

*Credit Team Due Diligence, Setting Terms  
(Normal and Extended) and Risk Evaluation:  
Antitrust and Contractual Restrictions on  
Information Gathering and Sharing*

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***Abstract***

*This body of work explores the antitrust and contractual restrictions to a credit team's information requests in the credit setting/validation process. The federal antitrust laws - the Sherman Act and the Robinson-Patman Act, as well as social media sites and customer contractual restrictions, are considered as data points and are evaluated in the decisioning of credit risk.*

The credit team has evolved from the customer and sales team's perception of a credit gate keeper (traditional view: the sales prevention department) to one of customer relationship builder through a principled application credit risk management.

But building the customer relationship requires the credit team to undertake and manage information from a variety of sources to evaluate credit risk. The credit team's best practice for new account evaluation may include contacting industry group members and competitors to share payment information to assist in evaluating credit risk. What kind of information can be shared, and a best practice as to the form of the information shared? What of social media sites to assist the credit team with the new account evaluation?

Likewise, the credit team managing credit risk with existing accounts requires constantly reviewing a variety of sources to maintain the risk profile of accounts. As with the new account

set up, what kind of information can be shared and a best practice as to the form of the information shared? What of social media sites in managing the account risk profiles?

And as to recent developments with managing current accounts, what of a customer pushing back on normal terms and insisting on extended terms. May the credit team reject the request after consultation with a competitor that is also supplying the customer? What of the credit team reaching out to industry group members as to whether they have been approached by the customer requesting extended terms?

What are the antitrust and contractual restrictions to a credit team's information requests in these settings? The federal antitrust laws, the Sherman Act and the Robinson-Patman Act, as well as social media sites and customer contractual restrictions, are considered data points when evaluating credit risk.

### **The Antitrust Laws and Credit Team Due Diligence**

Two key federal antitrust laws impact the credit team's information gathering, evaluation and setting credit lines and terms.

#### **The Sherman Act**

The Sherman Act prohibits any person from contracting, creating a combination of trusts, or otherwise conspiring to monopolize or restrain trade. The following may constitute illegal activity under the Sherman Act as they relate to the credit team:

- Agreement between competitors or credit group members to fix credit terms
- Agreement between competitors or credit group members to "black list" or refuse to extend credit, or grant requests for extended terms
- Agreement between competitors to allocate specific customer demographics or geographic territories

While these bright line examples are points that a credit team's best practice is to steer clear from, it's the subtle distinctions that may give the appearance of a collusive agreement that restricts credit. Email exchanges between competitors can be central to the appearance of complicity.

The Sherman Act is both a civil and criminal statute, punishable by fine and/or imprisonment. Violators may receive up to 10 years in prison and fines up to \$1 million.

#### **The Robinson Patman Act (RPA)**

The RPA bars discriminatory pricing. Suppliers may not offer more favorable pricing to one customer without extending comparable prices to similarly-situated customers. Pricing is not limited to the price charged for a particular product. Instead, pricing also applies to the credit function, with such points as:

- Credit terms
- Discounts
- Rebates
- Promotional Allowances
- Shipping Terms

The RPA applies to the credit team at the new account stage, as well as maintaining and terminating the trade relationship. The RPA requires that the supplier offer these inducements to its customers on a comparable basis. The RPA is limited to goods (not services). The RPA is a civil statute, and individual and class action lawsuits can be brought against violators.

### **New Account Setup and Pre-Sale Investigation**

The pre-sale investigation of the customer is a key duty of the credit team with managing credit risk. Identifying red flags in the credit evaluation process allows the supplier to refuse to sell on terms or condition the sale on credit enhancements, such as a personal guaranty, purchase money security interest, or letter of credit, to reduce credit risk.

### **Supplier References**

One method to gather credit information on an applicant requesting credit, or with an existing customer and an account review, is supplier references. Trade references, whether requesting or supplying, should be in writing, which may include email. The following are data points to include in a supplier reference:

- Customer since \_\_\_\_\_
- Sold since \_\_\_\_\_
- Last sale was \_\_\_\_\_
- Present balance is \_\_\_\_\_
- High credit is \_\_\_\_\_
- Days past terms \_\_\_\_\_

These data points assist the requesting supplier to independently evaluate the applicant's credit risk. The reason credit terms are not included with supplier references is that it may lead to a supplier simply relying on the reference's terms, rather than doing their own due diligence. This can give the appearance of an agreement to set terms, which may be a violation of the Sherman Act.

