

GSCFM - 2019 PROPER AND LEGAL CREDIT DECISION ISSUES



**Wanda Borges, Esq.
Borges & Associates, LLC
575 Underhill Blvd.
Syosset, NY 11791
516-677-8200 x 225
wborges@borgeslawllc.com**

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KNOW THY CUSTOMER The Cardinal Rule of Credit

- **Understand the legal “make up” of your customer**
 - **Corporation: an artificial entity, formed and maintained in accordance with the statutes of a particular state of incorporation.**
 - **Protects officers, directors and shareholders from personal liability provided compliance with state statutes is maintained.**

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KNOW THY CUSTOMER (cont.)

- **Limited Liability Company (not corporation)**
- **Another type of artificial entity**
 - **LLC's provide a protection similar to the "corporate shell" for members and managers of the LLC.**
 - **Tax consequences generally the same as with partnerships.**

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KNOW THY CUSTOMER (cont.)

- **Partnership**
- **An entity created by two or more "persons" (can be corporations or LLC's)**
 - **For the purpose of operating a business**
 - **Each partner completely responsible for all debt incurred by partnership**

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KNOW THY CUSTOMER (cont.)

- **Limited Partnership**
- **Similar to a Partnership or Joint Venture**
 - **Only the General Partner is responsible for partnership debt**
 - **Imperative to know who general partner is**

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KNOW THY CUSTOMER (cont.)

- **Limited Liability Partnership**
 - **Similar to a Limited Liability Company**
 - **Can only be formed by professionals**
 - **doctors, lawyers, engineers, dentists, other licensed professionals**

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KNOW THY CUSTOMER (cont.)

- **Sole Proprietor**
 - **An individual operating with no corporate or other protection**
 - **Individual remains totally responsible for all debts incurred in the business name**

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BUSINESS ESTABLISHMENT DETAILS

- **Date of Incorporation (or creation of other artificial entity) if applicable**
- **Date of start of business**
- **State of incorporation (or registration of other artificial entity) if applicable**
- **Federal tax identification number**
 - Now most important when trying to garnish bank accounts.**

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OWNERSHIP DETAILS

- **Name**
- **Title**
- **Home Address**
- **Ownership interest**

CREDIT APPLICATION: WHY USE IT AT ALL

- **Formation of a contractual relationship**
 - **Invoices are not contracts**
- **The credit application is often the only written agreement**
- **The credit application can provide information and specific legal remedies**

CREDIT APPLICATION: ESSENTIAL TERMS

- **TERMS AND CONDITIONS OF SALE**
 - **Payment Due Date (e.g. “Net 30 days” or “CIA” or “COD”)**
 - **Discount for prompt pay (e.g. “2% net 30 days”)**
 - **Interest/Service charge**
 - **Attorneys’ fees**
 - **“reasonable” doesn’t cut it**
 - **Costs of collection**

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CREDIT APPLICATION: ESSENTIAL TERMS

- **Correct Name - CRITICAL**
- **Type of Business Organization [SEE ABOVE]**
- **Principal Place of Business**
- **Requirement for Notification of Change of Name or Ownership of customer**

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CREDIT APPLICATIONS ESSENTIAL TERMS

- 3 Trade References
- Bank reference – Authorization generally required:

Applicant certifies that all information contained herein is true and correct. Applicant grants permission to _____ to obtain independent credit reports or credit reports and other information from its references and bank, and authorizes the credit references and bank reference to release information to _____ that may be used to determine credit worthiness.

CREDIT APPLICATION: ESSENTIAL TERMS

- Venue & Jurisdiction
 - Language that permits, but does not mandate, a particular state and/or court where a lawsuit may be commenced should be included on credit application
 - *This contract shall be construed under and governed by the laws of the State of _____. Any litigation concerning this contract may be commenced, at the sole discretion of credit grantor, in any local, state or federal court within the state of _____.*

INTEREST/ SERVICE CHARGES

- To enforce interest or service charges on past due sums, language to that effect should be included on credit application, not just on invoice:

Applicant agrees to pay all bills as rendered, and agrees that overdue accounts are subject to monthly service charges of one and one-half percent (1 ½%) per month or the highest amount allowable by law in the state where the customer is located

