

## REPRESENTING SMALL BUSINESSES SEEKING CREDIT

Credit is the lifeblood of small business, but process is the circulatory system. Central to every business are the processes that order inventory, process sales, pay bills, and generally keep the business going. The ability of the small business to obtain credit to finance projects, purchase inventory, and smooth out the business cycle should be apparent to everyone. Similarly, the need for the business to grant or accept credit to allow its customers to purchase its goods and services should also be self-evident. Either the business grants credit itself or it makes an agreement with a bank or credit card company to accept payments from the card. The purpose of this article is to address the sometimes apparent and sometimes non-apparent issues that confront the attorney for the small business owner over the life of the business.

### Forming and Beginning the Business

When any business begins, it is confronted with problems of obtaining equipment, inventory, supplies, marketing, utilities, and a place in which to operate. The start of the business is the beginning of the business credit. As a lawyer representing the business and, at this point, its principals, it is the attorney's function to set up the business so that the owners have minimal liability. This applies both to commercial liability and tax liability. The documents need to be correct, and the clients need to be instructed in the corporate formalities.

In setting up the business, the lawyer needs to become familiar with what the business is and what it intends to do. Lawyers are not trained to sell widgets. They are trained, however, in what processes are necessary to keep the business out of trouble.

Because the credit is being obtained for business and not "personal, family, or household" purposes, there are any number of traps to be aware of and avoid. First, federal "truth in lending" does not apply to loans for business purposes. In most places, usury laws that are applied to consumer loans are not applicable to business loans.

In many of the transactions, it is impossible to tell exactly what is being paid for the goods. Personal property lease transactions are a particular trap. In virtually all such cases, the lease is solicited by the supplier of the goods and the "financing" is supplied by a third-party leasing company. In theory, the client must sign a receipt for the goods and acknowledge that they conform to the contract "as agreed" before there is any obligation. In practice, the agreement is presented to the buyer when the order is taken, and the buyer signs this acknowledgement as a part of the stack of documents executed at the time that the agreement is signed. Then, regardless of whether or not the goods are delivered, the client owes the leasing company.

It is important for the lawyer to acquaint the client with any problems in the personal property leases before they are completed. Make sure that the equipment is installed and working before the acceptance is signed and returned. There might be other problems, as well. The leasing company is simply that, a leasing \*30 company. It will owe no warranty and is not responsible for the operability of the equipment purchased. Thus, if the telephone system, copier, or forklift stops working because it was not as represented, poorly made, not as warranted, or for any other reason, the leasing company still needs to be paid. The original vendor may be long gone, but the business is still liable, as is the guarantor.

Consumer statutes dictating that the venue for lawsuits be where the defendant resides do not apply in business cases. It is important for you, the lawyer, to understand the pitfalls and explain them to the client, hopefully before any trouble arises. When a problem does arise, you can expect the client to be sued in Iowa, Nevada, or some other, distant place; defense will require local counsel there.

A guarantee will probably be necessary to obtain credit, but it should, if possible, have a time limit: "This guarantee expires on [date] unless renewed." Clearly, when guarantors leave the business, they must write the lender and state that they are leaving and that they are canceling the guarantee. The letter should be sent both by regular and certified mail. You can't escape existing liability, but you can cap it.

As lawyers, we know the importance of correctly signing documents. Clients, however, have no idea of the importance. If this practice is instilled early, it will have beneficial effects for as long as the business operates, especially if the business gets into trouble.

The lawyer needs to point out to the client the need to maintain a separate economic existence at the earliest possible point. Utilities should be placed in the name of the business, not the individual. Accounts should be placed in the business name, and the client needs to be instructed how to sign documents, i.e.:

XYC, LLC

by \_\_\_\_\_

Its President/Manager/etc.

The business will need a place to operate and will need to obtain materials. As lawyers, we look at what can go wrong, not what will go right. If there are potential lien rights, the business must have the structures in place to make sure that the documents are generated, recorded, and enforced to support the lien. For accounting issues, this is and should be the province of accountants; however, for any business with legal obligations, this is the obligation of the lawyer.

