

## **Methods on Debt Collection and Risk Control**

### **Preface**

In the early days when there was a shortage of materials, usually the supply was not enough to meet the demand in the market. At that time, the suppliers' bargaining position was higher, so when they made transactions with the opposing parties, very often they would require the opposing parties to "prepay the purchase price". However, in recent decades, with the development of technology and the widespread information, many newly industrialized countries have arisen and actively developed manufacturing industry and export-oriented trade business. Under the harsh competition in the market, the condition to "prepay the purchase price" has become very rare. In the opposite, the mainstream of the trading terms has become "making the payment after the acceptance of the goods" or "calculation of the payable amount every month/season/half a year". Therefore, it has become an important issue for suppliers to protect their own rights and interests to minimize their bad debts, and smoothly collect their transaction prices.

### **Risk Control**

As to how to lower the risks of transactions in international trade or mid-term or long-term supply sales, the first work is to carefully select the trading partners and to carefully survey their financial credit in advance. Secondly, when the parties are entering into an agreement, it is important to regulate the payment methods and conditions to guarantee debt, and one party should bear the relevant costs for the debt guarantee in order to achieve the purpose to "prevent in advance and lower the risk". In the end, if the debtor is unable to pay the transaction price, then, it will enter into the stage of implementation of credits. The creditor first needs to investigate the debtor's financial or trading conditions. If the debtor still has surplus of assets or unrealized credits, the creditor should exercise his rights to assign the debt or apply for compulsory execution as soon as possible. He should try his best to "reduce the damages". With regard to debt guarantee and implementation of credits, this article will briefly describe them separately in the following.

### **Debt Guarantee**

When two parties enter into an agreement, the creditor may request the debtor to offer

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certain guarantee. If the debtor fails to perform his obligations, the creditor may request the guaranteeing institution to pay the guaranteed amount or sell the guaranteed objects in order to get paid (that is, “factoring” mechanism).

**1. Performance guarantee made by a bank**

The guaranteeing bank is a neutral third party. It shall bear the responsibility to guarantee that the debtor will perform his obligation to make the payment.

**2. Domestic irrevocable letter of credit**

The debtor shall be the applicant of the letter of credit, and the creditor shall be the beneficiary of the letter of credit. After the creditor delivers the goods in accordance with the conditions of the letter of credit, and requests the issuing bank to make the payment or make an acceptance, the issuing bank cannot change the terms of such letter of credit, and it shall make the payment to the creditor without any conditions.

**3. Performance guarantee made by insurance**

The debtor shall be the insured, and the creditor shall be the insurance beneficiary. The insurance company shall make a promise to the creditor that if the insured incident occurs (i.e. when the insured fails to perform his obligation according to the agreement), the beneficiary may request the insurance company to pay the insured amount.

For the above guarantee methods items 1 to 3, in practice, the banks or insurance companies will investigate the debtor’s credit situations before making the guarantees in order to determine the terms and costs for the guarantee or insurance after careful evaluation.

**4. Mortgage**

The debtor shall offer an object to set up a mortgage. If he fails to perform his obligation, the creditor may apply for compulsory execution upon the mortgaged object in order to get paid. According to the regulations of the Civil Code and the Personal Property Secured Transactions Act, the mortgaged objects which can be registered for mortgage can be divided into 3 types: real estate (such as land and buildings), rights (limited to superficies, agricultural rights and Dian (典權)) and personal properties (i.e. properties with high economic value such as machinery, equipment or automobiles, and so on).

**5. Pledge**

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The debtor shall offer certain personal property, securities, or other rights as the object for pledge. If he fails to perform his obligations, the debtor may sell the pledge object and get the price to be paid. In practice, the securities which are often set up as pledge objects include the following: government bond, corporate bond, mutual funds, stocks, beneficiary warrants, certificate of deposit issued by financial institutions, and so on.