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ATTORNEYS' FEES

- To obtain collection costs and/or attorneys' fees in the event of a lawsuit, language authorizing that should be included in the credit application:

Applicant agrees to pay all costs of collection, including actual out-of-pocket expenses and a collection fee of twenty-five percent (25%) if collected through a collection agency or attorney

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INDIVIDUAL CREDIT REPORT AUTHORIZATION

- **ADVISABLE FOR:**
 - Sole Proprietorship
 - Partnership
 - Small corporation

The undersigned is either a sole proprietor, a partner in a partnership, an individual who may be executing a personal guarantee in connection with the extension of credit to Applicant, or one of the principal stockholders of a corporation. I give permission to _____ to obtain and utilize an individual credit report on me personally to determine my creditworthiness.

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EQUAL CREDIT OPPORTUNITY ACT

- **The Equal Credit Opportunity Act (ECOA) is a federal law that makes it unlawful for any creditor to discriminate with respect to the extension of credit against an applicant on the basis of sex, race, color, creed, national origin, age or marital status.**

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EQUAL CREDIT OPPORTUNITY ACT DEFINITIONS

- **Adverse Action means:**
 - (i) refusal to grant credit in substantially the amount or on substantially the terms requested in an application
 - (ii) a termination of an account or an unfavorable change in the terms of an account that does not affect all or substantially all of a class of the creditor's accounts
 - (iii) a refusal to increase the amount of credit available to an applicant who has asked for an increase

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EQUAL CREDIT OPPORTUNITY ACT DEFINITIONS

- **Adverse Action DOES NOT INCLUDE:**
 - (i) a change in terms of an account expressly agreed to by an applicant
 - (ii) action or forbearance relating to an account taken in connection with inactivity, default, or *current* delinquency as to that account.
 - (iii) a refusal because creditor does not offer the type of credit or credit plan requested

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EQUAL CREDIT OPPORTUNITY ACT DEFINITIONS

- **Applicant means any person who requests or who has received an extension of credit from a creditor, and includes any person who is or may become contractually liable regarding an extension of credit.**
 - **The definition of Applicant includes guarantors, sureties, endorsers and similar parties**

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EQUAL CREDIT OPPORTUNITY ACT DEFINITIONS

- **Business Credit refers to extensions of credit primarily for business or commercial (including agricultural) purposes, but excludes extensions of credit in certain types of transactions, such as public utilities, securities and government credit.**

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EQUAL CREDIT OPPORTUNITY ACT DEFINITIONS

- **Trade Credit is NOT defined in the ECOA**
 - **Staff Commentary states that “the term ‘trade credit’ generally is limited to a financing arrangement that involves a buyer and a seller – such as a supplier who finances the sale of equipment, supplies, or inventory; it does not apply to an extension of credit by a bank or other financial institution for the financing of such terms.”**

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EQUAL CREDIT OPPORTUNITY ACT DEFINITIONS

- **Creditor means a person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of credit.**

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EQUAL CREDIT OPPORTUNITY ACT

● SIGNATURE OF SPOUSE PROHIBITED

- A creditor shall NOT require the signature of an applicant's spouse or other person, other than a joint applicant, on any credit instrument if the applicant qualifies under the creditors' standards of creditworthiness for the amount and terms of the credit requested.

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EQUAL CREDIT OPPORTUNITY ACT

- A creditor shall not deem the submission of a joint financial statement or other evidence of jointly held assets as an application for joint credit

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EQUAL CREDIT OPPORTUNITY ACT

- **PROPERTY JOINTLY OWNED BY APPLICANT AND NON-APPLICANT**

- **If a creditor relies upon property that the applicant owns jointly with another person, then the creditor may require the signature of the other person on instruments necessary to reach that property in the event of death or default**

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EQUAL CREDIT OPPORTUNITY ACT

- **COMMUNITY PROPERTY STATE**

- **A creditor may require the signature of the spouse of any instrument necessary, or reasonably believed to be necessary under applicable state law to make the community property available to satisfy the debt in the event of default under certain circumstances**

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EQUAL CREDIT OPPORTUNITY ACT

● COMMUNITY PROPERTY STATE (cont'd)

- If applicable state law denies the applicant power to manage or control sufficient community property to qualify for the amount of credit requested; and
- The Applicant does not have sufficient separate property to qualify for the amount of credit requested without regard to community property

EQUAL CREDIT OPPORTUNITY ACT REQUISITE 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 Federal Trade Commission, Equal Credit Opportunity, Washington, D.C. 20580.

