

NFIB

DEBT COLLECTION GUIDE



About the NFIB Debt Collection Guide

The NFIB Debt Collection Guide provides small business owners with practical information on preventing payment disputes and recovering unpaid debts. This Guide discusses topics such as written agreements and contracts, invoicing practices, collection letters, negotiation strategies, and options for pursuing unpaid accounts. It is intended as an educational resource and does not constitute legal advice. Please consult an attorney in your state if you need legal advice or representation regarding a specific collection matter.

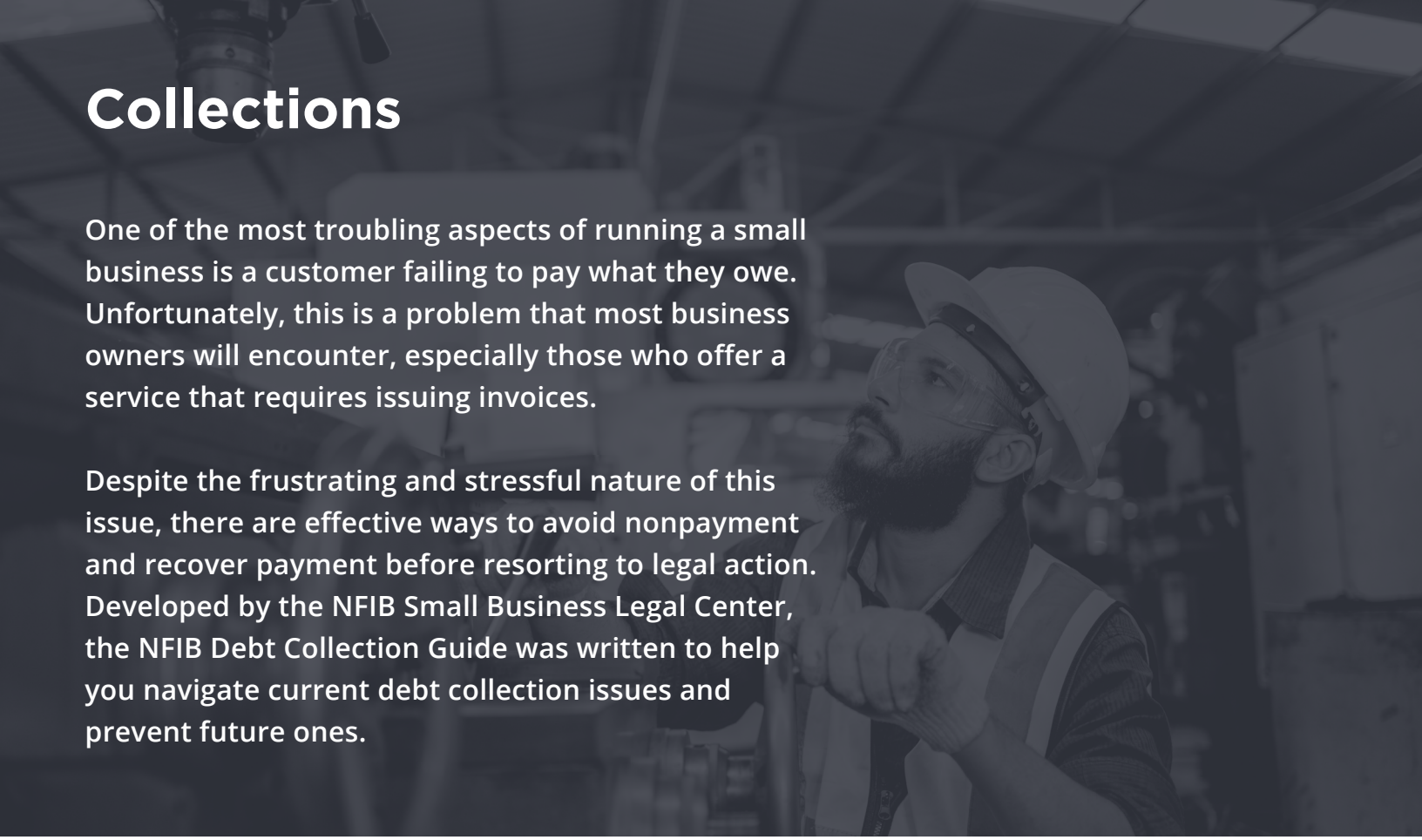
About NFIB

The National Federation of Independent Business (NFIB) is the nation's leading small business advocacy association. NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents, in Washington, D.C., and all 50 state capitals, the interests of its members.

About the NFIB Small Business Legal Center

The NFIB Legal Center is the voice for small business in the nation's courts and a legal resource for small business owners nationwide. The Legal Center is a nonprofit public interest law firm that litigates for and educates small businesses. Founded in 2000, the Legal Center has already been front-and-center in some of the most consequential cases of the past two decades, including a challenge to the Affordable Care Act and being the lead plaintiff in the lawsuit which overturned the COVID-19 Employer Vaccine Mandate. The Legal Center's education takes many forms, including responding to small business inquiries, holding monthly webinars, and providing legal guides.

