General Security Options for the Credit Professional

FEDERATION of CREDIT and FINANCIAL PROFESSIONALS

EXECUTIVE SUMMARY

Credit Management is, universally, a complicated profession. Besides the often built-in, yet unintended, "difference of opinion" with the Sales and Operations Departments, there are all of the legal issues, as well as the legal remedies for those issues. The following paper provide the reader a list of applicable laws affecting the Credit Professional's daily routine. To properly and effectively do the job, these laws must always be on the mind of that Credit Professional.

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General Security Options for the Credit Professional

Credit Management is, universally, a complicated profession. Besides the often built-in, yet unintended, "difference of opinion" with the Sales and Operations Departments, there are all of the legal issues, as well as the legal remedies for those issues. Below, is a list of applicable laws affecting the Credit Professional's daily routine. To properly and effectively do the job, these laws must always be on the mind of that Credit Professional:

- Equal Credit Opportunity Act (Regulation B)
- Fair Credit Reporting Act
- Fair Debt Collection Practices Act (It does, indeed, apply to commercial credit.)
- FACTA (**F**air & **A**ccurate **C**redit **T**ransactions **A**ct) & the "Red Flags Rules".
- Clean Air Act (EPA Regulation, 40 CFR), for the HVAC industry.
- Uniform Commercial Code
    - Article 2: Sales
    - Article 6: Bulk Sales (Many states have repealed this.)
    - Article 9: Secured Transactions
- Bankruptcy Code:
    - Chapter 7: Liquidation
    - Chapter 11: Business (some personal, under conditions) Reorganization
    - Chapter 13: Personal Reorganization
- Sales and Use Tax: Fifty-One states & hundreds of counties & municipalities
- Federal Prompt Pay Act
- Sarbanes-Oxley Act
- Graham/Leach/Bliley Act, regarding privacy.

Just as important as knowing the laws, though, it is essential that, when faced with a questionable decision, plus the pressure for increased revenue, the Credit Professional be aware of potential solutions, which may allow him or her to meet the revenue needs and risk mitigation requirements, simultaneously.

Personal Guaranty

A P/G is one of the more common forms of added security:

- The guarantor, even when this involves another company, a so-called Corporate Guaranty, must have a personal financial interest in the business. In most circumstances, the guarantor(s) will be the business owner (principal).
- Base this choice on a review of the principal's personal financial statements. While there is a certain psychological value to a PG, its true enforceability lies with personal assets that could be liquidated, upon receipt of a court judgment.
- Per the Fair Credit Reporting Act, get written permission, from all potential guarantors, to obtain a personal credit report. The assumption is, with an availability of funds, a business owner will likely handle the business's financial obligations, just as he or she handles his or her personal debts. This is the source of the above psychological incentive.
- Per the Equal Credit Opportunity Act and the FTC's Regulation B, you cannot require a spouse to sign. There is a solution for that, however. Consider whether available assets are jointly owned. While some jurisdictions allow for an attachment, without liquidation, of a jointly held asset, most do not. In the former instance, you may have the advantage of forcing payment, if they try to sell that asset, which may take years, as well as requiring renewal of judgments, and so on. Disqualify the principal, based on the fact that, by eliminating jointly held assets, he or she no longer has the Net Worth required for your acceptance. They may, then, volunteer a joint signature.
- The Guaranty needs to be linked to the concept of "due consideration" or in "consideration of the extension of credit" to the associated business.
- The best approach is to have a continuing, rather than a limited, Guaranty, with a requirement that any revocation must be in writing, with a notarized signature of all guarantors, at least 30 days in advance. This may then further require a review and a new business credit decision.
- If the Guaranty is limited, the customer must be aware that the further extension of credit will also be contingent upon certain factors.
- Include clauses that determine the venue for any enforcement procedures and the state, whose laws determine the foundation for that enforcement.

Standby Letter of Credit

A Standby L/C is another, stronger, option:

- This involves a written guarantee by the customer's bank that, in the event of default, it will pay, instead.

