



The Fair Credit Reporting Act, Credit Reports And The FTC's Recent Legal Opinion: What It Means To The Credit Professional

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A credit application and personal guarantee are important tools for a credit professional to reduce commercial credit risk. An equally important tool for the credit professional in analyzing commercial credit risk are credit reports, both business and consumer. The Fair Credit Reporting Act (“FCRA”) is federal legislation that governs consumer credit reports, and may affect how a credit professional gathers information to make a commercial credit decision.

The Federal Trade Commission recently issued a legal opinion in response to the National Association of Credit Management’s request as to whether a vendor extending commercial credit must obtain written consent from the consumer prior to pulling a consumer credit report for business purposes or for a personal guarantee of business credit. The FTC states in its legal opinion that a vendor must obtain the consumer’s consent prior to pulling a consumer credit report, even for a legitimate business purpose. What is the FCRA and what does the FTC’s recent legal opinion mean to the credit professional?

The FTC’s Legal Opinion

The FTC is a federal regulatory agency responsible for enforcing certain legislation, including the FCRA. NACM requested the FTC to provide an opinion to the legal question whether a vendor extending commercial credit must obtain consent prior to pulling a consumer credit report to be used for business purposes, or for a personal guarantee of business credit. The FTC states that a vendor must obtain the consumer’s consent prior to pulling a consumer credit report. However, the FTC made clear the scope of the FCRA is limited to consumer credit reports: “we interpret it to mean that reports to business [vendors] by commercial reporting services such as Dun & Bradstreet, which compile data and provide such reports only for commercial purposes, are not covered by the FCRA.” Opinion at p. 2.

Legitimate Business Purpose Exception Not Recognized

FCRA as a general rule requires a trade credit grantor to obtain written authorization from an individual to run a consumer credit report. Prior to the FTC opinion, there seemed an exception to FCRA where consent seemed not to be needed if there is a legitimate “business purpose” in connection with a credit transaction. The general language of the business purpose exception seemed to suggest that a business need may be sufficient to allow a credit professional to pull a consumer credit report without authorization from the individual if extending commercial or trade credit or obtaining a personal guarantee, such as a corporation’s president. The FTC opinion does not recognize the business purpose exception. The FTC notes that the business exception “provides no authority for a [vendor] to obtain a consumer report in connection with a credit application for any commercial purpose.” Opinion at p.3. The FTC opinion also does not recognize a right to pull a consumer credit report for a personal guarantee without first obtaining consent: “there is no permissible purpose too to obtain a consumer report on a corporate principal to evaluate the capacity of the company to pay a judgment.” Opinion at p. 3.

It should be noted that credit information providers, such as Experian, are generally not a safe harbor for vendors that contract with the information provider for credit reports. Thus, if a vendor fails to obtain authorization to pull a credit report and the report is pulled through the credit information provider’s service, the vendor may be liable for violating FCRA. The contract between the vendor and the credit information provider generally states that the information provider is not liable for the vendor’s failure to

obtain a consumer's consent.

Are Consumer Reports Relevant With Commercial Credit Extensions To A Corporation, LLC or Partnership?

Why should a credit professional considering extending commercial credit to a corporation, LLC or partnership be interested in pulling a consumer credit report? Consider the following.

You learn that your new open account corporate customer has gone out of business. Newspapers report that your corporate customer had orchestrated a bust-out and the president of the company has fled. Most frustrating, you learn too late that the president who orchestrated the bust-out has a personal history of defrauding creditors; and that the president's personal credit history reveals several judgments and a personal bankruptcy. Could you have headed off this problem earlier by obtaining a personal, or consumer, credit report on the president in connection with credit application?

In analyzing whether to extend trade credit to a closely held corporation, a credit professional may wish to review the president or shareholder's personal credit history. Often the payment history of such a corporation is a reflection of the payment history of the officer or shareholder. Likewise, to reduce risk of non-payment, a credit professional may seek a personal guaranty from a corporation's shareholder or officer, or limited liability corporation's member, before extending commercial credit. In connection with this guaranty, a credit executive may wish to review the guarantor's personal credit history.

The FCRA's Purpose

The FCRA regulates the use of individual credit reports and credit information. As noted in the FTC opinion, generally the collection of business, trade, and commercial credit reports are not covered by FCRA. The FCRA insures that credit reporting agencies, and the users of such reports, will respect a consumer's right to privacy by pulling consumer credit reports only after express written authorization of the consumer.

What Is A Credit Report?

As noted, the FCRA governs consumer credit reports. However, given the various forms of credit information now available over the Internet, what is a credit report under the FCRA? A credit report may be any written or oral communication bearing on a consumer's credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living. The credit report must be either used or expected to be used, or it must have been collected in whole or in part, for a "permissible purpose."