Personal properties and rights can both be the objects of pledge and mortgage. Their differences are as follows:

- (1) Mortgage: After the registration of a mortgage, the debtor needs not to transfer the possession of the object to the creditor. Therefore, the debtor may still use the object and earn the benefits from the object. However, when there is a compulsory execution, the personal properties which can be executed are limited to the mortgaged objects which can be seized by the court at the spot. Therefore, there could be a problem of impossibility to execute.
- (2) Pledge: There is no need to register a pledge. But the debtor needs to transfer the possession of the object to the creditor, so the debtor cannot continue to use the object or earn benefits from the object. However, if securities are set up as objects for a pledge, in practice, both parties will regulate the ownership of the interests belongs to which party in their agreement.

## **6. Guarantor**

The debtor shall seek persons who have financial ability (such as directors of the board, supervisors and so on) to be guarantors jointly and severally liable for the debt. "Personal Guarantee" is to use the guarantor's total assets and ability to repay as guarantee. Therefore, the guarantor may have the problems of bankruptcy or no financial ability. Usually, in the construction cases, in practice, the parties may require a bank to be the guarantor jointly and severally liable for the debt in the agreement.

## **7. Negotiable instruments**

According to the Negotiable Instruments Act, the payers may be divided into the following types in accordance with their qualifications: authorizing other people to make the payment (money order), the issuer of the instrument will make the payment by himself (promissory note), or authorizing a financial institution to make the payment (check). In practice, the frequently used instruments are

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promissory notes and guaranteed checks.

- (1) Promissory note: According to the regulations of the Negotiable Instruments Act and the Act Governing Non-litigious Matters, the holder of a promissory note may directly apply to the court for a decree to open the procedure for compulsory execution. As to money orders or checks, they will require the proceedings of simplified litigation. After the creditor obtains a confirmed judgment, he may apply for the compulsory execution. The procedures are usually longer and will take more time.
- (2) Guaranteed check: The guaranteeing bank will record the legend of “guaranteeing the payment” on the check. Once the check is guaranteed to be paid, the bank will transfer the guaranteed amount from the issuer’s bank account into the account for the guaranteed check in order to make sure it will be paid.

#### **8. Performance bond**

When the parties are signing the agreement, because they may fear that in the future that the debtor will not perform his obligation, therefore, they will require the debtor to submit certain amount to the creditor as the guarantee for the future performance, and this is the so-called performance bond.

#### **Implementation of Credits**

When the debtor obviously has no financial ability and the parties have not made any regulation for the provision of guarantee for the debt in the agreement, under such circumstances, firstly the creditor needs to make sure about the debtor’s business conditions. If the debtor has entered into the stage of reorganization, bankruptcy or liquidation, the court will restrain the debtor from making any property disposal or making payment to the creditors. The court appointee (such as the reorganizer, liquidator, or bankruptcy administrator) will make a financial list of the debtor, and distribute such properties to all creditors in accordance with their proportion of the credit. If the debtor has not entered into the above-mentioned proceedings, then, the creditor shall in details investigate the debtor’s financial statements and books, the conditions of his real properties and personal properties (such as machinery, raw materials and so on) and the debt-credit relationship between the debtor and his business trading partners, and so on. If the debtor still has assets which may be executed or if he still has credit

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which has not been collected, there are several ways to deal with the situation as follows:

**1. Assignment of credit**

If the debtor has credits such as purchase prices or receivable amount which have not been collected, then, the debtor may assign such credit against the third party to the creditor. Within the amount of such credit, the creditor shall succeed the debtor's position to request the third party to make the payment. However, if the third party has any defense rights or defense matters against the debtor, the third party may also use the defense against the creditor. But, if the debtor has collected the credits, then, there will be no application of assignment of credits.

**2. Payment order**

If the requested object of a creditor against the debtor is a certain amount of money, replaceable objects (such as machinery, equipment and so on) or securities (such as stocks, certificates of deposits and so on), the court may issue a payment order solely in accordance with the request of the creditor. The payment order will take effect from the time it is delivered to the debtor. If the payment order cannot be delivered within three (3) months, then, it will lose its effect. Further, if the creditor has not performed his counter-payment or if the location of delivery is in a foreign country, then, the creditor may not apply for a payment order.

