

I. IMPLEMENTING SOLID IN-HOUSE COLLECTION STRATEGIES

by D. Brent Wells

A. Why Knowing the Debtor is Critical

Properly identifying and evaluating the party or parties responsible for payment of the debt sought to be collected is critical. Since time is of the essence in collection of debts, any time spent pursuing recovery from strangers to the transaction is not only wasteful; it is counter-productive because valuable time has been lost in pursuing those truly responsible. A competing consideration is the need to pursue recovery from all parties potentially responsible since ultimate collectibility may be a function of perfecting a judgment against the one party having leviable, non-exempt assets—and that party may not have been the obvious primary obligor. Hopefully, the true debtor(s) have been identified at the commencement of the relationship, and carefully evaluated for creditworthiness.

One of the most important up-front credit intake considerations is knowing your debtor, and that includes gaining as much insight as possible concerning that debtor's business and financial wherewithal. A good credit application and credit intake protocol are worth their weight in gold! In practice, however, the strong motivation to close the sale at the earliest moment often results in a missed opportunity to assemble the ideal credit dossier on the customer—at a time when they would be most likely to share the information we will wish we had once a collection problem develops. The credit side of the transaction has a tendency to get the short shrift. Commercial creditors of all types and sizes are not always as careful as they should be about knowing with whom or what they are dealing. Accounts or contracts are often referred for collection through the Court system simply designated by the name of a debtor-business, without the creditor having any real awareness of the form or "composition" of the debtor's business organization.

Determining whose creditworthiness legally matters is crucial to the due diligence supporting the decision to extend business credit. Life was so simple when only proprietorships, partnerships, and corporations were the available entities. But with the advent of L.P.'s, L.L.P.'s, and L.L.C.'s, a much more complex analysis became required.

In the 2003 Texas Legislative Session, the various statutes regulating the different forms of business organization were brought together and codified in a single new Texas Business Organizations Code, which is quoted liberally below to illustrate the concepts. The new Code, which took effect January 1, 2006, only applies immediately to domestic entities formed on or after that date, and foreign filing entities registering with the Secretary of State to transact business in Texas on or after that date, with the precursor statutes still regulating pre-Code entities. Pre-Code entities may optionally adopt the new Code, if they choose, but by January 1, 2010, it will apply comprehensively, even to pre-Code entities. The new Code is a much more logical and straightforward elucidation in modern American English than previously existed. You may want to have online searchable access to the entire Business Organizations Code, which can be found at <http://www.capitol.state.tx.us/statutes/bo.toc.htm>.

1. **Who Is the Customer?**

a. **Proprietorship**

A proprietorship is legally identical to its individual owner.

b. **Partnership**

A partnership is an association of two or more parties to operate, as co-owners, a business for profit.

§ 1.002. Definitions

(34) **“General partnership” means a partnership governed as a general partnership under Chapter 152. The term includes a limited liability partnership.**

§ 152.051. Partnership Defined

(b) **Except as provided by Subsection (c) and Section 152.053(a), an association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether:**

- (1) **the persons intend to create a partnership; or**
- (2) **the association is called a “partnership,” “joint venture,” or other name.**

c. Corporation

A corporation is a creature of statute that has an independent legal existence as a person, separate and apart from its shareholders, if the requisite statutory formalities are followed.

§ 1.002. Definitions

- (14) **“Corporation” means an entity governed as a corporation under Title 2 or 7. The term includes a for-profit corporation, nonprofit corporation, and professional corporation.**

d. Limited Partnership

A limited partnership is a form of partnership, created by statute, which has two types of partners: general partners who have duties and liabilities similar to a general partnership, and limited partners who do not, but instead are more like shareholders of a corporation.

§ 1.002. Definitions

- (33) **“General partner” means:**
- (A) **each partner in a general partnership; or**
 - (B) **a person who is admitted to a limited partnership as a general partner in accordance with the governing documents of the limited partnership.**
- (49) **“Limited partner” means a person who has been admitted to a limited partnership as a limited partner as provided by:**
- (A) **in the case of a domestic limited partnership, Chapter 153; or**
 - (B) **in the case of a foreign limited partnership, the laws of its jurisdiction of formation.**

e. Limited Liability Partnership

- i. Available in Texas since 1991.
- ii. With the exception of the liability limitations discussed below, an LLP is treated as a general partnership.

- iii. The partnership name must reflect LLP status.
- iv. The partnership must file a registration with the Secretary of State identifying the name of the partnership, the address of its principal office, the number of partners, and a brief statement of its business.
- v. Under the Texas statute, \$100,000 of liability insurance must be obtained, or \$100,000 bond must be posted for satisfaction of tort liabilities.

§ 1.002. Definitions

- (48) **“Limited liability partnership” means a partnership governed as a limited liability partnership under Title 4.**

f. Limited Liability Company

- i. Available in Texas since 1991.
- ii. A creature of statute very similar to a limited partnership, except that an LLC need not have a general partner; all of the members of an LLC enjoy the protections of the shareholders of a corporation.
- iii. One or more organizers must file articles of organization with the Secretary of State, much like articles of incorporation.
- iv. The name of the entity must reflect LLC status.