The premises lease is probably the largest liability that the small business will take on. Commercial leases are drafted for the benefit of the landlord, not the tenant. You should stress this to your client and review the lease carefully. Do not rely on oral representations. (“Oh, yeah, there’s adequate parking, clients can park over there.”) The scope of a lease review is well beyond the scope of this article, but some issues stand out: Is the tenant responsible for taxes, operational costs (i.e., common area charges, maintenance, etc.), and insurance? This is commonly called a triple-net lease. When these expenses are added, exactly what is the tenant paying? What are the expense stops (i.e., what has the landlord budgeted for expenses, and how much of this can the tenant be obligated to pay)? Is there an option to renew? What signage and parking/access is the tenant allowed? (Signage, to let customers know that the tenant is there, and parking and access, to let customers actually visit, will make or break a business.) Most importantly, can the tenant’s business be lawfully operated in the location?

## **Operating the Business**

Once the business is in actual operation, there will be other issues. Get to know your client’s business. Get to know what its processes are. If the business is operated on anything other than a cash basis, the business will extend credit. If the business accepts credit cards, the credit card agreement is an issue and should be discussed. How soon after submission are the funds credited? What are the rules for recoupment by the bank?

Knowing your clients’ business is also important because you can’t protect them from liability or pursue their creditors unless you know what the business is and how it is operated. What exactly do your clients sell, and how do they get paid? This is important because both federal and state law impose liens and other rights in cases that can be asserted to protect or, in other cases, force your client to pay.

**\*31** For instance, RCW, the Revised Code of Washington, lists in excess of 40 separate types of liens that can be imposed as a result of work done by or for your client. Mechanic’s and materialman’s liens are common. However, there also are liens for horse trainers, restaurant employees, commercial real estate brokers, hotels, doctors, nurses, ambulance services, and any number of other services. The scope of lien law varies from state to state and is well beyond the scope of this article. The point is that if you represent a small business and the business sells services that can result in a lien, you, the attorney, must inform the client that they may have a lien and you must then work with the client to develop a process to perfect the lien; the client must then send the paperwork to you so that the lien can be foreclosed. Similarly, if the client can be liened, the client must know that. More importantly, the client must know how the lien is released when paid.

Similarly, the Perishable Agricultural Commodities Act of 1930 (PACA) ([7 U.S.C. § 499a](#)) and the Packers and Stockyards Act of 1921 (PSA)([7 U.S.C. §§ 181-229b](#)) provide bonding, fiduciary liability, and other requirements and liabilities. The potential liability can be extremely large and can create personal nondischargeable (in bankruptcy) debt for corporate officers. If your client sells perishable commodities, the paperwork needs to preserve the lien because it is easily lost if it is not properly and timely perfected.

If your client is shipping goods, you should work with your client to set up a system to ensure payment. If acceptance of a credit card is not possible, you might consider a letter of credit. A letter of credit is a mechanism whereby a bank acts as the guarantor of the transaction. Simply put, the bank is obligated to pay upon the happening of certain conditions. A letter of credit has many possible uses (e.g., a guarantee, a bond, security for performance, etc.). Letters of credit are not common but are an available option. If your client is shipping goods internationally, they are much more important and much more commonly used.

If your client is shipping or purchasing goods internationally, you should be aware of the [United Nations Convention on Contracts for the International Sale of Goods \(CISG\)](#). It has been enacted in the United States as a treaty. 52 Federal Register 6262, 6264-6280 (March 2, 1987); United States Code Annotated, Title 15, Appendix (Supp. 1987). Thus, it is the law of the land, and, pursuant to the federal supremacy, preempts state law (i.e., the Uniform Commercial Code). Significantly, many of the provisions of CISG are contrary the terms of the UCC. The parties can opt out of CISG, but they must do so by agreement. If your client is involved in any international transaction, refer to CISG. It may provide a defense or an offense not generally available under local law.