- In most circumstances, the bank will encumber certain, or all, assets on hand at that institution, as collateral. In other cases, they may set aside an unused portion of an existing Line of Credit, thus making that money no longer available for the customer's use.
- This is an excellent tool for securing an open account credit availability, for an entrepreneur, who has some personal financial strength and the skills needed for operating a business, but who does not have actual business management experience.
- Ask for a draft, before extending any credit that would be contingent upon the Standby L/C:
  - Include an expiration date that is either continuing, or at least 12 months out.
  - Do not accept verbiage that limits any eventual claim to only past due invoices. That will prevent you from claiming recent billings that are not yet beyond their due date.
  - The bank's payment should be immediately upon receipt of your written claim and copies of the invoices.
- It is recommended that you review the account, within 60 days of the L/C's expiration, in case you need a renewal.

Purchase Money Security Interest

Sometimes referred to as a "pimzi", or a PMSI, a **P**urchase **M**oney **S**ecurity **I**nterest is an excellent tool for securing credit extended for the sale of inventory items, regardless of industry. It is also used for other purposes, such as loans for the purchase of goods and software. In fact, Section 9-103 of the Uniform Commercial Code defines a PMSI as a security interest in goods or software used as collateral for an obligation that arises in connection with the sale of the goods or software to the debtor. Essentially, then, a PMSI can only be taken in goods (inventory) or software. The UCC definition of "inventory" is actually broader than you may think, since it also includes goods held for lease and work in process, in addition to "normal" inventory, but, as trade creditors, we are more interested in protecting our own inventory sales, on open account. To use it for that purpose:

- Both parties must execute a Security Agreement, covering the sale of goods, in the future only. Trying to secure an existing debt with this tool will not work. This security agreement can be a part of a regular Sales Agreement, which, in turn, can be combined with a Credit Application. However, under any circumstances, it must still be perfected, meaning that there is no hidden ability to claim a PMSI.

- To perfect the PMSI, the creditor must file a Financing Statement, otherwise known as a UCC-1, in the state in which the customer is legally organized. This filing must already be in place, before the customer receives the material, and…
- …the creditor must also send written notice to those specific secured creditors who already have an interest in the exact product that you are providing. The notice must include a description for each item. This notice must be received by the other creditor(s), again, before the customer receives the goods. It is then good for five years.
- During that five-year period, the holder of the perfected PMSI is free to extend secured credit to the customer, unimpeded by other security rights that would otherwise be superior to theirs.
- At the same time, the holder's rights extend only to the degree that he or she can identify the goods, on hand at the time of seizure, or how ever they may receive the goods back. Additionally, and very importantly, if the goods were sold, or otherwise disposed of, AND the holder can identify the proceeds, those proceeds are part of the holder's secured interest, and they can be seized as well.

Consignment

This provides the opportunity, as risky as it may be, to place your material at the customer's location, for his or her exclusive use, and, then, pay you for it, only, when it is re-sold. The benefit is that title to the goods remains with you, until it is re-sold, and you can repossess the inventory. Of course, the title may be yours, but the goods are in the hands of someone else, meaning that there is still a high degree of risk, until you can get your hands on the material. Points to consider:

- Prepare a Consignment Agreement:
  - Explain the purpose of the arrangement, in detail, including your retention of title.
  - Require that the material covered by it be segregated from the customer's other inventory, and that it be properly identified as such.
  - Allow for a company representative, usually the sales associate or a branch employee., to enter, at will, to count the items, for two reasons:
    - Determine what to bill for, so payment can be made.
    - Determine the items that need replenishment.
  - Include the location, where this inventory is to be held, and advise that it cannot be relocated, other than to sell it.
  - Require a Certificate of Insurance, listing your company as a co-loss payee or additional insured party. A previous employer of mine had an existing consignment, as of when I started, without this protection, and there was a "convenient" fire, forcing a lengthy and expensive civil suit.

- Very important: File a Financing Statement (UCC-1), to protect your interest in the material.
- Search for, find and notify any other secured creditors, with an interest in the customer's inventory.
- It is also important that you, as a Credit Professional, still consider the "credit risk", to some extent, since a consignment is not foolproof, even as you own the material still on hand.

