account. It is also helpful for the attorney to receive any letters or memoranda that show that the defendant at one time or another acknowledged the claim or even letters that set forth the debtor's disputes. Other available papers such as written orders or proof of delivery may be needed if the debtor/defendant contests the action. (If a contested lawsuit goes to trial, the claimant may also be required to supply a witness who can testify as to the validity of these documents.)

Many attorneys require that the creditor sign an assignment of the claim. This may cause the creditor to fear relinquishing his rights against his debtor. There should be no cause for concern. The assignment, in fact, is for the creditor's benefit and helps speed the legal process. The attorney does not

intend to take any proprietary interest in the claim, but rather to utilize the assignment to avoid the necessity of sending all the legal papers back to the creditor for signing and notarization each time a new pleading must be filed. The assignment is usually made to the attorney's secretary who can then sign all the pleadings as they are drafted. Furthermore, the assignment has some limited strategic value as the suit is brought in the secretary's name (although the creditor's name is included in the body of the suit) and a debtor cannot file a cross action seeking affirmative relief against the creditor without first searching him out and serving him, which may be very difficult if an out-of-state creditor is involved.

What Happens in the Course of a Lawsuit? It's very much like a chess game: strategy, intrigue, thrust and parry, which is all started by someone instituting a lawsuit. The party starting the action is known as the plaintiff. The party who is sued is known as the defendant. The suit is started by the filing of a complaint and the issuance by the court of a summons.

The summons is a simple document which says, in effect, that the defendant has been sued and to appear in the action and file an answer if he wishes to plead a defense. Otherwise, the summons warns him, judgment will be rendered against him for the sum stated in the complaint together with costs and the interest running from the date pleaded in the complaint.

The Complaint in broad allegations states the facts and reasons for the action. In the commercial field there is usually a simple allegation that the defendant is being sued for monies owed, for goods sold and delivered, or

for work, labor or services which were rendered to the defendant.

The defendant is served with the summons and complaint. In other words, a copy of the documents is left with him. If the defendant is a corporation, the service is upon an officer of the firm. If the defendant is an individual, he personally should receive the documents. However, if personal service cannot be effected, there is a provision for what is called "substitute service" against individuals and corporations. This is accomplished by leaving the papers with an agent or person apparently in charge of the business premises or with a member of the defendant's household who is over the age of eighteen. These individuals are advised of the nature of the papers which they are being given and then the serving party must also mail a copy of the papers to the named defendants at the address. Additionally, in rare circumstances, where no one is available to receive service of process, service may be made upon the Secretary of State's Office, or if a party is located out of state, the papers can be sent to that local marshal or sheriff for personal service there. If a defendant does not file an answer within a specified period of time, then the claimant can obtain a judgment by default.

What is a Writ of Attachment?

Obtaining a writ of attachment is a temporary method of protecting a creditor's interest. If a writ of attachment is granted the defendant's ability to use and dispose of the personal property is restricted or may be entirely taken out of his control during the pendency of the litigation. It is a procedure that is sometimes valuable to a claimant and which prevents the debtor from disposing of his assets or placing them out of the reach of the creditor. However, attachment proceedings

generally are allowed only under certain well-defined instances and may involve substantial costs. The plaintiff has the burden of proof to show the court that he has a valid claim that will be established at the time of trial.

What If the Suit is Contested? The debtor/defendant can retain an attorney who will interpose an answer to the complaint. The answer is a formal document in which the defendant sets forth his side of the story. Usually the defendant will enter a general denial which merely says that he is denying everything and forcing the plaintiff to prove every single allegation raised in the complaint. Additionally, it should be noted that a defendant can file a cross-complaint against the creditor. This is like a new suit that the debtor has against the creditor, and it usually asks for affirmative relief alleging that the creditor owes the debtor more money than the debtor owes the creditor. In this case it is the creditor who must now submit an answer to avoid the defendant getting a judgment. As stated, a cross-complaint is like a separate lawsuit. Because of the additional work involved and the additional exposure that the attorney must protect the creditor from, it is usually handled with a separate fee arrangement. However, as a practical matter, few cross-complaints are ever filed. Once an answer is interposed, the case is considered "at issue". The next step then is to clarify just what those issues are.

The debtor's attorney can make a demand for a Bill of Particulars which the creditor must respond to within ten days. This Bill of Particulars asks questions like: What was the agreement? Who entered into it and when? Was the agreement written or oral? What was sold? What work was done? What was

the price involved? When was the work done? When was the merchandise supposedly delivered? Was there a demand for payment? Did anybody send any billings? Were any credits ever extended? The creditor then answers these questions and they are set forth in the completed Bill of Particulars.

The creditor also has some "discovery weapons" in his arsenal to launch at the debtor/defendant. The plaintiff can serve the defendant with a document called a "Demand to Admit or Deny". In this document certain facts are alleged. The defendant is given a specified time to advise the plaintiff whether or not he admits those facts are true; if admitted, those factual issues are then resolved. If enough of the facts are admitted, the plaintiff may be able to establish his case at that point and will then file a Motion for Summary Judgment.