If your small business client is dealing with consumers, giving credit can lead to even more problems. The federal Truth in Lending Act (15 U.S.C. 1601 et seq.) requires disclosure in consumer transactions. The forms must be carefully drafted with attention to the size of the type, the manner in which interest and fees are calculated, and a host of other issues. Again, the requirements of the Truth in Lending Act are well beyond the scope of this article. Suffice it to say that if your small business clients regularly allow consumers (not businesses) to pay on installment, they are subject to Truth in Lending disclosures, and if the clients fail to comply, the consequences can be horrendous for a small business.

The UCC is important in virtually all of the transactions in which your small business client will engage. All sales of goods are governed by the UCC. If your client is financing the sale of goods, you must make sure that there is a security interest and it is properly perfected. Perfection of security interests of the UCC is beyond the scope of this article; however, it must be considered.

At this point you need to clarify precisely who the client is. This matter was addressed in detail in my article "Who Is the Client?" from the October/November 2010 issue of *GPSolo* magazine and will not be repeated here. However, it is important to remember that if the client is an entity, you represent the entity \*57 and not the individual owners or executives. There will be issues of attorney client privilege (to whom does it belong?) and payment. Know the issues before you start.

### **Dealing with Problems**

At some point there will be problems. Regardless of whether they are the result of the business cycle, bad management, embezzlement by a trusted employee, or something else, problems will inevitably arise. The reason is irrelevant. At this point you will be defending demands for payment from creditors.

As a debtor, the small business faces many more challenges than a consumer debtor. Consumer protection provisions do not apply to business debts. Consequently, collection agencies can pursue the client much more viciously. Provisions protecting consumers from holder in due course status, from allowing venue in far places, and from usury do not generally apply.

The Pew Health Group recently released a report as part of its Safe Credit Card Project. Business credit cards are a vast minority but enjoy none of the protections of consumer credit cards. For example, if your client's business credit card has a venue provision allowing for suit in Iowa, that provision is probably valid, as are provisions allowing for default interest.

### **Remembering Your Role**

Always bear in mind, it's your client's business, not yours. You are a lawyer, not an insurer. Lawyers are trained to look for problems, not solutions. We are not trained to make business decisions. It is important to know the difference between business questions and legal questions. Throughout the life of any business, many different questions will arise regarding sales of assets, purchases, granting credit, leasing space, etc. Remember, business is process. Anything that disrupts the process impacts the business. Legal problems impact process more than others. It is the lawyer's role to find and suggest solutions to the problems,

but the ultimate decisions belong to the client.

It is the obligation of the lawyer to ask the questions. The lawyer must explain the risks of the transaction and is obligated to ask the client about the benefits. As lawyers, we are obligated to provide well-balanced legal advice. We are not, however, insurers. As long as the client knows the risks, he or she can decide to take them, or not. Spending hours drafting around a problem that in a worst case will not amount to more than a few thousand dollars of liability may seem like good lawyering. However, this approach angers clients and makes your services unaffordable. A good CYA (“cover your assets”) letter to clients outlining the problems and informing them of the risks will prevent many difficulties later. Such a letter, clearly setting forth positive and negative aspects of a transaction, will allow clients to decide for themselves whether they want to proceed further. In many cases the CYA letter will be more helpful to the client than the careful legal drafting because it should set out the problems and potential solutions in a manner that the client can understand. The facts will be there in black and white, and the client must address them in the cool light of day. A good letter can save clients money and, more importantly, make them come back to you. A lawyer who can’t figure out when a problem is only a minor one that will cost more to solve than was ever at risk is not serving the client well, and the client will ultimately realize it.

### **Conclusion**

Representing a small business requires all the skill and knowledge required of representation of a large business. However, the budgets are tighter, and small business clients usually think that the lawyer is a problem maker, not a problem solver. Good representation means that you are solving the client’s problems. Good communication means that the client realizes it and comes to you for advice before the next problem arises.

### **Footnotes**

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