§ 1.002. Definitions

- (46) **“Limited liability company” means an entity governed as a limited liability company under Title 3 or 7. The term includes a professional limited liability company.**

§ 101.251. Membership

The governing authority of a limited liability company consists of:

- (1) **the managers of the company, if the company’s certificate of formation states that the company will have one or more managers;**
or
- (2) **the members of the company, if the company’s certificate of formation states that the company will not have managers.**

2. Who Is The Debtor?

a. Proprietorship

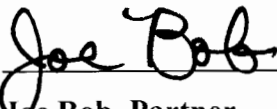
The individual proprietor is personally liable for the debts of the proprietorship.

b. Partnership

All partners in a Texas general partnership are liable jointly and severally for all debts and obligations of the partnership (including liabilities arising from harmful acts or omissions by a fellow partner).

BOB PARTNERSHIP: Joe Bob and Billy Bob

BOB PARTNERSHIP

By: 
Joe Bob, Partner

Joe Bob and Billy Bob are both debtors

§ 152.301. Partner as Agent

Each partner is an agent of the partnership for the purpose of its business.

§ 152.302. Binding Effect of Partner's Action

- (a) Unless a partner does not have authority to act for the partnership in a particular matter and the person with whom the partner is dealing knows that the partner lacks authority, an act of a partner, including the execution of an instrument in the partnership name, binds the partnership if the act is apparently for carrying on in the ordinary course:
- (1) the partnership business; or
 - (2) business of the kind carried on by the partnership.
- (b) An act of a partner that is not apparently for carrying on in the ordinary course a business described by Subsection (a) binds the partnership only if authorized by the other partners.

- (c) A conveyance of real property by a partner on behalf of the partnership not otherwise binding on the partnership binds the partnership if the property has been conveyed by the grantee or a person claiming through the grantee to be a holder for value without knowledge that the partner exceeded that partner's authority in making the conveyance.

§ 152.303. Liability of Partnership for Conduct of Partner

- (a) A partnership is liable for loss or injury to a person, including a partner, or for a penalty caused by or incurred as a result of a wrongful act or omission or other actionable conduct of a partner acting:
 - (1) in the ordinary course of business of the partnership; or
 - (2) with the authority of the partnership.
- (b) A partnership is liable for the loss of money or property of a person who is not a partner that is:
 - (1) received in the course of the partnership's business; and
 - (2) misapplied by a partner while in the custody of the partnership.

§ 152.304. Nature of Partner's Liability

- (a) Except as provided by Subsection (b) or Section 152.801(b), all partners are liable jointly and severally for a debt or obligation of the partnership unless otherwise:
 - (1) agreed by the claimant; or
 - (2) provided by law.
- (b) A person who is admitted as a partner into an existing partnership does not have personal liability under Subsection (a) for an obligation of the partnership that:
 - (1) arises before the partner's admission to the partnership;
 - (2) relates to an action taken or omission occurring before the partner's admission to the partnership; or
 - (3) arises before or after the partner's admission to the partnership under a contract or commitment entered into before the partner's admission.

§ 152.305. Remedy


An action may be brought against a partnership and any or all of the partners in the same action or in separate actions.

c. Corporation

When a creditor elects to do business with a corporation, it is transacting with that fictional legal entity alone, and the shareholders of the corporation will not be liable for its debts.

BOB CORPORATION: Joe Bob and Billy Bob

BOB CORPORATION

By: 
Joe Bob, President

Only the corporation is a debtor

§ 21.107. Liability of Shareholder

The existence of or a performance under a shareholders' agreement authorized by this subchapter is not a ground for imposing personal liability on a shareholder for an act or obligation of the corporation by disregarding the separate existence of the corporation or otherwise, even if the agreement or a performance under the agreement:

- (1) treats the corporation as if the corporation were a partnership or in a manner that otherwise is appropriate only among partners;
- (2) results in the corporation being considered a partnership for purposes of taxation; or
- (3) results in failure to observe the corporate formalities otherwise applicable to the matters governed by the agreement.

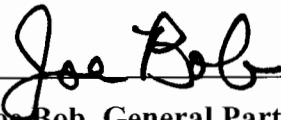
d. Limited Partnership

In a limited partnership, the limited partners are not personally liable for the debts of the partnership, while a general partner will be.

BOB PARTNERSHIP, LTD.:

Joe Bob, General Partner, and Billy Bob, Limited Partner

BOB PARTNERSHIP, LTD.

By: 
Joe Bob, General Partner

Joe Bob and the partnership are debtors, but Billy Bob is not

§ 153.102. Liability to Third Parties

- (a) A limited partner is not liable for the obligations of a limited partnership unless:
 - (1) the limited partner is also a general partner; or
 - (2) in addition to the exercise of the limited partner's rights and powers as a limited partner, the limited partner participates in the control of the business.
- (b) If the limited partner participates in the control of the business, the limited partner is liable only to a person who transacts business with the limited partnership reasonably believing, based on the limited partner's conduct, that the limited partner is a general partner.

§ 153.152. General Powers and Liabilities of General Partner

- (a) Except as provided by this chapter, the other limited partnership provisions, or a partnership agreement, a general partner of a limited partnership:
 - (1) has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners; and
 - (2) has the liabilities of a partner in a partnership without limited partners to the partnership and to the other partners.
- (b) Except as provided by this chapter or the other limited partnership provisions, a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to a person other than the partnership and the other partners.

e. **Limited Liability Partnership**

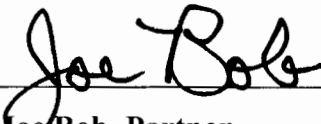
In an LLP, the general partnership rule that all partners are liable jointly and severally for all debts and obligations of the partnership is modified to shield innocent partners from personal liability created by another partner's errors, omissions, negligence, incompetence, or malfeasance, in which they did not participate; however, with respect to contractual debts, the general partnership rule may apply in some states. In Texas, since 1997, a partner in an LLP is not individually liable for contractual debts and obligations of the partnership incurred while it is an LLP.