The Motion for Summary Judgment is a request to the court for judgment without the necessity of the case going to trial, based on the grounds that there are not triable issues or no defense to the complaint. However, as a practical matter, judges are very reluctant to grant a summary judgment unless it is very clear that there is no defense to the action or that the defendant is really just putting forward a sham or attempting to delay the ultimate judgment. Most judges prefer adhering to the American tradition of allowing a party to have his day in court. Therefore, if there is any question at all as to a probable defense or an issue of fact to be resolved, the request for the summary judgment will be denied and the debtor will be allowed to proceed with the trial of the matter.

Another pre-trial procedure is known as a deposition. This is an oral examination which is recorded by a

court reporter and subsequently put into writing and sworn to by the witness before a notary public. This procedure is used to clarify the issues and to memorialize testimony for the trial which is to be held at a later date. This secures needed testimony of a witness who later, at the time of trial, may no longer be in the area, or may be unavailable to testify, or who may even be dead. The debtor's attorney can examine the claimant to ascertain some additional information and the creditor's attorney can examine the debtor as to his defenses.

What Actually Goes On On the Day of Trial? It should be noted that many cases are settled on the courthouse steps on the day of the trial. Typically, the parties are required to appear first thing in the morning before a presiding judge whose job it is to assign various cases to different trial courts. Each attorney will be required to advise the presiding judge whether or not they are ready with their witnesses and able to go forward with the trial on that day. The attorneys must also advise the judge of their time estimate as to how long it will take them to put on the case. Based upon this information, and the judge's knowledge as to what is already going on in any particular courtroom hearing, the presiding judge will assign the litigants to an actual trial court.

Once in the trial courtroom, the trial judge may request an in-chambers meeting with both attorneys before the start of the trial. This is to afford the actual trial judge an opportunity to briefly review the pleadings in the file and talk to the attorneys about the prospects of settlement. He may even give the attorneys his impressions and recommendations relative to a settlement. Some cases are settled at that juncture because an attorney hears the

judge's comments and figures a "reasonable" settlement at that time is better than an adverse decision later. However, if no settlement can be reached the matter will go forward to trial.

A trial follows well-defined procedures and is usually very formal. The plaintiff starts out by making an opening statement telling what he intends to prove. As he attempts to build his case he will call witnesses to the stand to be sworn and to testify as to the facts. When the attorney asks questions to establish his case, this is called "direct examination". After each witness has been examined the other attorney has an opportunity to ask questions and this is called "cross-examination". The scope of the questions asked in the cross-examination is limited to the testimony which is given in the direct examination. Anything else that the opposing attorney wants to get into the case from that witness, he will have to get by recalling the witness later when he presents his case. If during the cross-examination the opposing attorney has rattled the witness, or confused him, or perhaps hurt the plaintiff's case by some of the questions, then the plaintiff's attorney has an opportunity to clarify, or straighten out, or repair the damage next by a procedure called "redirect examination". After all the plaintiff's witnesses have been called and testified, and all the evidence establishing the claim has been introduced, plaintiff will then summarize his case and tell the court that the plaintiff "rests". It is then the defendant's opportunity to present their case in the same order by calling their witnesses, proceeding with direct examination, and introducing opposing evidence. These witnesses are then cross-examined by the plaintiff and the defendant can redirect if it is needed.

The defendant then makes his closing statements. Thereafter it is up to the judge or the jury to decide the issues and to render a decision.

In Presenting the Creditor's Case a Plaintiff has About Five Basic Elements to Establish in Order to Put on What is Called a "Prima Facie" Case. The creditor must show: (1) that he received the order, (2) that there was a price for the order stated and agreed upon, (3) that he delivered the order, (4) that he made demand for payment, and (5) that he has not been paid. If these elements are not proved by the plaintiff when he presents his case, the defendant may ask the court to dismiss the case and for judgment in his favor.

At any time prior to the rendering of a decision the attorneys, and the court itself, may make additional attempts to settle the case. In some instances cases are settled during the course of a trial, at a recess period, after both sides have had an opportunity to hear the testimony and realize the impact of strengths and weaknesses of the other's case. A settlement finalizes the action and releases the debtor from any more than the agreed upon amount.

If a judgment is rendered, the losing party has a right to appeal to a higher court. However, from a practical standpoint, in terms of expense and results very few commercial collection cases are ever appealed. If the trial goes through to a conclusion, the next step is to have the judgment entered.

We just covered the contest of a claim through the actual trial. Frankly, in the majority of commercial collection cases, the debtor/defendant neither obtains an attorney to represent him, nor does he file an answer.

Consequently, after the expiration of the time allowed to the defendant to file

an answer to the creditor's complaint, the plaintiff may simply apply to the Court for a judgment against the defendant. This is called a Request to Enter Default Judgment.

The plaintiff, in order to obtain the judgment by default, must file an affidavit with the Court swearing that the amount sued for is justly due and owing, and he must attach some evidence of the indebtedness, i.e., a copy of the statement of account, or the invoices that make up the account. The Request to Enter Default, in essence, also represents to the Court that the debtor/defendant has not taken issue with the allegations in the complaint, therefore, there is no dispute for the Court to hear or determine and judgment should be granted to the plaintiff without further ado.

