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AN OVERVIEW OF COLLECTION PROCESSES AND PRACTICES, WITH EFFICIENCY SUGGESTIONS FROM A SEASONED COLLECTIONS LAWYER

May-June, 2010
Texas Bar CLE

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Creditors' Rights: collections, foreclosures, pre-judgment and post-judgment extraordinary remedies, receiverships, lien priorities, judgment enforcement, and creditors' rights in bankruptcy including collateral recovery, claim litigation, non-dischargeability, plan negotiations, preference defense, and involuntary filings.

Consumer Claims: Deceptive Trade Practices - Consumer Protection Act, Finance Code, usury, Truth-In-Lending, consumer collections, insurance, manufactured housing industry issues, discriminatory zoning, *ad valorem* taxation, and deed restrictions.

Appeals: Texas state and federal civil appeals in the above subject areas.

Alternative Dispute Resolution:

-Approved ADR Provider, United States District Court, S.D.Tx.
-Arbitration Panelist, American Arbitration Association.
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-Arbitration Panelist, American Moving & Storage Association Household Goods Dispute Settlement Program.
-Med/Arb Neutral, Policyholder Remediation Plan, *In Re Prudential Insurance Sales Practices Litigation.*
-Mediation Certification (Section 154.052, Texas ADR Act), University of Houston, 1993.

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-National Association of Credit Management (over 40 CEU-approved presentations since 1988).
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-Texas Society of CPAs (over 66 CPE and CLE-approved seminar presentations since 1990).
-Harris County Constables: Precinct 5 (3 training programs since 1997).
-Equiva Services (Shell Oil Company) In-House Credit Seminars - 4 segments, 14 presentations (2002).
-Texas State Bar - Collections & Creditors' Rights: *Post-Judgment Receiverships & Turnovers* (2004).
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-Recipient, Leadership Houston's 25th Anniversary Top 25 Distinguished Alumni Award (2006).
-Texas Monthly Magazine "Super Lawyer" - Creditor/Debtor Law (2008, 2009).
-National Arbitration Forum - Award for Excellence in ADR (2009).

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AN OVERVIEW OF COLLECTION PROCESSES AND PRACTICES, WITH EFFICIENCY SUGGESTIONS FROM A SEASONED COLLECTIONS LAWYER

I. SCOPE OF ARTICLE

During the course of this CLE seminar on Collections and Creditors' Rights, many seasoned collection experts will be shining a bright light for you on various focused content areas. Listen to them, and hang onto their papers! The immediate skeletal discussion is not intended to duplicate that effort, but instead to provide an "aerial overview" of process and practice, along with a few specific recommendations for your attention from one more seasoned veteran collection attorney. **My personal "efficiency tips" are sprinkled in bold font throughout this paper.** Because effective collection is both an art and a science, you will perhaps hear some differences in opinion throughout the seminar on both legal and practical considerations involved in different phases of a collections practice. Reasonable minds can and do differ. An effective "collection mentality" can manifest itself in many different ways through many different attorney personalities. Thus, any specific opinions or observations espoused here must be blamed solely upon the author/speaker's thirty-year background and urban perspective.

II. FEE ARRANGEMENTS AND THE DECISION TO LAUNCH (OR NOT)

A. Costs vs. Benefits

Some debtors do not have to be sued, but most often, litigation is necessary to collect a delinquent unpaid debt. Litigation is the means, collecting money is the end. **Successful collection lawyers always keep their eye on the prize (*i.e.* money) and do not let their love of the litigation "game" become the priority.** 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 (and the lawyer!) 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. Remember also that **any fee arrangement with a contingent aspect, dependent upon a successful collection result, must be in writing under Rule 1.04(d) of the Texas Disciplinary Rules of Professional Conduct.** If your contingent or commission fee elements contemplate that you will deposit client money in trust, take out your percentage, and then remit net amounts, your written fee agreement should include express client authorization for you to endorse and negotiate instruments payable to the client in the client's name and, subject to proper transparency and fiduciary trust accounting on your part, fulfillment of the fee arrangement.

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. **Clients do not expect collection lawyers to guarantee results, but they do expect a businesslike attention to costs versus benefits.**

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, such as online subscription database services, 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 a given 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. Thus, they must likewise be a constant concern of the effective collection attorney.

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 and creditor's attorney 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? If the attorney does not develop good intuitions and insights concerning these considerations, and make appropriate recommendations to the client at all points along the way, then the client will ultimately be disappointed. **Close communication with and status reporting to the client is instrumental to a collection lawyer's success. This begins with good client education on the front-end to clarify realistic expectations. And if, at any point, it does not make sense to pursue collection, the attorney should be the first one to say so.**

B. 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 a 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 some 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. You will hear elsewhere in this conference about exempt property, but for purposes of this overview, suffice it to say that 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 the sobering obstacle of voluntary protection under the United States Bankruptcy Code. Remember that 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? Again, if it does not make sense to pursue collection, the attorney should be the first one to say so.

III. EVALUATING RESPONSIBILITY

A. Does your client *really* know who the debtor is?

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 debtor/creditor relationship, and carefully evaluated for creditworthiness.

One of the most important up-front credit intake considerations for the client is *knowing* the 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! You will love your clients who extend credit with such precautions. 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 we are approached to collect legally. 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, but is also crucial to your decision about who to make demand upon and who to sue. 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 is required. Successful collection lawyers must thus be conversant with all of the liability implications of the Texas Business Organizations Code. The "black letter" versions of these rules (which can have "gray" nuances) are as follows:

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.

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.

