

16

Legal action – considerations prior to commencement

Introduction

Scottish law

The significance of retention of title

Have other steps been exhausted?

Without prejudice offers

Should you take legal action?

Look at your conditions of sale

Statutory interest

Who to use

Legal services

Taking action

Checklist

Introduction

It is sometimes said that declaration of war is the ultimate failure of diplomacy. In the same way, legal action against a debtor signifies the end of a normal trading relationship. You will (or should) have stopped supplies. It is probable that you will not supply the same customer again. If you do so, the relationship will (or should) be a different one. You will need guarantees, or some very firm and believable assurances, that things will be different in future.

If you are about to start legal proceedings, then something has gone wrong with your normal trading methods and controls. Just possibly, you need to ask some questions about what has gone wrong and why. But do not spend too much time doing this. Everyone is unlucky from time-to-time and most businesses run some risks in order to secure sales. Any business that has a certain number of credit accounts will inevitably, from time-to-time, need to consider taking legal action. If there are a large number of credit accounts, legal action or write-offs are inevitable.

Chapter 17 shows how to obtain judgment, and Chapter 18 shows how to enforce judgment and actually secure payment. This introductory chapter is very important and you will use Chapters 17 and 18 more effectively if you have studied it. It gives background information about the legal process, draws attention to points that you should consider and decisions that you should make, and shows how to effectively plan to enforce your rights.

Scottish law

Scottish law has some similarities to English law, but there are many differences. You should therefore not rely on these legal chapters if you are enforcing a debt where Scottish law applies. Much of the general advice in this chapter is equally applicable and well worth consideration.

The same advice applies to other jurisdictions outside England and Wales, such as Northern Ireland, Jersey, etc.

The significance of retention of title

Retention of title was studied in detail in Chapter 15 on conditions of sale. It also features in Chapter 20 on bad debts.

Retention of title is designed to help you in circumstances such as the ones that you are now facing. It is often not the panacea that is sometimes supposed; there are practical constraints on its use, and even if you succeed in recovering the goods, the financial benefits will be inferior to getting your invoices paid. You are recommended to refer back to Chapter 15, and study the details of the constraints and how retention of title works.

Despite the drawbacks, retention of title should be considered if it applies, and if the practical difficulties are not too great. This, of course, assumes that goods are still in the physical possession of your customer. It may well have an extremely beneficial psychological effect on the customer if he is still in business. For a start, it shows that you are serious. It may be very damaging to his business if you repossess your supplies. He might need them urgently. Also, it could be extremely bad for his reputation if word gets out, and if there are embarrassing gaps on his shelves. It may be very bad for the morale of his staff too.

Perhaps only part of the goods are in the possession of the customer. If this is the case you can repossess these (or try to) and take legal action for the balance of the debt. You must give full credit for the goods that you take back, even though they may not be worth as much to you.

Have other steps been exhausted?

The great majority of legal actions for recovery of debt are successful. That is to say, they are successful in obtaining judgment; they are by no means all successful in enforcing judgment and actually obtaining payment. The reason that they are successful is that there is no dispute about the money being owing. Everyone knows that the money is owing; it is just that the customer will not, or cannot, pay it within an acceptable time-scale.

The sad reality is that, in most cases, the threat of legal action, then the reality of legal action, is what comes after the number two letter. Real disputes, as opposed to spurious disputes, are comparatively rare.

If there is a real dispute it is worth making strenuous efforts to resolve it before commencing legal proceedings. A defended legal action is very different from an uncontested one. If your action is undefended, you should get judgment in a matter of weeks and can then get on with enforcing the judgment. A defended action will drag on for a long time, certainly several months as a minimum. Both sides will incur costs, and if you lose, you will probably have to pay the costs of both sides. Even if you win you will probably not recover all that you have actually spent. A defended action will cost time as well as money and, depending on the strength of your case, there is a risk that you might lose. However, a case in the small claims track of a county court should only result in minimal costs and it should be decided more quickly.

For all these reasons it is probably worth trying to compromise and resolve a dispute without legal action. It might save you a customer as well. I am not advocating giving away too much, just being sensible.

