A GUIDE TO RECOVERING AN UNPAID DEBT
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Introduction
No matter how good your credit control procedures are, at some point you may find that you have a customer who has simply failed to pay an invoice, despite your best efforts to pursue them for payment.

In these circumstances you may need to take debt recovery action to secure payment of the debt by involving third-party debt collection agencies or by instigating court action or insolvency proceedings.

This factsheet explains the issues to consider before taking debt recovery action, the basics of late payment legislation and the various options for securing recovery of the debt.

What to consider before taking recovery action
Recovery action must be based on commercial decisions and you should carefully weigh up the business factors involved before committing to any course of action.

• What is the reason for the customer's failure to pay? Is the debt, or part of it, being disputed on some reasonable grounds? If so, how strong is the customer's claim and how strong is your case that the debt is actually due? Is there a danger that the debtor may have a valid counter claim against you?

• What is the value of the debt, or the disputed element of the debt and how does this compare to the value of your relationship with the customer?

Starting legal action or insolvency proceedings will usually end any relationship with that customer. Therefore if the value of the debt is low and the value of the relationship is high, you may decide that it is worth writing off the debt in view of any potential future business you may secure with that customer.

If it is a large debt and you feel that your relationship with the customer has become too difficult, you should consider whether you value that customer's ongoing business or if you would be comfortable losing them as a customer.

You should also consider:
• How much will it cost you to pursue the debt compared to its value?
• Is the debtor likely to be able to pay the debt and the associated recovery costs? It may be that they have no assets and clearly cannot pay.
• If you do go to court, how easy will it be to enforce any judgement achieved? For example it is not worth appointing bailiffs if the debtor has no identifiable assets in the UK for them to seize.

In some cases you may decide that, irrespective of the merits of a particular case, it may still be worth pursuing a debt in order to establish a reputation in the marketplace and encourage other debtors to pay. This choice should be based on a purely commercial judgement that this is in the best interests of your business and not used as a way to prove a point of principle or for personal satisfaction.

Late payment legislation
Since the introduction of laws and regulations covering late payment of commercial debts in 1998 and 2002 you have a statutory right to claim interest at a rate of 8% above the Bank of England's base rate (unless you have separately agreed some substantial contractual right to interest in your terms of business). The base rate at 31 December is the reference rate for the first six months in a year while the base rate at 30 June is the reference rate for the second six-month period.

The interest period runs from 30 days after the date of delivery or invoice, whichever is later, unless other terms have been agreed explicitly or established through the course of your dealings with a customer.

You also have the right to claim compensation for late payment of:
• £40 for debts under £1,000.
• £70 for debts of £1,000 to £9,999.
• £100 for debts of over £10,000.

Again, it will be a commercial decision for you to take whether or not to use these rights in respect of some or all of your creditors and you may want to check your competitors’ policies for a comparison of payment terms. If you are going to impose interest charges on late payment of invoices you need to be efficient at pursuing your debts. Customers may resent being charged if this is partly due to your failure to collect any monies owed.

You should notify your customers of your policy and ensure that your right to charge interest is included on all relevant documentation, such as invoices and statements. You should then notify individual customers once interest charges start to accrue.

You can pursue these debts through the courts in the same way as any other claim and, once paid, you should send the customer a bill or receipt documenting the interest and compensation paid.

Your options for recovery
Wherever possible you should try to recover debts through negotiation with your customer before taking other recovery action or involving third parties. If this does not succeed your options are:

Debt recovery agency
Debt recovery agencies (some of which are operated by specialist solicitors) focus on collecting debts and are set up with staff and processes dedicated to doing so. A letter from a debt recovery agency is often enough to generate payment from many debtors.

Agencies charge a commission, which is usually around 10% of the sum recovered. You should always use an agency that is registered with the Credit Services Association (CSA, www.csa-uk.com).

Alternative Dispute Resolution (ADR)
In order to avoid unnecessary cases going through the courts, Her Majesty's Courts and Tribunal Service (HMCTS) encourages parties to try and resolve cases without court proceedings. This may help you to avoid unnecessary legal costs.

ADR can take the form of mediation and arbitration by a trade organisation, ombudsman, professional body or any suitably qualified
person. ADR may be able to help you resolve your differences with the customer and help retain the relationship.