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.

e. Limited Liability Partnership

(1) Available in Texas since 1991.

(2) With the exception of the liability limitations discussed below, an LLP is treated as a general partnership.

(3) The partnership name must reflect LLP status.

(4) 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.

(5) Under the Texas statute, $100,000 of liability insurance must be obtained, or $100,000 bond must be posted for satisfaction of tort liabilities.

f. Limited Liability Company

(1) Available in Texas since 1991.

(2) 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.

(3) One or more organizers must file articles of organization with the Secretary of State, much like articles of incorporation.

(4) The name of the entity must reflect LLC status.

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).

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.

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.

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.

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

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

a. True Names vs. Assumed Names

(1) 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.

(2) 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.

(3) Any entity may sue or be sued in its assumed name.

(4) 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

(1) 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.

(2) 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.

c. Agents

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

(2) 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 *Southwestern Bell Media, Inc. v. Trepper,* 784 S.W.2d 68, 72 (Tex. App.--Dallas 1989, *no writ*) and *Burch v. Hancock,* 56 S.W.3d 257, 261 (Tex. App. – Tyler 2001, no pet.).

(3) 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.

(4) For the purpose of disclosing the true principal, it is not sufficient to use an assumed name of the principal in order to protect the agent. 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

(1) 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.

(2) 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 for your client not to take as many personal guaranties as they can get. And you will love having as many donkeys to pin the tail on as possible!

(3) Guaranties must be in writing and signed to be enforceable. See §26.01(b)(2), TEX. BUS. & COMM. CODE.

e. Changes in Composition

(1) 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.

(2) To protect itself fully, your creditor client should know who the 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.

(3) 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 often don't.

IV. MAKING DEMAND

Debtors have different levels of tolerance for formal collection procedures. Different straws will break different camels' backs! Some debtors who have consistently ignored the creditor's pleas and demands will suddenly be interested in payment terms once a demand letter from an attorney is received. Demand letters should always set deadlines and those deadlines should be meaningful. Creditor's counsel cannot draw a line in the sand and then fail to take initiative accordingly -- credibility is lost when nothing "bad" happens upon expiration of a demand response period. Even if the debtor fails to respond, or is unlikely to respond, to a demand letter, there are often good legal reasons for sending one. For example, a written demand can predicate a right to recovery of attorneys' fees under Chapter 38, TEX. CIV. PRAC. & REM. CODE. Or a written demand with proper notice language may be the best way to demonstrate compliance with the federal Fair Debt Collection Practices Act.

There may also be legal conditions precedent that need to be met before litigation can commence. For example, there is no general rule for recovery of attorneys' fees by prevailing parties in Texas. However, a prevailing creditor in a collection suit may recover attorneys' fees if the underlying contract so provides or if the requisites of Chapter 38, TEX. CIV. PRAC. & REM. CODE, have been met. To recover attorneys' fees under that Chapter, the creditor-claimant must present the claim to the opposing party (usually via a pre-suit written demand letter), and payment for the just amount owed must not have been tendered before the expiration of the thirtieth (30th) day after the claim is presented. Also, a pre-suit demand letter from an attorney may be all that is needed to get some debtors to pay.

In cases where the debtor is a consumer within the meaning of the FDCPA (generally, a natural person who incurred the debt in a transaction primarily for personal, family, or household purposes) it is critical to remember that the <u>debt collector must disclose clearly in all communications</u> made to collect a debt or to obtain information about a consumer "<u>that the debt collector is attempting to collect a debt and that any information obtained will be used for that purpose.</u>" 15 U.S.C. § 1692e(11). Failure to make such disclosure constitutes use of a "false, deceptive, or misleading representation or means" in connection with the collection of a debt and is a violation of 15 U.S.C. § 1692e. Likewise, at the demand stage, it is important

to remember complete and literal compliance with the "Miranda Warning" of Section 1692g of the FDCPA.

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 "home equity" 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 attorney'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).

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.

V. TELEPHONE COLLECTIONS

A. Dynamic Telephone Contact Techniques

Telephone collection, like all phases of collection, is an art and not a science. The first and last goal of telephone contact with the debtor is to collect money, sometimes without the need for litigation. Obviously, in the case of consumer debt, subject to both the FDCPA and the Texas Act mentioned above, the telephone should be used judiciously, if at all. If you are completely risk averse, and want to avoid any prospect of consumers "mis-remembering" what gets said over the phone and using it against you, then you should only use the telephone to collect non-consumer debt.

1. Telephone Demeanor

a. Be firm and businesslike—but as nice as they will "let" you be. Gather your flies with honey, if possible.

b. Be flexible, but persistent.

c. Take your signals from the debtor's demeanor.

d. Always be alert and never lose your temper.

e. Never use obscene or abusive language.

f. Never suggest that there may be consequences more serious than civil enforcement of the obligation to pay money.

g. Never be coy about your true identity.

h. Never threaten criminal action. This is a disciplinary issue under Rule 4.04 of the Texas Disciplinary Rules of Professional Conduct.

i. Because your voice is all-important on the telephone, develop a slower, more soothing, and

lower-pitched manner of speaking that is clearer to listeners and compels attention until you finish.

