“Uniform Commercial Code”

The “Uniform Commercial Code” or “UCC” is basically the codification in the U.S.A and elsewhere of what is referred to internationally as the “Law Merchant” or “Merchant Law.” Like those for Statutory entities, there are basic rules governing commerce between Companies, States and even Nations. Rules governing the sale of merchandise, contracts, delivery of goods, shipping and receiving and which party or parties are responsible at each point in a transaction. Procedures for Invoicing, Bill of Laden’s, Insurance as well as rules for Negotiable Instruments and their Acceptance, Honor, and Dishonor and Discharges are also included.

Just as with those statutes governing artificial statutory entities the UCC will take precedence over terms and procedures not otherwise written or agreed to between parties. As an example, if you Invoice (bill) another company for goods previously sold and shipped to them and they pay late or fail to pay and you are forced to bring suit to collect; if on your original invoice no interest penalty was declared for late payment none will be collectible. However, if you Packing Slip and Invoices declare an interest rate for late payment or cost of collection if necessary then these amounts may be awarded since the customers' previous acceptance of the goods is considered an acceptance of the terms on your Invoices for the goods.

Whole books can and are written on this topic alone. My purpose here is to simply call your attention to the fact that if your business involves more than point of sale purchases you may have issues that need consideration. As another example, you sell a heavy piece of equipment to a company some distance from you. When is the equipment considered to be the customers? After he pays for it but while it still sits in your place of business? Or after you put it on a truck to have it delivered? When the truck leaves your place of business is it the customers? Or when it gets there in good condition? If an accident occurs in route, you may claim it left your hands and was fine. But your customer may claim he never received it, so you still owe him what he bought.

As you can see from the above example and questions not having shared expectations or being ignorant of the standard practices could leave you with unexpected losses and obligations. In the above example if it’s clear to the customer that it is his equipment the minute it leaves your dock, then he will be sure to take responsibility for its being insured from that point. If on the other hand it has been agreed you will deliver it safely to his place then said insurance or risk is on you. From these examples, it should be clear how important your Forms, Paperwork, and Agreements are to reducing risk, misunderstanding, lawsuits, and loss.

By looking for the Uniform Commercial Code or UCC on most State’s Secretary of State’s business web site, you will find a Registration System for Debtors and Creditors. By filing a UCC-1 Form, a Creditor can name a Debtor and give Public Notice of Security Agreements. In much the same way a bank will record a mortgage with the County Recorder against Real Estate or place a lien on the Title of your vehicle with the Registry of Motor Vehicles it, or any other Creditor can put a Lien and Public Notice against an individual or Company’s Assets.

Although most large equipment such as milling machines, lathes or even bulldozers and tractors have Serial Numbers, Models and Makes, there is no central place of registration for these and other Business Assets. Therefore when such assets are sold on credit or placed as collateral the UCC-1 Form is documented and registered to show the Security Interest one individual or company has in another. It serves as Public Notice to all others that their claim against the same Debtor may be unsecured o subordinate to the earlier claim. Therefore as a Creditor, it is important to use this Registry to establish the priority of your claim or recognize your extension of credit will not be superior. As a Debtor it is important to be sure Creditors release their claim once they are no longer owed. Filings are usually posted for a set period such as five years. If your Debtors still owe you should be sure and renew your claim, or it will drop off. Likewise, Debtors need to be sure if their debt is cleared to have it released otherwise it may cause a delay if you seek Credit elsewhere and the new Creditor may believe them self to be subordinate to another claim. In some instances, a new Creditor may ask you to convince a previous Creditor to subordinate their claim to receive the new Credit.

In any case, it should be noted since we have all heard the caveat “Buyer Beware,” that if you are considering buying machinery, heavy equipment or other business assets from an individual or a business, it is your responsibility to check the Registry for liens. Should you make a large purchase of such items and fail to do so, you may be surprised to find that a Registered Creditor (lien holder) may take back his collateral (the machine you bought) from you and leave you an unsecured Creditor chasing the person you purchased from for satisfaction. And you have also probably heard the old saying, “You can’t get blood from a stone.” Or like the Rolling Stone’s hit song, “I can’t get no (satisfaction).”

Another scenario you should be careful of if you borrow money from a bank or Lease Company for a piece of equipment, for instance, is the wording on the claim. You may have no choice if you want the loan but to allow a UCC-1 filing against the equipment you are purchasing. However, be careful that along with listing the Serial Number and description of the equipment that they are securing that they have not made broad general statements regarding other equipment and assets you own already or such things as receivables and future income, etc.. etc.. or they will have the first claim on all of it. This could affect future decisions and credit while their debt remains outstanding.

While on the topic of Creditors and Debtors, lending and borrowing when in business your company has the potential of being both a Creditor and a Debtor. If you invoice customers in your business and allow payment after the fact by any span of time your business is a Creditor and your customer a Debtor. At the same time, if you are allowed to pay your bills after receiving them, you are a Debtor to your Vendors. Always be mindful of the fact that when you allow Debtors to owe you that you are either extending or lending them your own equity or savings, or, you are re-lending them that which has been loaned to you.