Collections



One of the most troubling aspects of running a small business is a customer failing to pay what they owe. Unfortunately, this is a problem that most business owners will encounter, especially those who offer a service that requires issuing invoices.

Despite the frustrating and stressful nature of this issue, there are effective ways to avoid nonpayment and recover payment before resorting to legal action. Developed by the NFIB Small Business Legal Center, the NFIB Debt Collection Guide was written to help you navigate current debt collection issues and prevent future ones.

TAKING PREVENTATIVE MEASURES

Sales Agreement:

The most important preventative step you can take to avoid nonpayment is to ensure both your business and the customer have a mutual understanding of the obligations of each party. Doing this verbally is NOT in your best interest. To properly protect you and your business, you must commit the terms of the agreement to writing.

Terms in the agreement should include:

- The service you will perform, and/or goods rendered. The more specificity the better.
- Price you will be paid for the goods/service.
- How you will be paid (payment types).
- Dates that payments are due.
- Interest to be charged for overdue payments.
- Provision where customer agrees to allow you to place a lien on their assets if they do not pay.
- Whether disputes will go through mediation or arbitration.

Information on written service agreements can be found here. Information and sample contracts for the sale of goods can be found here.

Credit Checks:

When dealing with large dollar amounts, it's crucial to perform credit checks before entering into the contract. Credit checks allow you to identify and weed out customers who have a demonstrated history of not paying their debts. Entering into a contract with a customer before doing a credit check is like buying a house without an inspection or loaning money to a random person.

Be advised: working with customers who have previously not paid their debts is extremely risky. You do not want to enter your business into an agreement with a customer who has a history of not paying their debts. Throughout the credit check process, it is important to be persistent, polite, professional, and prompt.

Invoice Tactics:

Even though it is the responsibility of your customer to pay for your goods or services, it is up to you to follow through with invoices according to the agreed upon payment schedule. For long-term work or sales agreements, your customer will likely want to pay in smaller periodic installments rather than one lump sum. Set the expectations from the start in your contract or written service agreement. You should add late fees and interest for late payments to incentivize timely payment.

MISSED PAYMENTS

When a Client Misses a Payment:

When a client misses a payment, do not assume the worst or become accusatory. Doing so could damage the relationship between your business and this customer. Customers who feel slighted by a business owner may resort to leaving negative reviews online or failing to make further payments out of spite.

In the case of a missed payment, it could be that your invoice was lost in a sea of emails or letters, and the missed payment was a simple oversight. Begin by sending a friendly reminder to your customer or calling to remind them of the overdue payment. As time passes without payment, you should become more forceful in your requests. It is important to note that a reminder should be sent promptly if payment is not received by the due date. Depending on the customer, circumstances of the nonpayment, length of the business relationship, and the amount owed, you may consider giving your customer a grace period to maintain friendly relations, or waiving any late fees or interest as a show of good faith if they are willing to pay immediately.

If letters are failing to reach your client, attempt to call them or set up a face-to-face meeting. This can help begin to resolve the issue in a more efficient manner instead of waiting on their response through email. If the customer you are dealing with is running into financial trouble, contacting them via phone or in person can be a good way to negotiate a revised payment plan. **ANY EXTENSION OR COMPROMISE SHOULD BE IN WRITING!**

If the customer avoids your communications, ignores you, or simply refuses to pay, you must then decide how to proceed. In this situation, you may wish to communicate a demand for payment.

The Demand:

When you have yet to receive payment and need to be more aggressive in your collection efforts, start by writing a demand letter (see final page for template). This is a formal demand for payment of the amount owed. It should include a reminder outlining the payment you are owed, the date it was due, forms of payment you accept, when you expect payment by, and any other pertinent information. In this letter you can state that any unpaid debt will result in further action. A demand letter should be sent by certified mail. This ensures the customer receives the letter and that you are notified upon delivery.

Post-Demand Negotiation:

After sending a demand letter, you should continue to contact the customer to negotiate a proposed resolution. Often courts will look poorly on legal action if the creditor has not offered the debtor some type of solution. Examples include:

- **Payment Compromise:** Offer to forgive some of the debt if the client pays the rest by a certain date. (“If you pay 80% within two weeks, I’ll forgive the other 20%”).
- **Payment Extension:** Offer a longer-term payment schedule that will reduce the amount of the installment payments. If a $1,200 payment was due within one month, offering to make it due in three months reduces the weekly payments from $300 to $100.

Final Letter:

If you have completed the above steps without receiving payment, you may wish to send one final letter prior to filing a lawsuit. This letter can mimic your debt collection letter, but also state your decision to file a lawsuit and that any future communications may be through legal representation (depending on the amount owed and type of legal action initiated).