LLP = Liability Like a Partnership

(in some states)

BOB PARTNERSHIP, L.L.P.: Joe Bob and Billy Bob

BOB PARTNERSHIP, L.L.P.

By: 
Joe Bob, Partner

Joe Bob and Billy Bob are both debtors

(in some states, but not in Texas since 1997)

§ 152.801. Liability of Partner

- (a) Except as provided by Subsection (b), a partner in a limited liability partnership is not personally liable, directly or indirectly, by contribution, indemnity, or otherwise, for a debt or obligation of the partnership incurred while the partnership is a limited liability partnership.
- (b) A partner in a limited liability partnership is not personally liable for a debt or obligation of the partnership arising from an error, omission, negligence, incompetence, or malfeasance committed by another partner or representative of the partnership while the partnership is a limited liability partnership and in the course of the partnership business unless the first partner:

- (1) was supervising or directing the other partner or representative when the error, omission, negligence, incompetence, or malfeasance was committed by the other partner or representative;
- (2) was directly involved in the specific activity in which the error, omission, negligence, incompetence, or malfeasance was committed by the other partner or representative; or
- (3) had notice or knowledge of the error, omission, negligence, incompetence, or malfeasance by the other partner or representative at the time of the occurrence and then failed to take reasonable action to prevent or cure the error, omission, negligence, incompetence, or malfeasance.

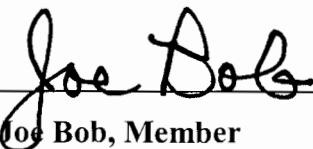
f. **Limited Liability Company**

All member-owners of an LLC are shielded from liability for the company's debts, just like shareholders of a corporation.

LLC = Liability Like a Corporation

BOB LIMITED LIABILITY COMPANY: Joe Bob, Member, and Billy Bob, Member

BOB LIMITED LIABILITY COMPANY

By: 
Joe Bob, Member

Only the L.L.C. is a debtor (not Joe Bob or Billy Bob)

§ 101.113. Parties to Actions

A member of a limited liability company may be named as a party in an action by or against the limited liability company only if the action is brought to enforce the member's right against or liability to the company.

§ 101.114. Liability for Obligations

Except as and to the extent the company agreement specifically provides otherwise, a member or manager is not liable for a debt, obligation, or liability

of a limited liability company, including a debt, obligation, or liability under a judgment, decree, or order of a court.

3. **Who Do We Make Demand Upon (and Sue)?**

a. **True Names vs. Assumed Names**

i. Each of the above-mentioned forms of business organization will have a true legal name, but may choose to do business under an assumed name, which may or may not bear any resemblance to the true name.

ii. Registration of an assumed name does not create an entity, but simply puts the world on notice of a party's decision to use a fictitious name.

iii. Any entity may sue or be sued in its assumed name.

iv. The entity behind the assumed name, and the parties who are debtors for that type of entity, may be sued for the debt created in the transaction.

b. **Undisclosed Principals**

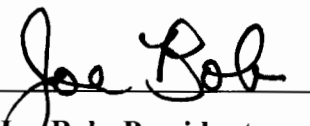
i. An undisclosed principal is liable for debts created by its agent if the agent is acting within the scope of authority, and may be liable even when the agent acts without authority if the principal retains the benefits of the transaction.

ii. While the creditor may pursue undisclosed principals (and the parties who are debtors for that type of entity) for collection of debts, the putative agent may not hide behind principals who are undisclosed.

XYZ CORP. D/B/A JOE'S LIQUOR STORE

JOE'S LIQUOR STORE

By: _____


Joe Bob, President

*Joe Bob can be a debtor (as well as XYZ Corp.)
because the true principal has not been disclosed*

c. Agents

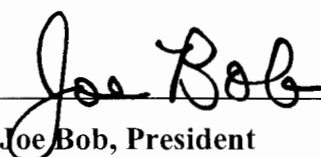
i. As a general rule, agents, or persons who with authority act for another who is their principal, are protected from personal liability for debts undertaken through their agency.

ii. However, this general rule visiting liability for debts on the principal while shielding the agent, only applies (1) if the representative capacity of the agent is well documented and (2) if the true principal is well disclosed. If an agent would avoid personal liability, he has the duty to disclose not only that he is acting in a representative capacity, but also the identity of his principal; the creditor with whom the agent deals has no duty to discover the principal. See *SouthwesternBell Media, Inc. vs. Trepper*, 784 S.W. 2d 68, 72 (Tex. App. - Dallas 1989, *no writ*).

iii. The same rule of personal liability will apply if the principal that is named is non-existent, such as, for example, a corporation which has lost its charter prior to the time of the transaction. An agent does not escape liability by purporting to act for a non-existent principal. See also §171.255, Texas Tax Code, for the personal liability of directors and officers associated with a corporation's forfeiture of corporate privileges in connection with failure to pay or account for state franchise taxes.

XYZ CORP. D/B/A JOE'S LIQUOR STORE

XYZ CORP.

By: 
Joe Bob, President

Joe Bob can be a debtor if XYZ Corp. lost its corporate charter before this contract was signed

iv. For the purpose of disclosing the true principal, it is not sufficient to protect the purported agent that an assumed name of the principal is used. It is incumbent upon the agent to protect himself by disclosing the true principal. It is not

incumbent upon the creditor to research assumed name records to discover connections between names and entities.

d. Guarantors

i. Persons or parties who would not otherwise be liable for a primary undertaking of liability for debt, may nonetheless be made liable contractually for the debt, increasing the number of obligors. Payment guaranties, which are drawn to make the guarantor's liability coextensive with the primary obligor's, create joint and several liability.

ii. With the complete abolition of the Deprizio Rule in bankruptcy (as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, effective October 17, 2005), there is no reason not to take as many personal guaranties as you can get.