### **Customer NDAs and Contractual Restrictions with Information Sharing**

Credit teams evaluating whether to extend terms to privately held companies commonly experience those customers refusing to provide their financials. As an inducement to coax the customer to share financials, the credit team may offer a non-disclosure agreement (NDA). While the NDA provides information sharing between supplier and customer, the NDA contractually restricts the supplier from sharing the financials with competitors or industry group members requesting information.

## **Social Media as a Supplemental Source to Evaluate New Accounts and Monitor Existing Accounts**

As discussed fully in my article “Customer Silence in the Age of Information: A Supplier’s Alternatives to Identify and Respond to Credit Risk Flags” published by CRF in Q2 2016, the credit team is free to use social media as a source to assist with credit risk evaluations in selling to the B2B space.

Credit teams have been counseled for decades on the application of the antitrust laws with the credit information gathering and sharing with traditional sources of information. Those same antitrust issues for credit dealing with traditional sources of information, has equal application with modern sources of information, such as social media. For example, a supplier may use social media as a basis to change credit terms, credit lines or hold orders based on a customer’s higher credit risk rating. Social media thus may be used to reclass the customer under a shorter terms RPA classification. By contrast, the Sherman Act can limit the sharing of social media data between competitors, including industry group members, such as with a negative Yelp rating or Linked In comments, where such information is the basis to collectively agree to deny or restrict credit.

Social media may also be a basis for the supplier to decline the applicant’s request for credit, or terminate the credit relationship. For example, at the new account stage, the credit team may evaluate the lack of a social media presence by the customer as negatively impacting the applicant’s request for credit, requiring the credit team to more closely scrutinize traditional information sources as to whether the applicant may be opened for terms. Likewise, the credit team may use social media sites, such as GoogleEarth, to confirm representations made by the applicant in the credit application. To the extent that social media sites validate inconsistencies, the credit team may refuse to open the account, and such a credit decision is consistent with the principles of the Sherman Act, provided the credit team acted independently with its evaluation of the social media data, and did not agree with other suppliers not to open the account.

The social media data may trigger the credit team to give an Equal Credit Opportunity Act (ECOA) adverse action notice that the applicant was denied credit, or the existing customer’s credit line was terminated. The ECOA notice does not require the supplier to identify social media sources as the basis for denying credit.

### **Ask and Ye Shall Learn: But How Much to Ask and How Much to Share?**

The mission of the credit team evaluating whether to extend terms or support a TPS is current information, whether from traditional data sources or modern sources, such as social media, which creates transparency and better decision making by the credit team and recommendations to management.

The credit team today has access to far more sources of information to better evaluate a customer’s risk profile. However, the credit team must appreciate the limits of information gathering from traditional sources of information, including industry group members, as well as social media sites. The federal antitrust laws, as well as contractual restrictions, may limit how

the credit team shares this information and acts upon it. As more credit teams embrace modern sources of information, such as social media sites, to assist with better evaluating credit risk, these modern sources of information still require the credit team to abide by the antitrust principles the credit team abides by with traditional data sources.

### **Customer Credit Information via Industry Groups**

Another step with the pre-sale investigation is to share customer payment history with competitors. The credit team, especially junior team members, must be careful with this source as the closer the supplier's credit team works with competitors, and the more credit information they exchange, the closer the supplier comes to violating the Sherman Act.

For this reason, the credit team should restrict discussion of credit information to industry group and credit group meetings, where the hosting association monitors the discussion, ensuring there is no conspiring amongst competitors.

- Discussion is limited to factual, completed transactions;
- No discussion of profit level, volume of production, discounts, rebates or shipping costs;
- No discussion on the acceptance, rejection, termination of, or refusal to sell specific customers; and
- Competitors do not meet informally after the official meeting.

The information gleaned provided from customer reference exchanges and credit group meetings is confidential. The credit team must safeguard the confidentiality of the information, including from the sales team.

### **Supplier (and Customer) Setting Credit Terms Under the RPA**

#### **Setting Credit Terms on New Accounts**

The credit team navigates credit term and credit line restrictions under the RPA by classifying their customer base according to the following factors:

- Customer's functional level (Wholesaler? Retailer?);
- The type of product the customer purchases (i.e. grade and quality); and
- The geographic region in which the customer does business (the customers' sales territories must overlap).