PROCESS TO RECOVER DEBT AFTER DEMAND AND NEGOTIATION

UCC Lien:

File a UCC Lien on the debtor's assets with the Secretary of State's office. You can only do this if the debtor agreed to grant a lien in the original agreement. Filing a lien will help prioritize your debt if the customer files for bankruptcy.

Arbitration/Mediation:

Arbitration is like a court case, but to a lesser degree. Costs can be substantial, but are generally cheaper than going to court, and resolution is often quicker than court proceedings. Arbitration services are available at www.adr.org. In contrast, mediation is where both parties sit down with a neutral party and a compromise is reached.

Arbitration and mediation are only available if the original agreement signed by both parties agreed to arbitrate or mediate disputes.

Small Claims Court:

The quickest form of legal action you can take is filing a claim in small claims court. Small claims court is a type of legal proceeding that resolves financial disputes quicker, easier, and with less formality than normal courts. One advantage of small claims court is that you don't need an attorney to represent you. Some states even prohibit attorneys from participating in small claims court. As the name suggests, these types of proceedings are limited to very small disputes. Each state sets its own dollar limit on how much you can sue for in small claims court. These limits can be found here.

Another advantage of filing a suit in small claims court is the simple fact that if your debtor fails to show up, you will win the case by default.

If you are dealing with an out-of-state customer, then a default judgment by your own state's court may not be enforced in another state. If your customer is out of state, then you may be better served by filing in small claims court where the customer is located. Expenses to do so, like travel and lodging, are tax-deductible.

Once you have a judgment from small claims court, you will need to apply to the court clerk's office for an execution on the judgment.

Collections:

If the amount owed exceeds the maximum small claims court limit in your state, your best course of action would be to take your claim to a collection agency.

Collections agencies survive on collecting a percentage of your owed debt. The simple downside is that you will not get 100% of the money owed. However, using a collection agency can often outweigh the time and money spent preparing for and participating in a civil lawsuit.

If the customer disputes the amount of the debt owed, then the collection agency cannot pursue the debt and will tell you to hire an attorney. You can find more information about how collection agencies operate here.

Debt Factoring:

If you are in a tight cash position, you can utilize a factoring service. These intermediary agents will purchase your accounts receivable for a determined percentage of the account's value. The factoring service will then own the debt and have to collect your customer's money. After doing so, they will send you the remaining amount owed on the account minus a percentage withheld for their service. The biggest advantage of using a factoring service is receiving cash up-front, rather than waiting for a collection agency to collect it. You can find more information about debt factoring here.

An Example of Debt Factoring :

- You sell your $20,000 dollar account from Customer Y to Debt Factoring Company A for 80% of the total debt. Up front your business would receive roughly $16,000.
- Debt Factoring Company A collects the entire $20,000 debt from Customer Y.
- Debt Factoring Company A then pays you the remaining $4,000 from the total debt, minus its factoring fees.





WHAT NOT TO DO

- Do **NOT** post negative reviews online! Doing so can open you up to a civil lawsuit for defamation if anything you say is not 100% factual. It can also backfire as new customers may view this as unprofessional.
- Do **NOT** misrepresent yourself or the facts!
- Do **NOT** threaten the customer with jail or criminal penalties!
- Do **NOT** call at unusual hours. Keep your calls limited to between 8 a.m. and 8 p.m.

For more information on recovering an unpaid debt, contact the NFIB Legal Center at info@nfib.org.

Please refer to the debt collection demand letter template on the next page.

[YOUR LETTERHEAD]

[date]

_____

_____[name and address of deadbeat]

VIA CERTIFIED MAIL,

RETURN RECEIPT REQUESTED

RE: NONPAYMENT OF AMOUNTS DUE TO
[YOUR COMPANY]

Dear Mr./Ms. _____:

Please be advised that I am acting on behalf of _____ [your company name] (the "Company"), to whom you owe $_____, together with accrued interest of $_____, for services rendered pursuant to the attached invoice dated _____, 20__.

The Company has contacted you a number of times to obtain payment of your overdue account. Despite these efforts, and your repeated assurances that all overdue amounts will be paid in full, you have not paid the Company's overdue account.

Please be advised that the Company intends and has authorized its attorneys to take all available legal action against you personally in this matter. This will be done forthwith if the

Company has not received the foregoing amount in full by the close of business on _____, 20__ [10 to 14 days from the date of the letter is customary].

Kindly remit payment in full to the undersigned, by bank or certified check, payable to "[Name of Your Company]"by this date to avoid further action. Your agreement with the Company provides for accrual of interest at ___% per annum (___% per month) which will continue to accrue until the Company has received payment in full of its outstanding invoice. Interest shall continue to accrue from the date of this letter at ___% per annum or the highest rate allowed by law if less. As a final matter, I call to your attention that if payment is not received in full by _____, 20__ as aforesaid the Company will seek payment of its legal fees and expenses, in addition to the amounts owed and accrued interest, in any action brought against you.

Please direct all future correspondence in this matter to my attention.

Very truly yours,

cc.: [name and address of your company's attorneys]