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Credit Applications

OVERVIEW

A well-defined credit application provides the basis for gathering information and implementing the company’s policies. The credit application is the primary document which allows the credit professional to “Know Your Customer (KYC).” It may also serve as a contract.



THINK ABOUT THIS

- Q. Why does a company need a credit application?
- Q. In a perfect world, what information should be included on a credit application?
- Q. How does a credit application protect a buyer and seller?



DISCIPLINARY CORE IDEAS

After reading this chapter, the reader should understand:

- ✓ The purpose of a credit application.
- ✓ How to obtain banking information.
- ✓ How the credit application acts as a contract.
- ✓ What goes below the signature line.

CHAPTER OUTLINE

1. The Purpose of a Credit Application 9-2

The Purpose of a Credit Application

Every credit professional appreciates the importance of a well-thought-out, informative and properly executed (signed) credit application. This document is crucial to the determination of the rights of the creditor (vendor/seller) in the event of a dispute with, or default of, a customer. Through the use of a well-drafted credit application, a credit professional may accomplish the dual goals of limiting credit risk, as well as addressing numerous contingencies that may arise in a credit relationship. A credit professional may also obtain a greater understanding of the nature of the customer's business simply by having more information with which to formulate questions about the customer's business dealings.

Gathering basic information about the customer, in compliance with current laws and regulations, is the core of the credit application process. In a perfect world, the credit manager should design (perhaps with the aid of counsel) a credit application that is concise and straightforward, yet contains all necessary information that will assist the credit analyst to make a credit decision, assist in the periodic review of the credit relationship, and provide support to counsel as needed, in the event of default. The credit application allows the credit professional to obtain information necessary to make decisions about a customer's ability and willingness to meet obligations within credit terms. This information can help increase sales of a company's products to new customers at the start of their business and to existing customers as the business grows. Credit applications can also make a significant difference in the collection of the account if a customer cannot or does not pay and must be compelled to do so through litigation.

Occasionally, obtaining information from some customers can be a sensitive issue. A customer may be disinclined to provide adequate information; unwilling to sign the credit application document; or become belligerent or uncooperative at the suggestion that the completed credit application is a prerequisite of the extension of credit. Credit grantors should keep in mind the nature of the exchange being requested: The customer wants products, merchandise or services without having to pay for them at the time of purchase. It is prudent for the credit professional to keep this fact in mind and point it out to the recalcitrant applicant. The credit application process is the credit professional's first, and sometimes only, opportunity to protect their company from risk of loss through credit sales and/or fraud. It should be routine to ask and insist that the customer/potential customer provide all of the information being requested on the credit application. The process of acquiring the requested information from the potential customer can also be indicative of future dealings with the customer, and should be considered in the credit review process.

The most advantageous time to ask for credit information is at the beginning of any buyer/seller relationship. Once the customer has been delivered products or services, the customer may no longer feel the need to be forthcoming with information or cooperate with the credit analyst. The opportunity to obtain information becomes inconsequential to the customer. Yet, the information that should have been obtained at the outset of the relationship is critical to the credit manager or analyst's credit review.

The key goal of a credit application is to assist the seller in learning as much as possible about the applicant before making a decision to extend credit. The credit application is often considered to be the cornerstone of the customer's file. It should provide basic information about the customer and be updated periodically to reflect changes in the company's policy and to obtain fresh information from the customer that better reflects the market and the various legal aspects affecting the credit function.

A properly constructed credit application can also serve as a document that can be relied upon for legal actions should litigation become necessary. One thing is certain about buyer/seller relationships: nothing is certain. Court dockets are filled with cases involving two parties litigating over that one little item that they were sure could never happen. In the absence of a written document like the credit application or a contract/agreement that spells out the way the two parties will conduct themselves, the judge, arbitrator or mediator is left to fill in the gaps using any factual evidence, parol evidence, the law of contracts and the UCC, which could have otherwise been spelled out in a credit application. It is unwise for the creditor grantor to leave the payment outcome to a third party without some written agreement.

A well-devised credit application is structured to assist the seller during the four stages of the buyer/seller relationship: (1) prior to extending credit, (2) during the credit relationship with the buyer, (3) during problems in a credit relationship and (4) during litigation.

It is very important for a seller to know its applicant. The credit application begins the relationship-building process and is an initial source of information to begin a fact-finding, fact-verification endeavor about the applicant.

In addition to using the credit application as an investigative tool, the credit application should create a contract between the seller and the buyer. The application should include all of the seller's desired terms and conditions of sale. A savvy customer will recognize the credit application as an agreement or contract to terms and negotiate the contract accordingly; the credit grantor should include every condition or term that addresses what has happened historically or could possibly occur in the industry or trade that would prevent the creditor from being paid on time or at all. It is far better to include in the credit application all terms and conditions to be negotiated rather than not including them at all. Not having a terms of sale clause included in the credit application may allow the customer's purchase order agreement to prevail in the event of a lawsuit, arbitration or mediation. In other words, in the absence of language favorable to the credit grantor, the credit grantor will lose to the customer on the basis that there was no [other] agreement to counter the customer's claim and subsequent documentation.

If a creditor wins a judgment in a legal proceeding, the credit application may also become a useful tool to help locate a judgment debtor's assets for collection purposes.

The Credit Application as a Source of Information

Basic Information

Date of application

By dating the application, it is easy to determine the start date of the agreement. If financial information is supplied, the date will provide a frame of reference.

Applicant's complete legal name

Determining the correct legal name of an applicant ensures that the credit application truly functions as a contract and is legally binding. If it becomes necessary to go to court, bringing action against the correct person or entity is required. If the name of the entity is not correct, the case will be dismissed for lack of proper name.

In some industries, it is not unusual for a customer to use a commonly known name rather than the name under which the company is registered. In this event, it is important to thoroughly research the Secretary of State or other licensing records before filing suit.

Having the official, exact legal name is critical when searching for any lawsuits, tax liens, mechanic's liens or judgments as well as obtaining credit reports and assumed name filings. Such information could be considered a red flag or evidence that cash flow is not sufficient to pay certain taxes or other obligations. Public records of this sort indicate that demands could be made on cash intended to meet operating expenses or pay outstanding bills, possibly causing a collection problem for creditors. Based on these details, the credit grantor can also verify facts and information presented on the application.

Newly established DBAs (doing business as) should also be identified and added to the credit file.



Comprehension Check

Why is it important to have the correct legal name of a credit applicant?

Address information including mailing address, physical address, P.O. Box

Address information can be verified online. The sales department can help by verifying physical address information. Not only does an applicant's physical address pinpoint the location, it is likely that the applicant's assets will be located there as well. Be wary when an applicant lists a mail drop for the address, as most fraud occurs by this method.

Telephone number, fax number, email and website

Always verify telephone numbers, fax numbers, email addresses and the applicant's website. These simple steps can often uncover many irregularities or inconsistencies.

Federal Tax Identification Number (FEIN)

If a company is engaged in business, it should have a federal tax ID number in order to file a tax return. This number is important for issuing 1099s and other purposes. More importantly, it conveys a message of consistency and organization that the entity is in business and willing to take all necessary steps to operate within the structure of laws and regulations governing business. Absence of a valid federal tax ID number could be an indication of credit risk if the customer is affected by IRS intervention.

Accounts payable contact information

This information saves time should the creditor need to contact the accounts payable department.

Years in business

The longer a firm has been in business, the more stable it would appear to be—and more information should be available to the credit department. If the credit department cannot gather enough information about a company that has been in business for several years, then the credit manager must question the account.

Amount of credit requested

Determining the amount of credit requested by the customer will help the credit manager deal more efficiently with the application process.

Lease or own

Should a seller ever be in a position to seek assets to satisfy a judgment, knowledge about a debtor's ownership of real estate is very useful. For instance, if the premises (office, warehouse, retail space, etc.) are leased, then the landlord could be a source of information about payment trends. If the company were to default, disappear or file bankruptcy, then the landlord could obtain a lien on all property, inventory and other assets until the lease agreement is satisfied. This may pose a collection problem for the credit grantor.

Sales tax exemption

In some businesses, exemption from sales tax status is important information to have on hand before invoicing. The credit grantor should obtain sales exemption certificates.

Sample language for sales tax exemption

Sales Tax Permit #:

I certify that [name of applicant/debtor] located at [address, city, state of applicant] is engaged as a registered

☐ Retailer ☐ Manufacturer ☐ Lessor ☐ Other, and is registered with the state and cities listed on the attached use tax exemption certificate, within which seller/debtor would deliver purchases and that any such purchases are for wholesale, resale, ingredients or components of new products to be resold, leased or rented in the normal course of applicant's business. Applicant is in the business of retailing, manufacturing, leasing (renting) the following:

Description of Business:

I further certify that if any property so purchased tax free is used or consumed by the firm as to make it subject to a Sales or Use Tax, that applicant will pay the tax due directly to the taxing authority when state law so provides, or inform the seller/creditor for added tax billing. This exemption certificate shall be part of each order which applicant may hereafter give to seller, unless otherwise specified, and shall be valid until canceled by applicant in writing or revoked by the city or state.

Under penalties of perjury, I swear or affirm that the information on this form is true and correct as to every material matter.

Authorized Signature

Date

Title

U.S. Resale Tax exemption certificates

According to the Multistate Tax Commission, “Whenever a seller receives and accepts in good faith from a purchaser a resale or other exemption certificate or other written evidence of exemption authorized by the appropriate state or subdivision taxing authority, the seller shall be relieved of liability for a sales or use tax with respect to the transaction.” Suppliers may obtain State Resale Tax Exemption Certificates from their reseller customers to avoid having to bill them for taxes. The customers must be resellers of the product and cannot be the end users.

The policy applies to customers who have “nexus” in a U.S. state. **Nexus**, defined as “*sufficient physical presence*,” is a legal term that refers to the requirement for companies doing business in a state to collect and pay tax on sales in that state.

Regarding Resale Tax Certificates:

1. Usually, the credit department is responsible for obtaining copies of new customers’ Resale Tax Certificates. The credit or tax department is then responsible for keeping them on file and requesting new ones before they expire (certain states only).
2. The states will audit companies to ensure they are obtaining and maintaining their customers’ certificates. If the company cannot provide them to the auditors, they may be fined by the states. These fines can be very punitive.
4. The Multijurisdictional Uniform Sales & Use Tax Certificate can be used in lieu of obtaining forms from customers who do business in 38 of the states. See certificate below.
5. Not all states have a sales and use tax.