Notification If Credit Is Declined Based Upon Credit Report

The FCRA requires that a credit grantor provide notice to the consumer if the credit grantor is denying credit, or otherwise taking adverse action with respect to the credit application, based upon the information obtained in the credit report. Thus, a credit grantor will provide notice to the company of the denial of credit; the credit grantor must also provide notice to the president, shareholder or guarantor with respect to whom the credit report was obtained.

The notice can be oral, in writing, or electronic. The credit grantor is required to provide the name, address and telephone number of the consumer reporting agency. In addition, the credit grantor must state that the consumer reporting agency did not make the adverse credit decision and such agency is unable to provide the consumer with the specific reasons why the adverse credit decision was taken. Finally, the credit grantor must notify the consumer of the consumer's right to obtain a free copy of the consumer report. Notice must also be provided of the consumer's right to dispute with the consumer reporting agency the accuracy or completeness of any information in the consumer report.

The FCRA In The Internet Age

The Internet is revolutionizing how the credit professional handles credit transactions. Credit professionals are using the Internet for a myriad of credit and financial functions, from credit research and scoring, to automatic invoicing customers through their Web site, to automatic payment posting. Credit departments are loading their web pages with credit applications and guarantees for the customer to retrieve. The electronic credit department has arrived.

On June 30, 2000, President Clinton signed into law the The Electronic Signatures in Global and National Commerce Act (The E-Sign Act). The E-Sign Act makes e-signatures as legally binding as ink-and-paper signatures. The E-Sign Act also eliminates legal barriers to storing documents and sending notices electronically. A credit professional may now engage in e-credit transactions across state lines and the credit sale contract is valid in all states.

Neither the E-Sign Act nor the FCRA should bar a credit professional from obtaining an electronic consent to pull a credit report, and otherwise be in full compliance with the FCRA. However, the E-Sign Act requires that the consumer decides whether to use an e-signature or handwritten signature, and the vendor must conduct test e-mailings before sending out subsequent e-mail notifications.

Verifying The E-Signature To Pull The Credit Report

The FCRA requires a vendor obtain the consumer's express consent to pull a credit report. But how does the credit professional know the e-signature from the consumer authorizing the pulling of a credit report is authentic? Technology to verify a person's identity, so-called digital identification devices, may solve this concern. An e-signature may be verified through a variety of technologies, including smart cards and biometrics. By using the digital verification, the credit professional may confirm the e-signature prior to pulling the credit report.

Penalties For Violating FCRA

The private enforcement provisions of the FCRA permit a consumer to bring civil suit for willful noncompliance with the FCRA, with no ceiling on punitive damages. The consumer may sue for negligent noncompliance, for actual damages sustained. The consumer may also seek to recover the consumer's attorneys' fees. In addition, criminal penalties may also be assessed including fines and imprisonment against any person who knowingly and willfully obtains a consumer report under false pretenses.

Complying With The FCRA

In light of the FTC's opinion, credit professionals should consider obtaining written permission to run a consumer credit. The following type of authorization language should be considered in the credit application and personal guarantee form.

FCRA Authorization Contained In Credit Application

A credit professional extending trade credit may consider including the following language in the credit application to authorize obtaining consumer credit reports on the corporation's individual insiders, or LLC's individual members. This language should be included as a separate form, or addendum to accompany the credit application, as the party that the credit professional seeks authorization is not the same party that signs the credit application. It should be noted that a credit application that provides general authority for the credit professional to pull a consumer credit report on a corporation's officers may be insufficient. Rather, the credit professional should obtain an authorization form from each party that a credit application is to be pulled.

The undersigned consents to [insert: Name of Your Business] obtaining a consumer credit report on _____ [insert—name of the sole proprietor/ President/Officer of corporation, LLC, partnership] for the purpose of evaluating the creditworthiness of _____ [insert—name of the sole proprietor/ President/Officer of corporation, LLC, partnership], in connection with this Application.

Alternatively,

Signed By:

[name of sole proprietor/President/

Officer of corporation/LLC/partnership]

Buyer, hereby grants Seller permission, through its agencies to check buyers credit and/or the credit of any or all of the signers for buyer, at any time for the purpose of establishing the maximum credit.

Alternatively,

Signed By:

[type name of guarantor here]

[Social Security Number and home address]

Seller is hereby authorized to investigate our personal and business credit references. An investigation may include the procurement of an individual credit report and the verification.

FCRA Authorization Contained In Personal Guarantee

A credit professional requiring a personal guarantee for extensions of trade credit may consider including the following language in a personal guarantee form to authorize obtaining a consumer credit report from the guarantor.

The undersigned consents to [insert: Name of Your Business] obtaining a consumer credit report on _____ [insert—name of the guarantor] for the purpose of evaluating the creditworthiness of _____ [insert—name of the guarantor], in connection with an application for business credit.

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