NOTE: THE AGENCY WILL CHANGE BASED ON THE CREDITOR'S BUSINESS INDUSTRY (e.g. banks, farms)

EQUAL CREDIT OPPORTUNITY ACT NOTIFICATION REQUIREMENTS

- **Business Credit Applicants**
 - **\$1 million or less – gross revenues in preceding fiscal year**
 - **gross revenues in excess of \$1 million OR AN EXTENSION OF TRADE CREDIT**

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EQUAL CREDIT OPPORTUNITY ACT NOTIFICATION TIMING & MANNER

- **Business Credit Applicants**
 - **Within 30 days after**
 - **receiving a completed application**
 - **taking adverse action on existing account**
 - **receiving an incomplete application**

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EQUAL CREDIT OPPORTUNITY ACT NOTIFICATION TIMING & MANNER

- **If counteroffer has been made by a creditor and the applicant does not expressly accept or use the credit offered, then notification of the creditor's action must be within 90 days of notifying the applicant of a counteroffer**

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EQUAL CREDIT OPPORTUNITY ACT CONTENTS OF NOTIFICATION

- **A statement of the action taken orally or in writing**
- **Inform applicant of its right to a statement of reasons AND provide the requisite ECOA notice**

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EQUAL CREDIT OPPORTUNITY ACT NOTIFICATION TIMING & MANNER

- **Trade Credit Applicants**
 - **Notify applicant, within a reasonable time**
 - orally or in writing; and
 - **If and only if applicant makes a written request for reasons behind credit decision within 60 days of being notified of adverse action,**
 - **THEN creditor must provide a written statement of reasons**
 - **AND requisite ECOA notice**

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ELECTRONIC NOTIFICATION OKAY

- **12 CFR §202.4(d) provides:**
 - **The disclosures required by this part that are required to be given in writing may be provided to the applicant in electronic form, subject to compliance with the consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act)**
 - **Where an application has been submitted in electronic form, then the disclosures may be given in electronic form without obtaining prior consent**

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EQUAL CREDIT OPPORTUNITY ACT SPECIFICITY OF REASONS

• Suggestions

- Insufficient number of credit references provided
- Unacceptable type of credit references provided
- Unable to verify credit references
- Poor credit performance with us
- Delinquent past or present credit obligations with others
- Garnishment, attachment, foreclosure, collection action, or judgment
- Bankruptcy
- Value or type of collateral not sufficient
- Lack of established earnings record
- Slow or past due in trade or loan payments
- Other, specify____

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EQUAL CREDIT OPPORTUNITY ACT RETENTION OF RECORDS

• Special Rule for Certain Business Credit Applications

With regard to a business that had gross revenues in excess of \$1 million in its preceding fiscal year, or an extension of trade credit, credit incident to a factoring agreement, or other similar types of business credit, the creditor shall retain records for at least 60 days after notifying the applicant of the action taken. If within that time period the applicant requests in writing the reasons for adverse action or that records be retained, the creditor shall retain records for 12 months.

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EQUAL CREDIT OPPORTUNITY ACT RECORDS TO MAINTAIN

- Any application together with written or recorded information obtained and used to evaluate application unless information is returned to applicant
- Copy of written notification of action taken and statement of specific reasons for adverse action
- Written statement submitted by applicant alleging a violation of ECOA or Regulation B

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EQUAL CREDIT OPPORTUNITY ACT

- Recommended Notification on Credit Application

If your application for business credit is denied, you have the right to a written statement of the specific reasons for the denial. To obtain the statement, please contact {name, address and telephone number of the person or office from which the statement of reasons can be obtained} within 60 days from the date you are notified of our decision. We will send you a written statement of reasons for the denial within 30 days of receiving your request for the statement.