Sample language for uniform sales & use tax exemption/resale certificate — multijurisdiction

UNIFORM SALES & USE TAX EXEMPTION/RESALE CERTIFICATE — MULTIJURISDICTION

The following states have indicated that this certificate is acceptable as a resale/exemption certificate for sales and use tax, subject to each state’s laws. The issuer and the recipient have the responsibility to determine the proper use of this certificate under applicable laws in each state, as these may change from time to time.

Issued to Seller: _____

Address: _____

I certify that:

Name of Firm (Buyer): _____

is engaged as a registered:

Address: _____

☐ Wholesaler

☐ Retailer

☐ Manufacturer

☐ Seller

☐ Lessor

☐ Other (Specify) _____

and is registered with the below-listed states and cities within which your firm would deliver purchases to us and that any such purchases are for wholesale, resale, or ingredients or components of a new product or service to be resold, leased or rented in the normal course of business. We are in the business of wholesaling, retailing, manufacturing, leasing (renting) or selling the following:

Description of Business: _____

General description of tangible property or taxable services to be purchased from the Seller:

Sample language continued

State	State Registration, Seller's Permit, or ID Number of Purchaser	State	State Registration, Seller's Permit, or ID Number of Purchaser
AL		MO	
AR		NE	
AZ		NV	
CA		NJ	
CO		NM	
CT		NC	
DC		ND	
FL		OH	
GA		OK	
HI		PA	
ID		RI	
IL		SC	
IA		SD	
KS		TN	
KY		TX	
ME		UT	
MD		VT	
MI		WA	
MN		WI	

I further certify that if any property or service so purchased tax free is used or consumed as to make it subject to a Sales or Use Tax we will pay the tax due directly to the proper taxing authority when state law so provides or inform the Seller for added tax billing. This certificate shall be a part of each order that we may hereafter give to you, unless otherwise specified, and shall be valid until canceled by us in writing or revoked by the city or state.

Under penalties of perjury, I swear or affirm that the information on this form is true and correct as to every material matter.

Authorized Signature: _____
(Owner, Partner, or Corporate Officer)

Title: _____

Date: _____

Check with each state's department of revenue for more information.

Type of business (wholesale, retail, distributor, manufacturer)

A general description of the business will help the seller understand the applicant's business. An applicant may have more than one type of business or it may be an indicator of fraudulent activity. If the nature of the business does not fit the need for the creditor's type of product, then the credit department has to ask, "Why are they buying our product and should we make an offer of open account, unsecured credit?"

NAICS Code

On the credit application, request the customer's **North American Industry Classification System (NAICS) code** which identifies their product or service and industry.

Below is an example of NAICS code 33461 (Manufacturing and Reproducing Magnetic and Optical Media):

- The first two digits of the code represent the firm's major industry
31-33: Manufacturing
- The third digit tells the subsector
334: Computer and electronic product manufacturing
- The fourth digit identifies the industry group
3346: Manufacturing and reproducing magnetic and optical media

- The fifth digit gives the industry
33461: Manufacturing and reproducing magnetic and optical media

The NAICS code 33461 tells us this about the customer: They manufacture optical and magnetic media and mass produce audio, video, software and other data on magnetic media.

NAICS codes enable the credit professional to:

- Know, at a glance, the primary industry in which the customer operates.
- Understand industry and competitive issues affecting the customer.
- Compare the customer to industry statistics and norms.



Comprehension Check

What is an NAICS code?

The Entity Itself—The Real Customer

Legal Status of Company: Corporation, LLC, Partnership, Sole Proprietorship

It is important to understand the legal structure of the applicant. If a creditor is selling to a sole proprietor, then the owner of the business is, literally, the business and is automatically liable for the entity's debts.

When dealing with a **general partnership**, *each individual partner can be held liable for all debt incurred as a result of the general partnership entity*. This is not an equal share formula. Any partner of the general partnership will be held liable for the entire debt of the general partnership—not an equal share. For example, if there are four partners involved in a general partnership entity, then any one of the partners may have to meet the obligation of the debt without consideration given to the other three partners. This simply means that the credit grantor can approach each partner until one of them satisfies the debt. The partners have an arrangement where they share equally in the investment and obligations. In a general partnership, the creditor need only trouble itself with collecting from any one of the various partners. The partner who finally pays may collect the appropriate sum of the paid obligation from each partner. It is not the creditor's duty or requirement to collect equal amounts from the remaining partners. Basically, the partner who has the money to pay, and does so, has a collection matter among the other partners.

A **corporation** is an entity, usually a business, having authority under the law to act as a single person distinct from shareholders who run it and having rights to issue stock and exist indefinitely. A corporation has an existence that is separate and apart from its shareholders. A corporation has the right to conduct business; to sue and be sued; and typically enjoys those rights and privileges provided under the laws of the state of its incorporation. As such, a great deal of information is commonly available relating to a specific customer who is incorporated through public record sources, Secretaries of State and possibly the Securities and Exchange Commission if the customer is an incorporated company that is publicly traded.

A **limited liability company (LLC)** is an unincorporated association that, when properly structured, provides limited liability to its owners, referred to as members, and provides tax advantages similar to S Corporations, formerly known as Subchapter S Corporations. Most states now recognize some form of a limited liability company.

With this type of entity, it can appear to the credit grantor that they are being asked to sell on open account credit to a general partnership. However, unlike the general partnership, the LLC entity behaves very similarly to a corporation with regard to sheltering assets and limiting liability for debts incurred by the entity.

The management philosophies of a corporation or LLC are often linked to its founders. As such, personal information about these individuals may play a key role in the credit-granting process. Later sections of this chapter address the ways in which personal information on owners, principals and members (of LLCs) can be properly and legally obtained when the credit grantor determines such details will be necessary in order to approve credit requested or increase credit limits to existing customers.

For the credit grantor, corporations and LLCs are the most common types of entities found. Selling to either one can present particular challenges to the creditor:

- Who has authority to enter into an agreement on behalf of the corporation or LLC?
- Who are its principals or members?

- What is the personal business background and history of the principals or members of the entity applying for credit?
- Who is ultimately liable for the corporation's or LLC's debt?

The credit grantor must first know the type of entity to which it is being asked to supply products or services in order to determine the risks and appropriate steps to take to protect itself from associated uncertainty or risk. Sometimes the creditor must consider using additional security instruments like a personal guarantee when selling to a corporation or LLC depending on the entity's creditworthiness.

A credit department can easily check the legal status of a company online with the Secretary of State's office to verify whether the company is in fact a corporation, its status (incorporated, dissolved, merged, fortified) and full legal name, the date of incorporation, the name of the resident agent and, in some states, the names and addresses of corporate officers and directors.

Other forms a business entity can take include a **limited partnership**. *A limited partnership consists of one or more general partners who are jointly and severally liable for the obligations of the partnership.* A limited partnership will also consist of one or more limited partners who are not responsible for the debts or liabilities of the partnership beyond the amount of the capital that each contributed to the entity. A general partner of a limited partnership may be a corporation. There is also what is known as a **master limited partnership**, *which is a type of limited partnership that is publicly traded over-the-counter or on a stock exchange*; a **joint venture**, *which is an association of two or more persons undertaking a single business enterprise for profit generally limited to one particular enterprise* (e.g., for the purpose of developing real property); a **municipal utility**, *which is a not-for-profit public entity owned and operated by the state or a political subdivision of the state* (for example, cities, public utility districts or a locally elected utility board); and a **cooperative**, *which is a private, independent entity owned and controlled by the members of the cooperative who use its services.*

Buyer's Obligation to Disclose Change of Name or Legal Status

A critical part of "Knowing Your Customer" (KYC) is for a seller to know the correct legal name and legal status of its customer. Specifically, a seller must ensure that it is contracting with the correct party. Otherwise, the seller might run into a later problem of being unable to collect its claim against a customer that is not identified correctly or has changed its legal status.

A seller can confirm its customer's correct legal name and legal status by performing a business name search with the Secretary of State's office of the applicable state. It is also imperative that a seller's terms and conditions account for a subsequent change in the customer's legal name or status. The terms should require that the customer notify the seller of a change in the customer's legal name and/or status and cooperate with the seller in modifying their contract as the seller deems appropriate. This would include the customer's agreement to enter into new agreements with the seller subsequent to any change in its legal name and/or legal status.

If a company changes its legal status, a new credit application should be signed. For example, if a sole proprietorship or general partnership incorporates or forms an LLC, the personal liability of the owner/proprietor or of the partners is extinguished. The credit application originally signed by the proprietor or partner is no longer valid for the new corporation or LLC. The same rule follows when mergers and acquisitions occur; a new credit application should be obtained replacing the previous agreement. In each case, these are new entities under the law. The credit agreement originally in place does not succeed.



Comprehension Check

Where can one check the legal status of a public corporation?

Principals, owners, officers and members

The credit department is charged with the responsibility of gathering the name of each person involved in the ownership of the entity whether it be for a sole proprietor, each partner of a general partnership, corporate officers or each member of a limited liability company. *Collecting social security numbers, home addresses and telephone numbers is a matter related to privacy issues; if credit grantors gather this type of information, then additional procedures are necessary as any personally identifying information must be kept strictly confidential. Likewise, the maintenance of personal and private information should be reviewed with counsel.*

It is important to know the ownership history to help the credit department gain confidence in the management of the business entity. Learning about the owners, officers, members (of an LLC) or principals is called antecedent information. This information tells the credit manager that the people who manage this company have experience or know the industry, which will help them succeed in the business venture. Antecedents help establish a record of successes or failures that the credit department can and should know in order to make credit decisions.

Laws and Regulations Covering Personal Information*

Various state and federal statutes and regulations require protection of defined categories of personal information. Some of them are likely to apply to corporations which possess any specified personal information about their customers. While the scope of coverage, the specificity of the requirements and the definitions vary among these laws, personal information is usually defined to include general or specific facts about an identifiable individual. The exceptions tend to be information that is presumed public and does not have to be protected such as a business address.

In general, a company must develop, implement and maintain a comprehensive information security program, including a risk assessment, containing detailed requirements for the information security program and detailed computer system security requirements.

The security requirements include:

- Encryption of all transmitted records and files containing personal information that will travel across public networks, and encryption of all data containing personal information to be transmitted wirelessly.
- Encryption of all personal information stored on laptops or other portable devices.
- Additional system security requirements are secure user authentication, secure access control, reasonable monitoring to detect unauthorized access, reasonably up-to-date firewall protection, reasonably up-to-date security software (including current patches and virus definitions), and education and training of employees.

