SCRIBBLES SQUIBS #3(February 25, 2013): Nine ways to better credit applications.

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Our last *Squibs* dealt with joint check agreements, a potential vehicle for suppliers and subcontractors to attempt to get paid, particularly when lien rights and bond rights may not be available. An earlier line of defense would be a better credit application, particularly for those supplying materials (including paving companies, sand and gravel companies, concrete supply companies) and equipment rental companies. Most of these ideas apply in *any* state, although any specific law listed here will be from Massachusetts.

What makes for better credit application forms and procedures? At least ***nine*** things.

1. All signatures must be notarized. All signatures on a credit application have to be made in front of a notary public. Massachusetts has had cases granting damages against notaries who later fail to verify a signatory's signature. As a notary public myself, my sense would be that any liabilities I might have for an improvident signature would not be covered by my *lawyers'* errors and omissions insurance. No notary will willingly expose himself/herself to this kind of potential exposure. And, notaries are regulated by the state and are a lot more 'findable' than an individual who purports to witness a signatory's signature *particularly* when that signature might be fraudulent and/or when that witness is poorly identified (i.e. no address). Trying to find witnesses as to signatures on important documents such as general indemnity agreements and credit applications years down the road can be problematic, if not impossible. And, where one of an individual's primary defenses is 'that's not my signature' on the bottom of the document and you, as the plaintiff, have the burden of proof as to that signature, you need to be able to provide evidence that it *is* the individual's signature. (While email seems the favored method of document transmission today, I have had handwriting experts tell me that signatures on a *faxed* agreement cannot be verified because the fax process alters them sufficiently that this cannot be ascertained as a matter of certainty. All the more reason you do not want to extend credit until you have the application in hand in *original* ink.)

2**. Always include an attorneys' fee provision.** There should always be an attorney's fee provision in your credit application so that if you feel the need to go to collection, you will be able to collect them in a legal action. Massachusetts follows what is known as the 'American Rule' on attorneys' fees, which says that absent a provision in an underlying contract (such as a credit application) providing for them or as allowed by a statute sued upon (e.g. public payment bond for general contractors, C. 93A claims for unfair and deceptive trade practices) each side must bear its own attorneys' fees other than the statutory award for attorneys' fees, which is *two dollars and fifty cents!* As many smaller accounts have doubtful collectability, the fact that you have to invest funds into a questionable enterprise deters many companies from aggressively

pursuing guarantors *and experienced debtors know this!* Can you find a lawyer willing to take it on a contingency? Maybe. But, you're not going to get the best effort when it appears the recovery will be zero. The time to protect your potential receivable is before you give your customer the *first thing.*

3. **Provide for the maximum rate of interest.** Some, but not all, credit applications provide for the payment of interest on overdue accounts. By statute in Massachusetts, 12% simple interest is provided for contract actions figured either from the date of breach of contract – if it can be determined – or from the date of the filing of the action, if no other rate is provided for in the underlying contract. Yet, in Massachusetts, a statute allows for the award of interest up to the rate of 20% and, under certain circumstances, a rate possibly higher. *If* the company you are pursuing remains in business, providing for both an attorneys' fee and a rate of interest at the maximum amount allowed in the jurisdiction where the transaction takes place may motivate some debtors to pay.

4. **Always have personal guarantors.** Two things must be kept in mind. First, ordinarily, shareholders, officers and directors are not ordinarily liable for a corporation's debts. Similarly, members of limited liability companies are not usually liable for their entity's debts. There are exceptions (i.e. payroll taxes) but these will not generally apply to trade debt. It is both easy and inexpensive to create a new corporation or a new limited liability company. And, generally speaking, in the absence of fraud (harder to prove than you might imagine), a successor company or even an affiliated company is not liable for another corporation's debts. (There is a concept known as 'piercing the corporate veil' but courts invoke is very rarely.) It may be attractive in some circumstances for a judgment-proof company to simply allow judgments to enter against it. While, initially, a creditor might find some solace in this, at our office, **Sauer & Sauer,** we always try to figure out on day one how any judgment we might obtain for a plaintiff can/will be paid. For a variety of reasons, those associated with a judgment-proof corporation may not think it even worthwhile to spend the money to put it in bankruptcy. A popular song from years back had, as a refrain, 'nothin' from nothin' is nothin'! Truer words never spoken! Surety bonding and, generally, lines of credit are guaranteed by individual owners of corporations and limited liability companies. Their individual responsibility for the debt is generally not affected by a corporation's obtaining a discharge in bankruptcy. As the individual owners of a corporation *themselves* may not want to file bankruptcy, having some of them 'on the hook' for your debt on a credit application may be absolutely essential, the last chance you have to be paid by *anyone*. And, if you learn nothing else from this article, please note that unsecured creditors (trade creditors) almost *never* receive anything appreciable, if at all, from a Chapter 7 bankruptcy (liquidation). After all, this is one of the reasons to *file* bankruptcy: to get rid of unsecured (or trade) debt. A Chapter 11 (reorganization) might seem to hold more initial promise to trade creditors but not that many contractors are able to successfully conduct a Chapter 11 due to the fact that necessarily new capital is required to fund the plan of reorganization (and, if the Debtor had that additional capital, it might not have filed bankruptcy

in the first place.) And, even successful Chapter 11 debtors end up paying the greatest part of the estate to priority claimants (e.g. taxes, wages) and secured creditors (banks with mortgages). In such circumstances where trade creditors get *anything*, it will be cents on the dollar and often paid over a period of *years*, if paid at all.