THE DEPRIZIO RULE IS DEAD:

TAKE AS MANY GUARANTIES AS YOU CAN GET!

iii. Guaranties must be in writing and signed to be enforceable.

e. Changes in Composition

i. Each debt transaction stands on its own for purposes of establishing who has liability at that time. Liability for a given debt transaction cannot be altered after-the-fact by merely reorganizing a business. The new form of business entity can only affect liability implications of transactions going forward.

ii. To protect yourself fully, you must know who your debtor is at all times. The creditor has the practical burden of maintaining such knowledge; however, as indicated above, the debtor has the legal burden associated with failing to adequately disclose the information to the creditor at any point.

iii. The Texas Assumed Business or Professional Name Act (Chapter 36, Tex. Bus. & Comm. Code) requires parties doing business under assumed names to register publicly. The same statute requires new assumed name certificates to be filed when material changes in information occur, such as a change in the name, identity,

entity, form of organization, or location of a registrant. Violation of this statute does not change the rules of liability for civil debt set out above, but does carry a criminal fine of up to \$2,000. Debtors would be well advised to keep their assumed name filings up to date and their creditors well informed as to their true status at all times. But they don't.

B. Key Differences Between Consumer and Business Debt

Both Texas and federal law are much more protective of individual consumers than they are of business debtors during the collection process. It is an important distinction to make because of the potential application of the federal Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. §§1692 - 1692o and/or the Texas Debt Collection Act, §392.001, *et seq.*, Tex. Fin. Code. Both statutes are triggered in the case of “consumer” debts, which are “primarily for personal, family, or household purposes.” While the FDCPA generally is only applicable to third-party debt collectors attempting to recover consumer debts, such as collection agencies or collection attorneys, the Texas Act includes within its concept of “debt collector,” subject to the statutory strictures and penalties, the *creditor itself* collecting its own claims.

Is the debtor an individual, natural person? Debts incurred by statutory business entities are always business debts, but debts incurred by individual, natural persons may be either consumer or business obligations.

Is the individual’s debt incurred “primarily for personal, family, or household purposes?” The answer is no if the obligation arises from a personal guaranty of a business entity’s credit transactions. The answer is also no if the obligation arises from a credit transaction associated with the business activities of a sole proprietorship. See *Beaton v. Reynolds, Ridings, Vogt & Morgan*, 986 F. Supp. 1360 (W.D. Okla. 1998). But the line of distinction can become blurry if the consideration for the debt is not clearly understood to be outside of the “personal, family, or household” rubric. For example, a credit card held in the name of an individual may be used to buy office supplies for a proprietor’s business, but it may also be used to buy the individual’s groceries. The credit card company would be well advised to treat the unpaid credit card balance as a “consumer” debt to which the FDCPA and the Texas Act will apply. What about a commercial bank loan secured in part by a mortgage lien on the proprietor’s personal residence? Or what about the mortgage debt on a residence that is subsequently converted to business rental property? When in doubt, you should always err on the side of treating the claim as a “consumer” debt. There are no adverse legal consequences associated with erroneously treating a business debt as if it were

a consumer debt. But there are serious adverse consequences, including the debt collector's liability for statutory damages and penalties, associated with erroneously treating a consumer debt as if it were a business debt (and therefore ignoring the FDCPA and Texas Act when they are actually applicable).

Be sure to give due deference to Chapter V of the material for this program. Ten-day demand letters that threaten suit in the event of non-payment are routine when the claim is a business debt. However, the routine ten-day demand letter is a blatant violation of the FDCPA when the claim is a consumer debt to which the FDCPA applies.

C. Factors in Deciding Whether to Pursue Collection

1. Costs vs. Benefits

When litigation is necessary to collect a debt, use of an attorney to pursue judgment and/or recovery is inevitable. In planning for collection litigation, the attorney and the creditor should consider fee arrangements to cover (1) the affirmative collection effort, (2) defense of any counterclaims that may be asserted, and (3) handling of appeals and bankruptcies that involve protecting the creditor's interest in collateral Courts. In any of these scenarios the fee may be based upon hourly billing, contingent fees and commissions, flat fees or percentage fees for progress in accomplishing certain stages or tasks such as filing suit, or some hybrid or combination of these various billing strategies. No one billing arrangement will necessarily be best for the creditor in every situation. For example, contingent commissions may make sense when the claims are small or voluminous, but may not make good sense when the claim is a large isolated problem involving a solvent, viable business debtor. And as in every other realm of service where quality matters, you get what you pay for. Legal services to collect debts are not fungible, and all attorneys are not equally effective or equally knowledgeable in this area of practice. The fee arrangement ultimately has to be beneficial for both the attorney and the client in order to work.

No matter how creative the collection lawyer and his or her client may be in devising fee arrangements, there is always the risk that attorneys' fees will be incurred that may not be recoupable. A claim may be reduced to judgment that is simply not collectible; or the law may not compensate the creditor to the full extent of actual attorneys' fee expense. For example, Chapter 38 of the Texas Civil Practice and Remedies Code permits the creditor's recovery of "reasonable" attorneys' fees in a contract or debt action, but the Judge and/or jury's determination of what constitutes a "reasonable" fee may be less than the actual out-of-pocket expense legitimately incurred by the creditor under the fee contract with its collection counsel. The risk that attorneys' fees may be incurred but never recovered must be factored into any decision to pursue collection.