2. Points to be Covered in the Contact

a. Identify yourself without ambiguity or hesitation.

b. Specify the amount of the debt and the nature of the debt: Is it an accelerated balance or an installment arrearage?

c. What is the name of the responding party?

d. Does the responding party have a title or job function he or she can describe? What is his relationship to the debtor?

e. 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.

f. How is the debtor legally organized: corporation, partnership, or proprietorship? LP, LLP, or LLC?

g. Who are the principals, owners, or officers of the business?

h. Which of those persons does the responding party report to? Will the boss get a report of this conversation?

i. Does the debtor use any assumed names or "trade" names?

j. What does the business do? Where is it physically located?

k. **Make a "demand" or request for payment in full, without any embarrassment or apology.** Will the debtor mail the check today?

l. Identify whether the debtor claims any justifications or excuses exist for non-payment. Is this a habitually slow payer or a new, isolated problem?

m. Try to limit the scope of the justifications or excuses.

n. Make a good record of any admissions made by the telephone responder.

o. "Admit" nothing.

p. "Accept" only that which is consistent with your main mission - to recover money.

q. **Give the debtor a "deadline." What is the method, manner, amount, and timing of the payment? "Some money soon" is not acceptable.**

r. Give the debtor "homework."

s. 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?

t. Follow-up in a timely manner.

3. Questioning Strategies

a. Use "open" questions where you have no idea as to the probable response or the response you would like to hear.

b. Use "leading" questions where you are verifying data you already have at hand, or where you are trying to elicit an admission.

c. In deciding whether "open" or "leading" questions are preferable, use all tools and information available to you, including your client's original credit application file (if any), online advertising and websites, or information turned up by "Googling." For example, knowing the nature of the debtor's business may help you determine when to call.

d. Limit your own talking and do not routinely interrupt—you cannot talk and listen at the same time. Listening is often 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.

e. Concentrate on what is being said, and shut-out outside distractions.

f. Take notes to decide what is relevant for logging after the call.

g. Listen for ideas that convey the whole picture—not just bits and pieces.

h. Be careful of interjections that suggest your approval or acceptance, like "OK," "I see," or "I understand."

4. Logging the Information and Results of the Telephone Contact

a. Make a memo of all pertinent facts and admissions discovered in the contact.

b. Use quotation marks to record the responding party's actual statements, clearly identifying who made them and his or her relationship to the debtor.

B. Respecting the Rights of Debtors

Successful collections depends on invoking a positive response from the individual in a position to pay. To a great extent, this depends on your ability to develop a positive attitude from the payor. The telephone is often a perfect instrument for achieving the desired "rapport." Given the restrictions and expense involved in forcing payment of debts, getting voluntary payment is certainly a desired outcome. The need to respect the legislated rights of your debtors is based on this desire as well as protecting yourself from liabilities and penalties for violations. *Always* extending basic courtesy and respect to your debtor are traits not commonly attributed to collection lawyers; however, these are efforts that will both increase collections and help maintain your client relationship.

Every unpaid account represents a story, a reason for non-payment. As collection attorneys, we hear these reasons often and tend to become immune to the effects. Using a more sympathetic approach, realize that in many cases this is a new situation for your debtor. Simple acknowledgment of empathy with the debtor's situation ("I hear you, and I'm sorry to hear that"), without admitting legal validity, can help establish a positive attitude on the part of your debtor without compromising your position as the creditor's attorney. Using techniques that include eliminating any valid reasons for non-payment, make the demand for payment with the expectation that your debtor's intentions are to pay. "How are we going to solve this $30,000.00 problem?" In providing the debtor an opportunity to explain any reason for non-payment and responding with a professional and respectful response, debtors with legitimate intent will respond with similar respect and professionalism and often grow to be collaborative with you about recovery of the debt.

The practical reality is that few people are willing to give any preference to someone who has personally offended them, including debtors. There is also an important issue of ethical responsibility. The duties that an attorney owes to a non-client debtor under the Texas Disciplinary Rules of Professional Conduct include truthfulness (Rule 4.01); avoidance of communication directly with a debtor who is represented by another lawyer (Rule 4.02); countering any impression on the part of an unrepresented debtor that the creditor's attorney-advocate is neutral or disinterested (Rule 4.03); and, not participating in or threatening any criminal charges solely to gain an advantage in the civil debt-collection effort (Rule 4.04).

VI. LEGAL GROUNDS AND OBSTACLES

If you evaluated responsibility thoroughly at the demand stage, then you will know who to sue (sometimes additions, deletions, or adjustments are made to the list of debtors responsible for the claim based upon information you learn post-demand, such as from telephone collection efforts, but most often, your lawsuit Defendants will correspond to your demand letter recipients). Be sure to file in a Court that has subject-matter jurisdiction (*i.e.* generally, the lowest level Court with power to entertain the claim and enter judgment) and arguably proper venue. **In commercial cases, the Defendant may waive any debate about debatable venue, but remember that in consumer cases covered by the FDCPA, suing a consumer debtor anywhere other than where he lives or where he signed the debt instrument is a violation.** 15 U.S.C. §1691i(a). You also face potential liability under §17.46(22) of the Texas Deceptive Trade Practices Consumer Protection Act.

Your cause(s) of action for collection of debt depend upon what your client brings you in the way of substantiation for the claim, but most often require you to consider the following:

A. Oral Transactions

1. Oral contracts are usually legally enforceable, but always present practical proof problems.

2. Some types of contracts must be in writing to be enforceable; *e.g.* guaranty agreements.

3. To improve the creditor's position, encourage your client to document the payment obligation.

B. Open Accounts

1. Accounts are easy to sue on under Rule 185, TEX. R. CIV. P., but present many of the same "swearing match" problems as purely oral transactions.

2. To improve the creditor's position, encourage your client to consider backing up the account with a written contract; consider taking guaranties to establish joint responsibility in other parties; if goods are involved, consider retaining purchase money security interests and promptly filing UCC-1's; if goods or services improve real property, consider taking timely advantage of statutory mechanics and materialmen's lien procedures.