After the payment order takes effect, the creditor's following procedures will be different based upon the fact whether the debtor raises an objection or not.

- (1) If an objection is raised: If the debtor raises an objection within twenty (20) days from the delivery of the payment order, then, within the scope of the objection, such order will lose its effect. The court will also deem the action of the creditor to request the court to issue the payment order as the raising of litigation, or applying for reconciliation. After the litigation is raised, the creditor needs to bear the time, labor and costs of the litigation, in order to obtain a confirmed judgment from the court or otherwise to apply for a court decree for provisional execution, then, the creditor may apply for the compulsory execution against the debtor's properties. If before the judgment is made, there is a concern that the debtor may conceal his properties, the creditor may apply to the court for provisional

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attachment or provisional measures in order to temporarily maintain the financial status of the debtor.

- (2) If an objection is not raised: If the debtor still makes no payment after he receives the payment order, and has not raised any objection after the expiration of the prescribed period of time, then, such payment order has the same effect as a confirmed final judgment. The creditor may start to apply for the compulsory execution proceedings.

### **3. Compulsory execution**

After the creditor obtains a ground for execution (such as confirmed final judgment, settlement, payment order, provisional execution, mortgage or pledge object auction or in accordance with the regulations of other laws), if the debtor does not perform his obligation automatically, then, the creditor may apply to the court for compulsory execution upon the debtor's properties in order to get paid.

#### (1) Procedures of execution

Applying for compulsory execution→seizure registration→evaluation of price/compulsory management → setting up the conditions and the minimum bidding price for the auction→proceeding with the auction→ notification of the result of the auction→payment of the auction price→ granting a certificate to prove the transfer of rights→distribution of sales price→if the debt is fully paid satisfactorily, then the procedures are closed/if the debt is not fully paid satisfactorily, and the creditor finds out and reports that the debtor still has properties left, then the compulsory execution and distribution will be followed→if the debtor has no more properties, the court will issue a credit certificate to the creditor→the procedures are closed.

#### (2) Distribution of sales price

(The following preference order is from the left to the right.)  
The fees for compulsory execution >taxes (such as land value-added tax, land tax, house tax, business tax levied through auction) >customs >guaranteed credits (such as mortgage and pledge)>wages owed to the labor within 6 months >other taxes (such as income tax and so on) >other preferential credits regulated by the law >ordinary credits.

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For the distribution of the sales price from the auction, the credit with former preference order shall be paid first. If there is a left amount, the credit with later preference order will get distribution for payment. If in the sales agreement, the parties have no agreement for any debt guarantee, then, such credit shall be ordinary credit without any preference order, and it will get distributed payment in accordance with the credit proportion.

(3) Certificate of credit

A certificate of credit means during the process of compulsory execution, if the debtor has insufficient or no properties to be executed, and after the creditor makes an explanation to the court, the court may directly issue a certificate of credit to the creditor. Or after the debtor's properties are executed, the amount/value of the properties is still not enough to pay the debts, and the creditor has investigated and reported to the court that the debtor has no more properties, the court will issue a certificate of credit to be kept by the creditor in order for the creditor to reapply for compulsory execution if he finds out in the future that the debtor has properties.

**Conclusion**

No matter for the sale of goods or provision of services, the business operators all face the issue of collecting transaction prices and risk control. It is especially important in the mid-term or long-term supply and cross-border transactions. In order to make sure that the debt can be smoothly collected and the risks can be controlled, a business should carefully select its clients and evaluate their financial situations before the transactions. When the parties are entering into an agreement, the parties should regulate provisions for payment and guarantee conditions. However, if after adopting the above-mentioned measures, the trading partners are still unable to make the payment, then the creditor should investigate the debtor's financial situations as soon as possible, and actively request the debtor to perform his obligation or to execute his properties, in order to minimize the damages and to maintain his own rights.

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