If the creditor's complaint is for merchandise sold or for services rendered to the defendant, the Court clerk will not require the plaintiff to come into Court and establish his case. The clerk will rely on the sworn documents filed with the Court. The clerk will check to see that the plaintiff gave notice to the debtor that the plaintiff would request a default judgment. The clerk will then review the complaint for the amount claimed due, compute the interest, figure in the costs expended in the suit, and enter a judgment by default against the defendant. In certain limited situations, the clerk may ask the plaintiff to appear in Court, before a judge, and actually establish the basis of the indebtedness before a default judgment is granted.

What Is a Judgment? The judgment is the court decree determining the amount due from the losing party to the winning party. Hopefully the winning party is the creditor. The judgment then becomes part of the permanent court records.

What Is An Abstract? An abstract is a record of the judgment that is then filed with the County Registrar of Deeds in any county where the defendant may have property. This creates a lien on any of the judgment debtor's property in that county for a specified number of years.

What Is an Execution? If the judgment is not paid then an execution follows. The execution is the order of the court directing the sheriff or another court officer, like the marshal, to seize the defendant's property to satisfy the judgment that has been rendered.

What Is a Levy? A levy is the process by which the sheriff or another court officer acquires possession and control over the judgment debtor's property to satisfy the judgment. The most common levies seen in collection cases are levies against a judgment debtor's bank account or wages. The marshal charges a fee for each levy. If property, other than cash, is seized by putting a marshal's keeper on the debtor's premises, the property must be removed from the premises, stored, advertised for sale and ultimately sold at public auction with the proceeds going to the judgment creditor. Needless to say this procedure is extremely expensive. The costs, while ultimately recoverable from the defendant, must be paid by the creditor. Therefore, in most instances a levy and sale will take place only in cases where substantial amounts of money and property are involved.

If there is no property of the judgment debtor available for seizure the court officer returns the execution papers to the court marked "Unsatisfied". In that instance the creditor must then look to other avenues of approach to recover his money. However, if the judgment has been paid, a document entitled "Satisfaction of Judgment" must be filed with the court.

If a creditor does not know what kind of property the debtor has to levy on, the creditor can resort to supplementary proceedings. These proceedings provide that the judgment creditor may, by a court order or by subpoena, direct the judgment debtor to appear in court and answer questions under oath relating to his property and his ability to pay. These proceedings are often referred to as "ORAPS" which stands for "Order for Appearance". The information that the creditor's attorney obtains from the defendant during the course of an ORAP can then be used to determine what kind of payment arrangement the debtor can live with or what assets he has which can be levied upon. The judgment debtor may not refuse to answer any reasonable questions relating to his assets or his employment. If he fails to respond to any question the attorney can obtain an immediate order from the court compelling the debtor's response.

If a judgment debtor attempts to ignore the court order which is personally served on him, requiring his appearance in court, the judge will issue a bench warrant to the marshal's office directing that the individual be arrested and brought before the court. He will then be required to post a bond to assure his future appearance to respond to questions. In some judicial districts, when the debtor appears for the next judgment debtor examination, the bond posted by the debtor will be turned over to the creditor in partial satisfaction of the judgment.

Judgment debtor examinations have been especially useful to attorneys in uncovering concealed assets which can be seized to satisfy a judgment or in finally determining that the judgment defendant has no assets with which to satisfy the judgment and that the

judgment is uncollectible. In the latter instance at least the attorney can write a definitive letter to the creditor recommending that the matter be charged off as a loss for tax purposes and that the file be retired.

What Else Is Helpful to Know about Pursuing a Commercial Claim?

In many instances, the creditor is located a substantial distance from the debtor's locale, and the long-distance nature of the attorney-client relationship dictates some special circumstances. The attorney should keep the client advised by sending written status reports on a regular basis. To avoid unnecessary inquiries, the attorney should advise the creditor how far ahead to advance their file for a further report. The client, for his part, can help speed along the proceedings by replying promptly and completely to the attorney's requests for information and documentation.

In general, it is not a good idea to forward original documents to the attorney unless they are requested. However, it is certainly helpful to equip the attorney from the very outset with photocopies of pertinent documentation and full information as to the circumstances surrounding the debt and any known disputes.

In some instances, the attorney may be authorized to settle a claim by accepting a return of merchandise. This usually results in a special fee arrangement in line with the value of the merchandise returned and the amount of credit granted by virtue of the return.

At any point along the way in the course of a commercial case, the collection process may be hampered by some form of insolvency proceedings. These may take the form of a bankruptcy petition (which acts as an automatic stay

against further action by a creditor), an assignment for the benefit of creditors (wherein a debtor assigns all of his assets to an independent third party for the purpose of liquidation), or a state court receivership (similar to bankruptcy). In any of these instances, it is important to protect the rights of the creditor by the timely filing of a proof of claim.

Thereafter, there is usually little to be done on the creditor's behalf other than to continue to monitor the situation and wait for the results of the proceedings.

Hopefully, armed with the knowledge you have gained from this pamphlet, you will better understand the nature and course of a commercial collection lawsuit.

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