C. Written Contracts

1. Written contracts are not only superior evidence of indebtedness; they can also potentially address other issues that affect collectibility (such as disclaimer of warranties, specification of lawful interest or late charges, and clarification/limitation of the creditor's performance obligations).

2. To improve the creditor's position, your client should consider taking guaranties to establish joint responsibility in other parties; if goods are involved, consider retaining purchase money security interests and promptly filing UCC-1's; if goods or services improve real property, consider taking timely advantage of statutory mechanics and materialmen's lien procedures.

D. Promissory Notes

1. Promissory Notes (". . . promise to pay to the order of . . .") are a specially recognized form of written contract that streamline proof of a debt and minimize legal obstacles to collection.

2. To improve the creditor's position, consider urging your creditor client to get signatures from co-makers or taking guaranties to establish joint responsibility in other parties; if goods are involved, consider retaining purchase money security interests and promptly filing UCC-1's; creditors should also consider taking collateral interests in other assets and promptly filing UCC-1's.

3. If you or your client are going to use a Note (for example, to establish installment payment terms for settlement), you must calculate and apply interest very carefully in order to avoid usury problems. Also, **use a good Note form that includes an anti-usury clause, an acceleration clause, a waiver of notices clause, and an attorneys' fees provision.**

E. Overcoming Defenses

Complete client information, including the credit file and <u>all</u> correspondence and documentation affecting the claim, are critical. Not only does the attorney need a complete file to present the affirmative claim most effectively, but also to anticipate and strive to successfully overcome defenses.

1. A simple denial requires the creditor to prove its claim by a preponderance of the evidence. Rule 92, TEX. R. CIV. P.

2. A presumption of validity attaches to a sworn account claim, unless and until the debtor denies it under oath. Rule 185, TEX. R. CIV. P.

3. A presumption of validity attaches to a Promissory Note claim, unless and until the debtor denies signature under oath. Section 3.308, TEX. BUS. & COMM. CODE; Rule 93, TEX. R. CIV. P.

4. Affirmative defenses, which are the debtor's burden of proof, can defeat the creditor's right to recover even if the claim for debt is established by a preponderance of the evidence. Rule 94, TEX. R. CIV. P. These "yes, . . . but" defenses include:

   a. **accord and satisfaction:** "Yes, I owed that debt, but the creditor agreed to accept something less and I paid the compromised amount." Moral: You and your client must carefully document, with signatures, any settlements, compromises, or payment arrangements agreed to with the debtor. Sloppy handling of payment arrangements

has been devastating to many a legitimate collection claim!

b. **failure of consideration:** "Yes, I agreed to pay that amount, but I didn't get what I bargained for." Moral: Don't expect much success in collecting a claim for non-payment when the creditor has not fully performed as promised, or if the creditor has delivered faulty products or services.

c. **fraud:** "Yes, I agreed to pay that amount, but I was tricked and lied to." Moral: Always operate honestly and ethically, and hope to avoid representing those who don't.

d. **statute of limitations:** "Yes, I would have owed that debt, but the creditor waited more than four years before filing suit." Moral: If the creditor waits too long to initiate litigation, the creditor's claim can be time-barred, no matter how large or how valid. Make sure *you* are not the reason that the statute of limitations elapses while a claim is in your hands! File suit promptly, and especially where the four-year statute may be looming.

F. Counterclaims

1. Look before you leap.

Any time a suit for debt is contemplated, the creditor and its counsel should carefully consider whether there is any legitimate room for justifiable criticism of the product, service, or other consideration creating the debt. You cannot assume that every debtor will simply acquiesce and acknowledge the obligation sued upon without a fight. The likelihood of a contest is greater when there is some credible challenge that can be raised concerning the deficiency in quality or quantity of the product or service involved. If a controversy is engendered, the reality is that aggressive defense counsel will "go fishing" for counterclaim potential as a means to put the defendant's best foot forward. Assure yourself *before you elect to sue* that the underlying transaction is "clean," *i.e.* try to objectively assess whether any facts exist that would support the debtor in urging a breach of warranty or breach of contract-type claim.

2. Encourage clients to maintain high standards of integrity and insure accuracy.

Fraud has always been a popular counterclaim in debt collection cases, but traditionally was difficult for the debtor to prove since the cause of action requires an *intentional* misrepresentation of *material* fact. Fraud counterclaims are still encountered, but much more popular are claims brought under the Texas Deceptive Trade Practices - Consumer Protection Act ("DTPA"). Contrary to popular belief, DTPA liability does not turn upon *deception* in the traditional fraud sense of *intentional* dishonesty. Nor is the DTPA limited to *consumer* claims in the popular sense of the word "consumer." Under the DTPA, unlike the FDCPA, a consumer is any party (including a business corporation with less than $25 million in assets) that seeks or acquires by purchase or lease any goods or services.

Misrepresentations are actionable under the DTPA regardless of materiality, and even negligent misstatements can be made the basis of a DTPA claim. With very limited exceptions, written contracts cannot waive or disclaim DTPA liability, in spite of their contrary verbiage. Texas providers of goods and services on credit must maintain high standards of honesty and good faith. Salespeople must be trained to qualify statements regarding the characteristics of what they are selling because if there is any inaccuracy, the debtor will potentially have grounds for a DTPA counterclaim. Any suit to collect a debt associated with the sale or lease of goods or services can be seriously infected by a DTPA counterclaim alleging that someone in the stream of commerce made statements about the goods or services that differed in some aspect from the reality.

