

THE COMMERCIAL FACTOR

W04
Newsletter for the Factoring Industry

• Volume 6
• Number 1
• Winter 2004



International
Factoring
Association

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A Publication of:

THE INTERNATIONAL
FACTORING ASSOCIATION

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San Luis Obispo, CA 93405

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San Jose, California

FIRST REGIONAL MEETING A SELL OUT!

The International Factoring Association held their first regional meeting on November 20th at the Silicon Valley Capital Club in San Jose, CA. The meeting surpassed our expectations and ended up as a sell out.

Attendees came from as far as New Jersey to network and listen to the featured speaker, Bob Zadek, Esq. The meeting started at 6PM with champagne drinks and appetizers. Dinner was served in The Library followed by some interesting topics including:

- Avoid the most frequently litigated factoring issue
- Design and sell factoring-related financial products
- Avoid the most insidious priority trap in factoring.

With an interesting mix of attendees from brand new factors to very experienced factors, everyone was able to gain some new information and meet some new people.

The attendees seem to favor quarterly dinner meetings. The IFA is looking to establish these meetings in various locations throughout the world. If you are interested in helping in any way with getting these meetings started, please contact Bert Goldberg at info@factoring.org

The IFA would like to send a special thanks to our Board Member, Gail Schulte for arranging the meeting facility and Bob Zadek for speaking.



 Bert Goldberg is Executive Director of the International Factoring Association. He can be reached at 805-544-8327 x12 or email him at bert@dissol.com.

Many of us in the factoring industry have turned to the IFA for legal insight and practical assistance. To date, the primary vehicles for legal insights have been our annual IFA Conventions, IFA telephone conferences, and our nascent IFA member internet discussion group. Without question, time and again, each of these alternatives have proven very helpful to interested members. Whether we have been graced with words of wisdom from industry legal practitioners at IFA workshops and teleconference calls, or practical advice from industry veterans in our discussion group, each of us has benefited from the experience.

Your IFA Advisory Board would like to make you aware of yet another powerful new method of legal assistance. Over the last couple of years, IFA Board Advisors have been eager to bring the resources of the IFA to bear on broad legal matters that affect our industry. The IFA has only now become fiscally able to consider offering expert legal assistance to our members who may be affected by a case that could eventually prove truly injurious to our industry.

To date, each of us, as factors, has had to conduct our own pursuit of our legal rights. Every factor knows all too well that entrance to our industry is usually accompanied by legal actions to protect our contractual rights to invoice collection. Virtually all of us have had to pursue account debtors for wrongful payment after due notice was delivered. All too often however, we encounter Courts with very little awareness, experience, and understanding of what we, as factors, do. Without first-hand experience with UCC Article 9-406, many judges are unsympathetic to our account-debtor claims.

Sometimes Courts, despite clear direction under Article 9-406, rule against us. Upon expensive appeal to higher Courts, these decisions are normally reversed... but what if an Appellate Court also missed the mark and upheld the lower court's initial finding? Such an injustice could be adversarial to our industry as a whole!

Another example might be wrong-headed decisions from Courts regarding their interpretations of Estoppel law and case analysis. A 'bad' decision from an appropriate Court could have a chilling effect indeed on our ongoing ability to assist the commerce of our land.

Because of potential judicial nightmares such as these, your IFA wishes to provide some assistance. Obviously, budget pressures and IFA resources are limited to only the most threatening of cases. As such, the IFA can not, and will not, supplement your on-going legal costs of business (unfortunately, plaintiff litigation is a customary cost of doing business!). Instead, the IFA wishes to remain advised of court actions that truly threaten our industry's way of doing business. Let's face it, Article 9-406 is the legal lynchpin of our industry's existence. If an adversarial ruling were to arise, without industry intervention, we could all be irreversibly damaged.

Accordingly, the IFA is pleased to announce our new Legal Assistance Program. This program is not designed to invite an avalanche of requests for assistance on hundreds of pending legal matters involving IFA members. Instead, it is the Advisory Board's intention to be extremely selective about those cases where industry intervention is warranted. This is an effort limited to the most serious of cases that could adversely affect our industry, and is intended to be

an adjunct to your ongoing legal action(s).

As for our level of IFA legal assistance, we currently envision it to be limited to Amicus (Friend of the Court) Briefs. We only intend to take action on those few cases where an adversarial ruling is reasonably possible, and where one would have significant negative effect on the way we conduct our business.

It is currently envisioned that these Amicus Briefs would be authored by IFA General Counsel or their legal designees. We expect to commence this program on or after April 1, 2004. Our procedure for selection will involve an application process (\$100 non-refundable fee) coupled with a complete submission of the legal briefs, (complaint, pleadings, answers, and relevant documentary evidence) related to the case

After careful review (to be conducted by IFA General Counsel and a legal review committee designated by your IFA Board of Advisors) those applications with applicable merit will be selected to obtain Amicus intervention from the IFA. We expect that this new member benefit will be welcomed by the IFA membership. As our Association continues to expand and mature, we hope to broaden the appeal and use of this program.