Floor Planning

This is a far better alternative, to a consignment, in that you get paid, usually faster than you would have, when you extend open account terms to your customer, even a prompt paying one. The reason is that the risk is assumed by a third-party finance company. That fact is also a possible point of contention, with your customer, because he or she must apply with, and be approved by, that finance company. However, since this is essentially just another form of business financing, much like a working capital line of credit, many customers understand the benefits, to both you and them. The first thing, of course, is to negotiate an agreement, with the third party. Some manufacturers already have one, as part of their normal operation. In other cases, there are companies that do this on a regular basis. I have dealt with both, including actually negotiating the entire program, to accommodate multiple vendors, to actually presenting that program to the Sales, Marketing and Operations Departments, and, then training their personnel. Once that is in place, it is up to the field people, to sell it.

As with any program or process, there are multiple things to consider:

- There are two types of payment arrangements for your customer, both of which involve the finance company's risk, not yours:
    - Pay as Sold: More or less, this is just like a consignment, except, as the customer uses material, your company bills the finance company, who then, in turn, bills the customer. At the same time, the finance company pays you, according to agreed-upon terms.
    - Scheduled Payments: Basically, you bill the finance company for everything, and then the customer pays them, according to the agreed-upon terms, perhaps monthly payments, over six months. You get paid immediately.
- Recourse: This is part of your agreement, with the finance company, or not. If it is, and the customer defaults, they can return the receivable to you and demand repayment.

- Of course, your ability to sell under this arrangement requires your customer to apply with, and get approved by, the finance company, before you can deliver, under the main agreement. Sometimes, a customer will balk at the extra effort.

Credit Insurance

This is also an option to reduce risk, although there are costs involved:

- On one hand, this arrangement is mostly between your company and the insurance company, almost.
    - You arrange for the coverage, where the insurer will pay you, upon a default by your customer.
    - There is no separate application for credit to be submitted by your customer.
    - Their involvement with the insurer will begin, after you are reimbursed, when your customer will have to pay that insurer.
- Depending upon your exact arrangement with the insurer, they will have a certain amount of input into your credit policies and decisions per customer. If you fail to abide, at your option, your coverage in that instance will change, perhaps to the point of no coverage for that account.
- During the coverage period, the insurer can be a good source of information, to assist with your business credit decision. They will monitor your accounts, within their overall client base and through other means, such as public record, and then, alert you to adverse circumstances.
- From a purely risk mitigation perspective, this can be good, especially as you get reimbursed for delinquent invoices.
- From a sales support point of view, there may be some issues.
- Just as with any insurance coverage, there are premiums involved, which, hopefully, will be more than offset by the reimbursements.
- Investigate thoroughly, both in considering which carrier to choose, and the various costs and other factors involving management, credit policies, and so on.

Other Options

There are a number of other options, with which you can reduce, even eliminate risk, although the latter could also cost you a customer:

- ***Documentary Letter of Credit***: This is similar in concept to the Standby L/C, except that it is limited to a single transaction. It is very common in international trade, but it can also be used domestically. Basically, a bank(s), in agreement with a mutual customer, will pay, upon submission of a written claim, completed in strict accordance with the L/C's terms and conditions. These conditions may be very strict, such as how shipments of goods are secured on trucks rail cars or ships, so be careful. I was personally involved in a shipment of vehicles, where the gauge of the metal straps securing them in the hold of a freighter was specified in the L/C. Failure to abide by any one of these conditions can result in non-payment.

- ***Factoring***: This essentially eliminates all risk, because a company may decide to sell its receivables, at a discount, to a third party. In this instance, all credit decisions are made by the Factor. Normally, this option includes the potential for recourse, just as with Floor Planning. The agreement will have some conditions, under which the Factor may be able to return the unpaid Receivable to your company. Given the degree to which they have control over the extension of credit, to your customer, be sure to protect your company, by carefully reviewing the agreement, and make sure that you seek legal counsel.
- ***Deposits***: A marginal customer may be willing to put funds on deposit with you, in case of default. In the meantime, he or she could be given the opportunity to pay according to terms, perhaps for a specified period of time, in order to show the ability and intent to meet your terms. It is much like the concept of a Standby L/C, except the funds are already in your bank.
- ***Cash in Advance***: This could be on a single transaction basis, or the money could be put on account, as a credit, to be depleted, as purchases are made.
- ***Cash on Delivery***: Self-explanatory.
- ***Incentives to pay***:
  - Normal prompt-payment discounts are a common way to entice a customer to pay on time. I have seen situations, where the discounts available to a customer, and properly used to advantage, constituted that business's entire profit. Obviously, pricing in that industry was cut-throat.
  - An anticipation discount is a case, where a customer with extended terms can pay earlier than scheduled, to gain the discount.