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FAIR CREDIT REPORTING ACT

- **FAIR CREDIT REPORTING ACT (FCRA) governs:**
 - **Obtaining and using a**
 - **Consumer Credit Report**

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FAIR CREDIT REPORTING ACT DEFINITIONS

- **“Consumer” is “any individual”**
- **“Consumer Report” is “any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer’s credit worthiness...serving as a factor in establishing the consumer’s eligibility for –**
 - (A) credit or insurance to be used primarily for personal, family, or household purposes;**
 - (B) employment purposes; or**
 - (C) any other purpose authorized under section 1681b of this title**

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FAIR CREDIT REPORTING ACT DEFINITIONS (cont'd)

- “Investigative Consumer Report” is a consumer report or portion thereof in which information on a consumer’s character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom he is acquainted or whom may have knowledge concerning any such items of information.

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FAIR CREDIT REPORTING ACT PERMISSIVE USE OF CONSUMER REPORT

- In response to the order of a court having jurisdiction to issue such an order, or a subpoena issued in connection with proceedings before a Federal grand jury
- In accordance with the *written* instructions or permission of the consumer to whom it relates

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FAIR CREDIT REPORTING ACT PERMISSIVE USE OF CONSUMER REPORT

- **In connection with a legitimate business need for the information**
 - (i) **in connection with a business transaction that is initiated by the consumer; or**
 - (ii) **to review an account to determine whether the consumer continues to meet the terms of the account.**

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FAIR CREDIT REPORTING ACT NON-PERMISSIBLE PURPOSE

- **The Federal Trade Commission has stated that the extension of trade credit was NOT a legitimate business need and insisted that written authorization be obtained prior to a trade credit grantor obtaining or utilizing a consumer credit report.**

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FAIR CREDIT REPORTING ACT PERMISSIBLE PURPOSE

- A business transaction in which an individual has accepted personal liability for business debt, such as in the case of a sole proprietor, partner, or guarantor, **DOES** provide a permissible purpose under Section 604 of the FCRA to obtain and use a consumer credit report

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INDIVIDUAL CREDIT REPORT AUTHORIZATION

- Permissible business purpose though it may be, It is recommended that you include authorization in your credit application

The undersigned is either a sole proprietor, a partner in a partnership, an individual who may be executing a personal guarantee in connection with the extension of credit to Applicant, or one of the principal stockholders of a corporation. I give permission to _____ to obtain and utilize an individual credit report on me personally to determine my creditworthiness.

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DODD-FRANK ACT AMENDMENT IMPACTS FCRA AND ECOA COMPLIANCE

- Creditors that make adverse decisions based on information in an applicant's consumer report must disclose
 - The numerical credit score used in taking the action
 - The range of possible credit scores under the model used
 - Key factors (up to 4) that adversely affected the consumer's credit score and the model used
 - Date on which credit score was created
 - Name, address & telephone number of the consumer reporting agency or other person or entity that provided the credit score or the credit file upon which the credit score was created
 - Statement explaining credit scores
 - Statement that the consumer reporting agency did not make the decision to take the adverse action and is unable to provide specific reasons for the adverse action

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DODD-FRANK ACT AMENDMENT IMPACTS FCRA AND ECOA COMPLIANCE

- **SAMPLE** Statement explaining credit score

A credit score is a number that takes into account information in a consumer report and that a credit score can change over time to reflect changes in the consumer's credit history

YOU ARE NOT REQUIRED TO DISCLOSE A CREDIT SCORE AND RELATED INFORMATION IF A CREDIT SCORE IS NOT USED IN TAKING THE ADVERSE ACTION

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DODD-FRANK ACT CHANGES TO ECOA NOTICE

**IF YOU HAVE USED A CONSUMER CREDIT REPORT TO
MAKE YOUR DECISION THEN THE FOLLOWING
ADDITIONAL LANGUAGE MUST BE ADDED:**

Our credit decision was based in whole or in part on information obtained in a report from the consumer reporting agency listed below. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You also have a right to a free copy of your report from the reporting agency if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

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FAIR AND ACCURATE CREDIT TRANSACTIONS ACT OF 2003

- **Disposal Rule - Requires proper disposal of information in consumer reports and records to protect against “unauthorized access to or use of the information”**
 - ❖ **Papers must be Burned, Pulverized or Shredded**
 - ❖ **Electronic media containing consumer information must be erased so that the information cannot practicably be read or reconstructed.**
- **Organizations Covered – include credit grantors, debt collectors, attorneys, lenders, consumer reporting companies**

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