Obviously, current IFA membership is required for assistance under this member benefit. Applications for consideration can be downloaded from the IFA website at www.factoring.org

Finally, we would welcome your feedback to this new program. We assume that the membership will find this to be a welcome new addition to member benefits, however, our modest budget doesn't allow for frequent use of this beneficial tool. We need to know: "Would members be willing to increase IFA membership dues in exchange for an expansion of this new program? Let us know what you think by emailing us at info@factoring.org

 Ken Walsleben is Principal of The Hamilton Group. He can be reached at 800-351-3066 or email him at ken@hamiltongroup.com.

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Finance Company Services

The 10th Annual Factoring Conference, to be held in Miami Beach, is shaping up to be the largest and most interesting conference to date. Registration is running ahead of all previous years.

The conference will be held April 21st - 24th at the Eden Roc Resort & Spa in Miami Beach, FL. The Eden Roc is a Renaissance Hotel, which is the upscale division of the Marriott chain. This beautiful Art Deco hotel was built in 1955 and has recently undergone a \$14 million renovation. If you are thinking about attending, here is some important information for you:

Registration:

Register soon, early registration ends January 31, 2004. Early registrants will save \$50 per attendee. You can register via:

- Web Site at www.factoringconference.com
- Phone at 800-563-1895 or 805-544-5724
- Email at conference@factoring.org
- Fax to 805-544-3905
- Mail to: 2004 Factoring Conference, 555 Chorro Street, Suite B, San Luis Obispo, CA 93405 USA

Hotel:

The Eden Roc is a 349 room hotel. If you do not reserve your room early, you may not be able to stay at this beautiful property. Room rates are only \$199, but you must reserve by March 21, 2004. The Eden Roc can be contacted by calling 800-327-8337 or 305-531-0000. You must indicate that you are with the "Factoring Conference".

Airlines:

American Airlines is the official airline for the conference. They are offering a group rate on all flights. Additional discounts are available if you reserve 60 days in advance. To take advantage of the discount, contact American Airlines at 800-433-1790 and refer to designator AN# A4844AA.

Rental Car:

Although transportation is provided for all conference activities, you may wish to do additional sightseeing around Florida. Avis is the official rental car agency for the conference and is offering a group rate for all rentals. You can contact Avis at 800-331-1600 or www.avis.com. Our discount number is S820399. If you are planning to rent a car, note that the hotel charges \$20 per day parking fee.

Activities:

We have scheduled many activities to allow you to explore some of the interesting areas of Florida while networking with other conference participants. This year we will be featuring:

- **Golf:** Wednesday April 21, 11 AM to 5 PM. This year's golf tournament will be at the Miami Beach Golf Club. This course is only minutes from the hotel. The course has recently undergone a \$10 million renovation making it one of the most unique and premier courses in the area. Your \$140 fee includes transportation and lunch. We will be featuring a shotgun start.
- **Deep Sea Fishing:** Wednesday April 21, 12 PM to 5 PM. This is a new activity which will allow non-golfers to network with other conference participants. The \$140 fee includes the boat trip, transportation to the boat, fishing instruction, bait and lunch.
- **Welcome Reception:** Wednesday April 21, 5:50 PM to 7:30 PM. This year's welcome reception will be hosted by ACFC

and is open to all conference participants. Appetizers, drinks and entertainment will be provided.

- **Guest Tour:** Thursday April 22, 9 AM to 3 PM. Our guest tour will be a tour of Miami Beach. The tour will highlight many of the most beautiful and interesting areas of the diverse city. The \$85 fee will include transportation, guided tour and lunch.
- **Hospitality Suite:** Thursday April 22, 7 PM to 10 PM. Sponsored by Metro Financial Services, the Hospitality Suite is open to all conference participants. Appetizers, drinks and entertainment will be provided.
- **Banquet Dinner:** Friday April 23, 7 PM to 10 PM. The banquet dinner is one of the highlights of the Factoring Conference. This year's dinner will be held on the beach at Nikki Beach Restaurant and Bar. Appetizers, drinks and a gourmet dinner will be provided. Nikki Beach is considered to be the premier hot spot in Miami Beach to enjoy "Paradise on Earth". Transportation will be provided.
- **Operational Round Table:** Saturday April 24, 9 AM to 12 PM. Historically this has been one of the biggest benefits of the entire conference. Factors are given the opportunity to discuss various operational issues with their peers in an informal round table environment. Continental Breakfast is provided.
- **Snorkeling/SCUBA Diving:** Saturday April 24, 9:30 AM to 7 PM. Our undersea adventure will be at the John Pennekamp Coral Reef State Park by Key Largo. This is America's first undersea park and will provide excellent diving opportunities. Transportation, boat trip, dive equipment, lunch and snack are provided. The fee is \$110 for snorkeling and \$160 for SCUBA (must present a valid SCUBA license).