Some writers on credit control advocate offering to settle for less than the full amount, even though there is no real dispute. They advocate this on purely practical grounds, saying that it is a cost effective thing to do. They say that if you are owed £1,070, a without prejudice offer to settle for an immediate £1,000 in full and final payment will often work.

I most emphatically disagree. Why on earth should you do this? Your case is good, so you will win. Apart from moral considerations there is a very practical reason for not doing it. You cannot afford the reputation of someone who is open to this sort of settlement. It is catching. Others may try to get the same favour. It is a digression, but interesting to note that Robert Maxwell would often seek to reduce his debts by offering immediate payment of a reduced sum in full and final settlement.

Without prejudice offers

In the above section, compromise was discussed. If there is a genuine dispute it may well pay to try and negotiate a settlement. If you try to do this, you will want to make sure that your efforts do not count against you if compromise fails. You most definitely do not want your offer quoted against you in court and taken into account in the legal process.

To avoid this you should memorise the words 'WITHOUT PREJUDICE', clearly quote them on any document concerned with the attempted settlement, and say them before any verbal offer. It works in the following way:

- All correspondence and offers should very clearly be marked 'WITHOUT PREJUDICE'.
- No documents marked in this way can be used in the legal process.
- The other party may accept a without prejudice offer, which is the point of making it. When a without prejudice offer is accepted it becomes a contract and is binding on both parties.
- If an oral compromise is reached it is binding, but it is very sound practice to confirm the agreement in writing. This avoids arguments about exactly what was agreed.
- A without prejudice offer may be withdrawn at any time before it is accepted.

Should you take legal action?

Legal action will cost money, very probably more than the costs that you will recover from the debtor if you win. It will also take some time, possibly not very much but in some cases a great deal of your time. This may be in filling in forms and perhaps in providing information for your solicitor or credit agent. If the case is defended the time requirement will escalate.

You should only take legal action if all other reasonable procedures have been exhausted. This means that normal, reasonable requests for payment have been made and a final warning letter has been sent. If there is a genuine dispute, there should have been a reasonable attempt to settle it.

Does the debtor have the means to pay? If he genuinely does not, then legal action is pointless. Blood cannot be got out of a stone. Obtaining judgment would turn out to be a paper victory. The object is to get actual payment. This said, most customers can pay if they have to, notwithstanding protestations to the contrary.

Finally, it is sometimes necessary to ask yourself if you are proposing legal action for commercial reasons, or if you are doing it as a matter of principle. Principles are very fine things. We all should have them. But be clear about your motivation. If you are doing it on principle, and not for the money, you should acknowledge it to yourself and perhaps to the boss (if you have one).

The final warning letter

It is sad, but true, that some customers will only make payment when faced with the imminent prospect of something unpleasant, or the reality of something unpleasant. Payment is often forthcoming when customers are faced with the following:

- Supplies are cut off. This assumes that they want further supplies and cannot conveniently obtain them elsewhere.
- They receive a credible final warning of impending legal action.
- Legal action is commenced and a claim is served.
- Judgment is entered against them. Judgment is entered on the Register of County Court Judgments if it is obtained in a county court, but the entry may be removed if payment in full is made within a month.
- Enforcement proceedings are taken.

A credible final warning letter will produce payment in well over 50% of all cases. A further reason for sending one is that the courts expect a final warning letter to be sent and may penalise you on costs if it is not. So it is very well worth issuing such a letter, and making it a good one. This was covered in detail in Chapter 6. Please note that the letter must be credible. It should say what is going to happen and when it is going to happen. And the customer should believe it.

A good example of a final warning letter was given in Chapter 6, and it is repeated in Appendix D at the end of this book. A good final warning letter will have the following features:

- By definition there is only one final warning letter. If you send more than one, something is wrong.
- It should not make empty threats. If you do not mean it, do not say it.
- It should be short and to the point.

Look at your conditions of sale

- It should state the exact deadline and the amount to be paid. It is marginally better to state an exact date rather than a number of elapsed days.
- It should state exactly what will happen if payment is not made by the specified date.

In order to achieve maximum impact it is sound practice to send the final warning letter by recorded delivery. For the same reason it is a good idea, in some circumstances, to send the letter to a person who has not been involved so far, and with a copy to the original contact. If the customer is a company, it could achieve extra impact to address the letter to the Company Secretary.

