

## Getting Customers to Formally Acknowledge Their Debts

In construction credit, trade creditors are often reluctant to process a legal claim to assert payment rights to a project. There are a variety of reasons for this, according to Sam Smith, regional finance manager-East, at Crescent Electric Supply Company in East Dubuque, IL.

“Many times, we don’t want to rush into making a claim on our rights as we are trying to maintain a customer relationship, or maybe our claim wouldn’t be that solid (i.e., we didn’t send notices when we should have or we let a deadline pass),” he said. In other cases, credit professionals don’t want to spend the time and money it takes to process a lien, bond or Miller Act claim.

But it’s always important for trade creditors to remember what their rights are—from contract rights to mechanic’s liens, payment bond rights and more, he said.

When a customer is not paying balances due, credit professionals have to ask themselves a few basic questions to determine whether and how to assert those rights to payment that are so crucial. These questions cover how far along the job is, how much is owed from the general contractor (GC) and if there are any disputes involving the products or services. Lastly, creditors should attempt to ascertain whether a customer is willing to sign an *acknowledgement of debt*. “The key point here is get involved early and you will see much better results,” Smith said. “Remember, if you’re not going after the available funds, potentially your competition is.”

An acknowledgement of debt is basically a document drafted by the trade creditor and signed by the debtor that clearly explains the amount owed, that no credits are due to the debtor and there are no disputes on the job. “My philosophy has always been that if the debtor is reluctant to sign the document, there are other issues you need to look at,” he said. The signed debt acknowledgement document gives trade creditors a better understanding of the debtor’s position regarding disputes, balances due and so forth. The balance described in the document confirms the debtor’s ties to the creditor’s terms and conditions. Also, if there is a personal guarantee on the account, it is reaffirmed by being incorporated into the document. “Ultimately, if you needed to go to court, the process of obtaining summary judgment would be much faster, and cheaper,” Smith said.

This type of document is highly fluid and can be modified to meet the particular needs of any debt situation. For instance, assume that a debtor with a basic acknowledgement of debt decides to dispute \$5,000 for a defective product. Instead of going along with the debtor who wishes to use the dispute as a reason to avoid signing a debt acknowledgement, construction creditors can craft a statement that states the dispute in question, saying: “Other than said dispute, there are no other credits or offsets due to customer X on account Y.” The debt acknowledgement can also be crafted to refer to a specific job, rather than an overall customer account.

### Next Steps

After the debt acknowledgment has been signed, if there are any disputes remaining, work on getting payment on the non-disputed portion of the debt, Smith advised. Meanwhile, try to resolve those remaining disputes, which may require the help of the sales team or vendor.

Make sure to set hard and fast deadlines for resolving those disputes, both with internal parties as well as the debtor, he said. After the disputes have been resolved, work on updating an acknowledgment of debt statement to include the fact that no more disputes on the account remain.

Continue asking debtors to agree to a payment plan and include any related language in the debt acknowledgement statement. Smith suggested that if the debtor agrees to sign a debt acknowledgement but does not agree to the payment plan language, include this: "Customer X agrees to enter into a payment agreement for the balance with Company Z by \_\_\_\_ (date). If a payment agreement is not entered into, it will not change the effectiveness of this acknowledgement."

"The acknowledgment of debt form can be a very effective, flexible tool in your credit toolbox," Smith said. Like any other legal document, consider having it reviewed and approved by counsel first.

– Nicholas Stern, senior editor