

COLLECTIONS 101

Given the current state of the economy, many merchants are experiencing financial difficulties. As a result they are defaulting on their obligations to ISOs by failing to pay for chargebacks and not paying merchant advances. Consequently, my clients are seeking to collect from their merchants for these unpaid debts. In this article, I will discuss the steps you can take to assist you in collecting such debts, assuming the merchant is not contesting the underlying obligation, and the important things you should consider as you move through the collection process.

The Demand Letter:

The first step in the collection process is the demand letter. By the time a client is asking me for help collecting a debt, the client has already contacted the merchant a number of times by phone, fax, e-mail or mail. It has now come to the point where the merchant will not voluntarily pay so my client has requested I take it to the next level by “going legal” with the merchant. To that end, I send a demand letter to the merchant in order to try to get the merchant to honor its obligations.

The demand letter needs to be direct, concise and able to convey to the merchant all the negative ramifications of the merchant’s the failure to pay the debt. To motivate the merchant to pay, I usually start with a demand for the amount due and then outline why the money is due and owing (i.e. the merchant has signed a valid contract and failed to pay amounts due under the contract). I also add that the merchant’s credit will be negatively impacted by its failure to pay and that the merchant and its principals will be placed on the terminated merchant file (“TMF”) list.

To the extent that the debt has been personally guaranteed by a principal of the merchant, I like to remind the personal guarantor that their personal assets, as well as the assets of the company, will be subject to seizure when my client obtains a judgment. If the merchant is unwilling or unable to pay at this stage, then the next logical step is to file suit, assuming that is warranted.

Should You File the Lawsuit?

If the merchant is unwilling to pay after a demand letter, there are a number of factors to consider before taking the next step and filing a lawsuit. In some circumstances it may not make financial sense to file a lawsuit because the amount you are trying to collect is just not enough to warrant paying an attorney to collect the debt. If you are trying to collect \$15,000, it may cost you many times that amount or more in attorney’s fees to get a judgment against the merchant, leading to the conclusion that filing a lawsuit is not warranted.

Even if the judgment you are seeking is a large one, you are usually well advised to do some sort of asset search on the merchant. By checking if the merchant and its principals own any real estate and running a credit report on the them, you may be able to get a sense if this merchant is a credit worthy person or someone who is on the brink of bankruptcy. If you determine that the merchant and any personal guarantors have little or no assets, it may not make sense to pay an attorney additional money to get a worthless judgment because you are unable to collect anything from the merchant in spite of the judgment.

Obtaining the Judgment:

If you decide to sue the merchant, it is usually not that difficult to obtain a judgment. For the most part, if the merchant is not contesting the debt it will not fight the lawsuit. This leaves you in the position of having to file suit and then move forward with the steps to obtain what is called a “default judgment” against the merchant. The process I describe below is based on my experience in my state of California but the procedure is fairly similar in most states.

The first step in the process is to draft the complaint and file the lawsuit. In the complaint, the main cause of action is usually for breach of contract in the case of failure to pay chargebacks under a merchant agreement. Of note, you may want to add a fraud cause of action if appropriate. A fraud allegation would be warranted for instance, if the merchant took deposits for furniture sales that resulted in chargebacks, knowing full well that the merchant would never stay in business long enough to actually deliver the furniture. The advantage to getting a judgment against the merchant for fraud is that such a judgment is not usually dischargeable in bankruptcy.

Once the lawsuit is filed, it needs to be served on the merchant and any individuals named in the lawsuit. It is important to make sure you name any personal guarantors in the lawsuit so that you may seize their assets when you get a judgment. To serve the lawsuit, you usually need to have the lawsuit handed to the defendants, mailed via certified mail or any other methods allowed under the law. Once the defendants are served, that starts the clock on the time period they have to respond to the lawsuit, which is usually about 30 days.

In this example, I am assuming that the merchant will not contest the case and not file anything in the court to defend the lawsuit. If that is the case, you can take the “default” of the merchant which effectively ends the case for the merchant. All that is left for you to do is prove the breach of contact and/or fraud allegations and your damages.

In order to prove your case, you will have to provide the court with evidence, usually in the form of written declarations under the penalty of perjury, and also any relevant documents. The declaration needs to be from a knowledgeable person at the ISO

that is suing setting forth the contract terms, how the terms of the contract were breached (i.e. the merchant did not pay) and the amount of the damages suffered by the ISO (the amount of chargebacks for instance).

The declaration along with any other required documents are filed with the court and as long as all is in order, the court will usually sign and enter a judgment against the defendants. Only rarely does the court require actually testimony in court to prove the case.

However, now that you have the judgment, the hard part has just begun. You have to actually collect on the judgment from the defendants. But, I will have to reserve an explanation of that process for a future article – stay tuned!

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