For information on organisations that provide arbitration and mediation services go to:

- The Ministry of Justice civil mediation directory (www.civilmediation.justice.gov.uk).

Court proceedings

In England and Wales claims for debt recovery should be filed with your local County Court. Alternatively claims up to a value of £100,000 can be started directly on the Money Claim Online website (www.moneyclaim.gov.uk).

In Scotland claims are made to the Sheriff Courts. Go to www.scotcourts.gov.uk/taking-action/small-claims for more information.

In Northern Ireland claims are handled by the Northern Ireland Courts and Tribunals Service. Go to www.courtsni.gov.uk for further information. Claimants can also use the Small Claims Online service at www.courtsni.gov.uk/en-GB/Services/Online_Services/Pages/default.aspx#smallclaims.

Once you have your judgement from the court, you will need to enforce it. This can involve seeking further court orders (and incurring further costs).

See BIF 37, An Introduction to Making a Small Claim to Recover an Unpaid Debt for further information.

Insolvency proceedings

If you can prove that the debtor is insolvent and that you are owed over £750 you can petition the court to liquidate the debtor if they are a company, or file for their bankruptcy if they are individuals. In Scotland personal bankruptcy is also referred to as sequestration and a creditor must be owed at least £3,000 before they can petition a court for an individual's sequestration.

Failure to satisfy a judgement debt, or failure to pay within 21 days of a statutory demand for payment, are taken as proof of insolvency by the courts.

Although this is a powerful threat there is a danger that you may run up costs in pushing a debtor into insolvency. If they are liquidated or bankrupted this will not ensure that you get paid (other than for your petitioning costs, which will normally rank as an expense of the liquidation or bankruptcy). There will be insolvency fees and secured creditors to pay before any money is available for paying normal trade creditors. Take advice from a licensed insolvency practitioner or your solicitor before starting this sort of action.

Hints and tips

- Ensure that you have good credit policies and procedures in place so that your billing arrangements and payment terms are clearly documented and accepted by the customer.
- Always send a final notice stating that recovery action will be taken if payment is not received within a specified time.
- Consider factoring your debtors on a non-recourse (insured) basis so that a factoring company takes over responsibility for any debt recovery action and you are covered against bad debts. See BIF 34, An Introduction to Factoring and Invoice Discounting for more information.
- If you are having difficulty in collecting a debt, seek confirmation from the debtor that the balance is acknowledged as being due (even if they are seeking to delay payment). This can then be used to challenge any later attempt to dispute that the debt is payable, or as evidence to support a claim of insolvency (that the customer is unable to pay its debts as they fall due).
- Consider whether you should mitigate your loss by seeking to recover your goods under your Reservation of Title clause, also known as a 'Romalpa' clause. This should be made clear in your terms and conditions of trade and means that ownership of the goods does not pass to the customer until they have been paid for in full.

Further information

For practical start up and small business tips, ideas, know-how and news, go to:
Website: www.enterprisequest.com
To access hundreds of practical factsheets, market reports and small business guides, go to:
Website: www.scaevenger.net

BIF 34 An Introduction to Factoring and Invoice Discounting
BIF 37 An Introduction to Making a Small Claim to Recover an Unpaid Debt
BIF 422 An Introduction to Credit Control

Useful contacts

Her Majesty's Courts and Tribunals Service is responsible for court proceedings in England and Wales. It has an online directory of courts. Website: www.justice.gov.uk/about/hmcts
The Scottish Court Service is responsible for court proceedings in Scotland. It provides information on making a claim and has an online find-a-court facility.
Tel: (0131) 444 3300
Website: www.scotcourts.gov.uk
The Northern Ireland Courts and Tribunals Service is responsible for court proceedings in Northern Ireland. It publishes information on how to make a claim and provides contact information for all the courts in Northern Ireland.
Website: www.courtsni.gov.uk
The Chartered Institute of Arbitrators is a professional body for those working in dispute resolution. It provides guidance on dispute resolution and has an online directory of members.
Tel: (020) 7421 7444
Website: www.ciarb.org
The Credit Services Association (CSA) is a trade association for debt collection agencies. It publishes an online directory of members.
Tel: (0191) 217 0775
Website: www.csa-uk.com

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