3. Be wary of usury.

Texas is unique in its draconian treatment of usury violations. Even seemingly modest violations of legal interest limitations can result in severe penalties and even forfeiture of the principal debt. See Chapter 305, TEXAS FINANCE CODE, for commercial transactions governed by Subtitle A, and Chapter 349, TEXAS FINANCE CODE, for consumer transactions governed by Subtitle B. For example, if a Texas creditor requires a debtor to assume or guarantee a pre-existing third-party liability as one of the considerations for extending new credit, the gross amount of the assumed debt can be counted as "interest" in evaluating whether usury ceilings have been exceeded in the new transaction.

In one such case, *Alamo Lumber Co. v. Gold*, 661 S.W.2d 926 (Tex. 1984), the Texas Supreme Court held that "a lender who requires as a condition to making a

loan, that a borrower assume a third party's debt . . . must include the amount of the third party's debt in the interest computation." Applying this rule, the creditor (Alamo) "had charged more than double the amount of interest permitted by statute" when it *accepted the proposal of its debtor* (Reed) to extend credit to the debtor's mother (Gold) on the condition that Gold would also assume Reed's open account. At the time of the agreement, Reed owed $23,552.80; Gold signed a note for $30,893.10, which represented the amount of Reed's debt plus attorney fees that Alamo had paid in connection with the total transaction. Alamo then extended credit to Gold in the amount of $82,925.34, which was secured by a lien on real estate owned by Gold. The Court stated that "Alamo's requirement that Gold assume Reed's independent open account as a condition to Alamo's [extension of credit to Gold] made the $23,552.80 interest as to Gold." The Court cited *Laid Rite, Inc. v. Texas Industries, Inc.*, 512 S.W.2d 384, 389 (Tex. Civ. App.--Ft. Worth 1974, no writ) and *Stephens v. First Bank and Trust of Richardson*, 540 S.W.2d 572 (Tex. Civ. App.--Waco 1976, writ ref'd n.r.e.), among many earlier Texas usury cases and case law from other jurisdictions to support this conclusion. The Supreme Court explicitly rejected Alamo's argument that it did not intend to charge usury, and that the notes were non-usurious on their face, quoting *Cochran v. American Savings & Loan Association*, 586 S.W.2d 849 (Tex. 1979): "it is not the lender's subjective intent to charge usury that makes a loan usurious, but rather his intent to make the bargain that was made." The ultimate result of the case was that the creditor lost any right to repayment of the principal of either of the notes (totaling over $113,000.00); the liens which secured the notes were cancelled; *and* the creditor was ordered to pay to the debtor a penalty of over $90,000.00 (double the amount of interest charged) and to pay the debtor's attorney fees of $25,000.00.

If a Texas creditor applies an interest charge to a delinquent open account without having a written contract authorizing such charge, then the rate had better not exceed 6% per annum and the interest had better not begin to accrue until the thirtieth day after the debt becomes due. See Section 302.002, TEX. FINANCE CODE. In *Steves Sash & Door Co., Inc. v. The Ceco Corp.*,751 S.W.2d 473 (Tex. 1988), the creditor forfeited $13,454.70 in principal debt because it had erroneously charged $245.69 in interest on this amount during the "30-day grace period." The creditor also was required to pay a penalty of $2,000.00, post-judgment interest, and attorneys' fees. It is immaterial whether the usurious interest has been collected or whether the creditor has changed its mind about attempting to collect it. The mere act of charging can trigger the usury analysis, not just collection. In the *Steves* case, the debtor still owed more on its open account than the amount of the creditor's total forfeiture and penalty.

There is an opportunity pursuant to statute to "correct" usury by disavowing usurious charges, but correction is only effectively invoked if the creditor confesses to the usury prior to having it brought to the creditor's attention by the debtor. See §349.201, TEX. FINANCE CODE, for Subtitle B (consumer) and §305.003(a), TEXAS FINANCE CODE, for Subtitle A (commercial). "[T]he creditor [must] give[] written notice to the obligor before the obligor gives written notice of the violation or files an action alleging the violation." **If usury correction is to be undertaken, it should be done in the original demand letter.**

The bottom line is that Texas creditors must be very wary of interest. Even post-judgment, a miscalculation of the interest due on an obligation justly owed can create controversy. See, for example, *Solomon v. Briones*, 805 S.W.2d 916 (Tex. App.--San Antonio 1991), writ denied *per curiam*, 842 S.W.2d 278 (Tex. 1992) and *Hunt v. Baldwin*, 68 S.W.3d 117, 129 (Tex. App. – Houston [14th Dist.] 2001, no pet.). Interest must be calculated carefully and never applied unilaterally to a debt. The interest statutes applicable to a particular type of transaction must be known and adhered to. Under Texas law, certain types of financing have different interest rules than other types. When in doubt, I hope my creditor clients do not charge interest. Both you and your clients should always take the conservative approach in calculating interest and pay-off figures. Always make it clear that all you intend to charge or collect is "lawful interest" since this may save an iffy demand, invoice, pay-off quote, or transaction document.

The surest way for a creditor to create a problematic potential counterclaim is to apply interest in a "punitive" fashion, such as insisting upon a 2% per month charge on an open account that was not approved by the debtor in writing in advance. But if you miss the chance to correct this usury at the demand stage, then you have contributed to the problem!