Note that encryption is already required for federal agencies that have information about individuals on laptops and portable media. As encryption becomes a legal requirement in areas like these, it is likely to become the standard of what is reasonable.

The obligations don't stop, however, at protecting the confidentiality of information. Many states have laws that require notification concerning data breaches. While there are differences in their scope and requirements, they generally require entities that own, license or possess defined categories of personally identifiable information about individuals to notify affected individuals if there is a breach. Like the reasonable security laws, many of these laws apply to covered information about residents of the state. Some require notice to a state agency in addition to notice to consumers. Most of these laws have encryption safe harbors, which provide that notice is not required if the data is encrypted and the decryption key has not been compromised. Some states also now have laws that require secure disposal of paper and electronic records that contain defined personal information.

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Comprehension Check

What security is needed to protect the confidentiality of customer information?

Related Business Ventures and Related Concerns

Ask about previous business ventures. What was the name of any previous business holding of the principal, and how was it concluded (sold/failed/bankruptcy/etc.)?

Additionally, ask if the principal is currently involved in any other business. After gathering these details, build a "family tree" of all the business holdings in which the principal is involved. This information will be insightful as to what degree of attention the principal may, or may not, pay to the actual business entity that is applying for credit. The information will also be helpful if one or another of the related concerns is not doing well financially or has been

sued or has liens filed. If this is the case, then the question becomes: how much of the money that was available to pay outstanding invoices is now in demand for one, or more, creditors of the related concerns?

Bank and Trade Information

Bank References, Including Bank Name, Address, Account Numbers, Bank Loan Officer or Contact Name and Information

The seller may be able to contact the applicant's bank directly; therefore, it is helpful to obtain a contact name or a loan officer's name. Account numbers are important if post-judgment execution or garnishment action is ever required. Useful information about loans includes the type of loan, the original amount of any loan, the total amount due, loan payment trends and whether a personal guarantee was provided, or whether any collateral secures the loan.

The credit department looks for average balance information to determine if the amount of open account credit requested matches the available average bank balance normally carried in the customer's checking account: a customer requesting \$50,000 of unsecured credit who carries an average bank balance in the "low four figures" (\$1,000–\$4,000) may require further scrutiny. The credit grantor also should determine whether or not any items have been returned unpaid (NSF) and, if the customer has a borrowing account, the payment history of active loans with the bank.

Many banks have policies concerning the release of customer information. Even though current laws do not prevent banks from providing information on the business/commercial bank customer, many banks have chosen to adhere to a standard "no information" policy. Banks are often limited to a larger degree because of banking regulations intended to protect bank information related to consumers. As a result, banks are inclined to view every credit inquiry as if it were a consumer inquiry and, therefore, decline a response to the request. Some banks will respond if they have written authorization from their customer to release information, but may charge a fee to the inquirer.

To help credit personnel obtain bank information on a customer, consider creating a separate signature line in the bank information section of the credit application for the customer/applicant to authorize the release of bank information on commercial or business accounts.

Sample language for bank authorization

I hereby authorize the bank named herein to release information requested for the purpose of obtaining and/or reviewing my company's credit from time-to-time.

Information about Banks and Other Creditor Security Interests

The offices of the Secretary of State may be able to provide useful information about an applicant. Using UCC-1 filings, credit grantors can review information about bank and other creditor security interests. UCC-1 filing reports are a matter of public record, are generally free and will tell the creditor if the applicant has borrowed money, purchased equipment or capital assets or entered into leases. Typical collateral seen in UCC-1 filings are accounts receivable, inventory and/or equipment encumbered by a present lien or security interest and blanket and hereafter acquired security. This means that everything the customer or applicant has is encumbered to a security holder. Names, addresses and telephone numbers of secured parties are included in each UCC-1 filing.

By reviewing such filings, the credit manager can tell by the filing date if lenders are willing to continue to loan money. The credit manager can also begin to determine whether the customer has financial flexibility or if the customer is too heavily encumbered to meet the potential credit grantor's requirements.

UCC-1 filings can also act as a secondary source of information. For example, if a customer defaults or, worse, closes its doors and cannot be located, a UCC-1 filing will identify the names, addresses and telephone numbers on each filing. With this information, the credit department will have possible leads in order to locate the customer—and possibly be able to secure return of goods or collect money.

Trade Reference Information

Most customers expect this question on a credit application and are ready with three, four or five references. While these direct references are valuable, they should not be the primary source of information on which the credit grantor bases a credit decision. The applicant will always provide the best references they can, therefore one would expect these references to be positive.

Beyond the applicant, a credit grantor may query fellow businesses for reference information. Care should be exercised, however, when credit information is shared among creditors. Any and all information exchanged should reflect only those transactions that have been completed and are in the past. There should be no discussion as to any future action a creditor may take—"We are going to file suit this week." There should also be no disparaging remarks about principals of the business or the business itself. Comments that reflect the historical nature of the relationship are appropriate as long as they are factual statements relating to payment habits and actions taken by the creditor providing the information. Such statements can describe: how long sold, date of last sale, high credit, total balance, amount current, past due 30, 60, 90+, and other historical comments (e.g., "They usually pay promptly"; "They take discounts"; "They are slow to 90 days but eventually pay"; "They were placed for collection"; "We had to sue"; etc.).

When seeking information, it is proper protocol to also provide information. A creditor should always be forthcoming when making an inquiry of a credit reference. For example, "This [customer/company] has applied for credit from our company and has given your company as a reference." All information exchanged is strictly confidential and should not be disclosed to any party outside of either company's credit department.

Free Flow of Information

Trade credit grantors enjoy the luxury of a free flow of information for the asking. They should be willing to share their current customer information when asked and to maintain confidentiality upon receiving such information from another business credit grantor.

The **NACM Canons of Business Credit Ethics** establish standards relating to the proper exchange of credit information among creditors which contains historical and current factual information to support the process of independent credit decision-making. No permission is required whatsoever to obtain a commercial/business credit report from any agency, including NACM Affiliates, Equifax, Experian, D&B and others about a business or potential business customer. The misconception in this area stems from consumer credit privacy laws that absolutely require permission to obtain personal information and from banks, which have internal policies that vary from bank to bank as to whether or not they will release commercial/business customer credit information.

The Antitrust Division of the Federal Trade Commission governs the gathering and dissemination of commercial/business information and is based on competition and restraint of trade while the Fair Credit Reporting Act and various consumer privacy protection laws govern the gathering and dissemination of personal consumer information.



Comprehension Check

What information should be required on a credit application?

The Credit Application as a Contract

The properly executed credit application is a binding contract when there is agreement to terms and conditions. Remember, the process of obtaining the signed application is a negotiation. As such, including all provisions in the credit application that protect or benefit the credit grantor is the objective. Negotiation generally means that neither party gets everything it wants. But if the questions aren't asked or if the conditions are not included in the credit application, they will certainly not be answered.

One way to think about this process is to consider everything that could possibly make the selling company successful in the event of default or other adversarial relationship with a customer. Then include language to address each issue on the credit application. While several will be addressed in this section of the chapter, every industry and each individual company should focus on those specific issues germane to their own business/industry. A customer or potential customer may negotiate some items, but some discussion will take place prior to the formation of a relationship that may avert an otherwise adversarial, and potentially costly, situation later. Negotiation of terms

may be acceptable depending on the specific terms under discussion. The credit application should be a reflection of the challenges and situations a company has experienced over time. Therefore, include language to cover every situation experienced as a means to limit those occurrences from taking place again.

Agreement to Terms and Conditions of Sale and Credit Policy

The credit application is the only document necessary to form a contract for open account credit, absent a bid proposal or a subcontract agreement entered into by a supplier or subcontractor to which agreement to terms is a condition of the letting of the job or project. Aside from these instances, the credit application document sets forth the agreement between the two parties and describes, identifies and otherwise defines the terms and conditions upon which the parties will do business. Once signed, the credit application is legally binding, including all terms and conditions outlined within the agreement.

Sample language for terms and conditions

All invoices are due [per credit grantor terms]. All amounts for purchases from [name of credit grantor] are payable at [address]. COD restrictions may be placed on any past due account. I (We) agree to pay account promptly within terms stated.

Switching From Credit to Cash Terms

A seller selling on credit terms invoices its customer with payment due at some later date. The seller's terms and conditions should permit a switch to cash in advance terms when its customer fails to timely pay any invoice owing to the seller or the seller has a cause for concern about its customer's creditworthiness.

A provision for a change in payment terms can take a variety of forms. As is the case with most terms, a seller's ability to obtain favorable terms depends on its negotiating leverage. It might prefer the unfettered right to allow or terminate credit terms at its sole discretion. Alternatively, its terms might include the ability to switch to cash terms in the event a customer breaches its contract with the seller or the customer's financial condition has substantially deteriorated to warrant a termination of credit terms. This provision can also state that all amounts the customer owes the seller will be immediately due and payable when the seller changes payment terms.

Sample language for change in payment terms

The credit terms provided by seller are in its sole discretion and can be terminated at any time by seller; if at any time seller reasonably determines that buyer's financial condition does not justify the continuation of seller's performance, seller, at its sole discretion, may require full or partial payment in advance for the contracted goods from buyer; declare the total amount owed by buyer immediately due and payable; or, without any notice, suspend or terminate any performance without protest or penalty from applicant, including cancelling unfulfilled orders.

Terms and Conditions in Another Place

A seller will often have a set of terms and conditions on its website (or another location). Terms posted on the seller's website or in another place would be binding on a customer if the terms are incorporated by reference in a written signed agreement between the parties. Best practices require that a seller's credit application or other agreement signed by its customer includes the customer's agreement to be bound by the terms and conditions posted on the seller's website or other place. A link to the website where the applicable terms and conditions are located should also be included (and the link must actually work as a faulty link would likely result in the provision being deemed unenforceable). It is also good practice to require customers to periodically execute acknowledgments when the seller updates its terms and conditions to bind the customer to such updated provisions.

Buyer Modification of Terms

A customer's agreement to a seller's terms and conditions does not necessarily preclude the customer from subsequently submitting future purchase orders containing contradictory terms that could supersede the seller's more favorable terms. A seller can protect itself from this risk by including, as part of its terms, language that no modification or waiver of any terms by the customer will be enforceable without the seller's prior written approval and the seller's terms will govern to the extent of any discrepancy between its terms and those submitted by its customer in any sales quotation, purchase order or similar document.



Comprehension Check

Why do terms of sale have to be set forth in writing in a credit application?