Some suppliers do not bother with conditions of sale. Others do but fail to make them legally enforceable. If you do have enforceable conditions of sale, they may contain something that will help you in the present situation. This was explored in detail in Chapter 15.

It may be possible to raise further invoices and take legal action to recover a larger amount. Sometimes not absolutely everything permitted by the contract is actually invoiced. Examples may be certain travel and training costs. These are waived in the interests of the long-term relationship. If you are taking legal action, there almost certainly is not going to be a long-term relationship. You may as well increase the amount and get what you can.

You should seriously consider invoicing for interest if permitted to do so under the terms of a contract. This may generally be done, subject to contract terms, from the dates that payments become contractually due, and it may be possible to claim interest on late payments that have been received. The amounts involved may be large. It may be done for a period back to when the claim is statute-barred. This is five years for Scotland and six years for the rest of the UK.

If contractual interest does not apply, you should seriously consider claiming statutory interest under the Late Payment of Commercial Debts (Interest) Act 1998.

Statutory interest

You may be able to claim statutory interest under the Late Payment of Commercial Debts (Interest) Act 1998. Full details of the Act are given in Appendix A. The Act took effect in stages with the final stage taking effect for contracts made after 7th August 2002.

The Act provides for interest at 8% over base rate, so it is well worth claiming and the amounts involved may be quite large.

Unclaimed interest may be claimed right back to the time that the claim is statute-barred. This is five years for Scotland and six years for the rest of the UK. Perhaps interest has not been claimed because of customer relations. But customer relations do not now matter too much. It is time to get what you can.

Who to use

There are three possibilities:

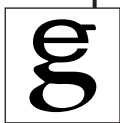
1. You can do it yourself.
2. You can use a solicitor.
3. You can use a credit agency.

If you use the High Court, it is a requirement that a solicitor acts for a limited company. This is not the case if a county court is used and you are permitted to do the work yourself if you wish. The High Court requirement to use a solicitor does not necessarily mean a solicitor in practice. Many credit agencies employ solicitors and some large companies do so too.

To fill in the forms for the county court, and to do the other work, may seem a daunting prospect, but it is entirely feasible to do the work yourself. If you handle a significant number of cases, you will become practised and proficient, and obtain the benefit of economies of scale. You will save money too.

On the other hand, we employ specialists to do a lot of things that we could do for ourselves. I am well able to clean windows, but I still employ a window cleaner to clean the office windows. This is because he is a specialist and he does it more quickly than I do. It pays me to concentrate on what I am good at and the main purpose of my business. It is a matter of individual judgment. It probably pays to use a solicitor if the case is very complicated or defended, and a company has to do so if it is a High Court action.

Legal services



Payment for legal services

Solicitors traditionally charge for their time and also for reimbursement of their expenses and court costs. Some still do charge in this way, especially if you only use their services rarely. However, many now charge a percentage of the sum actually recovered. Most credit agencies operate in this way too. The eye catching appeal is 'NO WIN - NO FEE'. They say that you have nothing to lose by engaging their services. This is not strictly true because you will almost always be responsible for court fees, whether anything is recovered or not.

It works according to the following hypothetical example:

10% of amount recovered	from 0 - £500
5% of amount recovered	from £501 - £1,000
2% of amount recovered	from £1,001 - £5,000
1% of amount recovered	over £5,000

The solicitor or credit agency is expecting a reasonable mix of large debts and small debts, and a reasonable mix of good prospects and difficult prospects. Usually the fee is payable even if payment is obtained without legal action being taken. It is normal for the solicitor or credit agency to send a warning letter and this often gets good results.

Payment by this method can be a good idea. There is considerable attraction in 'NO WIN - NO FEE'. However, do not forget the court fees which you will usually have to pay.

Do be careful if you pass over a large debt with a good chance of success. The amount of work involved in collecting a large debt may be no more than the amount of work involved in collecting a small debt. It may even be less. Under the above scale of charges you will pay £30 for the successful collection of a £300 debt. But you will pay £1,105 for the successful collection of a £100,000 debt. If you have a large debt with good prospects of success, it may pay to negotiate with the solicitor or credit agency, and ask for special terms.