For example, let’s say that you owe a machine company that produces a product made from brass. Your supplier of brass bars which you make your products out of allows you to buy as much as $20,000 worth at a time. This means you have a $20,000 Credit line with them. Now if you sell this brass product to your customers and allow then 30 days to pay the Invoice you send them. Then depending on the number of them and the amount you extend to each, in essence, is the amount of the Credit line you have with your brass supplier that you are passing on to others. Therefore extreme care should be taken to consider the number and amount of Open Accounts you allow your customers so as to prevent any one or more of them from affecting your Company’s Credit. For example, allowing 20 different customers each $500 Credit line would be a risk of 50% of your credit line but considering the chance that 20 different customers will all become slow or non-payers all at once is very minute, hence not very risky. However, should you allow only a couple customers $5,000 Credit lines the risk becomes much greater and any one or more could seriously affect your ability to pay your Creditor.

The bottom line is even if you have customers larger and more creditworthy than your own company that does not put you or your business in a position to extend credit beyond your means. The above examples are simplified to make a point. Although a company may have multiple sources of credit from banks, vendors, lease companies, etc.. any company with large Accounts Receivable (outstanding invoices) needs to keep an eye on their overdue accounts. Realize that every dollar of interest on borrowed funds, equal to the amount of overdue funds owed you, is interest you are paying on behalf of others. (Lost Profits)

Many small companies and even large ones at times use their existing inventories of product and supplies or their receivables (outstanding invoices not yet paid) to borrow money to keep operations going. These techniques can be very beneficial to the rapidly growing company with restricted Capital or cash flow. It can allow for a small company to fill a huge order they might otherwise need to pass on and help add important new customers and business to their market share.

You may hear these described as Receivable and Inventory financing (loan) or Factoring Receivables. Usually, a company pledges inventory, assets and outstanding invoicing as collateral for loans against a certain percentage of the outstanding receivable or existing inventory. Payments are scheduled and maintained against a ratio of the outstanding invoices actually loaned against. Payments can increase if your customers become slower at paying you back within terms. For instance, you have a huge order that just came in, and you need to buy the materials to make your product and make the sale. So you take invoices that you have already sent out to customers who owe you say $20,000 and should pay within 30 days. This $20,000 of invoices is pledged to the Factoring Company (Private Lender) who agrees to lend you up to 75% of the outstanding invoices (your receivables). In this case $15,000 for a 2% discount of the invoices with a .25% per day penalty for invoices over 30 days old. So you take your $15,000 advance against your invoices and use it to enable you to buy raw materials and meet other costs associated with filling your new order and creating yet more invoicing.

If 80% of the invoice you pledged pay within the 30-day term you gave to them and say the other 20% take an extra month you will pay the Factoring Company (Lender) a total of $700. This is 2% of the pledged invoices (20k) or $400 plus .25% per day on the late 20% portion of the invoices (4k x . 0025 x 30 days) or $300 for a total of $700 on loan. If you continue to borrow against the new invoicing at the same average amount and rates that constant $15,000 advance annualized would cost the Company $4,000 in interest for the year. The Factoring Company would be producing a 28% percent rate of return on its Capital lending for its investors.

This is a great money maker for the lender and an acceptable deal or necessary evil for the rapidly growing small business in need of Capital for growth. However, this is an absolute death kneel for any small business who selects these methods to overcome financial problems, slow business or having overextended credit to slow paying customers.

If the only way you can create or increase business is by extending credit and payment terms, you need to take a hard look at your pricing or the actual viability of your business model. If you have a good and desirable product or service but do not have the Capital or size to open accounts let those customers claiming to have excellent credit for which you should be willing to extend terms go out and get a loan, use Visa or Master Card or Letters of Credit from their own Bank.

For instance if you have a high priced product or service which you do not want to release or perform until payment is received but consequently the customer does not wish to make payment for until it's received and determined to be genuine or as described the reluctance on each side can be satisfied with a “Letter of Credit'. This is a situation that takes place often with international transactions. No U.S. manufacturer, for instance, wants to ship costly goods or materials to a country overseas and hope to be paid once they get there. Nor does the overseas customer wish to make payment to a Company here and then find the goods were never sent. The cost of going to and then dealing with an unknown legal system of the other jurisdiction in an attempt to get satisfaction is prohibitive. One bad transaction could eliminate the profit of many good transactions.

These risks may be overcome or significantly reduced by the use of "Letter of Credit." If a customer in the Foreign location is indeed trustworthy and creditworthy, he can place funds with or be extended credit by his own Bank. In turn, his bank will send a Letter of Credit expressing its willingness to pay the invoice irrevocably, upon the meeting of certain conditions by the seller. This promise is made to the seller's Bank by the buyer's Bank. The conditions usually include Shipping Manifests showing goods shipped and quantities from one point and their subsequent arrival on Bills of Laden at the arriving point at which time funds are released Bank to Bank. Some Quality Control or other criteria may also be a part depending on the particulars in various industries or service sectors.

As stated previously this report is not meant to be a comprehensive discussion on UCC Law or the topics associated with it. It is intended only to make its existence known to the new small business owner along with some considerations and issues in which more knowledge may need to be sought out.

I hope the preceding report or information has been helpful and that it provided you with some information you did not previously have. If you have any unanswered questions or would be interested in exploring further options for business or estate planning please feel free to contact us.

We offer a free first consultation which typically runs from 30 to 60 minutes. In that time we give a short overview of the services we provide and attempt to answer any questions you may have and to discern what services if any that we may be able to provide you with. We are not high pressure and will not ask you to make any purchase or decision during that time.

We will take the information offered by you and prepare a quote or estimate for any services you may have an interest in. We will provide that quote or estimate within a day or two of the free consultation by whatever means you prefer ie email, phone, fax or postal mail. It will be up to you after that whether to contact us again or not. We will not send endless emails, make harassing phone calls, or send continuous junk mail and we will never provide your information to other companies for any reason.

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