

## **CREDIT APPLICATIONS: TERMS TO BIND YOUR CUSTOMER**

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### **A. Why a Credit Application?**

The credit professional documenting the credit sale appreciates the importance of a credit application. A credit application can be central to setting forth the rights of the vendor in the event of a dispute with the customer. A credit professional may limit credit risk and address contingencies with an effective terms and conditions section of a credit application. The article discusses some of the key terms and conditions that a credit professional may consider to bind the customer. Mike Brittan discusses the credit application as a source of information and basic terms of the credit application, while Scott Blakeley discusses some terms and conditions that may aid the credit professional in resolving customer disputes. Mike's discussion is set out in sections "B" through "D" below, while Scott's discussion is set out in section "E."

### **B. The Credit Application as a Source of Information**

There's only one place to gamble, and it's not with your company's profits. As hard as it might seem sometimes, the only time to get the information you really need to prevent a sheer 'roll of the dice' is at the beginning of the customer/vendor relationship. How many times have you been successful getting needed information after your company has already delivered to a customer? Think of it as though you are negotiating a deal. Your customer, (new or existing), wants your company's product/service without paying you today. You want information - today. It's a simple trade involving no exchange of money - today. If all goes well, you each get exactly what you want.

Absent getting a properly completed credit application, you may not have the leverage you need later. So use the leverage of asking for a few answers today in order to let your customer have the privilege of paying you later. If you allow credit application questions to go unanswered, you may find yourself explaining later to your boss, or a judge, why you did. Imagine yourself in front of your boss, or in a courtroom, being asked: "Mr/Ms. Jones, did you know the questions to ask in order to protect your company from unnecessary risk before you extended credit terms to this customer?" Of course you did. They were right there on your credit application. "Then why didn't you get the answers you were looking for before you extended terms?"

Mr./Ms. Jones: "Umm...er...well..." It's a dubious position. You have only two possible answers: "I guess I was, maybe... stupid". Or, "I was a conspirator in this misdeed". Either answer is not a particularly good career builder.

### **C. The Credit Application as a Contract**

A properly executed credit application is a binding contract when there is agreement to the terms and conditions. Remember, you are negotiating. You want to put as many provisions as you can think of in the agreement that will protect your company from risk of loss due to default or other adversarial relationship that may arise during the course of business with customers. Negotiation means you won't *always* get *everything* you want in your contract. But it does mean that you will get what you want a heck of a lot more often if you ask it than if you don't. So, don't be shy.

A customer may negotiate a condition or two, or a term or two out of your credit application, but that may be okay, depending on what they are. But this is your company, this is your contract, and your credit application should be a reflection of the trials and tribulations your company has experienced getting paid by customers in your industry over time. Therefore, include what you think is best to cover every situation you have experienced and contract to avoid those occurrences from again presenting themselves.

### **D. Basic Terms of the Credit Application**

#### **1. What is the Legal Name of Customer's Business?**

If it becomes necessary to go to court, you have to bring action against the correct person or entity. If you don't have the right name, it's like being sued for something your cousin did (or didn't do) and will be dismissed by the court because the right being isn't named. Maybe your customer doesn't even know the legal name of the business. In some industries this is not really that unusual. If you are extending credit to a company in one of these industries then, before you file suit, research the Secretary of State or local licensing records or have your attorney do so before entering your Motion for Judgment. Otherwise, you may lose before you get started.

#### **2. The Entity Itself**

Sometimes, when answering the first question the customer gives you an indication of the type of entity they are. But still, I highly recommend a specific area on the credit

application asking; Corporation or LLC? Proprietorship or Partnership? How your customer is formed describes the very Nature of the Beast and tells you how and against whom you will proceed in the event of default. For example: You will need Personal Guarantees if you expect to pursue a debtor in court who is incorporated or is structured as an LLC.

### **3. Trade References and Information Exchange**

You should get references. Ask for trade references on your credit application. How much weight your credit decision deserves using references given by the customer is always a source of debate. The idea is to get the customer to tell you from which other suppliers or vendors from which they currently buy on open account. Then you go about checking with those sources how your new customer might be expected to pay you should you decide to give them open credit terms. Good plan. But wait. If your customer has good references then, surely, those are the ones you can expect to see. Remember, any of us when asked to give references are going to try to think of the best ones we can give. Who doesn't want to put their best foot forward? Knowing other suppliers inside and outside the industry can provide additional sources of information if you get that little gnawing feeling in the back of your head that says something more is needed. Never, never stop asking questions if ever you feel like something just isn't adding up.