If the new account and one or more of the supplier's customers meet these factors, then those customers will fall under RPA's like-customer evaluation. If the supplier offers the new account more favorable pricing than it does with existing accounts, it may be in violation of the RPA.

The classification factors must also be balanced with the credit team's risk evaluation. This means the credit team's due diligence impacts the application of RPA and provides a foundation to treat higher credit risk customers in a different class than they otherwise would, and justifies shorter terms for this type of customer.

## **Supplier Changing Credit Terms on Existing Accounts**

Credit terms and credit lines are not static in an evolving trade relationship. Credit teams change terms and lines in response to a customer's financial standing. Thus, the antitrust laws allow for credit term changes, provided the change is: (1) based on the customer's credit worthiness; (2) is not intended to give the customer a competitive advantage or leave it at a disadvantage; (3) is decided upon unilaterally (rather than agreed to by competitors); and (4) does not constitute discriminatory pricing.

## **Customer Changing Terms (or Attempting to): Term Pushback Strategy (TPS)**

Customers continue to rollout extended terms to their supply chain and disregard supplier-set terms to better fit their working capital and cash flow needs.

## **Querying Industry Group Members, Direct or Indirect**

Credit teams appreciate that industry groups can provide timely financial information of customers, including customers moving suppliers to extended terms. Where the customer is adopting an informal TPS, the credit team receiving the TPS may seek, as part of its credit evaluation, whether industry group members have also received the request and whether they have agreed. The reason industry groups exchange customer terms, in part, is to enable members to determine whether a customer is past due.

However, there are risks for members to discuss terms without industry group leadership oversight, whether in-person or through email. A best practice for credit teams is to request the industry group leader to solicit members as to whether they have been approached by a customer rolling out a TPS. Consider the following query:

*A member received a demand for extended terms from [customer]. Please respond whether you have been approached by the customer, but do not share your plan of action, as it may be an inappropriate discussion on terms. The results will be shared with the group.*

Industry group members generally start with the principle that they, as a company, and industry, are better served with all customers' TPS requests being rejected. But the group response to TPS runs afoul of the Sherman Act and collusive behavior to restrict credit. And the reality is that industry group members are competitors, and because of this, are looking for opportunities to gain a competitive edge, which includes using extended terms to buy market share.

However, a best practice for industry group members is to avoid the appearance that they have agreed to restrict a customer's terms by collectively responding to a TPS. However, per the Sherman Act, industry group members *cannot* collectively agree to reject the TPS in order to keep the customer within terms. Any rejection of a TPS must be done unilaterally.

## **TPS and the Antitrust Laws**

The essence of credit terms discrimination under the RPA as it relates to the credit team is that two or more competing customers are charged different terms for the same product. The credit team's first step is attempting to classify its customer base. There is no RPA liability where the customer pushing the unilateral TPS does not directly compete with any of the supplier's other customers. Where there are multiple competitors, however, the RPA applies.

The RPA applies to discriminatory terms and credit lines, regardless of whether the supplier or the customer is setting the more favorable pricing. Even where the customer's TPS sets the favorable terms, the supplier may be liable under the RPA.

If the supplier is not willing to extend terms, the credit team may use the RPA to resist a customer's TPS. When presented with a TPS, the supplier may underscore to the customer that, under the RPA, allowing a customer to extend the terms of a trade relationship is no different than the supplier setting the extended terms.

## **The Sales Team's Aid?**

The sales team has a financial interest in the credit team's response to an applicant's initial request for credit, as well as an existing customer's request for extended terms. To that end, the sales team may try to assist in the evaluation by undertaking its own information gathering. While the sales team may aid in the information gathering through their own contacts with competitors, the restrictions the credit team is bound by according to the federal antitrust laws has equal force to the sales team. Likewise, the bylaws of credit industry groups bar the sharing of group information with sales, which extends to industry group responses to a TPS inquiry.

## **Ask and Ye Shall Learn: But How Much to Ask and How Much to Share?**

The mission of the credit team evaluating whether to extend terms or support a TPS is current information, which creates transparency and better decision making by the credit team and recommendations to management. As discussed, that information to grant or refuse terms, or approve or reject a TPS, comes from a variety of sources, including industry group members.

The takeaway is the credit team must appreciate the limits of information gathering from industry group members as provided by the federal antitrust laws, even where that information crystalizes the potential credit risk. The credit team, especially junior team members, must appreciate their role as to both when they request credit, or make demands for extended terms.

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