Many collection cases present easy issues of investigating and locating the debtor, presenting a straightforward claim on an account, note, or contract, and then obtaining a judgment summarily or by default. However, when third-party resources must be employed to investigate or locate the debtor or its assets, expenses are incurred that will generally not be recoupable even if the collection case is entirely successful. Contracts signed by the debtor may provide that such collection expenses can be rolled into the principal claim, but very often they do not, or there is no written contract at all. If a case is complex enough to require consultants and/or expert witnesses to address key litigation issues such as reasonableness of expenditures, valuation of real or personal property, or performance/non-performance in specialized or technical areas, the costs of such consultants or experts must be considered as part of the costs of pursuing a recovery. Except in very limited circumstances, the cost of such litigation support is generally not recoverable, even by a completely successful litigating creditor.

No matter how simple the collection claim may be, the creditor's personnel must devote time and attention to documenting the claim and supporting the litigation effort. This "lost opportunity" cost for the creditor may be minimal when the claim is a \$5,000.00 invoice on an open account for which a default judgment is taken; but it may be very significant when a \$500,000.00 commercial claim is contested, counterclaims alleging \$2 million in damages are filed, extensive discovery is engaged over a period of two years or more, and testimony is needed over several days or even weeks for depositions and trial. Where your claim falls on the spectrum between these two extremes presents serious issues of non-recoverable internal costs that may not be readily quantified, but certainly impact the creditor's bottom-line.

Court costs and filing fees must be incurred at every step along the way in the formal litigation process. There will be initial filing fees, Citation and service fees and the costs of the serving authority, subpoena generation and service expenses, Court Reporter expense for taking and transcribing depositions, recording fees for recording Abstracts of Judgment, filing and service fees for initiating garnishments, and even Constable or Sheriff fees for levying execution on a judgment. While reimbursement of many of these Court

costs may be awarded to the creditor when a judgment is rendered, the creditor must always proceed with an awareness that such Court costs may never be recovered if the creditor is unsuccessful in winning a judgment or recovering the claim from the debtor.

While pre-judgment and post-judgment interest are theoretically available to reward the creditor for having to wait out a recovery, such interest very often falls far short of completely compensating the creditor for the time-value of the money involved. For example, under Texas law, open accounts will only earn pre-judgment interest at six percent (6%) per annum from the thirtieth (30th) day after the debt becomes due, if there is not an agreement between the debtor and creditor lawfully providing for a higher rate. Section 302.002, Tex. Fin. Code. Similarly, the statute governing post-judgment interest caps the rate at eighteen percent (18%) per annum in contract cases, even where the contract calls for a higher, lawful rate. Section 304.002, Tex. Fin. Code.

When all of the aforementioned quantifiable and non-quantifiable costs are taken into consideration, does it make sense to pursue the collection?

2. Collectibility vs. non-collectibility

The debtor's solvency is obviously a key factor in evaluating collectibility. Unfortunately, the creditor is often in the dark as to the debtor's true and complete financial condition at the time the collection problem develops. Obviously, one scenario of collectibility is envisioned when the debtor is a major corporation with \$50 million in net assets and a healthy monthly cashflow of \$1 million; quite another scenario is presented when the corporate debtor has no assets, owes \$500,000.00 in unsatisfied liabilities, and closed its doors to business six months ago. Where your claim falls on this spectrum of solvency is extremely critical in assessing your prospects for success. An important corollary is that "fresher" claims generally have better prospects for success. Even though the Texas statute of limitations for collection of debt, §16.004, Tex. Civ. Prac. & Rem. Code, is four years, the practical reality is that viability of a commercial collection claim drops off radically after six months of delinquency.

Corporate debtors are not entitled to exempt any property from the claims of their creditors, but they can commit their assets to the claims of particular creditors who are secured by liens. In a liquidation scenario, the secured creditors will enjoy their liens in their collateral, but the unsecured creditors may not find any assets left over for their consumption. Individual debtors have very liberal exemptions under Texas law, which can also take assets off of the screen for creditors. For example, Section 41.001 of the Texas Property Code exempts homestead property regardless of its value, and Section 42.001 of the Texas Property Code carves out \$30,000.00 worth of personal property for an individual or \$60,000.00 for a family. Obviously, if the individual debtor does not own any non-exempt property, it is not worth much for the judgment-creditor to have a million dollar judgment against him.

No matter how well documented the creditor's claim or cause of action might appear to be, no matter how obviously and justly owed the debt might seem, there is always the risk of losing contested litigation owing to the vagaries and uncertainties of Judges, juries, and other human elements in the litigation process. In cases where palpable defenses and counterclaims are presented, the likelihood of success on the collection claim is inversely proportional to the debtor's vigor and chances of winning on the countervailing issues. Some of the more popular defenses and counterclaims in collection cases focus on the creditor's failure to deliver the quantities or qualities of goods or services which the debtor would have anticipated in order to justify the charges incurred. There are plenty of opportunities under Texas law, such as the Texas Deceptive Trade Practices - Consumer Protection Act (DTPA), for a debtor to affirmatively complain and claim damages or offsets associated with a product or service that did not measure up to expectations. And of course, the ultimate "defense" to a debt claim is the debtor's invocation of voluntary protection under the United States Bankruptcy Code. See Chapter VI of this material to fully comprehend that sobering obstacle. The fundamental premise of bankruptcy is to excuse (*i.e.* discharge) debts that are justly owed.