The best way to properly exchange credit information on a customer is to remember the basic rule of "past and completed transactions only". Also, never offer subjective information, opinions, anecdotal information or financial information about a customer and be careful giving a telephone reference unless you are certain the person with whom you are discussing the account is someone who has a reason to have the information they are requesting and knows how to treat the information you give them in the confidential manner required by all good credit managers.

### **4. Bank Information**

Hard to get and then, when you do, what does it really say. Well, reading between the lines when you successfully obtain bank information requires a bit of experience and acquired knowledge. I address in this article getting the bank to respond. That's why I like a short statement authorizing the bank to release the information that customer has agreed to let us ask with a separate signature line for the customer specifically authorizing the bank to release information on the account(s):

*"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"* Add a separate signature line to this area of your credit application, have the customer sign and send it off with your request.

## **5. Agreement to Terms and Conditions of Sale and Credit Policy**

Make your terms and credit policy legally binding on your customer(s). Your credit application is a document that sets forth the agreement between you and your customer and describes, identifies and otherwise defines the terms and conditions upon which you and that customer are going to do business. A good credit application will usually save your business legal fees. A statement describing when payments are due and where payments are to be made is all we are looking for here: *"All invoices are due [per your company terms]. All amounts due for purchases from [your company] are payable at [address]. C.O.D. restrictions may be placed on any past due account. I (we) agree to pay account promptly within terms stated."*

## **6. Charging Interest**

As with most calls I get on this subject, the member is worried about State Usury Laws. Most State Usury Laws deal with consumer transactions not commercial transactions. But, as we all know, the good ole' commercial customer might just buy something on his/her commercial account and then use the products or merchandise for personal or household use thus slipping into a consumer transaction as defined by law and now you, the unsuspecting creditor, are charging interest rates at Usury levels.

Absolute correct method and language for charging interest legally in every state - regardless of Usury laws is: All invoices are due (**Your Company terms**). A service charge of one and one half percent (1-1/2% per month), or (18% per annum) or the highest legal rate, which ever is less may be assessed on delinquent invoices.

## **7. Change of Ownership**

Avoid the 'Goldilocks Syndrome' - the shock and awe of finding new owners (the Wolf) in your customer's house (Grandma's Bed). *"We [customer] understand that we must notify [your company] in writing, and by certified mail of any change in ownership, the name or the business structure under which credit is established. This language may further, and possibly personally, bind the customer who sells the business to a new owner or changes the status of the entity at later time."*

## **8. Certification of Use of Credit**

*"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".* Language of this nature could quickly eliminate another defense by a customer who utilized the company credit established with you for other than resale or service purposes.

## **9. Signature**

*"The person executing this agreement has authority to bind the customer and is authorized by the customer to enter into the credit application terms and conditions".* This language ensures that even if the signer is not an officer or executive of the company, the company is still legally bound.

Still more provisions can be included in the credit application; "No Modification", "Personal Guaranty", "Right of Offset", "ECOA Statement", "Authority to Investigate", "Accurate Information". Some other terms and conditions that may resolve customer disputes are considered by Scott Blakeley below.

## **E. Terms and Conditions that may Resolve Customer Disputes**

### **1. Waiver/Duty to Inspect**

You want to know at the earliest opportunity whether your customer has concerns regarding the product you shipped or service provided. To that end, consider requiring your customer to inspect and complain within a specific period. By imposing on your customer a duty of early inspection and objection, and a waiver if the customer fails to do so, strengthens your case for prompt collection of the delinquent account. Consider:

*Applicant also agrees to examine immediately upon receipt, each of [Creditor]'s statements, and to advise [Creditor] of any disputed transactions or 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.*

## **2. Attorney's Fees**

Should your customer be required to pay your attorney's fees and costs if you are forced to file suit to collect on the delinquent account, your customer may reconsider and pay the account. The general rule is that each side must carry their costs to collect and defend a collection suit. However, if you include a provision in your credit application that your customer pays, you can shift these costs. Consider:

*Applicant further expressly agrees that it shall be liable and pay all attorneys' fees, collection costs and court fees, and any other expenses, whether or not incurred in connection with litigation, including but not limited to attorneys' fees and costs associated with the enforcement of any of the terms of this Application and attorneys' fees and costs resulting from a default under this Application.*