Interest Charges

When considering a provision for service or finance charges, it is important to avoid violating state usury laws. Although most state usury statutes deal with consumer transactions, a customer may make a credit purchase using a business/trade credit account but then use the items purchased for their own personal use. Law governs this issue according to how the product or merchandise is used rather than how the product or merchandise is purchased.

Potential problems can arise when a customer does not pay for the merchandise or products within terms, and the credit grantor assesses interest, finance, late or similarly named delinquency charges. Even though a credit application may include language that says the customer understands that they are applying for business credit, the credit application contract terms will not prevail if any term violates the state usury law. If the products purchased on credit are used for "personal, family or household use," the transaction is of a consumer nature and consumer credit laws apply, including the amount of interest that may be assessed. State statutes vary, which further complicates matters.

Sample language for interest charges

All invoices are due [credit grantor terms of credit/sale]. A service charge of one and one-half percent (1½%) per month, or eighteen percent (18%) per annum, may be assessed on delinquent invoices but not to exceed at any time the highest legal rate of interest legally allowed.

This language may help to avoid a usury violation in states where the credit grantor may unknowingly make a consumer transaction to a customer for goods or services on open account and later attempt to collect any form of late payment charges on the transaction. This language may also help credit grantors prevail in the event of litigation involving collecting interest on non-usury commercial or business transactions. Courts will generally allow the interest rate agreed to in the signed credit application document as long as the goods or services were not used for personal, family or household use.

A seller should also include, as part of its terms, the reimbursement of attorneys' fees incurred in any lawsuit or through other actions to collect their past due claims or involving any disputes with their customer. The extent to which the seller will be reimbursed for its attorneys' fees can vary depending on the seller's negotiating leverage.

Certification of Use Provision

The objective is to attempt to avoid a defense by a customer that buys products or merchandise from a business credit grantor on open account ostensibly to use in a business manner but instead uses the products/merchandise for "personal, family or household purposes." Such usage shifts the transaction from business credit to consumer credit and, thereby, opens the door to consumer protection defenses.

Sample language for certification of use

I (We) certify that this request is for the extension of credit for business purposes only and is not intended for the extension of credit for personal, family or household purposes.

The nature of the transaction itself will dictate the outcome of this defense. How products or services were used is what a court will consider. Nonetheless, this language remains an important part of the credit application because it clearly states the intention of the parties entering the credit agreement or contract and puts the customer on notice that the creditor should be notified of a purchase that will be used for “personal, family or household purposes.” Certification of use language may not be necessary for every industry or business unless a credit customer can potentially use products purchased for “personal, family or household use.”

Venue Provision

The intent of including this provision on the credit application is to keep any litigation in the credit grantor’s location; the venue provision affords the creditor that right. Without this provision, the credit grantor could be required to travel to the **venue** (*customer’s location*) to bring suit or to defend a lawsuit. Including a venue provision in the credit application may cause the customer to reconsider payment on the delinquent account given that the customer would have to come to the creditor’s location to defend against an action.



Comprehension Check

Why is it important to specify **venue** in the credit application?

Sample language for venue provision

It is understood that this agreement is entered into in the state of [], County of [], and is governed by the laws of the state of [].

OR

Applicant agrees that all issues and disputes relating to any credit arrangement extended hereunder shall be governed in accordance with a competent jurisdiction chosen at the discretion of [creditor] and that applicant expressly waives its venue rights without reference to conflicts of laws or legal principles.

Third-Party Collection Fees and Attorney’s Fees

The general rule is that each party to a lawsuit must pay its own costs to collect and to defend a collection lawsuit. However, with a credit application provision that the customer agrees to pay, or to indemnify, the creditor whether or not a lawsuit is filed, the creditor then can recover fees paid to a collection agency.

In some states, attorney’s fees may be automatically awarded to the prevailing party. However, absent language stipulating payment of third-party collection agency fees, courts generally do not award those fees.

Sample language for collection fees

In the event of default, and if this account is turned over to an agency and/or attorney for collection, the undersigned hereby agrees to pay all reasonable fees and/or costs of collection whether or not suit is filed.

Change of Ownership

The credit professional can avoid the shock of finding new owners in a previously approved customer’s business by stipulating language in the credit application that addresses this issue.

Sample language for change of ownership

We [customer/credit applicant] understand that we must notify [credit grantor/supplier] in writing, and by certified mail, of any change in ownership, whether in the name of the entity or in the business structure of the entity under which credit is established, no later than 30 days after such change is effective.

Inclusion of this or similar language may personally bind the principal of a customer who sells the business or inventory to a new owner or who changes the status of the entity at some point after the establishment of business credit without providing notice. Such a modification (e.g., from proprietor or partnership to corporation or LLC) shifts the liability for purchases made after the change and affords protection from personal liability by virtue of the new status. Without knowledge of this event, the credit professional could unwittingly sell on open account terms to a customer when a personal guarantee may have been in order. It is imperative to then reevaluate the credit before continuing a relationship with the new owner or entity by way of a new credit application. It really is a new credit relationship and should be treated as such.

Certification of Credit Application Responses

Include language attesting to the fact that the information supplied is true and correct.

Sample language for certification of credit application responses

The applicant certifies under the penalty of perjury that the statements contained in the application are true and correct. Applicant understands that the seller intends to rely on all of the information presented in this application in determining its credit-worthiness.

Signature

An officer or principal of the company applying for credit does not necessarily have to sign the credit application agreement. If there is an authorized representative to sign such documents, then that signer can legally bind the company even if the signer is not an officer or executive of the company. Language to consider including in the credit application document that would appear above the signature line(s) should say substantially:

Sample language for authorization to sign

The person executing this agreement has authority to bind [the customer] and is authorized by [the customer] to enter into the terms and conditions set forth in this credit agreement.

Situations can arise in which a customer is reluctant to sign the credit application or feels it is a large enough business concern to evade the credit application signing process altogether. Insisting that the credit application be properly executed (signed) could stand in the way of making a sale by creating ill-will with the customer, the sales department and possibly management or ownership. A signed credit application document is a first defense in any dispute or potential litigation with a customer; therefore, it is essential that the credit application be signed by the customer or the customer's representative.

A signed credit application can also prevent a customer's after-the-fact effort to change terms later by their issuance of a purchase order or other document incorporating different terms of sale from those established in the credit application document. Absent a signed application, terms initiated in a later document may prevail causing the credit grantor to comply under unintended terms.

The credit professional is tasked with finding ways to say "yes" to customers regardless of information obtained or their disinclination to execute a credit application document. The credit professional must then determine how to manage the risk associated with the decision to sell on open account credit.

A signed credit application is pertinent only if there is no preceding signed document, such as a bid proposal, which incorporates terms if accepted by the issuer, or a subcontract or supply agreement in which agreement to terms is a condition of the letting of the job or project. The credit professional may or may not be involved in this process as these contracts and bid proposals are frequently authorized without input from the credit department. The credit professional can be of assistance, however, by making management aware of objectionable terms

included in such contract documents and by knowing where to find resources to help their company avoid perilous terms in contracts.

If a contract term is dubious or uncertain in nature, the rule is simple: “When in Doubt—Line it Out.” See the Crest Ridge case study for more details.

The following options are suggested as alternative methods that may be considered whenever a customer is averse to signing the credit application:



Comprehension Check

Whose signature is needed on the credit application?

Credit Card Authorization Agreement

This form can be offered to the customer in lieu of the credit application. Such an agreement simply means that the credit professional will charge purchases made by the customer at the time the order is placed.

Electronic Funds Transfer Authorization (EFT)

Using this method, the customer agrees to allow the credit professional to simply transfer funds from its bank account at the time the order is placed.

Management Indemnification Form

A form signed by management, or the individual who overrides the signed application requirement, protecting the credit professional if the customer appeals to a higher authority than the credit professional, in order to obtain credit without a signed credit application.

Shipment Terms

Understanding when the ownership of goods sold changes hands is a very important subject that credit department personnel at all levels should understand clearly. The transfer of goods from seller to buyer presents an element of risk. The goods can be lost, damaged or destroyed while in the care of a transportation carrier. Therefore, the issue of who is responsible for the risk of loss must be defined.

The Uniform Commercial Code has specific rules governing risk of loss, which is an issue separate and apart from title (ownership). Risk of loss depends upon the terms of the agreement, the moment the loss occurs, and whether one of the parties was in breach of contract when the risk of loss occurred. Risk of loss can be contractually addressed by using *commonly accepted shipping terms (Incoterms®)*. In addition to the shipping terms, the following is commonly used to create shipment contracts, whereby the seller turns the goods over to a carrier for delivery to the buyer. In a **shipment contract**, *both title and risk of loss pass to the buyer when the goods are given to the carrier*. The seller has no responsibility for seeing that the goods reach their destination.

No Arrival, No Sale *places the expense and risk during shipment on the seller*. If the goods fail to arrive through no fault of the seller, the seller has no further liability to the buyer.

If no agreement has been made for either a shipment contract or a destination contract, then the risk passes to the buyer on receipt of the goods if the seller is a merchant. If the seller is not a merchant, the risk passes to the buyer when the seller tenders (offers) delivery of the goods. The UCC Article 2 definition of **merchant** is “a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.” **Seller** is “a person who sells or contracts to sell goods.” So a merchant deals in goods and a seller sells goods.



Comprehension Check

In a **shipment contract**, when do title and risk of loss pass to the buyer?

Figure 9-1

Credit Card Authorization Form

The following form was originally developed by NACM MidAmerica of Oklahoma City, OK. All rights reserved.

[VENDOR] COMMERCIAL CREDIT CARD PAYMENT PROGRAM

[APPLICANT] agrees to the following terms and conditions regarding payment by credit card.

AGREEMENT TO PAY

[APPLICANT] agrees to honor all credit card charges for product purchased from [VENDOR]. Should the credit card be declined, [APPLICANT] may demand payment, prior to any further shipments.

PAYMENT OF OBLIGATIONS

[APPLICANT] agrees to pay to [VENDOR] at such place designated by it, obligations evidencing credit extended by [VENDOR] in accordance with the applicable payment, finance and service charge schedule in effect from time to time.

CHARGEBACKS

[APPLICANT] agrees that any disputed charge, request for chargeback or adjustment, will first be reported to [VENDOR]. [VENDOR] will have 10 business days to resolve the dispute with [APPLICANT].

[APPLICANT] has 30 days to dispute, or request a chargeback, any credit card charge. [APPLICANT's] failure to dispute the charge, or request a chargeback, 30 days after payment constitutes a waiver of any right to chargeback the payment.