VII. GETTING TO JUDGMENT

Judgments are not money, but they can give you extremely valuable collection tools and enhance your bargaining power in negotiating payment arrangements. **So don't turn up your nose at any judgment you obtain, and be glad to get them any time you can.**

The "litigation" mentality sometimes prefers judgments obtained after a hard-fought trial on the merits and perhaps an appellate process. This is anathema to the economics of collection, however. Although you may enjoy trials and appeals, you hope to keep the efforts and risks necessitated by such processes to a minimum. **The "collection" mentality is just as happy with judgments obtained more easily - such as defaults, summary judgments, and agreed judgments.**

With regard to default judgments, my personal practice is to review the citation carefully before it is forwarded for service, ride herd on the process server to accomplish proper service, and check the citation service return before it is filed (in case an amendment of the return is necessary). When it comes to defaults, you must consistently adhere scrupulously to legal requirements, without ever getting sloppy. The first time you get sloppy, such as by "finessing" a default without a sustainable record of proper service, fate will insure that *that* will be the very case where counsel will appear before the judgment is final and move (with some likelihood of success) to set it aside. If you consistently insist upon having a perfect record to support entry of a default, then in that occasional case where a motion to set aside is urged, you will have some prospect of defeating it, and thus more bargaining power. **When motions to set aside defaults are made, I usually file a response in opposition to clarify the risk to opposing counsel and the debtor - but I also typically try to get a payment arrangement negotiated (supported by leaving the judgment in place) before the motion to set aside is actually heard.**

Summary judgments are often successfully based upon deemed admissions, when discovery requests served with the Petition are not timely answered. I am a big believer in serving discovery requests with the collection Petition. Summary judgments can also be based upon unsworn answers filed in Rule 185 cases or creditor affidavits that cannot be truthfully refuted. Many debtors are in confession and avoidance mode, essentially unable to refute the creditor's claim, but hoping to defeat it with affirmative defenses or counterclaims. In such scenarios, Rule 166a(i) no-evidence motions, at the appropriate time, can clear the way for a creditor-friendly result.

Agreed judgments should be taken routinely to support and "secure" agreed payment arrangements. Although a debtor who responds favorably to a demand letter by acknowledging the debt and agreeing to terms may just need to sign a settlement promissory note, one who does not get interested in doing the right thing until you sue him should have to endure the "collateral damage" to his credit standing associated with your taking of an agreed judgment. To keep the debtor incentivized, agreed judgment awards are often more onerous than adherence to the payment terms of a side agreement (avoid making your judgment "conditional" on its face by putting the payment terms in the judgment itself). **The creditor's promise not to execute so long as payment performance is consistent with the settlement agreement should be religiously complied with, but should not clutter-up your judgment.**

VIII. PLUSSES AND MINUSES OF E-FILING

One of the latest trend issues for collection lawyers striving for maximum efficiency is whether or not to use e-filing. Processing pleadings with a paper-based system creates inefficiency and higher costs with significant burdens on limited Court facilities. There is no question that e-filing is faster, more convenient, and saves resources (paper, messengers, couriers, postage, *etc.*) and scanners have become *de rigueur* in law offices. More and more Courts across the state are available for e-filing, and federal District and Bankruptcy Courts have been committed to CM/ECF filing for some time. In some Courts, e-filing is the only option (paper filings are not accepted), and eventually all Courts will be "paperless." **For now, during the transitional years, when you have a choice whether to use e-filing or traditional paper filing, the key threshold question is whether or not the particular Court itself has truly embraced e-filing.** If a particular Judge is only grudgingly allowing e-filing, does not consult the computer screen to review PDFs and handle dockets, and is still looking for hardcopies of pleadings in a paper file, then you can obviously be at a disadvantage with e-filing. However, the opposite is also quite true: failing to scan and submit your documents to the Court online can create serious disadvantages if your opponent is doing so and the Judge is relying upon the e-filing system. With the elapse of only a few more years, standardized uniformity and consistency of e-filing will

quickly evolve, and there will not be any question that e-filing is the way to go. But for now, know your Courts.

As far as the state County and District Courts are concerned, the starting point for understanding and getting underway with e-filing is the "Official Portal of Texas," the Texas Online E-Filing for Courts website at www.state.tx.us/portal/tol. At this site you can determine which Courts are participating, evaluate an appropriate Electronic Filing Service Provider with whom you should subscribe (there are currently eight certified EFSPs for Texas online e-filing), and get answers to all of your questions concerning hardware/software requirements, costs, and logistics. If you have not yet tried e-filing, subscribe to an EFSP and give it a personal "beta-test." There is no time like the present to begin adjusting to the undeniable trend of the future, given our Internet-driven world.

IX. DOCKETING

The only way you can maintain sanity and viably manage the needs of a high-volume collection docket (particularly where you have numerous matters pending at various points in the litigation process at any given time) is with a well-maintained automated docketing or calendaring system. There are dozens of viable software programs on the market for this purpose, so pick one that has been around for awhile and that your colleagues recommend (for example, I have used *Abacus* productively for many years). Whether the deadlines are self-imposed for the sake of diligent and conscientious handling of your client matters, or whether they are externally imposed (such as discovery response deadlines or statutes of limitations), **some time and attention should be devoted every single day (1) to prioritizing your time based upon the practice reminders provided by the daily docket, and (2) to re-docket files to insure that all are set for future attention dates and do not fall "off the screen" into the malpractice mire.**

