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A Credit Manager's Guide to the Top 10 Credit Application Provisions

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As a commercial collection attorney, I have the benefit of seeing and analyzing credit applications from a wide array of clients. However, by the time I receive a client's credit application, typically the account is already in arrears and any rights they may have were established long before. In this piece, I share some contract provisions that allow me to be the most effective when collecting delinquent commercial accounts. In the spirit of a particular late night talk show host, what follows is my top ten list of credit application provisions that can place you in the best possible position to ward off common defenses and collect the funds that are due to your company.

1. Give the Credit Application the Highest Priority

Oftentimes goods or materials are provided after your customer provides a purchase order. Do you read the purchase order? Frequently, businesses fail to read the fine print. What can be missed are inconsistent provisions of the purchase order that can trump all the powerful provisions in your credit application. For example, your terms require payment within 30 days of invoice, but your customer's purchase order requires payment only if your customer is paid by its customer. This type of provision is well-known in the construction industry as a "pay-if-paid" provision. So long as the provision has language that makes it clear that you bear the risk of non-payment to your customer, these clauses will be enforceable and prevent you from recovering until your customer has been paid by its customer for the materials you supplied.

> The credit application integrates and merges all such verbal agreements into the terms and conditions of the written credit application. Thus, if the alleged term or condition is not in the written agreement, it is not enforceable.

In order to provide yourself with best possible argument around potentially nasty provisions of your customer's purchase order, you should have a provision in your credit application which indicates that the terms and conditions of the credit application take priority over any inconsistent terms contained in other customer-provided documents.

Also, consider employing the following practice tip. When you receive a customer-issued purchase order, send it back with a note, to be signed by the customer, agreeing that if the purchase order's terms are inconsistent with and/or in conflict with the terms of your credit application, the terms of the credit application shall apply.

2. Personal Guaranty

This tip is probably self-explanatory. In cases where your customer is not paying, often it is due to their own financial issues. Instead of *you* financing your customer's trade debt, a personal guaranty apportions liability to your customer's principal(s) in the event that the company defaults. When the principal(s) of the business has personal liability that is independent from the company's exposure, you will have greater payment leverage.

3. Attorneys' Fees and Costs[1]

Having a provision in your credit application that obligates your customer to pay your counsel fees and costs is a must. Such a provision negates the often-used strategy to negotiate based on the theory that you should compromise the value of your payment demand in recognition of the expected cost of collection litigation. Quite simply, an attorneys' fees provision gives you greater leverage and assigns more risk to the customer in the event of payment default.

4. Merger/Integration Clause

Have you ever had a situation where your customer claimed that they had a verbal understanding with the branch or salesperson? If so, the claim becomes a "he said, she said" situation with typically no documentary proof. Having a merger and integration clause precludes your customer from claiming there was a side deal or that there is a binding, legally enforceable prior understanding or agreement. The credit application integrates and merges all such verbal agreements into the terms and conditions of the written credit application. Thus, if the alleged term or condition is not in the written agreement, it is not enforceable.

5. Finance Charges

If you are forced to perform the functions of bank by financing your customer's material costs for a period of time beyond your payment terms, you should act like one. Charge your customer interest or finance charges, at a reasonable rate, just like a bank would if it were providing financing for trade debt.

> In order to waive the warranties implied by the UCC, the disclaimer must be expressed in clear and prominent language.

6. Forum Selection Clause

A forum selection clause is important, especially in regions like the northeast or mid-Atlantic where there is geographical proximity to a number of different states. Instead of being forced to commence a lawsuit in the jurisdiction of your customer's business, a selection clause allows you to pick the location where the claim must be filed, usually where your business is located. This clause gives you the ability to select the most convenient, effective and efficient location to have a claim decided.

7. Arbitration Provision (One-Way)

A one-way arbitration provision allows you to choose if you want a claim decided in court or in arbitration. In essence, it allows you to select the ground rules well in advance of any issues. Even better, if your customer decides to bring a claim against you, it gives you the power to force that claim out of court and into arbitration, which may not be attractive to your customer.

8. As-Is Sale/No Warranty

If you fail to include such language, you may have provided certain warranties to your customers who purchase from you. By including the appropriate language, your customer will not be successful in making a warranty claim against you based on allegations of a defective product. It is worthy to note that if the Uniform Commercial Code (UCC) is applicable to the sales of the goods or product, which is very likely, there are certain warranties that will be implied. Typically, these are (a) the implied warranty of merchantability (dealing with the quality of the goods) and (b) the implied warranty of fitness for a particular purpose (if you know or have reason to know your customer's intended use of the goods). In order to waive the warranties implied by the UCC, the disclaimer must be expressed in clear and prominent language. In fact, to waive the warranty of merchantability, the word "merchantability" must be used or words such as "as is" or similar language that make it abundantly clear to the customer that you are not providing any warranties.

9. Severability

A severability clause allows you to protect the credit application if any of the provisions are found to be unenforceable or overreaching. Instead of finding the entire agreement unenforceable, only the offending provision will be considered deleted with the remaining provisions surviving and enforceable.

10. Non-Waiver

We have all the heard the phrase "no good deed goes unpunished." That is often true in contract law when you decide to be lenient and not enforce your rights against a customer that fails to perform their end of the bargain. When this happens, the next time your customer fails to perform, and you attempt to enforce your contract rights under the credit application, your customer can argue that as a result of your prior leniency, you have waived your rights. In order to prevent this, your agreements should contain a non-waiver clause that requires any waiver of rights to be in writing in order to be effective. By including such a clause, you can choose to be lenient on one occasion, without having that business decision used against you later.

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1. There are certain laws that allow for recovery of counsel fees. Such laws do not always apply, are often narrow in scope, or give a judge discretion whether to award such fees.

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