AUTHORIZATION FOR PAYMENT

[APPLICANT] hereby authorizes [VENDOR] to charge its credit card for any and all purchases. The following representatives of the [APPLICANT] are authorized to use the [APPLICANT's] credit card.

Credit Card Number: _____

Expiration Date: _____

Address of Account Holder: _____

Phone Number of Account Holder: _____

Email Address of Account Holder: _____

Individual/Personal Card _____ Corporate/Company Card _____

Cardholder authorizes payment of/up to: _____

A legible enlarged photocopy of the front and back of the credit card must accompany this authorization request.

All payments on credit cards will be charged upon receipt.

Representative _____	Title _____
----------------------	-------------

Representative _____	Title _____
----------------------	-------------

Representative _____	Title _____
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[APPLICANT] agrees to inform [VENDOR] within 10 days of any changes to those authorized to use its credit card.

WARRANTIES AND REPRESENTATIONS

[APPLICANT] warrants and represents that the signature on the claim slip will be genuine and authorized by cardholder and not forged or unauthorized.

Figure 9-1 Credit Card Authorization Form continued

TRANSACTIONS COSTS

[APPLICANT] is not entitled to a cash discount for payments by credit card.

TRANSFERABILITY

This agreement is not transferable by [APPLICANT] without [VENDOR'S] consent. Any attempt by [APPLICANT] to assign the Agreement in violation of this paragraph shall be void.

FAILURE OF CUSTOMER TO FULFILL OBLIGATIONS

Should [APPLICANT] fail to fulfill any of the obligations under this agreement, [VENDOR] may declare the entire balance due and immediately payable, and may proceed to enforce the full payment of such balance, including finance and service charges. In event of suit to collect such payment balance, [VENDOR] shall pay all reasonable attorney fees and actual court costs.

GOVERNING LAW

All transactions involving the credit extended under this agreement shall be governed by the laws of the State of [], which are expressly adopted to control all transactions under this agreement.

WAIVER OF STATUE OF LIMITATIONS

[APPLICANT] expressly waives the defense of the statute of limitations for the period permitted by law.

AGREEMENT OF CUSTOMER

[APPLICANT] expressly agrees to the provisions contained in this agreement and manifests this agreement by his/her signature.

RECEIPT OF COPY OF AGREEMENT

[APPLICANT] acknowledges receipt of a copy of this agreement.

Date: _____, By: _____

[APPLICANT]
Date: _____, By: _____

[VENDOR]

INDIVIDUAL PERSONAL GUARANTEE

Date _____, 20xx

I, (name) _____, residing at address _____, for and in consideration of your extending credit at my request to (company) _____ (hereinafter referred to as the "Company"), of which I am (title) _____, hereby personally guarantee to you the payment at _____ in the state of _____ of any obligation of the Company and I hereby agree to bind myself to pay you on demand any sum which may become due to you by the Company whenever the Company shall fail to pay the same. It is understood that this guarantee shall be a continuing and irrevocable guarantee and indemnity for such indebtedness of the Company. I do hereby waive notice of default, non-payment and notice thereof and consent to any modification or renewal of the credit agreement hereby guaranteed.

Signature _____

Social Security No. _____

Witness _____

Address _____

The following case study describes what can happen when a creditor moves forward without a signature on his/her credit application.

CREST RIDGE CONSTRUCTION GROUP, INC. VS. NEWCOURT INC.

The impact of terms contained on a credit application was recently illustrated in litigation between Crest Ridge Construction Group, Inc. ("Crest Ridge") and Newcourt Inc. ("Newcourt"). Crest Ridge, a construction company, won a subcontract to build certain sections of the Liberty Science Center in Jersey City, New Jersey. One portion of the subcontract required Crest Ridge to supply architectural wall paneling for the Center. The principals of Crest Ridge began discussions with Newcourt, a low-cost foam paneling supplier. Shortly after the discussions began, Newcourt issued a price quotation to Crest Ridge which stated that it was "subject to credit department approval." Newcourt also furnished Crest Ridge with a credit application. The terms and conditions in the credit application and price quotation did not state any specific required credit terms.

Crest Ridge returned the credit application to Newcourt a few weeks later. The completed credit application form stated that Crest Ridge had been established in 1985 and listed one banking and four trade references. Newcourt checked out the banking reference and attempted to verify the trade references. The bank reported that Crest Ridge did have an account and had an average balance of \$5,000. Newcourt was not able to verify the trade references. Because it was concerned about the creditworthiness of Crest Ridge, Newcourt began to investigate other methods of guaranteeing Crest Ridge's payment.

Meanwhile, Newcourt and Crest Ridge continued to discuss the project. Crest Ridge issued a purchase order to Newcourt quoting a price and referencing Newcourt's original price quotation. Newcourt supplied samples of its wall paneling material, job specifications and calculations, three revisions of shop drawings and final drawings showing where each panel would be placed at the Center. Three months later, Newcourt wrote to Crest Ridge suspending all further work on the wall paneling project and demanding payment in full within two weeks. The letter did not mention any credit problems but instead stated that full payment was required because of the "encumbering and confusing progress and lack of receiving pertinent data necessary to satisfy the requirements on the above-referenced project." Crest Ridge attempted to contact Newcourt several times but there was no response. Crest Ridge finally went to another supplier and covered with higher-priced paneling. Newcourt never shipped any paneling to Crest Ridge.

Crest Ridge sued Newcourt for breach of contract. Newcourt argued that there never was a contract because Crest Ridge did not obtain the approval of Newcourt's credit department. The court held that although Newcourt "required" that the price quotation was subject to credit department approval, it did not act in a manner consistent with that language. It went ahead and exchanged price quotes, showed its product and acted in many ways consistent with the existence of a contract. Thus, the court ordered Newcourt to pay damages equal to the difference in amount Crest Ridge was required to pay the higher-priced supplier.

Lessons to Be Learned from Newcourt

Newcourt appears to have had a credit application procedure which left something to be desired. It required references and other information that gave it reason to be concerned about whether it would receive payment from Crest Ridge. It also supplied certain terms and conditions on its credit application that Crest Ridge executed. Newcourt did not act consistent with its terms. Although Newcourt's credit department had apparently not given its approval, Newcourt's behavior gave every indication that a deal had been made. It provided material samples, three revisions of shop drawings, fastening details, stipulations as to the color of each panel and final drawings showing where each panel would be placed. Crest Ridge believed that it had a contract with Newcourt. The court examining these facts also believed that Newcourt acted as if a contract had been made. The court found that Newcourt's demand that it be paid in full prior to any manufacturing or shipment was unjustified under the terms and conditions set forth in the credit application. The court noted that Newcourt did not supply any credit terms to Crest Ridge.

Courts are predisposed to finding that a contract exists. The court considering the Crest Ridge/Newcourt dispute was no different. The court was willing to determine that based upon the terms and conditions contained in the credit application or through the actions of the parties that Crest Ridge and Newcourt had a contract between them. In this instance, the court found that the credit application terms were for the most part disregarded by Newcourt as evidenced by its actions. Had Newcourt really wanted to rely upon its terms and specifically the requirement that its credit department must approve the transaction, then Newcourt would have had to refrain from moving ahead with performance and discussions until such time as the credit department approved the relationship or perhaps sent a letter stating that it could not proceed without the approval of its credit department. It did not. In fact, Newcourt acted as if a contract did exist up until it stated that payment must be made in advance. Newcourt had set up its credit application in many ways that should have protected it, yet Newcourt acted inconsistently in such a way that the court found that its actions dictated the terms of its contract and it was found to have breached the contract.

This material originally appeared in a past issue of Business Credit magazine and was written by Deborah Thorne, Esq., while a partner in the law firm of Barnes & Thornburg LLP.

Supplemental Information

Other provisions may be included on the credit application that may be beneficial to specific industries and businesses or in certain circumstances. A credit professional may include these terms on the credit application as supplemental language to other terms and conditions or as replacement language for items discussed that do not apply to certain industries or businesses.

Waiver/Duty to Inspect

Use of this provision requires a customer to inspect and notify creditor of any dispute within a specific period of time or surrender the right to do so later. This language strengthens the case for prompt collection of delinquent accounts and avoids the practice of some customers who would withhold payment of any portion of an invoice where there may be a dispute on a smaller portion of the invoice.

Sample language for waiver/duty to inspect

Applicant agrees to examine immediately upon receipt, each of [creditor's] invoices and/or statements, and to advise [creditor] of any disputed transactions or billings/statements within 10 days of receipt, together with a written statement specifying the reasons for such dispute. Failure to notify [creditor] of any dispute with respect to defective goods or billing shall constitute a waiver of all such disputes.

Escheatment/Inactivity

Every state has legislation that requires individuals and companies to **escheat**, which is defined as the “reversion of property to the state in consequence of a want of any individual competent to inherit.” (*Black’s Law Dictionary*, Abridged Tenth Edition, 2014).

Escheatment includes all forms of property, both tangible and intangible, including a customer’s credit balance. Escheatment laws provide that the state becomes the legal owner of abandoned property based on the concept of state sovereignty. To write down a seller’s escheatment exposure, a credit professional may consider imposing a reasonable inactivity fee to the credit balance.

Sample language for escheatment/inactivity

[Creditor] imposes an inactivity fee of \$_____ per month against any credit balance presumed abandoned by applicant. An account is presumed abandoned if there is no activity for one year.

OR

[Creditor] reserves the right to assess a monthly service charge on account paid outside credit terms to the maximum amount permitted per jurisdiction.

Setoff Rights

Setoff rights are a significant state law remedy that can help a trade creditor reduce its exposure on a claim against a financially distressed customer. Setoff enables a creditor to net out the amount it owes its customer from the amount the customer owes the creditor. For example, a seller might be owed \$100 for goods sold to a customer on credit, but the seller might separately owe \$100 to the customer in connection with an entirely separate business transaction. Setoff allows the seller to net out and set off the amounts owed which results in full payment of its claim.

Creditors that sell to and buy from their customers can include a setoff provision as part of their terms. A typical setoff provision will permit the seller to offset any indebtedness owing to the customer against the seller’s claim against the customer.

Sample language for setoff rights

Seller and buyer agree that notwithstanding anything to the contrary contained herein or in any other contract, agreement or document, seller may offset any debt now or hereafter owing to buyer against any debt now or hereafter owing by buyer to seller including transportation charges.

Therefore, in the example, in the event the customer is unable to pay the \$100 it owes to the seller, the seller can cancel its \$100 debt to the customer, resulting in a 100% recovery on its claim. In the context of the customer's bankruptcy, a seller's setoff right is like a secured claim where the seller could reduce its claim against its customer on a dollar-for-dollar basis by concomitantly reducing its indebtedness to the customer. This contrasts with the seller being relegated to general unsecured creditor status with a far lower likelihood of recovery of its claim in the absence of any setoff right.