X. FUNDS HANDLING AND PROCESSING

Honest handling of client funds, and the associated full-disclosure periodic trust accounting, are non-delegable fiduciary duties that belong to the attorney alone. Thus, the trust account you maintain for segregation of client funds will only see deposits or withdrawals (*i.e.* check-writing) upon your signature. However, as a practical matter, you will place some well-supervised reliance upon your trust accounting software (which may link to or be integrated with your collection docketing software) and a dependably mature staff person who has full appreciation of your professional responsibility and the liabilities potentially attaching to your handling of "other people's money." Since you hope that lots of instruments (*i.e.* checks, cashier's checks, and money orders, not to mention the occasional cash) will be coming your way which you will need to deposit, verify as representing good funds, and/or then take out your own fees, it is critical to have a full and transparent understanding with the client about the timing and logistics surrounding any funds to be collected. **If your contingent or commission fee terms contemplate that you will deposit client money in trust, deduct your percentage, and then remit net amounts, your written fee agreement should include express client authorization for you to endorse and negotiate instruments which on their face are payable to the client in the client's name. The client should also approve your systems and procedures for net recovery remittances on a routine periodic basis.**

Texas Disciplinary Rules of Professional Conduct:

Rule 1.14. Safekeeping Property

(a) A lawyer shall hold funds and other property belonging in whole or in part to clients... that are in a lawyer's possession in connection with a representation separate from the lawyer's own property. Such funds shall be kept in a separate account, designated as a "trust" or "escrow" account.... Complete records of such account funds and other property shall be kept by the lawyer and shall be preserved for a period of five years after termination of the representation.

(b) Upon receiving funds or other property in which a client... has an interest, a lawyer shall promptly notify the client.... Except as stated in this rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client... any funds or other property that the client... is entitled to receive and, upon request by the client..., shall promptly render a full accounting regarding such property.

XI. POST-JUDGMENT COLLECTION

The State of Texas offers perhaps the most challenging set of obstacles and exemptions regarding the enforcement of judgments of any state. Perhaps this explains why there are so many debtor-oriented and consumer-oriented statutes in Texas (however, there are no exemptions for corporate assets). Donna Brown's paper is one of the best resources ever on post-judgment collection. But meanwhile, here are a few "nuggets" of particular post-judgment wisdom from someone who has collected many Texas judgments and loves every minute of it.

A. Abstracting.

Many commercial litigators know the importance of abstracting your judgment in any county where the judgment-debtor has or might have real property, because under §52.001 *et seq.*, Tex Property Code, "a first or subsequent abstract of judgment, when it is recorded and indexed [properly], if the judgment is not then dormant, constitutes a lien on the real property of the defendant located in the county in which the abstract is recorded and indexed, including real property acquired after such recording and indexing." It is likewise well known that judgment liens created by the abstract have a duration of 10 years under §52.006, TEX. PROPERTY CODE. **What is not generally well understood, however, is that in order to extend the life of a judgment lien *beyond* ten years, you must (1) extend the life of the judgment itself (*i.e.* keep it from becoming dormant) *and* (2) extend the life of the lien by recording a second abstract before the first one expires. See §34.001, TEX. CIV. PRAC. & REM. CODE. Performing only the second step without performing the first is useless because the lien evaporates when the debt evaporates.** Make a study of renewal and revival of judgments before their ten-year anniversary.

B. Discovery

The most effective formal post-judgment discovery under Rule 621a, TEX. R. CIV. P., is a subpoenaed post-judgment deposition with comprehensive *duces tecum* document production by the judgment-debtor. Written post-judgment discovery is usually much more trouble than it is worth. Informal post-judgment discovery of assets, such as via online subscription services like Accurint.com or PublicData.com, is increasingly the preferred way to quickly garner useful information and be prepared to take the most potent and efficient post-judgment depositions.

C. Execution

Effective execution strategy under Chapter 34, TEX. CIV. PRAC. & REM. CODE, and Rules 621-656, TEX. R. CIV. P., is both an art and a science. **Although the power of a writ of execution is the ability to seize and sell property, green money is still usually the better product of an execution procedure.** The threat of seizing and selling exists in the context of the actual non-exempt real or personal property available to be levied upon. For example, if the property available to be levied upon looks like it might bring $20,000.00 in an execution sale, but the judgment-debtor will come up with $15,000.00 cash to avoid seizure, I will gladly take the cash every time. Sometimes the execution scene is a perfect environment to negotiate an immediate cash partial payment (through the Sheriff or Constable) toward the judgment and a post-judgment moratorium agreement to collect the rest. Obviously, you need to have the best possible working relationship with the Sheriffs or Constables involved.

Sheriffs and Constables around the state vary in their degree of enthusiasm, effectiveness, and knowledge about lawful execution procedures. The best ones will make a clear record of everything that transpires, including your instruction on behalf of your judgment-creditor client for them to seize particular assets. **I routinely carry a digital audio recorder and a smartphone videocamera to every execution procedure to avoid any possible future debate about what happened at the scene (*i.e.* condition of the premises upon arrival, what was said and by whom, what was loaded onto the truck, what options were presented or discussed, what post-judgment payment arrangements were agreed upon, *etc.*).** For example, in the case of individual judgment-debtors, you always want the serving officer to give the judgment-debtor an opportunity to waive his exemptions by designating property to be seized under Rule 637, TEX. R. CIV. P. The audio or video recording is the best way to document what was actively designated by the debtor.