Advice on using solicitors and other specialists

Books such as this often advise that if you appoint a solicitor, you should always do what he says without question. I do not agree with this advice and neither do many solicitors. Certainly you should take your solicitor's advice on legal matters, and beware of the consequences if you do not, but the same is not necessarily the case with

commercial decisions. You know most about your business and it is you who should take these decisions, after considering the advice of course.

You may decide that it is too expensive to continue, or too time consuming, or the risk of bad publicity is too great. Perhaps you come to feel sorry for the debtor. This can often happen and you will probably encounter some very sad cases. You may want your solicitor or agent to follow a different line of action or enforcement, or to take payment by instalments.

Sometimes a case can take on a momentum of its own, but my advice is to stay in charge. This is not hostile to solicitors, many of whom welcome clients who wish to give firm guidance.

On a different matter, large amounts of time can be wasted preparing for legal proceedings. Remember, that the great majority of the actions will not be contested. All too often there is a reflex reaction of photocopying all outstanding invoices for the solicitor, and many other documents too. It is done because it is always done, and everyone would rather be safe than sorry. If there are only one or two invoices it will not take long, but if there are hundreds it can be an enormous job.

The solicitor has to prepare the claim, and to do this he will need a list of all outstanding invoices, showing invoice numbers, dates and amounts. He will also need to know what the invoices are for, but often a sentence or paragraph will give this information.

My advice is to give the solicitor or credit agency the above and ask if it will suffice. Very often it will suffice and you can save yourself a job. If it is especially complicated or there are difficult features you can do it on request. Also, you can do it later if it is necessary to rebut a defence that is entered.

The costs of legal action

Many of the main court fees are set out in Appendix C. These may be recoverable from the customer if you win. But they have to be paid in advance by you. 'Recoverable from the customer' means actually paid by the customer. Judgment in your favour is not the same thing, the customer must actually hand over the money. You are, of course, taking legal action to force your customer to hand over some money, but if you fail (despite obtaining judgment), the amount to be written off will be bigger.

If the action is contested, and if you win, you will probably get your legal costs paid. The bad news is that it will be according to a scale which may well not completely cover all that you have paid out. If you lose a contested case you will probably have to pay your customer's legal costs as well as your own. In these circumstances, the miserliness (as solicitors see it) of the scale charges will work in your favour. You will probably pay less than your customer has actually spent.

You may reduce the impact of costs by using a solicitor who only charges a percentage of the sum actually recovered. Even then you will almost certainly have to pay the court costs. It may be obvious, but solicitors make a profit, even ones who only charge a percentage of the sum recovered. You pay in the end, but the successful recoveries subsidise the unsuccessful actions.

If you are doing the work yourself, you will not have solicitors' costs. Do not underestimate the cost of your own time. It is a common mistake.

To reiterate a point, do remember that if you win you must actually recover your costs from the customer. Getting judgment is not the same as actually getting paid.

All this may seem designed to stop you taking legal action. This is most definitely not the purpose, but you should be knowledgeable about the costs. Most actions are not defended and these are much cheaper than those that are. You should think about the costs if you have the prospect of a defended case.

Taking action

The importance of getting key facts right

The law requires certain details to be exactly correct. In particular, it requires the defendant to be correctly identified. If you get it wrong, it will probably delay your action and result in extra costs. It is not too difficult to get it wrong, so take care.

Is the defendant a sole trader, a partnership, a limited company or plc, or is it some other body such as a building society or trade union? The first step is to get it clear in your mind; the second step is to research the details and write it down correctly.

It is a legal requirement that limited companies, and certain other bodies, have to record key information on their stationery. A limited

company is required to show the full and exact name of the company, the company registration number, and the address of the registered office. An offence is committed if it fails to do so. It is very sound practice to send a piece of the customer's notepaper to your solicitor or credit agent. It is a good idea to do this in all cases, not just when the customer is a company.

If the defendant is a company, it may be best to address the claim to its registered office, though another address having a connection with the claim may be used. The address of the registered office can be discovered, so long as the exact company name is known, but it may save a lot of trouble if you have the notepaper. The address of the registered office may be obtained from Companies House but you must quote the exact name or the company's registered number.

