

Credit Where Credit Is Due: Good Practice In The Sphere Of Credit Reporting

In the current economy, it is inevitable that debtors will look more and more to esoteric and creative ways of fighting their creditors. Credit professionals dealing with individuals or small, closely-held companies have to be especially watchful for countersuits. As the cliché goes, the best form of defense is offense, and what might have been originally considered a straightforward collection action can turn quickly into a countersuit, and then a bet-the-company litigation. For credit departments watching their bottom line, the experience can become a nightmarish, run-away train. Countersuits are independent actions, which don't automatically go away when you discontinue your original lawsuit; thus, when faced with one, you may even lose the ability to pack it in and call it a day because you are throwing good money after bad.

One area of law not often seen in countersuits, but which will surely grow in time, particularly given the increased reliance placed on credit scores, are claims based on credit reporting. This article seeks to give a brief overview of the potential issues that can arise in this context, as well as pointers for the credit professional to avoid countersuits.

Fair Credit Reporting Act Violations

The Fair Credit Reporting Act ("FCRA") is a federal statute regulating the dissemination of information relating to consumer credit. In its own words, it was enacted for the purpose of requiring credit reporting agencies to "adopt reasonable procedures for meeting the needs of commerce for consumer credit, personnel, insurance, and other information in a manner which is fair and equitable to the consumer." Facially, it may not appear overly relevant to credit professionals who deal primarily with business clients. However, whether it is in the context of sole proprietorships, or personal guaranties from shareholders, the tentacles of the FCRA can reach into your everyday business decisions, and knowledge of its provisions is important.

Let's start with the most common and impor-

tant questions: Can you pull the personal credit report of a sole proprietor who applies for business credit? The answer is: Get his/her consent.

Under the FCRA, a credit report can be pulled for specified "permissible purposes." 15 U.S.C. § 1681b. These permissible purposes include: (1) considering the consumer for employment; (2) considering the underwriting of insurance involving the consumer; (3) an application for consumer credit; and (4) an otherwise legitimate business need in a business transaction initiated by a consumer. While this latter purpose of "legitimate business need" might intuitively seem to encompass a sole proprietor's application for business credit, it has been interpreted narrowly. The "legitimate business need" must relate to the consumer relationship. A credit report, however, can always be obtained where consent has been given. As such, it is the easiest bright-line rule to adhere to. Require their consent to a credit report as a condition of extending credit. If they are reluctant to provide it, that says something in and of itself.

Can you pull the personal credit report of a sole shareholder of a corporation you sell to, and who is providing a personal guaranty of the debt? Once again, the answer is: Get consent. The fact that a shareholder is providing a personal guaranty does not alter the nature of the transaction. You are providing business credit, which does not involve a consumer relationship contemplated by the FCRA (e.g. employment, insurance, household finance). You can perform research on the guarantor in other ways – run a search of the bankruptcy docket (www.pacer.gov) to see if (s)he has ever filed for bankruptcy protection; pull the Dun & Bradstreet report of his/her business; run a Lexis Nexis search to find associated companies, and then try to track what happened to them. If you are seeing an individual with multiple defunct entities associated with his name, be suspicious. However, unless you get consent, do not pull the credit report.



Johnny White, Esq.

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The consequences for failure to comply with the FCRA can be serious. Criminal penalties are possible. And in the context of a civil action, for willful noncompliance, punitive damages can be assessed against the offender, and a court can order payment of the consumer's attorney fees. The statute of limitations on actions is 5 years, or 2 years after discovery of the violation. Thus, if during the discovery/document production stage of a lawsuit, it emerges that you pulled a credit report without authorization, even if it occurred years ago, your debtor could still bring that countersuit.

Fair Debt Collection Practices Act Violations

Another pillar of federal regulation of the consumer credit industry is the Fair Debt Collection Practices Act ("FDCPA"), which puts limits on the types of actions lenders and collectors can take when pursuing a debt. For example, it prevents a collector contacting neighbors or friends, it limits the time of day when a collector can call up a debtor, and other forms of harassment. As with the FCRA, the FDCPA was enacted to regulate consumer credit, which means that business debts are not covered by it. When dealing with a sole proprietor or guarantor, your debtor will often labor under the mistaken belief that the FDCPA applies to them, but this is incorrect. When violations of the FDCPA are threatened, they are generally hot air. (Of course, that should not be taken as tacit approval of sharp collection practices, which could be independently actionable. Be civil.)

Common Law Slander of Credit Under State Law

While not being regulated by the above federal statutes is fortunate for business credit in one respect; in another, it opens the door to a different avenue of attack for debtors: a common law defamation action for slander of credit. Under the federal doc-

trine of "preemption," when federal law occupies a field, potentially conflicting state law can be displaced in whole or in part. Certain courts hold that the FCRA partially preempts defamation claims; however, as business credit is not covered by the FCRA, there is nothing to prevent your sole proprietor/guarantor suing for defamation.

The elements of a typical state law claim for defamation are: (1) publication; (2) of a statement of fact; (3) that is false; (4) and made with negligent disregard for the statement's truth or falsity; and (5) made without privilege. Certain statements can attract the characterization of "defamation *per se*," which means no explanation of their defamatory nature is required to be proved. One such category of defamation *per se* are statements which tend to injure a person in their business or profession. Needless to say, a false claim that a person fails to honor their business debts would be such a statement. Thus, reporting a sole proprietor/guarantor to collections should be done with caution if there is a suggestion that a customer is disputing the debt's validity. If you are going to be suing them anyway, there is little to be gained.

The possibility of a countersuit for defamation also provides another reason why a demand letter is a good practice before proceeding with more heavy-handed collection methods. A defamatory statement must be published to a third-party to be defamatory. A letter not addressed to any third party does not do this; and if it elicits no response from your debtor, the chance of a dispute cropping up later is less likely. But remember, while caution is always an advisable approach, don't be too scared — truth is always an absolute defense.

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