Creditors that do business with affiliated entities might attempt to broaden their setoff rights to allow them to net their claim against one affiliate to reduce their obligation to another affiliate. This is called a "triangular setoff." Taking the example, in this situation a seller is owed \$100 for goods sold on credit to its customer, but the seller separately owes \$100 to the customer's affiliate. The seller can include a term that permits it to offset its indebtedness to its customer or its affiliates against the seller's claim against the customer, with the applicable affiliates doing business with the seller agreeing to be bound by this particular provision.

Sample language for a triangular setoff

XYZ and its direct and indirect affiliates, divisions and subsidiaries, including, but not limited to, XYZ Holdings Inc., XYZ Inc., XYZ Limited and XYZ LLC (hereafter collectively "XYZ") and ABC Inc. and its direct or indirect affiliates, divisions or subsidiaries, including, but not limited to, ABC Inc. (collectively "ABC") agree that notwithstanding anything to the contrary contained herein or in any other contract, agreement or document, XYZ may offset any debt owing by XYZ to ABC against any debt owing by ABC to XYZ.

Alternatively the seller, its customer, and the customer's affiliates can enter into a separate setoff agreement. Trade creditors should note, however, that while triangular setoff provisions are enforceable under state law in a non-bankruptcy context, bankruptcy courts have refused to enforce this provision in a bankruptcy setting. Therefore, even in a case where a seller, its customer and the customer's affiliate unambiguously agree to grant the seller triangular setoff rights against the affiliate, the seller will likely lose its triangular setoff rights upon the filing of bankruptcy by the customer and its affiliated entities. The seller could minimize the risk of loss of its triangular setoff rights by obtaining the affiliate's guarantee of the customer's obligations to the seller.

Waiver of the Right to a Jury Trial

It is important to seek the agreement of the customer to waive its right to a jury trial. Virtually every state will permit the waiver of a jury trial by a business debtor, provided that it is created in a commercial setting.

Sample language for waiver of the right to a jury trial

The parties hereto knowingly and intentionally waive the right to a jury trial on any issue or dispute that may arise between them.

Prejudgment Remedy Waiver

Sample language for prejudgment remedy waiver

Applicants do hereby expressly and irrevocably waive any notice and/or hearing, which may be required for prejudgment remedies under the statute of the state of [state].

Alternative Dispute Resolution (ADR)

Consider language in the credit application that provides for binding arbitration or mediation should a dispute arise. Mediation or arbitration usually can be set in a matter of days with an arbitrator or mediator experienced in collection or business disputes. Conversely, a hearing or trial by jury could take months or years to be heard by a judge. Arbitration is binding and eliminates litigation or trial by jury whereas mediation is not binding and does not circumvent litigation if either party is not satisfied with the mediator's decision. The decision to add an arbitration or mediation provision in a credit agreement is one that should be made after careful deliberation with management and counsel, to ensure that all appropriate factors are considered.

Use this tool judiciously as binding arbitration also eliminates litigation as an alternative.



Comprehension Check

When should ADR be considered? How does it differ from mediation?

Sample language for alternative dispute resolution

Applicant agrees that applicant will submit all disputes to final and binding arbitration (or mediation) in [State,] in accordance with the American Arbitration Association or the National Association of Arbitrators (if arbitration is selected). Applicant agrees to be bound by the arbitrator's (or mediator's) decision.

Security Instrument/Agreement

Although perfection of the security agreement is required to properly demonstrate the right to collateral, the credit application can contain language that creates the security interest and will then be considered a security agreement.

Sample language for security instrument/agreement

Applicant hereby grants to the [creditor] a security interest in [] and any and all purchases made by Applicant from creditor (the "Collateral"), and hereby authorizes the [creditor] to execute and file on behalf of the applicant any such UCC financing and continuation statements as the [creditor] deems necessary to perfect its and/or its Assignee's security interest in the Collateral.

Financial Information

For customers that are small companies, financial statements can be difficult to obtain since they may not have audited annual financial statements. If this class of customer represents the largest part of the customer base, include an easy-to-complete balance sheet and income statement form as part of the application. If the customer base is made up of larger companies, financial statements should be available. In either case, it is crucial for the creditor to obtain financial information, signed by an authorized officer, and to attach such financial information by reference into the credit application.

A section should be included in the credit application stating that the applicant agrees to provide updated financial information upon request. Financial statements can detect changes in legal status.

Sample language to obtain financial statement

Attached to (or included within) this credit application is the most recent financial statement of the applicant/undersigned. The undersigned agrees to provide to creditor updated financial information on request, and to timely provide an annual financial statement to creditor as a condition of the continuation of this credit.

If the applicant is a corporation, a balance sheet can be copied from an 1120 tax return. Not all applicants can provide an audited financial statement, but it is recommended that the seller obtain financial information to evaluate creditworthiness.

The application can include a question about whether the applicant has ever filed for bankruptcy and/or has been involved in an involuntary bankruptcy proceeding, an assignment for the benefit of creditors or a composition agreement, which are all insolvency proceedings.

Buyer's Obligation to Provide Financials

A seller's terms should also require that their customers periodically deliver financial statements to the seller. There are several reasons why this can be informative. First, a seller's knowledge of its customer's financial condition by reviewing the customer's financial statements would be helpful in any decision concerning future business. A seller's review of its customer's financial statements would also assist the seller in deciding whether to tighten credit terms or switch from credit to cash terms.

Limitations on Liability

A seller's terms should also impose a cap on its liability to its customer. These provisions should limit a seller's and their affiliates' cumulative liability to the total amounts their customer had paid to the seller.

Sample language for limitations on liability

The aggregate cumulative liability of seller and its affiliates under common control with it, directors, officers, employees, representatives and agents for all claims arising hereunder, notwithstanding the form in which any such action is brought, whether in contract, tort (including negligence), or otherwise, shall be limited in the aggregate to the total amounts paid by applicant to seller under any invoice or order confirmation.

Any such provision should also confirm that a seller would not be liable for consequential, incidental, indirect, special, exemplary or punitive damages, third-party claims, loss of revenues, loss of profits or loss of savings.

A seller should also include a provision that requires its customer to inspect the goods purchased from the seller and raise complaints within a short period of time. For example, requiring a customer to assert all complaints in writing within seven days of delivery of the seller's goods and providing for a customer's waiver of claims that were not timely and properly asserted will increase the likelihood of full payment of a seller's claim against the customer.

Sample language for customer inspection of goods

Applicant is under an obligation to inspect contracted goods immediately upon receipt for correctness, completeness and conformity. Incorrect, incomplete or nonconforming contracted goods must be reported to seller in writing within seven (7) days from the date of delivery of the contracted goods. Otherwise, buyer shall be deemed to have accepted the contracted goods. Upon written notice from buyer, seller will correct incorrect and/or incomplete orders at its own expense. For nonconforming contracted goods, seller, at its sole discretion, will (i) repair the product or part thereof; (ii) furnish a replacement product or affected part thereof; (iii) issue a refund in an amount equal to the original selling price for the item; or (iv) deny the claim according to those terms.

A seller should also include language that shortens the statute of limitations for a customer to commence a lawsuit against the seller for breach of contract and other claims. Article 2 of the Uniform Commercial Code (which governs transactions for the sale of goods) stipulates that the statute of limitations is four years for any lawsuit asserting breach of contract or breach of warranty claims. However, the contracting parties can shorten the statute of limitations to as low as one year. Therefore, a seller's terms should state that a customer must commence an action alleging a breach of warranty or any other breach of contract claim within one year after the cause of action arises.

Limitations on Warranties

Article 2 of the Uniform Commercial Code also provides that certain implied warranties will be read into sales contracts, unless the contract waives such warranties. Article 2 creates an implied warranty of merchantability that requires goods sold to be merchantable (i.e., fit for the ordinary purposes for which such goods are used). Article 2 also contains an implied warranty of fitness of purpose where the customer is relying on the seller's expertise in making sure the goods are suitable for the customer's intended purpose. There might be other implied warranties arising through course of dealing or usage of trade.

A seller's terms and conditions should include a disclaimer of all implied warranties. Only those warranties that the seller and the customer agreed to include as part of the disclaimer should be binding on the seller. Some states allow general disclaimers of all implied warranties, while other states require listing each specific warranty that is being disclaimed.

As a best practice, a seller's terms should include a disclaimer of all implied warranties of any kind, including, without limitation, warranties as to performance, merchantability, or fitness for a particular purpose, and warranties arising by statute or otherwise, or from a course of dealing or usage of trade.

Sample language for disclaimer of implied warranties

Except as provided in seller's products warranty, warranty of title or infringement, seller does not make or give any representations, guarantees, warranties or conditions of any kind, express or implied, including, without limitation, warranties as to performance, merchantability, or fitness for a particular purpose, and warranties arising by statute or otherwise, or from a course of dealing or usage of trade.

Stating that all goods are sold "as is" can also serve to alert the customer that the goods are being sold without any implied warranties of any kind. Lastly, a seller should make sure provisions limiting warranties are in bold font and/or capital letters since the Uniform Commercial Code requires that any provision excluding warranties be conspicuous.

Liquidated Damages

Liquidated damages are damages that the parties agree will compensate an injured party upon a specified breach. Liquidated damages typically include a customer's damages arising from a seller's late delivery of goods or provision of services. Liquidated damages clauses are often expressed as a percentage of the overall value of the sale or service in question.

Absent including a liquidated damages clause as part of a seller's terms, courts will be left to determine actual damages, which is often difficult, and can vary depending on the circumstances. As such, best practice is for a seller to include a liquidated damages clause in its contracts in order to attain cost certainty in the event of a dispute. While liquidated damages may turn out to be greater than actual damages in certain circumstances, the seller would at least gain comfort from having a clearer understanding of its overall risk profile.

Indemnification

A seller's terms should also include a seller's indemnification in favor of its customer and vice versa. Indemnification provisions can take several different forms. The seller's objective should be to have as narrow an indemnity in favor of the customer as possible. Customers often seek to include broad indemnification provisions where the

seller indemnifies its customer for all customer claims regardless of which party is at fault. Despite the fact that these broad indemnification provisions are unenforceable in certain states, sellers should try to narrow their scope at the outset. A reasonable indemnity from the seller's perspective imposes liability on the seller to indemnify its customer for actions that are solely the seller's fault.