When all of the aforementioned hurdles are taken into consideration in a particular claim situation, does it make sense to pursue the collection?

D. Locating and Notifying the Debtor

1. Dynamic Telephone Contact Techniques

Telephone collection is an art and not a science. The first goal of telephone contact with the debtor is to collect money without the need for litigation. The second goal of such telephone contact is to provide a foundation for effective litigation if telephone demands are unfruitful.

a. Telephone Demeanor

- i. Be firm and businesslike—you are conveying an impression.
- ii. Be flexible, but persistent.
- iii. Take your signals from the debtor's demeanor. Be as nice as they will let you be.
- iv. Always be alert and never lose your temper.
- v. Never use obscene or abusive language.
- vi. Never suggest that there may be consequences more serious than enforcement of the obligation to pay money.
- vii. Never be coy about your true identity or job description.
- viii. Never threaten criminal action.
- ix. Because your voice is all-important on the telephone, develop a slower, louder, and lower-pitched manner of speaking that is clearer to listeners and compels attention until you finish.

b. Points to be Covered in the Contact

- i. Identify yourself by name and job function.
- ii. Specify the amount of the debt and the nature of the debt: Is it an accelerated balance or an installment arrearage?
- iii. What is the name of the responding party?
- iv. Does the responding party have a title or job function he or she can describe? What is his relationship to the debtor?

- v. Do the responder's duties and responsibilities include responsibility for the bills you are trying to collect? Remember—companies may owe the money, but people pay the bills.
- vi. How is the debtor legally organized: corporation, partnership, or proprietorship? LP, LLP, or LLC?
- vii. Who are the principals, owners, or officers of the business?
- viii. Which of those persons does the responding party report to? Will the boss get a report of this conversation?
- ix. Does the debtor use any assumed names or "trade" names?
- x. What does the business do? Where is it physically located?
- xi. Make a "demand" or request for payment in full, without any embarrassment or apology. Will the debtor mail the check today?
- xii. Identify whether the debtor claims any justifications or excuses exist for non-payment. Is this a habitually slow payer or a new, isolated problem?
- xiii. Try to limit the scope of the justifications or excuses.
- xiv. Make a good record of any admissions made by the telephone responder.
- xv. "Admit" nothing.
- xvi. "Accept" only that which is consistent with your mission.
- xvii. Give the debtor a "deadline." What is the method, manner, amount, and timing of the payment? "Some money soon" is not acceptable.
- xviii. Give the debtor "homework."
- xix. Identify and inquire into any successor liability issues. Has the business been sold? Was it an asset sale or a stock sale? Are the same individuals still involved as principals?
- xx. Follow-up in a timely manner.

c. Questioning Strategies

- i. Use "open" questions where you have no idea as to the probable response or the response you would like to hear.
- ii. Use "leading" questions where you are verifying data you already have at hand, or where you are trying to elicit an admission.
- iii. In deciding whether "open" or "leading" questions are preferable, use all tools and information available to you, including your original credit application file (if any), yellow page directory advertising, internet websites, or information turned up by "googling." For example, knowing the nature of the debtor's business may help you determine when to call.
- iv. Limit your own talking and do not routinely interrupt—you cannot talk and listen at the same time. Listening is the more important priority. Some debtors will be more likely to pay after they have vented to a good listener about whatever is on their mind.
- v. Concentrate on what is being said, and shut-out outside distractions.
- vi. Take notes to decide what is relevant for logging after the call.
- vii. Listen for ideas that convey the whole picture—not just bits and pieces.
- viii. Be careful of interjections that suggest your approval or acceptance, like "OK," "I see," or "I understand."

d. Logging the Information and Results of the Telephone Contact

- i. Identify yourself properly, as well as the date and time of the memorandum, whether on paper or in a computer notes system.
- ii. Minimize the use of abbreviations that only you know and understand.
- iii. Make a memo of all pertinent facts and admissions discovered in the contact.

- iv. Use quotation marks to record the responding party's actual statements, clearly identifying who made them and his or her relationship to the debtor.
2. Sample Collection Letters
 - a. Business

**CERTIFIED/RRR
and REGULAR MAIL**

Debtor Sales, Inc.
908 Marywood Drive
Dallas, Texas 75060

Attention: John Greeny, President and Registered Agent

Re: *CreditorSteel & Trading, Inc. vs. Debtor Sales, Inc.*; Principal
Balance Due: \$56,043.73.

NOTICE OF CLAIM AND DEMAND FOR PAYMENT

TO THE ABOVE-NAMED DEBTOR SALES, INC.:

Please be advised that the undersigned attorney and letterhead law firm are Creditors' Rights and Collection Counsel for the above-named Creditor Steel & Trading, Inc. In connection with such representation, we have been supplied our client's records concerning outstanding and overdue balances for goods provided by Creditor Steel & Trading, Inc. at the instance and request of Debtor Sales, Inc. In spite of routine invoicing for such goods duly provided as agreed, Debtor Sales, Inc. has failed and refused, and continues to fail and refuse to pay its account owed to Creditor Steel & Trading, Inc., despite numerous attempts on the part of our client to provide various payment options which Debtor Sales, Inc. has refused to honor, leaving the above-referenced principal balance due.

Now, therefore, formal demand is hereby made, pursuant to Chapter 38, Tex. Civ. Prac. & Rem. Code, for payment of the sum of FIFTY SIX THOUSAND FORTY-THREE AND 73/100 DOLLARS (\$56,043.73) in full within ten (10) days of the date of this letter. Such payment should be delivered to the attention of the undersigned attorney at the letterhead address in cash or certified funds only.