It may not be completely clear who the defendant should be. Customers do not always make it easy to know if they are acting as individuals, on behalf of a partnership or on behalf of a limited company. Sometimes your own systems may be at fault. But it has to be right. John Brown is not the same as John Brown Ltd, and neither are the same as John Brown (Systems) Ltd.

Of course other details should be right too. You should be claiming exactly what is owing, no less and certainly no more. The details of the claim should be exactly correct.

The danger of delay

If you are having problems with a customer, it is probable that others are too. You will be in competition with other suppliers, and you may be at a disadvantage if you delay. This applies to delay in getting judgment, and it applies to steps to enforce the judgment.

It is often thought that assets seized from the debtor will be applied pro rata for the benefit of all creditors with judgments outstanding. This is not so. The money will be applied to the creditors according to the dates on which the warrants of execution were issued. The same principle applies to most of the other enforcement methods.

This can be illustrated with a rather extreme example:

- ABC Ltd is owed £10,000 by XYZ Ltd and obtains a warrant of execution on February 1st.
- DEF Ltd is owed £1,000,000 by XYZ Ltd and obtains a warrant of execution on February 2nd.



- The entire assets of XYZ Ltd are seized by the bailiff and (after all costs) the amount realised is £10,300.
- ABC Ltd gets £10,000. DEF Ltd gets £300.

The nature of the legal system

Claimants often find the legal system deeply frustrating. They know they are in the right and they think that the courts should join in and get their money for them. They do not like the technicalities. They might just understand the neutrality up to the point where judgment is obtained, but they think that not enough is done for them after that point.

A moment's pause for thought does show that neutrality up to judgment has to be correct. The whole point of a court is to decide who is right. You might know, but it has to be established. There are reasons for technicalities too. You only need to imagine yourself as a defendant. You come home from a holiday in the Himalayas to find a case has been started and finished, and that your furniture has been sold to pay a claim that you did not know existed, and which is spurious anyway. Thank goodness for technicalities.

It might be expected that a court would take a partisan approach to enforce the judgments that it makes, rather as it will enforce a penalty for contempt of court. But it will not do this. It will provide the forum for you to enforce it and it will act as a neutral umpire to see that the rules are followed. You have to pay in advance for each step that you take. It will not initiate enforcement action. Sorry! But that's the way it is.

Delays in the system may be frustrating and these are often caused by the large number of cases that have to be dealt with. Some courts are worse than others in this respect. Delays are not just a British phenomenon. Ireland is just one country with a worse problem.

Choosing the right court

A claim may be issued in the High Court or in any county court. The choice is restricted by the monetary value of the claim and possibly by other factors. Subject to this, you may choose which to use. This is explained in detail in Chapter 17.

Checklist



- ✓ Do consider enforcing retention of title; if you can and if it is sensible to do so.
- ✓ Do remember that the great majority of actions are uncontested. Everyone knows that the money is payable.
- ✓ But, if there is a genuine dispute, do try hard to resolve it.
- ✓ Do remember that enforcing judgment is often more difficult than obtaining judgment.
- ✓ If you negotiate and make concessions, do ensure that the negotiations are 'without prejudice'.
- ✓ Do understand that if the customer really cannot pay (as opposed to will not), there may be no point in taking legal action.
- ✓ Do be clear whether you are acting for commercial reasons, or as a matter of principle.
- ✓ Do always send a credible final warning letter, and make it a good one. This succeeds in more than 50% of all cases.
- ✓ Do look at your conditions of sale (if you have them and if they apply). Can they help? Can you invoice anything else? Especially, can you invoice interest?
- ✓ Do not be afraid of doing the work yourself, if you have time and if it is an area where it is permitted.
- ✓ Do consider paying a solicitor or credit agent by means of a percentage of sums actually recovered.
- ✓ But if you do, do not forget court costs and consider special arrangements for a large debt with a good chance of success.
- ✓ If you employ a solicitor or credit agent, do stay in charge for the commercial decisions.
- ✓ Do resist unnecessary work. It pays to ask if it can be avoided.

- ✓ Do watch costs.
- ✓ Do get the facts right, especially the exact correct name of the defendant.
- ✓ Do send an example of your customer's stationery to your solicitor or credit agent.
- ✓ Do realise that it may pay to act quickly. Others might gain an advantage if you delay.