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“Winning the Game” With a Comprehensive Credit Application

The credit application is arguably the single most important factor in the control, collection and limitation of losses relating to the management of accounts receivable and collection of delinquent accounts.

Yet, both large and small business creditors constantly enter the game with only half a “play book”. Consequently, they lose more games (uncollected accounts) than they should because they are playing with both a weak offense and weak defense. They are using an incomplete and ineffective credit application.

The comprehensive credit application serves to satisfy two primary purposes:

First Purpose: The Offense

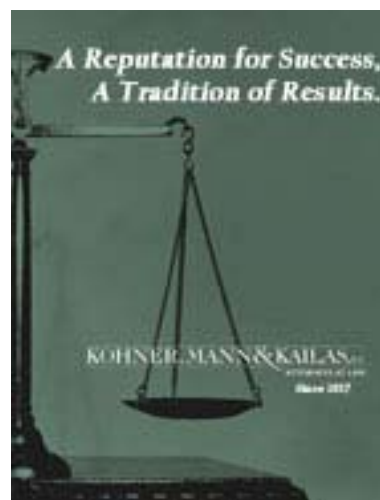
The first purpose is to collect and store that available background scenario, facts and information that will allow the credit professional to evaluate and determine the creditworthiness of the applicant. It helps the credit professional to decide whether the credit risk should be taken in the first instance. By taking the initiative with a “state-of-the-art” credit application, the creditor is insisting upon that pertinent information necessary and available to insure a sound credit decision. The credit professional can intelligently reject all those accounts that would tend to be future problem accounts and “losers” that are best left to the competition. In essence, the credit professional is playing to “win” from the first play of the game.

Second Purpose: The Defense

Use of the “state-of-art” credit application will insure that the customer (debtor) agrees to pay the full account plus the greatest reasonable interest available, collection costs, attorneys’ fees, and all other legally collectible incidental costs. In essence, the creditor is protecting against any loss whatsoever, even if the accounts should become delinquent, by including the proper provisions in the credit application to be signed by the debtor. This defensive measure provides the legal basis for the creditor to recover completely (without any loss) in the event the creditor has placed the account for collection early enough, and while the debtor is still a fully viable and collectible entity.

Be Aggressive

The truly aggressive “superstar” creditor will exercise those additional defensive and offensive devices not generally utilized by the meek creditor. Industry competition and other considerations are often blamed for the creditor’s election to not insist that the debtor provide creditor a reasonably current financial statement at the time the signed creditor application is provided. The



meek creditor will also opt not to have the customer provide one or more personal guarantors in the event the debtor is a relatively undercapitalized corporation, LLC, or other like entity not generally carrying personal liability of its principals.

The financial statement is a valuable offensive "play" which will help the creditor to determine whether to take the credit risk in the first instance, or to what extent to limit the line of credit to be extended. The personal guaranty(s) are an excellent defensive "play" to provide possible additional collection potential in the event of a weak debtor entity. Our office has regular and substantial success in collecting in full upon otherwise uncollectible claims, only because of the availability of one or more personal guarantors. It can be the difference between collecting an account in full or having to write an account off as completely uncollectible and a total loss.

The Need for Financials

The practice of our firm, with respect to the credit applications we draft for our clients, is to provide a provision in the credit application requiring that the customer affix a current financial statement to the credit application. Our clients advise us that most customers do provide some type of financial statement as requested. If no financial statement is attached, the creditor will have to exercise a value judgment as to whether it wants to accept the risk without the financial statement before providing the credit, or limit the credit line as it deems appropriate.

As a matter of course, our law firm provides for personal guarantees in the credit applications that we draft for our clients. Our clients tell us that when presented properly, most customers will sign the credit application without objection irrespective of the personal guaranty included at the time the customer opens up a credit line. That is the time to request the guaranty and not when the creditor has a large delinquent account balance against the customer (debtor) that appears of questionable collectibility, and creditor must "beg" for the officer of the debtor entity to put personal assets on the "line", by signing the personal guaranty at that subsequent time. Time after time, our office collects otherwise uncollectible accounts receivable only because of the availability of the personal assets of the principals of the debtor entity, as provided by the personal guarantees signed by them.

As one would expect, there are rudimentary and basic informational considerations which should be addressed in the credit application, to collect that data required to identify and evaluate the prospective customer. The complete name, address, phone number, fax number and identification number (tax number for a corporation and social security number for an individual) are essential.