What Are the Unique Challenges in the Construction Industry?

To begin with, your expectations of getting paid will usually involve multiple layers of direct participants and possible third parties:

- Manufacturer
- Wholesale Distributor (Supplier, you)
- Potential Supplier to Supplier
- Subcontractor and Sub-Subcontractor
- General Contractor
- Property Owner (Residential, Commercial, Governments, HOAs, Property Mgt.)

- Lender or other source of funding
- Government entities, including the Federal Government, 50 States and the District of Columbia.
- If your company operates nationwide, you need to be aware of specific Federal and state laws, in addition to those listed earlier:
    - Miller Act (Payment Bond claims on Federal projects)
    - Mechanic's Lien laws, of which there are 51.
    - Public bonded jobs, also 51 (These are often referred to, as "Little Miller Acts".)

Imagine receiving a new credit application, at your location in Maryland, from a DBE (**D**isadvantaged **B**usiness **E**nterprise), located just across the Mason-Dixon Line, in Pennsylvania, with a six-figure rush order, some of which will be picked up in Maryland, with the rest being delivered to Pennsylvania, some which will go to the job site, in one local jurisdiction, and some to the customer's location, in yet another local jurisdiction. On top of that, some of the material has to be shipped, directly by the manufacturer, from somewhere a few states away, to the job site, to save time. Then, to make matters even more complicated, the job itself is to build three new condominium buildings, as well as finishing a fourth, which includes a gym and a pool. Another three buildings were completed 20 years ago, for which your DBE has a maintenance contract, and the entire community, within the city limits of Philadelphia, is intended to promote home ownership for low-income families, so it is partially funded by the city government and HUD (Dept. of **H**ousing and **U**rban **D**evelopment). Even the entrance to this new section required building a bridge over railroad tracks and a road. Parking is underground, and your customer specializes in sprinkler systems, which will be installed everywhere, plus HVAC systems. Does that sound a little more complicated than a simple shipment of goods?

In the construction industry case at hand, certain questions, among many others, come immediately to mind:

- What is a DBE, and why should you be interested?
- Multiple tax jurisdictions are involved, such as the State of Maryland, the Commonwealth of Pennsylvania, the City of Philadelphia and a county(s). So, do the people generating the invoices understand those issues? Does your customer?
- What about the Federal source of some of the funding, and does it matter from whom the rest of the money is coming?
- What about the existing HVAC systems? Do they fall within the jurisdiction of the Clean Air Act, and does your DBE employ technicians certified to work with restricted CFC and HCFC Refrigerants and the applicable equipment?
- Assuming that you can eliminate all of these and other non-financial issues, what does one do to mitigate other risk factors, perhaps the most important of which is the ability for your customer to pay you, and are there other options available, if there is a concern about that ability? Of course, all of the options discussed in the previous pages are also available. The following options are exclusive to the construction industry, which itself consists of multiple segments, public and private.

<u>Mechanic's Lien and Bond Rights</u>

Sometimes also referred to as a Construction Lien or a Materialman's Lien, this is a lien or real property, which is available to suppliers and contractors on building projects. Any items that are attached to the real property, such as HVAC or a fire sprinkler systems, become part of that property. The catch is that there are 51 different laws that govern their availability to creditors. Obviously, if you and the project are in the same state, that issue will not affect you, per se. However, it will not hurt to have a greater understanding of the subject, and, if you handle multiple states, that is a given.