A seller should also seek its customer's indemnity for certain claims that might be brought against the seller in connection with a transaction. For instance, a seller might wish to seek protection from product liability claims. The seller's terms can require the customer's indemnification of the seller for product liability claims brought against the seller where the customer's intervening act had caused the product defect. This provision would be beneficial where the customer receives the product from the seller and the customer's subsequent improper installation causes a malfunction and exposes the seller to potential liability. The customer should bear the cost where it was clearly at fault.

Force Majeure

A seller's terms should also state that the seller is not responsible for its failure to perform under an agreement with a customer if such failure is the result of a force majeure event. **Force majeure events can include "acts of God," such as floods, earthquakes and hurricanes, as well as other events, such as war, terrorist activities, labor disputes and electrical failures.** The seller's objective should be to define a force majeure event as broadly as possible so as to assign as much risk as possible to the customer.

Below the Signature Line

Consent to Obtain Consumer Credit Report—FCRA Authorization

After completing the investigation of the potential business customer, or review of the existing business customer, the credit professional may believe that the customer represents a questionable credit risk. The credit professional must then determine whether to sell or to continue to sell on open account credit basis to this customer and/or at current credit limits. The credit professional may decide that a review of the personal credit history of the principal of the business entity is warranted in order to make an appropriate credit decision.

In this case, the credit professional will want to obtain a consumer credit report. In order to legally obtain this report, the **Fair Credit Reporting Act (FCRA)** requires a two-pronged test. First, there must be a "permissible purpose" to obtain the report. Second, "written authorization" from the individual whose report will be reviewed must be obtained. A provision in the credit application seeking general authority for the credit professional to obtain a consumer credit report on a proprietor, partner, officer/principal of a corporation or member of an LLC will not be sufficient to obtain such a report.

With regard to the first test element, "permissible purpose," the credit grantor automatically has the existing applicant's permission because there is either a request to enter into a business credit relationship with the credit grantor or there is already an established business credit relationship.

Sample language for the second test FCRA element

The undersigned individual who is principal, proprietor or partner of the entity applying for business credit, and therefore desirous of a business relationship with [creditor], recognizing that his or her individual credit history may be a factor in the evaluation of the credit history of the applicant, hereby consents to the use of the consumer credit report of the undersigned by [creditor] as may be necessary in the credit evaluation process and for periodic review for the purpose of maintaining the credit relationship.

The FCRA goes on to say that this authorization must be "conspicuous" in that the applicant must be clear that permission is being given to obtain their personal credit report. In order to meet the "conspicuous" test, the FCRA suggests that the language be printed in bold, all caps or otherwise stand out from other terms and conditions

in the credit application. This language may also be treated as an addendum to the credit application and offered to the customer as a separate document for the principal's signature.

Personal or Corporate Guarantee

A personal guarantee can be a valuable tool for the credit department when information available on the business entity itself is unavailable or unsatisfactory. A **personal guarantee** is obtained from a principal of an entity such as a president or other officer or shareholder; a member or multiple members of an LLC; or from any third-party source unrelated to the business but who can be offered as a signatory. A **corporate guarantee** is used when a corporation agrees to be held responsible for completing the duties and obligations of a debtor to a lender, in the event that the debtor fails to fulfill the terms of the debtor-lender contract.

The objective for the credit department when obtaining a personal guarantee is to ensure "pass-through" to the personal assets of the individual signing the guarantee in order to offset the risk the credit grantor may be taking by providing open account, unsecured credit. Individuals who sign a personal guarantee acknowledge, via their signature, that they understand that should the business entity for which they are offering their guarantee default in any manner then the credit grantor may look to them for satisfaction of any and all debt incurred by the entity.

Personal guarantees are unnecessary for an entity structured as a proprietorship or general partnership because the proprietor, owner or partners of a general partnership are automatically personally responsible for debts incurred by the business entity owned or controlled by them.

The difference between a personal guarantee and a corporate guarantee is that an individual person or persons are attesting to their faith and trust in the company or business entity to meet their obligations to the creditor named. They will "stand-in-the-shoes" of the customer in the event of default. The result is the same for a corporate guarantor except that the guarantor is actually another company that will be approached for payment in the event of default of the business entity to which the creditor is being asked to extend open account, unsecured credit.

In the personal guarantee the consent language is **not** required to appear separate and apart from the guarantee form itself because the guarantor and the person consenting to the request to obtain consumer information should be one and the same. This is unlike the credit application process wherein an authorized representative can enter into the credit application terms and conditions. The authorized signer on the credit application, however, may not be the person whose consumer credit report will be required. The signer of the credit application cannot provide consent for the acquisition of another party's credit report. Therefore, a separate signature area for consent is necessary, including those instances in which the authorized signer of the credit application and credit report subject are one and the same.

Credit professionals must understand that, under certain circumstances, it is possible to have three separate signatories in the process of obtaining a credit application: the signatory of the credit application, the signatory of the consent to obtain a consumer credit report and the signatory of the personal guarantor.

In the process of obtaining consent to obtain consumer credit information, the credit professional will generally require the social security number of the individual whose consumer report is to be obtained. In gathering personal information of this nature, the credit professional should be reminded that the **Gramm-Leach-Bliley Act** and certain other privacy regulations must be considered when gathering and keeping this personal information. A review of company policy with appropriate legal counsel is warranted and recommended.

Guarantee language can be included on the credit application form itself or it can be an addendum. If the guarantee appears on the credit application form, then it is advisable for the guarantee language to appear below the signature line where the customer would agree to the credit application's terms and conditions. There are numerous reasons for doing so; the main one has a great deal to do with FCRA requirements to obtain personal information on the guarantor. *Any personal or corporate guarantee is only as good as the person (or company) signing it. If they are not creditworthy, then the guarantee could be of little value when enforced. It is not necessary to comply with FCRA regulations regarding a corporate guarantee, as a creditor is not required to have a "permissible purpose," or to obtain permission, written or otherwise, to obtain credit information on a business entity regardless of their structure.*

Key terms of a personal or corporate guarantee are:

- It should be termed a “payment guarantee” as opposed to a “performance guarantee.” This means that the guarantor agrees to pay the creditor and not perform on a contract.
- It should be “absolute and unconditional,” meaning there is no mistake and that the creditor is not required to fulfill some condition in advance of demanding payment under the guarantee.
- It should be a “continuing” guarantee. That is, the guarantee continues in force as long as debt exists.
- It should be “irrevocable,” which means the guarantor cannot avoid, or otherwise destroy, the efficacy of the guarantee without written notice to the credit grantor and acceptance by the creditor of the revocation.

Additional terms to consider when drafting a personal or corporate guarantee:

- Guarantors agree to seller’s specified interest rates.
- Guarantors agree to pay all costs of collection (attorney’s fees and court costs).
- Guarantors agree to the specified governing laws.
- Guarantors agree to be joint and severally liable with the debtor to the seller.
- Guarantor’s consent to jurisdiction (optional).
- Guarantor’s waiver of a jury trial (optional).
- Guarantor’s waiver of counter claims.
- Guarantor’s signature.
- Guarantee should be witnessed and notarized.

Sample language to consider in the Personal Guarantee

- In consideration of credit extended by Seller to Buyer, I assume personal and individual responsibility, etc.
- The guaranty is open, continuous and not limited in time.
- This guaranty shall remain force until Seller receives notice from me that this guaranty is terminated.
- I knowingly and voluntarily waive any right to trial by jury.

It is advisable to seek legal counsel to ensure that any guarantee entered into with a customer is in compliance with current policies and is written in such a way as to achieve the payment protection desired.

Corporate guarantees should always include a corporate resolution from the company or entity guarantor. This step ensures that no claim will come forth that the corporation did not authorize entering this obligation without knowledge and consent on behalf of the principals, shareholders and board of directors of the corporate entity.

The ECOA does not permit a credit grantor to require a spouse to sign a personal guarantee if that spouse is not directly involved with the business credit applicant.

If a guarantee of another corporation, an affiliated corporation, a parent or a subsidiary is obtained, obtain a corporate resolution authorizing the obligation. A parent corporation can guarantee the debt of its subsidiary. The official corporate seal should be placed on the documents.



Comprehension Check

What are the essential elements of a **personal guarantee**?

Sample language for personal guarantee

PERSONAL GUARANTEE

For valuable consideration, the receipt of which is acknowledged, including but not limited to the extension of credit by [Company Name] to _____ the undersigned, individually, jointly and severally, unconditionally guarantees to [Company Name] the full and prompt payment by _____, of all obligations which Guarantor presently or hereafter may have to [Company Name] and payment when due of all sums presently or hereafter owing by Guarantor to [Company Name]. Guarantor agrees to indemnify [Company Name] against any losses [Company Name] may sustain and expenses [Company Name] may incur as a result of any failure of Guarantor to perform including reasonable attorney's fees and all costs and other expenses incurred in collecting or compromising any indebtedness of debtor guaranteed hereunder or in enforcing this guarantee against guarantor. This shall be a continuing guarantee. Diligence, Demand, Protest or notice of any kind is waived. It shall remain in full force until guarantor delivers to [Company Name] written notice revoking it as to indebtedness incurred subsequent to such delivery. Such delivery shall not affect any of guarantors obligations hereunder with respect to indebtedness heretofore incurred.

The undersigned personal guarantor, recognizing that his or her individual credit history may be a necessary factor in the evaluation of this personal guarantee, hereby consents to and authorizes the use of a consumer credit report on the undersigned, by the above named business credit grantor, from time to time as may be needed, in the credit evaluation process.

Sign Name _____ Print Name _____ Date _____

Sign Name _____ Print Name _____ Date _____

Witness _____ Date _____

Equal Credit Opportunity Act (ECOA) Notice

The **ECOA** prohibits a business credit grantor from discriminating with respect to the extension or renewal of credit based on race, color, religion, national origin, sex, marital status or age. It is important that a credit application does not contain questions which could be interpreted as discriminatory. The following language is required and can be placed in the footer of the credit application:

Sample language for required ECOA notice

The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission, Division of Credit Practices, 6th Street and Pennsylvania Avenue, NW, Washington, DC 20580.



Comprehension Check

What is contained in the ECOA regulations?