Additionally, if the creditor is to fully evaluate its risks, the credit application must very clearly evidence the legal entity or "makeup" of the customer. Is the customer a sole proprietor? A partnership? If so, the names and addresses of all partners are invaluable. Is the customer a corporation or LLC? If so, the state of charter, and names and addresses of all principals and officers are of value. With this specific data, the creditor can open the new account with the correct, verified entity, which will be readily available to help evaluate the credit risk or ascertain the legal entity to be sued in the event of any subsequent delinquency in the account. Getting this "right" at the beginning can save a lot of time and trouble later, when the specific information is an absolute necessity. Trade names or style names should be collected and noted for any future use. The names and addresses of the principals and officers will be useful if service of process is required in the event of suit on a defaulted account or if any of these individuals must be sued on their personal guarantees.

The applicant's bank references are important (full name and address of bank, name and address of loan officer, etc.) in the event that a future garnishment is desired to effect collection of any delinquent account that has been reduced to judgment.

The proposed customer should be required to pay all expenses and reasonable interest and/or service charges to the extent legally enforceable and to the extent the customer is able to pay same. Maximum collection can only be effected in such fashion, if the terms to recover same are

clearly set forth in the written language of the credit application. Interest, service or finance charges, or whatever can be fully recovered if reasonable and clearly provided for in the contract created by the written language of the credit application.

A rate of 1.5% to 2.0% interest per month on the defaulted balance is generally considered reasonable, or the application can provide for "the greatest amount allowed by law" within a subject jurisdiction. Attorneys' fees and collection costs of 25% of the amount outstanding (which is within the usual costs of collection on a commercial account) may be recovered if the written language is clear and definite. Without such planning and specific language, the creditor's recovery is generally limited to statutory interest and attorneys' fees which are generally of a very nominal amount and much less than can be recovered by the specific terms of the credit application contract.

Many creditors include in their credit application specific language setting forth terms of payment and credit terms. Our law firm does not include these in the credit application as such, as a credit application should limit its content to only that pure data and information that will aid in the credit risk evaluation and that language which will ensure maximum recovery in collection upon possible delinquency. Our recommendation is that terms of payment and credit terms are best provided to the proposed customer on a separate document submitted for the informational purposes to the customer, and which information can be easily amended each time there is a change required. A change of terms will not then be a problem because the credit application included terms which were effective at the time of execution, but not effective at the subsequent date of any such changes.

Any other general information deemed desirable by the creditor, such as amounts to be ordered, places of delivery, persons responsible for payment or to accept delivery, etc., is best accomplished in a separate "fact-gathering" sheet, and possibly on the same sheet setting forth applicable payment and credit terms.

In the credit applications our firm drafts for clients, we use language on the credit application that the debtor agrees to creditor's usual terms and conditions as promulgated and amended from time to time. As previously mentioned, those specific credit and payment terms in force at the time of the execution of the credit application can be best communicated by a separate document. This ensures the individual credit application will be free of collateral considerations not specifically addressed to the evaluation of the credit risk and recovery of maximum collection on any delinquent account.

Names and addresses of business references and a listing of major secured creditors and their collateral will be extremely valuable in the creditor's tracking of the applicant's creditworthiness.

If properly designed, all of the above information can be fit on the front and back of one sheet of 8.5x11 paper, and when written in simple English, can be easily understood by the judge who may be called upon and from whom you are seeking a judgment against the applicant customer "now" turned debtor.

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About Kohner, Mann & Kailas, S.C.

Founded in 1937, KMKSC is a business and commercial law firm listed in Martindale-Hubbell's Bar Register of Preeminent Lawyers. KMKSC provides quality legal expertise across the areas of law encountered by businesses in the normal course of their operations and growth. Our services range from high-profile appellate representation and international business issues to ensuring that critical everyday needs, such as debt recovery, are fulfilled efficiently and expertly. Our purpose is to deliver excellent results for our clients, whether the issue is advice on the avoidance of legal disputes, closing a deal, protecting assets or winning in court. KMKSC is continually advancing the interests of its clients in negotiations, transactions, litigation and alternative dispute forums across North American and beyond. We help U.S. companies address the legal issues raised by trading across international borders and provide legal support and advice to foreign companies operating in American markets.

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