The first thing to understand is the language of mechanic's liens and surety bonds:

- In an ***<u>Unpaid Balance</u>*** state, lien rights are good only to the extent that funds remain unpaid on the total contract.
  - If the owner pays the Prime Contractor in full, whether or not anyone else is paid, no one has lien rights.
  - Timing is critical, particularly if there is a potential to trap funds for payment of our debt.
  - The term, "trap funds", refers to the opportunity to force the owner, to set aside money for your payment.
- In a ***<u>Full Balance</u>*** situation, it is possible that an owner may have to pay twice in order to avoid a lien. Occasionally, certain specific circumstances in an Unpaid Balance state may allow for double payment, but this is not guaranteed. In either circumstance, this is popularly known as "Double Jeopardy".
- ***<u>Surety Bonds</u>:*** Federal projects are governed by the Miller Act, while public (State and Local Government) are covered by separate state laws, often referred to as "Little Miller Acts". Bonds may also apply on private projects:
  - When called for by contract or …
  - …in order to avoid the potential for a lien.
- Each state lien law will refer to either a ***<u>first or last furnishing</u>*** of labor or materials. The timing of a notice, prior to or after one or the other, or lien filing will determine the effectiveness of lien rights.
- When allowed by state law, ***<u>Pay-when-paid</u>*** or ***<u>Pay-if-paid</u>*** clauses in construction contracts may be binding on us, even if we did not specifically sign, or see, the contract. This is especially dangerous in Unpaid Balance states.
- ***<u>NTO</u>*** (**<u>N</u>**otice **<u>t</u>**o **<u>O</u>**wner) is the key document, especially regarding:
  - Content: The notice must identify and link the product to the job.
  - Timing: Each state dictates the different requirements, regarding when it is to be sent and under which conditions…

  - There are also states, with no statutory requirement for this notice. However, experts will nearly always suggest that you send one anyway, which is allowed.
  - The reason for the notice, in the first place, is to protect the property owner, from the foreclosure consequences of the process. Upon receipt of the NTO, a smart property owner will immediately confer with the GC, to follow up on payments to sub-contractors and suppliers.
- ***<u>Tiers</u>***: Each party in the project falls into a specific tier, which governs their potential, or not, for lien rights:
  - At the Top: Property Owner, Lender(s) & the Property
  - Tier 1: General Contractor (aka Prime Contractor)
  - Tier 2: Subcontractors
  - <u>Tier 3: Material/ Service Suppliers & Sub-Subcontractors</u>
  - Tier 4: Suppliers to Suppliers, others (Generally, but not always, those below the line do not have lien rights. Also, be aware that one's Tier position may change the what, how and when, of the process.)

The process for the NTO, as well as the subsequent lien filing, lawsuit and foreclosure is so complex, especially across multiple states, it is recommended that you provide the details to people in the field:

> **<u>California</u>**
>
> This is a **<u>Full Price</u>** lien state, which means that, under certain circumstances, the owner may be required to pay twice, in order to satisfy a lien. Furthermore, any contractor not holding a valid C-20 license cannot avail themselves of the lien remedy. Please be aware that, typically, we and the sub-contractor have the same lien rights.

Notice the reference to a C-20 license? California is an interesting, and sometimes unique, state, with more than few legal requirements, not seen in some other states. The C-20 is a specific HVAC state license, which a contractor must have, or they are in violation of state law, and they risk losing lien rights, in a state, where, otherwise, such rights are guaranteed in the state constitution. Here, it is a good idea to refer back to the White Paper that discusses the responsibilities of HVAC wholesale distributors, and their Credit Departments, in the "Golden State, which still does, in fact, have "California Republic" on its state flag. They strictly enforce the EPA, and state, requirement that only properly certified technicians handle CFC/ HCFC ozone-depleting refrigerants and associated equipment, to the extent of having an undercover police force, posing as homeowners. Per the EPA, and the Clean Air Act, it is the wholesalers' responsibility to monitor and control the distribution of this material.

Private Timeframes:

Notice: Send a Notice to Owner (NTO) along with the direct contractor and lender within 20 days of the First Furnishing. All invoices for the job must specifically reference the job, in addition to POs and so forth. Material should be delivered directly to the job site. A Ship-to address will be established for each job. Note: Because of this very short timeframe, it is imperative that a job sheet be submitted before delivery. In the case of an Auto Credit, a completed and properly signed Credit Application and Sales Agreement must be received and approved before proceeding.