## **3. Venue**

If you are selling an out-of-state, or out-of-country customer, you want any legal disputes with that customer, including any collection suit, to be brought in your home court. To that end, a venue provision in your credit application provides you with that right. The venue provision may force your customer to reconsider payment on the delinquent account given that they would have to come to your home court to defend against the action. Consider:

*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 principles.*

## **4. Escheatment/inactivity**

Businesses and residents abandon over a billion dollars of tangible and intangible property annually. Every state has legislation that requires individuals and companies to escheat, or abandon property, to the state after some period. 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 vendor's escheatment exposure, a credit professional may consider imposing an inactivity fee to the credit balance. Consider:

*[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.*

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

## **5. Arbitration/Mediation**

When a customer fails to pay according to credit terms, and the failure to pay is about the customer's cash flow and not a dispute over the product or service provided, you want to get a judgment fast, when your other collection efforts have been exhausted. However, filing a collection suit in some jurisdictions can be time consuming, especially with courts in metropolitan areas. These courts may be backlogged with a variety of law suits and, therefore, may take you far too long to collect. To press for payment, consider a provision in your credit application that provides that you may submit your claim to binding arbitration. Often, the arbitration can be set in a matter of days and you can get an arbitrator experienced in collection or business disputes. Consider:

*Applicant agrees that Applicant will submit all disputes to final and binding arbitration, in \_\_\_\_\_, in accordance with the rules of the American Arbitration Association or the National Association of Arbitrators. Applicant agrees to be bound by the arbitrator's decision.*

## **6. Terminating the Credit Sale**

You agree to extend terms to a new customer only to learn prior

to delivering your large order that your customer may be in financial difficulty. You now believe, that, although the customer has not defaulted under the terms of sale, that the customer likely will not be able to pay for the credit sale. You want to convert your credit sale to a cash transaction. You are better off converting the credit transaction to cash if you have in your credit application the unilateral right to terminate the credit sale, rather than having to send a letter demanding adequate assurance. Consider:

*[Creditor] reserves its right, at its sole discretion and without notice, to cancel all available credit and refuse to make future advances.*

### **7. The Fair Credit Reporting Act Authorization**

The Fair Credit Reporting Act generally requires a trade credit grantor to obtain written authorization from an individual to run a consumer credit report. A separate form, or addendum to accompany the credit application, should be considered, as the party that the credit professional seeks authorization to pull the credit report may not be the same party that signs the credit application. A credit application that provides general authority for the credit professional to pull a consumer credit report on a corporation's officers may be insufficient. Consider:

*The undersigned consents to [Creditor] obtaining a consumer credit report on \_\_\_\_\_ [Name of sole proprietor/President/Officer of corporation, LLC, partnership] for the purpose of evaluating the creditworthiness of \_\_\_\_\_ [Name of sole proprietor/President/Officer of corporation, LLC, partnership], in connection with this Application.*

*Signed By:*

\_\_\_\_\_  
*[Name of sole proprietor/President/Officer of corporation/LLC/partnership]*

### **FCRA Authorization Contained in Personal Guarantee**

*The undersigned consents to [Creditor] obtaining a consumer credit report on \_\_\_\_\_ [Guarantor] for the purpose of evaluating the creditworthiness of \_\_\_\_\_ [Guarantor], in connection with*

*an application for business credit.*

*Signed By:*

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*[Guarantor]  
[Social Security Number and home  
address]*

### **A Credit Application Helps Make Sound Credit Decisions**

A well crafted credit application can be the source of information from your customer that can be the basis of making a sound credit decision, including whether a credit enhancement, such as a personal guarantee, may be needed. The terms and conditions of the credit application, likewise, can also protect the vendor from credit loss by leveraging the customer to pay you.

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<sup>1</sup>Mike learned credit from Dun & Bradstreet as a Business Analyst and later sold credit information for D&B until 1980 when he was recruited by the NACM Board of Directors for NACM Kansas Affiliate, Inc. In 1992 he merged the Kansas affiliate with NACM Oklahoma Division Inc and became known as NACM MidAmerica. The association now provides commercial credit bureau services in several Midwest states and nationally through numerous partnership alliances with other associations. Mike is the President & Chief Operating Officer of NACM MidAmerica. Mike is responsible for turning around several struggling companies during the past 25 years. He is a graduate of Kansas Newman University and studied law at Oklahoma City University's School of Law, Night Division.

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