Credit Application Fraud, Signs, Steps, Remedies and the Savvy Vendor

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April 9, 2025
Pewaukee, WI

NACM
National Association of Credit Management
CONNECT
Driving results

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Agenda

- Credit Apps
- Fraud!

The Credit Application

- Basic method of evaluating a new (or current) customer
- Provides general and specific information for follow-ups
- Information to obtain:
  - Legal and d/b/a names and main address (and alternates)
  - States of incorporation
  - Names of officers and directors
  - Registered agent(s)
  - Banking details
  - References (from banks, lenders, other vendors, etc.)
  - Authorizations
  - Guaranties
  - Financial Statements
  - Information regarding pending litigation claims, disputes with creditors, etc.
- Inclusion of choice of law / jurisdictional provision

The Credit Application

- Credit Application provides the following:
    - Information to evaluate creditworthiness
    - Sufficient information to commence UCC, real property and litigation searches if necessary
    - Sufficient information to begin litigation, garnishments, or other legal actions
    - Provides locations of assets should asset seizure become necessary
- Renew application each year (if possible)
    - Ensures up-to-date information

Personal Guaranty

- A personal guaranty provides additional means for a vendor to protect itself against the risk of customer non-payment
- Commonly, principals or shareholders of a privately-held shareholder may be approached to provide a personal guaranty
    - Due diligence should be conducted to make sure that guarantor is creditworthy and has sufficient assets to make good on the guaranty

Guaranty

- Common types of guaranties include:
  - Guaranty of payment
    - Creditor can look to guarantor without exhausting collection efforts against customer
  - Guaranty of collection
    - Creditor must exhaust collection efforts against customer prior to proceeding against guarantor

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Guaranty

- Guarantor Execution
  - Notarize/witness signature
  - Make sure individual guarantor is signing in personal capacity (no title)
- Corporate/LLC/Partnership Guaranty
  - Evidence of authority of Corporate/LLC/ Partnership signatory
  - Acknowledgement/notary

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What to Include in a Guaranty

- Guaranty of payment is irrevocable and unconditional
- Detailed representations and warranties regarding guarantor’s ability to perform
- Claims of guarantor to debtor are subordinated to those of the creditor
- Waiver of subrogation rights
- Reinstatement of guaranty in event of preference recovery
- Waiver of guarantor’s counterclaims, setoff rights, defenses, etc. against creditor, debtor or other guarantors
- Attorneys’ fee and cost reimbursements
- Choice of law / jurisdiction

Other Ideas to Secure Payment

- Security Interests
  - Perfection (UCC-1), Possession, Control
  - PMSI

CREDIT APPLICATION FRAUD

THE SIGNS

FAKE SIGNATURE

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CREDIT APPLICATION FRAUD

THE SIGNS

LACK OF SIGNATORY AUTHORITY

CREDIT APPLICATION FRAUD

THE SIGNS

FALSE FINANCIALS

- For company
- For guarantor

CREDIT APPLICATION FRAUD

THE SIGNS

FRAUDULENT INDUCEMENT

- No intent to pay
  - Toys ‘R’ Us example

CREDIT APPLICATION FRAUD

THE SIGNS

FAKE COMPANY

CREDIT APPLICATION FRAUD

THE SIGNS

FALSE DELIVERY LOCATION

Fraud

Fraud comes in many forms – though we'll see it mostly in two forms:

- Fraudulent transfers under bankruptcy and state law;
- General/Common Law Fraud – "A false representation of a matter of fact – whether by words or by conduct, by false or misleading allegations, or by concealment of what should have been disclosed – that deceives and is intended to deceive another so that the individual will act upon it to her or his legal injury."

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The Effects of Fraud

- It is estimated that fraud creates a net loss of 5% of business revenues globally – or approximately $3.7 trillion. (ACFE)
- Fraud – particularly in the occupational context – has been the primary contributor to the downfall of several major corporations, including WorldCom, Enron, FTX, and Tyco International.
- But even smaller frauds, like those caused by customers, can have significant effects on the bottom line, and if unidentified and unchecked, can cause serious harm to the integrity of a company's credit department.

Who Commits Fraud?

Businesses can be damaged from fraud from a number of perpetrators:

- Management
- Employees
- Suppliers
- Customers
- Organized Crime

Common Law Fraud

- Frauds are actionable against the defendant under the "common law" of all 50 states.
- In some cases, fraud claims can be pursued by statute (e.g., consumer protection laws)
- Elements of common-law fraud are generally:
  1. A false statement of material fact;
  2. The defendant's knowledge that the statement was false;
  3. The defendant's intent that the statement induce the plaintiff to act;
  4. The plaintiff's reliance on the statement; and
  5. The plaintiff's damages resulting from reliance on the statement.

Common Law Fraud

Pros:

- Can sometimes achieve treble damages
- Can sometimes prevent discharge in bankruptcy (sole proprietorship)
- Gives the market proof of lack of willingness to be a victim

Cons:

- Can be expensive
- Can be hard to prove
- Can be hard to collect

Fraudulent Transfers

- What is a Fraudulent Transfer?
  - Actions may be brought to avoid and recover transfers that were fraudulent in nature.
  - Can be brought under both state (Uniform Fraudulent Transfer Act) and federal (United States Bankruptcy Code) law.
- Two primary types of fraudulent transfers:
  - Actual fraudulent transfers (requiring proof of fraudulent intent by the transferor)
  - Constructive fraudulent transfers (which do not require proof of actual intent to defraud)

When Might You Be a Victim of a Fraudulent Transfer?

- Guarantor transfers all of its assets to prevent you from collecting on a judgment
- You receive payment from a corporate affiliate (rather than the direct obligor), despite that affiliate having no direct obligation to pay
- A substantial transfer of assets by a customer renders it insolvent (and unable to pay you)
- A customer incurs a significant debt or secured obligation just prior to filing for bankruptcy
- A customer engages in inter-company transfers in order to duck

QUESTIONS

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