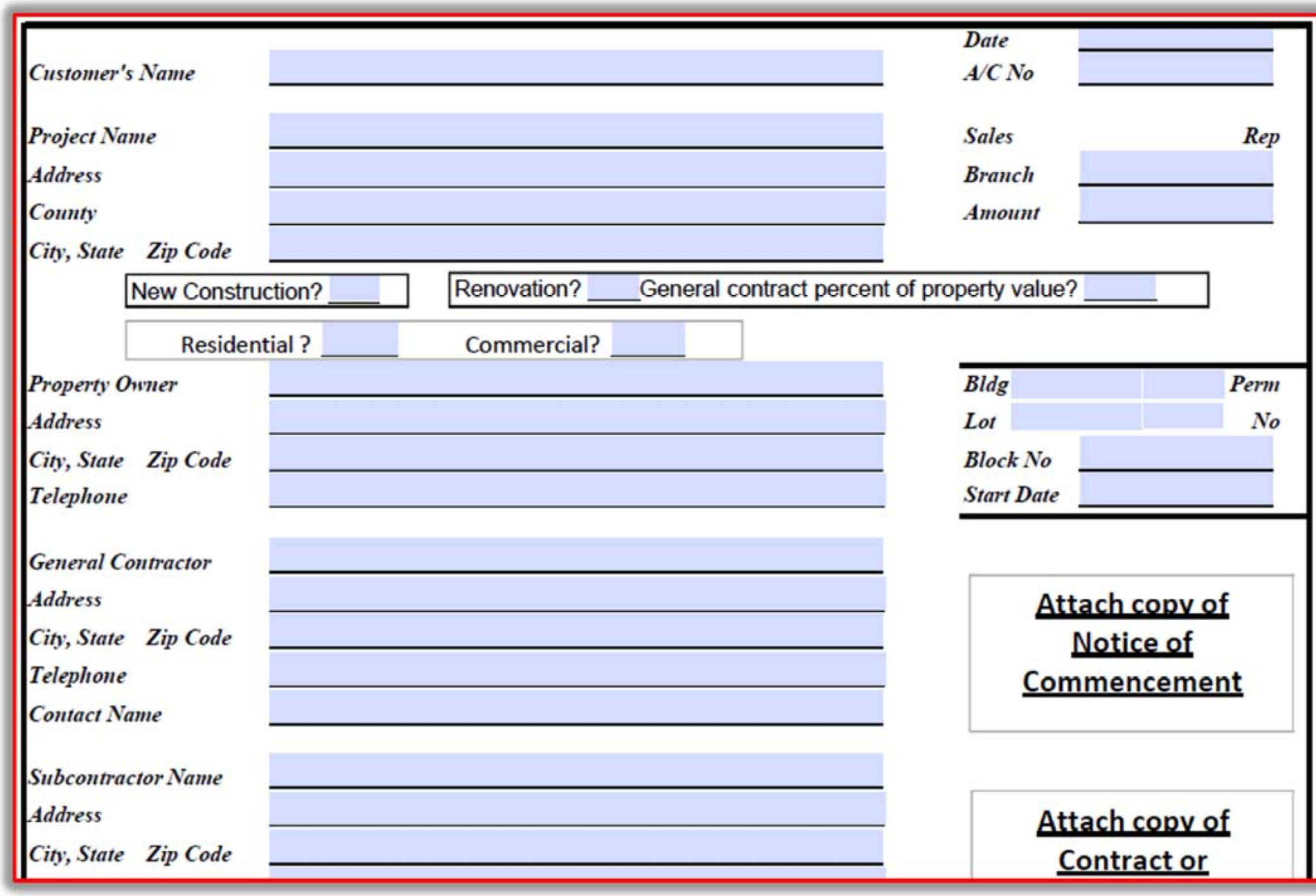
Lien: Notify the owner with a Notice of Mechanic's Lien and a copy of the lien itself, prior to filing and with 90 days of the completion of all work. If the owner has filed a Notice of Completion or a Notice of Cessation, this timeframe is reduced to 30 days.