Judgment-debtors often erroneously believe that the existence of contract liens on their personalty will preclude seizure and sale. However, **since the purchaser at the execution sale buys whatever the debtor owns subject to such liens, the encumbrance alone does not preclude execution. See Rule 642, TEX. R. CIV. P. However, if the secured party, such**

as a bank creditor with a blanket lien, comes running to the debtor's aid and has the right to demand possession of the personal property collateral because of the insecurity created by your levy process, you must relinquish possession in order to avoid conversion liability. Read *Grocers Supply Co. v. Intercity Investment Properties, Inc.*, 795 S.W.2d 225 (Tex. App.--Houston [14th Dist.] 1990, *no writ*). Faced with this reality on many occasions, I have often seen some value in suggesting that my unsecured creditor client might need to evaluate its options to place the judgment-creditor in an involuntary bankruptcy under §303 of the Bankruptcy Code. Depending upon the credibility of the suggestion and the relative economics (such as the size of my judgment relative to the bank's outstanding credit to the debtor), I have, more than a few times, collected my judgment by a further advance from the secured creditor bank, which does not want to face the prospect of realizing upon its collateral with its debtor under the jurisdiction of bankruptcy. A fun way to turn around the bankruptcy threat we creditors' attorneys so often hear!

D. Garnishment

At the post-judgment stage, no bond need be posted, but this remedy to capture funds or property in the hands of third-parties such as banks, is still only available upon proof that the debtor does not, within the knowledge of the plaintiff, have property in Texas subject to execution sufficient to satisfy the judgment. A good record of return of execution *nulla bona* is important both in terms of predicating garnishment, and extending the life of the judgment under §34.001, TEX. CIV. PRAC. & REM. CODE. **To set up garnishment, we always ask the judgment-debtor in his post-judgment deposition if he has assets in Texas subject to execution sufficient to satisfy the judgment. They usually say "no," in which case your risk of wrongful garnishment is minimized.** If they say "yes," then that admission of course leads to some interesting questions. We also have a provision in every post-judgment payment agreement whereby the debtor stipulates that he does not have assets in Texas subject to execution sufficient to satisfy the judgment, and thus is receiving valuable consideration by entering into extended payment installment terms.

Liability for wrongful garnishment may arise under the following circumstances:

1. Judgment creditor makes an untrue statement in the affidavit supporting the Application for Writ of Garnishment.

2. Judgment debtor actually has property within the State of Texas subject to execution sufficient to satisfy the judgment **and** the affiant had **actual knowledge** of this fact. *King v. Tom*, 352 S.W.2d 910 (Tex. Civ. App.--El Paso 1961, no writ).

3. If judgment creditor failed to make a reasonable inquiry regarding whether such property exists, such failure may constitute constructive knowledge. *Massachusetts v. Davis*, 160 S.W.2d 543, 554 (Tex. Civ. App.--Austin 1942), aff'd in part and rev'd in part on other grounds, 168 S.W.2d 216 (1942), cert. denied, 320 U.S. 210 (1943).

4. Judgment debtor may recover actual damages for wrongful garnishment. *Peerless Oil & Gas Company v. Texas*, at 158 S.W.2d 758 (1942).

5. The judgment debtor may recover exemplary damages if the judgment creditor acted maliciously and without probable cause. *Biering v. First National Bank*, 7 S.W.90 (1888).

E. Turnover

The Turnover Statute at §31.002, TEX. CIV. PRAC. & REM. CODE, gives the Court a great deal of discretion to meet the needs of particular judgment collection scenarios that do not fall squarely within the traditional remedies. For example, the Court may order turnover of specific property (a form of injunction) and/or appoint a receiver, without the conditions, obstacles, and bonding requirements ordinarily encountered prejudgment or at common law.

XII. USING MEDIATION AND SETTLEMENT TO COLLECT DEBT

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 will acknowledge to you that they owe (*i.e.* an extension or work-out settlement). 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 (particularly if your note form includes a release in favor of your client!). 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). Prepare the note and send it to the debtor requiring 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 prepare and file suit.

Where the full amount of the debt is acknowledged and an extension is requested, then get a payment deal in place right away. But sometimes the conversation with the debtor will include the debtor's disputes, excuses, and denials designed to lay blame on your creditor client 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 your client'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 your collection suit. Remember the virtues of recouping your client's own costs, even if they have to forego some of the profit that they originally 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 you and your client 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. A settlement letter agreement outside of the note can stipulate 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 ultimately be given up by your client 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 you and your client determine 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 your client's business judgment and discretion advised by your experienced counsel, 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," an explicit release should probably also be signed in favor of your client to insure that the disputed issue which justified the compromise has been fully resolved.

At every stage in the collection process, from the initial demand all the way through to post-judgment execution, as you gain ground, there will be opportunities to cut deals for payment. Keep your ears open, suggest such agreements constantly, and go for them if the opportunity presents itself. Although you will establish rapport and reach

agreements with many debtors, and this is how the largest percentage of dollars are collected in practice, there will be certain scenarios where this goal and intention on your part will be frustrated:

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 to collect, 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 the grasp of you and your client. If you sue, you expect to have to defend a counterclaim. **Consider calling upon the services of a good third-party neutral mediator, of which there are many in Texas, even pre-suit.**

Although most mediation is conducted while a lawsuit is pending (and this may be strategic in particular cases), it is not essential. If your debtor is reasonable and willing to participate in mediation, a final compromise may be negotiated and documented that allows you and your client to collect some serious money (*e.g.* $65,000.00?). Even if a settlement is not concluded as a result of the mediation, at a minimum you will learn a great deal of useful information to support your effective use of the Court system to attempt to collect the money thereafter. So, **be a believer in mediation, whenever the opportunity arises! It serves the collection process well by pretermitting the need for a lot of counter-productive litigation effort and the concomitant risk to your success. Remember these two "birds" who will serve you well in a creditors' rights practice: (1) the "early bird," and (2) the "bird in hand."**