5. Make sure your form specifically provides for trade and banking references and then check them. Many forms may have one or may have the other or may have neither. If you get specific names with telephone and fax numbers (and emails) and check them, this is at least *some* evidence of the credit worthiness of your potential customer. Being a member of credit associations such as NACM is also a help, as such organizations may have some vehicles by which problem debtors may be identified.

6. Do not exceed the credit limits you initially establish. Better credit applications will provide that the credit is extended for a specific amount. So, for a newly formed company, this might be for a nominal amount, such as five or ten thousand dollars. But, what so frequently happens, when that 'good job' comes along, the creditor is anxious to get that piece of business and simply ignores its own limits. *What might be done* in such a circumstance would be to give the customer a nominal initial credit without requiring personal guarantors but insist on them if the customer wishes any major increase in his/her credit limit. *And/or* going above a certain credit limit will require copies of applicable payment bonds or joint check agreements or both and, as to a private job, who the owner and what the street address is of that project.

7. Include terms as to the provision of street addresses for private jobs, the obtaining of available payment bonds otherwise and/or for joint check agreements. Your customer has no legal obligation to give you a joint check agreement (covered in our last *Squib*.) But, if they agree to this up front, providing that the failure to provide one can be considered a breach of the credit application, puts you in a better position to insist on one down the road. Particularly for companies supplying materials, it is key to know to what job(s) those materials are going, both for lien rights and for payment bond rights. A project identification is essential for *anything* leaving your shop and the best lawyer in the world can't provide this after the fact. Other than through the internet or through Freedom of Information Requests (public projects), the only way to get any detailed information is through discovery, which requires the initiation of litigation first.

8. Always have a contract with your customer as to each transaction. I can think of one client who has told me, almost proudly, that it never has written contracts with its customers. But, then, when they are in the soup, they don't enjoy being told that Massachusetts lien law requires a written contract to have lien rights. Not having a written contract will at least delay payments from a payment bond. When sizeable amounts are at stake, the absence of a written contract might make unattainable actions for bank account and real estate attachments and make it unlikely that a judge will give you a 'reach and apply' order as to monies due your customer as to another project (which remedy is available in Massachusetts.) "I will paint your house with

one coat primer, one coat finish at 67 Pleasant Street Dedham for the sum of eight thousand dollars" would be a legal enforceable contract provided that it is signed by both parties. Some folks in business are scared by the idea of having a contract: who will prepare it, what must it contain, will this turn this customer away? A contract simply is an agreement to accomplish a certain result for a certain sum signed by the 'parties to be charged' containing some description of the scope and identifying a price. It can literally be that simple.

9. Follow your own procedures! I have found that some companies leave the obtaining of a credit application as a responsibility of their salesmen, whose principal interest – let's face it - is getting commissions from the sale. Many companies pay these commissions up front for work obtained and don't tie them in to what monies are actually recovered for those jobs. I have found that for businesses with a family name in the title, often, the worst offenders to these rules are the owners! They'll look at the *potential* for a certain job as to sales without really evaluating their realistic opportunities to get paid. And, many times what happens is that a creditor will extend *more* credit to a customer that already owes them money on a past job(s) in the hope that the new job will pay for itself and for the prior balance. *'Don't throw good money after bad'* is often quoted but not always followed. I recall vividly a certain trade debtor (who later filed bankruptcy personally listing four casinos as creditors) who would invite those who extend him credit to his very fancy house at Christmas time serving them lobsters and other goodies, telling them about his plans for jobs for the next year. Often, they bought into this. None of God's children is perfect. Still, good business practices are *good business practices!*

CONCLUSION. The more of these suggestions followed, the fewer your outstanding receivables might be. "If I do this, this will affect sales," the salesman, sales manager and owner might say. Maybe so. But, perchance, many of the customers actively resisting these agreements may have accounts that are uncollectible down the road and/or have been down this road before. After all, if it is your customer's practice to pay its bills, it won't be overly concerned with *what* your credit application says, as there will never be a default under it. A business must ask itself: 'Do I want to possibly not get the sale now or do I not want my receivable to be more collectible down the road?' I'm not smart enough to give you a full-proof answer. I'll only say that I have noted in many commercial transactions that I have been involved with that people are more accepting of contract terms when they are presented with them up front, *before credit is extended*. Once a course of dealing has been established, it's hard to then change the terms of your dealings. Additional resources on this subject, including a model form for a credit application, can be found in the 'Construction Articles' section of our website: wwwsauerconstructionlaw.com.

These materials should be considered as general information only. They are not intended as legal advice. As to legal advice, consult with an attorney of your own choosing. Additional resources on many construction law subjects, including forms, can be found in the 'Construction Articles' section of our website: wwwsauerconstructionlaw.com.