Foreclosure: File suit within 90 days of recording the lien. Additionally, one must file a Notice of Pendency (aka *lis pendens*, Latin for "suit pending") within 20 days of filing for foreclosure.

Public Timeframes:

Any public (state and local) contract exceeding $25,000 requires a 100% payment bond. The process is similar to that for liens.

- ***Job Sheet***: This is actually the beginning of the process. It is essentially a guide for the troops in the field, to obtain the information required for the NTO and for your analysis of the project.
  - Shown below is part of a standardized online sheet, which covers the basic information needed. As shown above, some states may require additional information, such as California, Arizona as well, require the NTO to also go the lender.
  - Some states help with the process, by requiring the GC to file a Notice of Commencement.
  - Why ask about renovation, if most states dictate that liens are enforceable for new construction, only? For instance, Maryland allows for liens on renovated property, whose value, after the job, was improved by 15%, or more.
  - In some states, the rules for residential are different from commercial.



Customer's Name

Date

A/C No

Project Name

Address

County

City, State Zip Code

Sales Rep

Branch

Amount

New Construction? ____

Renovation? ____General contract percent of property value? ______

Residential ? ______ Commercial? ______

Property Owner

Address

City, State Zip Code

Telephone

Bldg Perm

Lot No

Block No

Start Date

General Contractor

Address

City, State Zip Code

Telephone

Contact Name

Attach copy of Notice of Commencement

Subcontractor Name

Address

City, State Zip Code

Attach copy of Contract or

- "Attach copy of contract or (Purchase Order)": The basic Law of Contracts is in play, always:
  - Offer: Someone wants to do business with you
  - Acceptance: You agree
  - Consideration: Exchange of goods or services
  - Can be ***oral*** or written, including an email
  - Beware of dangerous language:
    - Patents, copyrights, suitability for a specific purpose
    - Reference to contract specs, pay when/if paid terms, other references to contracts
    - Indemnification clauses and other references to warranties/ liability
    - Reference to execution constituting acceptance, and more…

An example of such language:

> Substantial performance of the General Contract by the Contractor is a condition of the Contractor's obligation under this Subcontract. If the Owner becomes bankrupt or otherwise defaults in his payments to the Contractor under the General Contract, then, upon written notice thereof to the Subcontractor, the Contractor may terminate this Subcontract and will thereupon be liable to the Subcontractor only for the cost of work actually performed and justifiable expense incurred by the Subcontractor up to the time of receipt of said notice solely to the extent those costs and expenses are actually recovered by the Contractor from the Owner. The Subcontractor understands and agrees that payment to the Contractor by the Owner is a condition precedent to the Contractor obligation to pay the Subcontractor.

There are many other clauses that could cause substantial issues, some of which will not be eliminated by the filing of an NTO or lien.

How does one try to get around such issues? Consider a Joint Check Agreement, and be aware that the words "joint check" often confuse people, from customers to sales associates and so on. They believe that a customer's statement that they will be paid by a "joint check" often simple means that the payment from the General Contractor will be made out to them, as your sub-contractor customer, and your company, as a supplier. That may suffice, in limited cases. However, a true JCA will protect you, from a variety of dangerous contract clauses, and provide the advantage to you of the joint and several liabilities of the GC and sub. If they submit the GC's form, review it carefully, and strike any language that requires payment by the owner as a requirement for payment to subs and suppliers. Better yet, use your own form, which should include the language that both the General Contractor and your customer, which is usually the Sub-Contractor, are "jointly and severally liable" for the debt, along with other protective language, as shown below:

> Nothing in this agreement shall be construed to make [redacted] a party to the purchase order or any other contract existing between the General Contractor/Owner and the Subcontractor nor shall [redacted] be responsible for the whole or partial performance thereof. This agreement is superior to and shall not be affected by any back charges, setoff or counterclaim that GENERAL CONTRACTOR/OWNER has or may have against the SUBCONTRACTOR.