Failing to receive such payment as demanded, we have already been instructed to initiate suit to collect the unpaid debt. Should such litigation be required, the Court will be requested to award to Creditor Steel & Trading, Inc. and against Debtor Sales, Inc. not only the aforementioned principal balance due, but also lawful interest, reasonable attorneys'

fees on the order of \$20,000.00, and Court costs incurred in prosecution of the collection action.

This matter deserves your most prompt and serious attention. If you ignore it, you will potentially see a \$56,043.73 problem mushroom into a \$75,000.00+ problem.

Sincerely,

WELLS & CUELLAR, P.C.

D. Brent Wells

b. Consumer

CERTIFIED/RRR
and REGULAR MAIL

David White Watkins
6019 Black Friar's Circle
Friendswood, Texas 77547

Re: Loan No. 825908 (Promissory Note and Change in Terms Agreements shown by Exhibit "A" hereto).

**NOTICE OF DELINQUENCY AND
DEMAND FOR PAYMENT OF ARREARAGE**

Dear Mr. Watkins:

Please be advised that the undersigned attorney and letterhead law firm are Creditors' Rights and collection counsel for Big Bank of Texas, N.A. ("the Bank"). In connection with our representation, we have been supplied with the instruments whereby the above referenced loan was made, renewed, and extended by the Bank (see Exhibit "A" hereto which is incorporated hereby by this reference).

I am sure you are aware that the loan is very much delinquent, your last payment having posted on November 8, 2005. The Bank has lost patience with your repeated failure to timely pay installments when due. NOW, THEREFORE, formal demand is hereby made on behalf of the Bank that you cure the entire arrearage by paying the total sum of

\$11,573.50 (*i.e.* fourteen installments), delivering same in cash or certified funds to the attention of the undersigned attorney at the letterhead address.

Failing to receive such payment, the Bank has instructed our firm to accelerate the maturity of the loan, declaring the entire loan balance to be due; and if necessary, to commence civil litigation against you aimed at collecting the entire principal balance outstanding, all lawfully accrued interest, the Bank's reasonable attorneys' fees, and Court costs incurred in connection with the collection action.

This matter deserves your serious attention to avoid the prospect of acceleration and ensuing collection litigation. If you are interested in discussing the foregoing, I hope you will call me at (713) 222-1281, but please do not contact any personnel of the Bank as I have been designated as the only authorized point of communication with you. The Notice set forth below is incorporated herein by this reference as if set forth verbatim.

Sincerely,

WELLS & CUELLAR, P.C.

by D. Brent Wells for
BIG BANK OF TEXAS, N.A.

NOTICE

The attorney sending this communication is a debt collector. This is an attempt to collect a debt, and any information obtained will be used solely for that purpose. Unless you notify this office within thirty (30) days of receipt of this communication that you dispute the validity of this debt or any portion thereof, we will assume the debt to be valid. If you notify this office, in writing, that you dispute this debt or any portion of it within thirty (30) days of receiving this communication, we will (1) obtain verification of the debt, and (2) mail a copy of such verification to you. In addition, upon written request from you, within the same thirty (30) day period following the receipt of this communication, we will provide you with the name and address of the original creditor, if different from the current creditor.

3. Effective Skip Tracing Tools

Finding People

Craig Ball's Website

<http://www.craigball.com>

Howard Nations' Website

<http://www.howardnations.com>

Accurint (Subscription for Fee Service)

<http://www accurint.com>

Can locate almost anyone, find deep background and historical information, and shorten research time and costs. Accurint provides aliases, historical addresses, relatives, associates, neighbors, assets, and more. Used by lawyers, insurance professionals, law enforcement agencies with the latest cutting-edge technology, this site helps conduct searches much more cost-effectively than any other alternative.

Email & Telephone

AnyWho Directory

<http://www.anywho.com/index.html>

Find telephone number, email, home page URL, toll free number, and address.

Bigfoot's Global E-Mail Directory

<http://www.bigfoot.com/>

The Internet's largest collection of e-mail addresses and white page listings.

Cell Phone Numbers Magic

<http://www.cell-phone-numbers.com/?hop=mpndotcom>

Cell phone number magic retrieves cell phone numbers and mobile phone numbers and can reverse them.

FoneFinder

<http://fonefinder.net/>

Telephone search engine that returns the city, state, and country of any phone number in the world.

Intelius Telefinder

<http://find.intelius.com/index.php>

People search that includes Name, Address, Phone Number & Neighborhood Information.

MobilephoneNo.com

<http://www.mobilephoneno.com>

This site offers free listings to people who choose to register their wireless number here. Searching is also free.

Telephone Directories on the Web

<http://www.infobel.com/teldir/>

This is a directory of directories listing world phone books, world yellow pages, world white pages, sometimes fax listings, email addresses and more. Alphabetic, residential, classified, people, companies.

Telephone Search Engine

http://www.embassyworld.com/directories/global_telephone.html

An engine based on placing international calls from international locations. Gives calling codes and instructions and allows you to search every on-line telephone directory in the world.

WhoWhere E-Mail Addresses

<http://www.whowhere.lycos.com/>

Locate individuals, their e-mail addresses or businesses.