Figure 9-2 Terms and Conditions Sample Form

1. The undersigned Applicant agrees to the use of its signature on this application as authorization to release credit information from Applicant's bank and from all other sources of credit information regarding the Applicant.
2. Should credit availability be granted by COMPANY to Applicant, all decisions with respect to the extension or continuation of this credit shall be at the sole discretion of COMPANY.
3. When requested, the undersigned Applicant agrees to provide annual financial information to properly substantiate the continuation of credit extension as required by COMPANY.
4. Applicants from whom COMPANY will require security in exchange for the extension of credit will cooperate as necessary to enable COMPANY to perfect an appropriate security interest including, but not limited to, a security interest in the goods sold by COMPANY to the Applicant.
5. The undersigned Applicant hereby agrees that all amounts due for goods and services purchased from COMPANY are payable at the remittance address shown on the invoice and according to the terms specified by COMPANY as stated on each invoice. The undersigned Applicant hereby agrees to remit the total amounts due as reflected on COMPANY'S invoices. If the Applicant believes an adjustment to any invoice is warranted, the Applicant shall request in writing that appropriate credit be issued and shall cooperate with COMPANY in verification of the propriety of such credit.
6. No term or condition contained in any purchase order, offer, writing or other communication to COMPANY shall be valid and binding upon COMPANY unless agreed to in writing by an authorized representative of COMPANY or is identical to the written terms and conditions of sale of COMPANY.
7. The undersigned Applicant agrees to apply cash discount to credit memos, as long as cash discount is part of the Applicant's payment terms. Promotional credits are not subject to cash discount.
8. In the event that COMPANY takes possession of Applicant's existing stock ("Lift Out Inventory") through a stock lift, Applicant warrants good title to the Lift Out Inventory. Applicant agrees to identify, prepare and supply COMPANY with any releases or terminations of security interests, financing statements and liens affecting the Lift Out Inventory accepted by COMPANY. Applicant warrants that the removal and disposal of Lift Out Inventory by COMPANY will not (a) violate any loan agreements, security agreements, credit sales agreements, other agreements, bulk sales laws, tax consents or clearance requirements or court or administrative orders, contractual agreements or other legal obligations to which Applicant is a party or subject; or (b) give rise to claims against COMPANY of any kind by anyone claiming by or through Applicant an interest in or contractual rights regarding the Lift Out Inventory. Applicant also assigns to COMPANY all warranty rights, chooses in action and general intangible rights pertaining to the Lift Out Inventory.
9. The undersigned Applicant acknowledges that in the event of default, including payment default, (defined as payment received beyond terms as designated on invoices), COMPANY reserves the right to take any or all of the following actions:
 - (a) Impose a moratorium on order shipment.
 - (b) Reduce the credit limit.
 - (c) Conduct a credit investigation of the business entity which will require updated trade and bank reference information.
 - (d) Require financial statements to clarify the customer's financial status.
 - (e) Require some type of security such as a UCC-1/Purchase Money Security Agreement, Cross-Corporate Guarantee, Personal Guarantee or Letter of Credit.
 - (f) Require immediate payment of the account balance in full.
 - (g) Revoke open account terms.

Figure 9-2 Terms and Conditions Sample Form continued

10. The undersigned Applicant agrees to notify the COMPANY credit department of any changes of ownership and further agrees to remain liable for all purchases made prior to such change unless COMPANY otherwise agrees in writing.
11. The undersigned Applicant agrees to pay a fee of \$50 for any check returned for non-sufficient funds.
12. The parties shall endeavor to resolve within 90 days any dispute arising out of or relating to this Agreement by mediation under the CPR Mediation Procedure then currently in effect. Unless the parties agree otherwise, the mediator will be selected from the CPR Panels of Distinguished Neutrals. Any controversy or claim arising out of or relating to this Agreement, including the breach, termination or validity thereof, which remains unresolved by mediation shall be submitted to binding arbitration in accordance with the CPR Rules for Non Administered Arbitration then currently in effect, by three independent and impartial arbitrators, of whom each party shall designate one; provided, however, that if one party fails to participate in the mediation as agreed herein, the other party can commence arbitration prior to the expiration of the time periods set forth above. The arbitration shall be governed by the Federal Arbitration Act, 9 U.S.C. §§ 1-16, and judgment upon the award rendered by the arbitrators may be entered by any court having jurisdiction thereof. The place of arbitration shall be CITY, STATE and the governing law shall be the laws of STATE without regard to STATE'S rules on conflict of laws. A party may file a complaint at any time before arbitrators have been selected to seek a preliminary injunction or other provisional judicial relief, if in its sole judgment such action is necessary. Despite such action the parties will continue to participate in the procedures specified in this Agreement.
13. The undersigned Applicant agrees to pay, in the event the account becomes delinquent and is turned over to a collection agency, all attendant collection costs and attorney's fees as allowed by law in the state of STATE.
14. The Applicant understands that if a return is accepted to cover delinquent debt, COMPANY reserves the right to charge a 10% handling fee on the credit memo. Freight costs on the return are the responsibility of the debtor.
15. The Applicant hereby certifies the accuracy and truth of the information provided in this application, and in the information provided in addition to this application, and acknowledges that such information is given for the purpose of inducing COMPANY to extend credit to Applicant and to assist in the investigation of the Applicant and the subsequent decision on the extension of credit to the Applicant. By signing this application, the signatory represents and affirms that he/she is a duly authorized representative of the Applicant with full power and authority to agree to the terms and conditions set forth in this application and to bind the Applicant hereto.
16. I affirm that the information contained in this application is complete and accurate. COMPANY is relying on this information as affirmed. All information contained herein is material and any omission and/or misstatement could result in immediate termination of credit extended by COMPANY.

Signed and dated _____

The investigation and eventual credit availability decision by COMPANY will be executed in compliance with the Federal Equal Opportunity Act as administered by the Federal Trade Commission which prohibits discrimination on the basis of race, color, religion, national origin, sex, marital status or age.

**Reprinted from the NACM Graduate School of Credit and Financial Management project, 2016.*

Key Terms and Concepts.....



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Comprehension Check.....



1. What information should be required on a credit application?
2. Why is it important to have the correct legal name of a credit applicant?
3. What is an **NAICS code**?
4. Where can one check the legal status of a public corporation?
5. What security is needed to protect the confidentiality of customer information?
6. Why do terms of sale have to be set forth in writing in a credit application?
7. Why is it important to specify **venue** in the credit application?
8. Whose signature is needed on the credit application?
9. In a **shipment contract**, when do title and risk of loss pass to the buyer?
10. When should **ADR** be considered? How does it differ from mediation?
11. What are the essential elements of a **personal guarantee**?
12. What is contained in the **ECOA** regulations?

Summary



- The credit application is crucial to the determination of the rights of the creditor in the event of a dispute with, or default of, a customer. With a well-drafted credit application, a credit professional may accomplish dual goals of limiting credit risk, addressing contingencies that may arise in a credit relationship.
- The credit application is the credit professional's first, and sometimes only, opportunity to protect their company from risk of loss through credit sales and/or fraud. This is most advantageous to obtain at the beginning of the buyer/seller relationship.
- The credit application is structured to assist the seller in four stages of the buyer/seller relationship:
 - **Prior to extending credit**
 - **During the credit relationship with the buyer**
 - **During problems in a credit relationship**
 - **During litigation**
- The credit application is usually the primary source of information on a business looking for credit. Basic information for any credit application includes:
 - **Date of application**
 - **Applicants legal name**
 - **Address information including mailing address, physical address, P.O Box**
 - **Telephone number, fax number, email and website**
 - **Federal Tax Identification Number (FEIN)**
 - **Accounts payable contact information**
 - **Years in business**
 - **Sales tax exemption**
 - **Lease or ownership of real estate**
 - **Type of business**
 - **NAICS code**
- Understanding the legal structure is also an essential component of any credit application because it allows a credit manager to understand who is liable for any debts accrued by the organization.
- A creditor can easily check the legal status of a company online with the Secretary of State's office. If a company changes its legal status, a new credit application should be signed.
- It is critical for any credit professional to understand the law and regulations surrounding personal information. Many states also require notification to individuals concerning data breaches.
- Obtaining bank references may be necessary when extending credit. However, even though current laws do not restrict banks from providing creditors information regarding business customers, many banks have chosen to adhere to a standard "no information" policy.
- Trade credit grantors enjoy the luxury of a free flow of information, and should be willing to share their current customer information, while maintaining confidentiality if obtaining customer information from another business credit grantor. The **Canons of Business Credit Ethics** establish standards relating to the proper exchange of credit information among creditors which contains historical and current factual information to support the process of independent credit decision-making.

- It is important to remember that the process leading up to a signed credit application is a negotiation.
- It is also important to avoid violating state usury laws. Law governs how the product is used rather than how it is purchased. Therefore, the amount of interest specified can only be collected if it is in the signed agreement and has been used for business/commercial purposes, aside from “personal, family, or household purposes.” A Certification of Use Provision can be added to a credit agreement to avoid a defense by a customer who uses their business credit to buy products they intend to use for personal use. This is only necessary if the products have potential for “personal, family, or household use.”
- A **venue** provision is essential part of a credit application to ensure credit grantors will not be required to travel to bring or defend a lawsuit.
- In order to be awarded attorney fees, it is suggested that this be stipulated in the credit agreement to ensure that it is not overlooked in court proceedings.
- During a change in business ownership, a reevaluation of credit before continuing business with the organization is imperative. A new credit application should be the beginning of this new relationship.
- An authorized representative can legally bind the company even if the signer is not an officer or executive of the company.
- Alternative methods of authorizations if customers are averse to signing a credit application include:
 - Credit Card Authorization Agreement
 - Electronic Funds Transfer Authorization (EFT)
 - Management Indemnification Form
- Due to the fact that transfer of goods from seller to buyer can present substantial risk, it is important to establish who is liable in these circumstances. Based on Uniform Commercial Code, risk of loss depends upon the terms of the agreement. This can be addressed by using the commonly accepted shipping terms (Incoterms®).
- Other supplemental information that may be included in the credit application includes:
 - **Waiver/duty to inspect**
 - **Escheatment/inactivity**
 - **Right of offset**
 - **Waiver of the right to a jury trial**
 - **Prejudgment remedy waiver**
 - **Alternative Dispute Resolution (ADR)**
 - **Security instrument/agreement**
- Big or small, financial information for a company should be provided. If the company is small, a variation of financial information should be provided, like an easy-to-complete balance sheet or income statement. For larger companies, financial statements should be provided.
- It is important to follow **ECOA** laws when obtaining a personal guarantee, but keys to a personal or corporate guarantee are:
 - **Payment guarantee**
 - **It should be “absolute and unconditional”**
 - **It should be “continuous”**
 - **It should be “irrevocable”**
- The ECOA also prohibits discrimination based on race, color, religion, national origin, sex, marital status or age.

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