

Are your customer credit applications good enough?

A lawyer's checklist

Want to avoid potential legal arguments with debtors looking for an excuse to avoid paying their accounts? **Ben Sewell** explains your first step should be to check your customer credit applications. This article assists credit managers to execute a review of customer credit applications.

With inflation and interest rates on the rise some of your customers may be looking for ways to manage a liquidity squeeze. Unfortunately, those customers may see their trade suppliers as an "alternative financier" and may either extend your trading terms or indefinitely delay payment to ease their own cash flow pressure.

Credit managers will be familiar with strategies to minimise credit risk. These include:

- Make sure your customer credit application and terms of trade are clear
- Use credit checking to screen new customers
- Case manage customers whose credit terms have blown out
- Move quickly to recover overdue debts

Why is your customer credit application important?

The simple answer is that it is the contractual document that establishes your legal relationship with customers.

Lawyers understand your customer contract includes not only the customer credit application, quotes and purchase orders but potentially conversations and emails with your customers.

The key issue for credit managers is to recognise that the written contract docu-

ments should be clear and consistent to avoid arguments "down the track". This starts with the customer credit application.

If a customer wants to dispute an account their lawyer will start off by reviewing your contract documentation. Your contract documentation includes:

- Customer credit application
- Customer quotes
- Purchase orders
- Consignment Invoices and terms of trade
- Credit Notes
- Emails to the customer containing representations or agreements

If there is a legal dispute a Court may undertake an exercise of interpreting this contract documentation and if there are inconsistencies in your contract documents your chances of recovering the whole account may be reduced.

The advantage with a comprehensive customer credit application is that you have the opportunity to establish a clear legal relationship before you start supplying the customer with goods or services. It may also exclude verbal representations made by sales staff that undermine your recovery prospects. The customer credit application is also the first document your lawyer will want to see if the customer disputes the account.



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Some of the important components of a customer credit application include:

- Identification of your company and the customer
- Your rights to recovery
- Privacy law obligations
- Limitation of liability

Correctly identify the customer and your company

It is surprising how many debt recovery claims are torpedoed because of simple issues like the correct identification of the parties to the claim.

If your customer credit application doesn't identify the debtor properly, such as their legal name and Australian Business Number (ABN) you may discover that their trading name, i.e. ABC Supplies, isn't registered. For example, if the customer hasn't registered their trading name with the Department of Fair Trading or obtained an ABN you may need to start the difficult task of identifying the legal person you traded with. If you take action against the proprietors of ABC Supplies in their personal capacity they may then argue that the legal entity that ordered the goods was not the proprietors but their company ABC Supplies Pty Ltd.

This can potentially open up a legal argument but the point should be to avoid this by ensuring your customer credit applications contain exact descriptions of your customer in terms of their legal name and ABN. If the customer is a proprietary limited company you should obtain their Australian Company Number (ACN).

On the other hand if your company has changed its name recently or started

invoicing through a different company in your corporate group you need to ensure that your customer credit application contains the correct name. If there are changes to your corporate group there is a risk the customer credit application may no longer apply.

Maximise your recovery rights

If you are dealing with a proprietary company, i.e. the proverbial \$2 company, it is reasonable to require that the directors of that company provide a personal guarantee for all debts incurred. This may protect you against the "phoenix company", the situation of a company loaded with debts and then strategically abandoned by its directors.

You may want to have the right to reclaim goods supplied to the customer who then defaults on payment. Alternatively, you may want to require a liquidator appointed over the customer to pay for those goods rather than assign you to the category of "unsecured creditor". The best protection is to ensure that your customer credit application includes a retention of title clause (also known as a Romalpa clause). It should state that ownership in goods supplied does not pass to the customer until the customer has discharged all indebtedness. This should also be included in your consignment invoices.

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Some businesses provide their customers with extended trading terms to generate new business. This may prove to be an obstacle if it becomes obvious that the customer is outside of payment terms on some invoices but not others- you will want to claim the whole debt that has been incurred. In legal terms some of the invoices may be "due" but are not "due and payable". Your customer credit application should state that should there be any default in making a payment all monies owing shall become immediately due and payable.

There is a right to claim interest if you file a claim with a Court but if the debt is paid before legal proceedings commence you will want the right to claim interest upon default. Your customer credit application should provide that if the customer defaults in the agreed trading terms (e.g. 30 days net) you will be entitled to charge interest each calendar month on all overdue amounts until the date of payment.

Debt recovery costs such as mercantile agents and solicitors can be expensive. If your credit application does not provide the right to recover all collection and legal costs you may not have a right to recover all these costs from customers that delay payment. Your customer credit application should include an indemnity for debt collection and legal costs. ►

Meet your privacy obligations

If you want to undertake credit checks into customers or to report payment defaults your customer credit application needs to obtain the consent of the customer. This will include:

- Consent to obtain credit information; and
- Consent to disclose this information regarding the customer and it's directors or proprietors.

If you use a credit reporting agency they may be able to assist you with this as well.

Limit your potential liability

There are some forms of potential liability that cannot be excluded by contract, such as under the Trade Practices Act, however, as far as possible your customer credit application should include that no warranty has been provided by your company or that it shall not be under any liability in respect of loss or damage to the extent allowable by law. This is a complex area and any provision may need to be specific to your business.

Your customer credit application can include time limits for the notification of any customer claims. This is useful in disputes when the customer may be considering a cross claim against your company.

If you are forced to take action against a customer based in another state you don't want to have to face proceedings in that state. To avoid this your customer credit application should include an agreement that the parties submit to the exclusive jurisdiction of Courts of your home state. ■

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This article is not intended to be comprehensive but rather to offer you a starting point in analysing your customer credit applications. Some other issues you may also consider include, change of customer ownership, trading trusts, setting up the director's personal guarantee as a deed of indemnity, returns procedures, debts payable on incomplete work, etc.

Cheat sheet – check your customer credit application

- Credit applications are defined as “commercial”
 - Your company is correctly identified and it includes members of your corporate group
 - The customer's name and ABN/ACN clearly identified
 - Director's guarantee is required for proprietary companies
 - Retention of title clause
 - Credit terms withdrawn and debt payable on default
 - Collection costs indemnity
 - Privacy consent
 - Any claims to be notified within 7 days
 - Interest paid on debts outside trading terms
 - Limitation of liability to the extent allowable by law
 - Exclusive jurisdiction clause
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