E. Offering Solutions to the Debtor

The ideal solution is, of course, for the debtor to pay 100% in full today. But the reality is that even the best intentioned debtors often need time to pay what they acknowledge that they owe (*i.e.* an extension or work-out). And if you can get cash flowing your way, that is usually far better than insisting upon a lawsuit. Press for the largest downpayment you can get by asking the debtor to propose a specific amount first and then trying to negotiate it upward until you sense that the debtor's "real" limit has been reached. Then attempt to negotiate a monthly (or weekly) installment payment that the debtor can reasonably fit into its cashflow, but which maximizes your pace of recovery. It is often helpful to use lawful interest as a motivator to encourage a short term of payment: "We will not need to charge any interest on an amortization of less than six months, but if you need more than six months, I am required to run interest at 10% per annum."

Once terms have been negotiated in principle by telephone, they should be promptly reduced to writing, preferably in a promissory note, for the debtor to sign. If you ultimately have to sue, taking the note improves your prospects in the collection action because the note presents a simple straightforward claim and "settles" any previous issues in dispute between the parties concerning the original transaction that gave rise to the debt. You can also potentially increase the universe of debtors by getting co-debtor signatures on the note to guarantee the debt (such as from individual principals of a debtor corporation). Free promissory note forms are available at <http://smallbusiness.findlaw.com/business-forms-contracts/>. Prepare the note and send it to the debtor requiring its signature and return to you, with the downpayment, in a short timeframe. If the signed note and downpayment are not timely forthcoming after you have offered a commercially reasonable solution and been given false assurances by telephone, then you know you need to proceed immediately to suit.

F. Handling Denials and Extension Requests

Where the full amount of the debt is acknowledged and an extension is requested, proceed as suggested in section E above. But sometimes the conversation with the debtor will include the debtor's disputes, excuses, and denials designed to lay blame on the creditor or to criticize the product or service that gave rise to the debt. Listen carefully to the denials, avoiding any admissions or acknowledgments. It is appropriate to disagree with the debtor's denials and complaints if they are truly not well-founded. But often a legitimate complaint is voiced which, upon the creditor's investigation or objective consideration, actually justifies a compromise or reduction in the amount of the debt to be collected. It is always better to compromise such issues on a reasonable basis before suit, if that can be done, than to defend a counterclaim in the creditor's collection suit. Remember the virtues of recouping your own costs, even if you have to forego some of the profit that you built into the transaction.

If a compromise is in order, strive to postpone the compromise or waiver on the creditor's part until the debtor has performed by payment. For example, if the account claim is for \$10,000.00, but the creditor determines that a \$2,000.00 compromise is appropriate because of some deficiency in the delivered product, a settlement note could be taken for \$10,000.00 to be paid by the debtor at \$1,000.00 down and \$1,000.00 per month. The creditor can agree that if and when eight of the \$1,000.00 payments have actually been timely made, then the last two scheduled installments will be forgiven and the note returned to the debtor marked "paid in full." If the debtor has mentioned or threatened the prospect of bankruptcy, this strategy of "back-end waiver" is even more important. Indeed, with a possible bankruptcy looming, the "back-end waiver" should not be given until ninety days have elapsed behind the last timely installment payment. Otherwise, there is a risk that the waiver will be applied but some of the recovery will nonetheless have to be given up by the creditor as a preference under Section 547 of the Bankruptcy Code.

In some cases it will be impossible to require a "back-end waiver" and a "front-end waiver" will be necessary. For example, if the account claim is for \$10,000.00, but the creditor determines that a \$2,000.00 compromise is appropriate because of some deficiency in the delivered product, it may be better to take the settlement note for \$8,000.00

than to miss the chance to recover 80% of the account without a lawsuit. This should be done with caution as a matter of business judgment and discretion, especially since some debtors simply will not sign a note for the uncompromised amount, no matter how strongly the “back-end waiver” is programmed. However, if the debtor is going to enjoy the benefit of a “front-end waiver,” a release should probably also be signed in favor of the creditor to insure that the disputed issue which justified the compromise has been fully resolved.

G. Examples of Scenarios You May Face

a. The Screamer or The Nut. Hang up. Do not attempt to discuss financial business with a screaming or irrational person.

b. The Seasonal or Cyclical Business. If the debtor's business is the type that generates its largest cashflows in predictable cycles, you may have to be creative about setting up a settlement note that calls for lower payments (or no payments) during the periods when cashflows are reduced.

c. The Turnip. Your debtor is on the brink of financial disaster, as you confirm by reviewing credible financial statements. You are owed \$100,000.00, but your debtor proves to you it has a long list of unsatisfied payables and only has assets amounting to \$10,000.00. Under such circumstances, it may be prudent to take the \$10,000.00, since that is all of the blood that is in the turnip. However, try not to give up the rest of your claim until ninety days has gone by following the \$10,000.00 payment with no bankruptcy having been filed by or against the debtor. Otherwise, you may give up the \$90,000.00 in settlement and then be forced to give up the \$10,000.00 as a preference under Section 547 of the Bankruptcy Code.

d. The Unresolved Dispute. You have a \$100,000.00 receivable, but the debtor has convinced you of a problem that you believe justifies a \$20,000.00 compromise or discount. The debtor, however, insists that a \$50,000.00 compromise adjustment is called for. As long as there is a stalemate on this issue, the debtor is not paying anything, but you know that at least \$50,000.00 is eluding your grasp. If you sue, you expect to have to defend a counterclaim. Consider calling upon the services of a third-party neutral mediator. See *e.g.* <http://www.txmca.org> for qualified Texas mediators. If your debtor is reasonable and willing to participate in mediation, a final compromise may be negotiated and documented that allows you to collect some serious money (*e.g.* \$65,000.00?).