The two liability language changes eliminate the argument that your customer cannot pay you, because the GC has failed to pay him/ her, since the GC is also liable to pay you, whether the owner pays them, or not.

Something else to consider, simply for the sake of knowledge and a total understanding of the lien process, is that, often, the mere fact that all proper procedures were followed, and the NTOs were received by the right people, payment will follow. However, some folks mistakenly believe that following the procedure is a guarantee that the payment will follow. Just be aware, of the following points, from a PowerPoint presentation, and do not give up on the process, as it almost always accomplishes what you need:

- You must comply absolutely with timing & content.
- Certain dangerous contract terms may still exist.
- In some states, other types of lien are superior, such as in Maryland.
- Suppose all parties have no money or skip with it?
- The process includes foreclosure proceedings, seizure of property and sale, then distribution of proceeds.
- Will there be enough money?
- Bankruptcies?
- Fraud?
- It can take years, and the costs may exceed the reward.

Lastly, there is another, often overlooked, alternative, to collect what is owed:

Construction Trust Laws

Construction Trust Laws have been implemented in some, but not all, states. There are two important aspects:

- Funds paid by a property owner, to a general contractor, or by a general contractor, to a sub-contractor, creates a Trust, for the benefit of those supplying labor or materials, to the project.
- Principals become personally liable, for the proper disbursement of those funds.

States with Construction Trust laws:

- Arkansas and Georgia also have a provision for possible criminal charges, against the Principals.
- South Carolina has a provision, for a first lien on funds.
- States, with standard trust fund statutes, include Delaware, Illinois, Maryland, Michigan, New Jersey, New York, Texas and Vermont.

Several attorneys have recommended that, in the absence of one of these laws, and considering the circumstances regarding a marginal project, you could consider a Trust Agreement. Make note of the fact that, in two states, there are possible criminal charges, as well as civil liability. If circumstances are such that all else does not provide the proper comfort level, within your company's policies, needs and requirements, you can consider making use of this tool. As a last result, and payment does not seem likely, and business assets are less than needed to cover a debt, an action against the Principals may help. In the worst of circumstances, again, within those same policies and such, you can contact your legal department or an attorney, to draft a

Trust Agreement, as a substitute for the lack of state help. In Arkansas and Georgia, the mere mention of the Construction Trust Statute can get you paid.

Lien Waivers

This category falls under the subject of "dangerous language". Essentially, it is short for giving away or voiding all of your potential lien rights, as of the time you accept the language. This can be accomplished, in one of two ways, sometimes, both:

- *Original Contract:* This is one of those areas, where the appropriate state comes into play. Basically, the contract will include language that waives the lien rights of everyone, even those who are not a party to the original document. It is passed down, by including in subsequent purchase orders or contracts, a reference to agreement with the terms and conditions included in the original contract. This is precisely why a Credit Professional in the construction industry should ask for that document, as part of the inquiry for job information, aka Job Sheet. When appropriate and needed, alter your PO or contract, to avoid references back to any overly restrictive contract. Also, keep in mind, that some states forbid lien waivers in original construction contracts, and some still allow the restriction. Be alert.
- Partial and Final Waivers: During the payment process, subcontractors, and others, will require a waiver of lien rights:
    - Be aware of the specific waiver language, regarding a full and final waiver, without full and final payment.
    - An "unconditional" waiver is dangerous, because, even when accepted in error, courts will rule in favor of the debtor.
    - Use your own document, if possible, which should limit any waiver to what is specifically paid for.
    - If necessary, strike any "bad" language in their document, and replace it with "conditional" language, requiring not just the receipt of specific payment, but also the clearance of funds. If necessary, list the actual invoices.
    - Always, strike language claiming a full waiver or acceptance of payment-in-full, unless it is, indeed, the case, and, once again, always make such waivers, any waivers, are contingent upon clearance of funds on the actual final payment.

The point of this article is to let you, the Credit Professional, know that there are nearly always options, to allow you to make that critical business credit decision, in support of your sales effort and in compliance with your requirement to mitigate risk. Your company's policies and needs are always critical, to where this information leads you. The Federation of Credit and Financial Professionals is here to help, as always.

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