[CONTINUED ON PAGE 4](#)

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Speakers:

This year's lineup of speakers is one of the most diverse and interesting we have ever had. All speakers were selected for their in-depth knowledge of the topics as well as their ability to pass on useful information to the participants. The schedule is:

Thursday, April 22		
9:00 – 9:30	IFA Update	Bert Goldberg
9:30 – 11:00	Wall Street & The Economy	Peter Ricciuti
11:30 – 1:00	Money Laundering	Charles Klingman, Steve Kurtz, Esq., Saskia Rietbroek, Ken Walsleben
2:30 – 4:00	Recent Rulings affecting the Factoring Industry Invoice Stipulations (Missing or Stated) That May Give You Nightmares What Can a Government Agency Require of You That Makes Your Notice of Assignment a Miserable Task?	Mike Ullman, Esq.
2:30 – 4:00	Maverick Marketing	Terri Langhams
2:30 – 4:00	Factoring 101	Gail Schulte
4:30 – 6:00	Workout Scenarios	Wayne Coker, Wade Hladky, Lee Shodiss, Debra Wilson
4:30 – 6:00	Memory Improvement	Jon Keith
4:30 – 6:00	Factoring 102	Ron Winicour

Friday, April 23		
9:00 – 9:30	Technology and Factoring	Bert Goldberg
9:30 – 1:00	The Law of Factoring - In Depth and Dirty	Bob Zadek, Esq, Barkley Clark, Esq.
2:30 – 4:00	Understanding the Paper You are Buying Is the Underlying Collateral Really There? What Information Do You Need For Various Industry Types?	Jay Atkins, John Beckstead, Esq., Allen Ferderic, Jr., Darla Hill
2:30 – 4:00	Team Building	Dr. Joaquim de Posada
2:30 – 4:00	The Importance of Periodic Accounting, Operational and Credit Reviews	Amy Breslin, CPA Brian Young, CPA
4:30 – 6:00	Fraud Panel	Vinnie Galano, Jr., David Marrin, Bret Schuch, Mark Weinberg
4:30 – 6:00	How Do You Measure Up? What Distinguishes You From Your Competition?	Richard Worthy

For anyone involved with the Factoring Industry, this conference is a must attend event. We are looking forward to seeing you there.



Bert Goldberg is Executive Director of the International Factoring Association. He can be reached at 805-544-8327 x12 or email him at bert@dissol.com.

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The International Factoring Association's (IFA) goal is to assist the Factoring community by providing information, training, purchasing power and a resource for Factors. The IFA provides a way for Commercial Factors to get together and discuss a variety of issues and concerns to the industry. Membership is open to all banks and finance companies that perform financing through the purchase of invoices or other types of accounts receivable.

The Commercial Factor invites the submission of articles of interest to the Factoring Industry. For more information on submitting articles or advertisements, please e-mail info@factoring.org, or call 800-563-1895.

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WHEN ARTICLE 9 AND THE INTERNAL REVENUE CODE COLLIDE

Revised Article 9 has been in place for two and one half years and everyone has been comfortable in the fact that if you file your financing statement in the state where your factoring client is registered using the exact name as listed in the state's official records, your financing statement will prevail over all subsequently filed liens. That is not necessarily the case when the Internal Revenue Code and the UCC crash heads.

In the recent case *Crestmark Bank v. United States (In re Spearing Tool & Manufacturing Co.)*, 292 B.R. 579 (Bankr. E.D. Mich 2003), the bankruptcy court resolved a priority fight in favor of the IRS. In *Spearing Tool*, Crestmark Bank perfected a blanket lien against all of the debtor's assets in April 1998. In April 2001, Crestmark Financial Corp entered into a factoring arrangement with the debtor and perfected its security interest in April 2001. Both Crestmark Bank and Crestmark Financial Corp filed their financing statements under the debtor's registered name, Spearing Tool & Manufacturing Co. in Michigan, the state where Spearing Tool was incorporated and under the names as listed in the state's official records. As part of their due diligence, Crestmark Bank and Crestmark Financial Corp conducted periodic lien searches using the state's official search logic system.

On October 15, 2003, the IRS filed two federal tax lien notices with the Michigan Secretary of State under the name "Spearing Tool & MFG Company, Inc." Crestmark Bank's and Crestmark Financial Corp's periodic lien searches using the state official search logic system did not pick up the IRS' filing.

In a priority dispute which occurred in the debtor's bankruptcy case, the court ruled in favor of the IRS. Under the UCC, the IRS filing would be considered a seriously misleading financing statement under UCC. UCC Sec. 9503(1)(a) requires that a financing statement be filed under the debtor's correct name as reflected in the public records of the jurisdiction wherein the debtor is registered. If the filing is not reflected using a search of the state's official UCC data base using the official search logic, the IRS' financing statement would be seriously misleading.

The Spearing Court did not take the UCC approach. Rather the court noted that while IRS

Code Sec. 6323 which requires that the IRS file its personal property lien with the Michigan Secretary of State, that section does authorize the state to prescribe the form and content of the IRS notice. The net result was that the IRS notice, which was a seriously misleading statement under the UCC, prevailed over the previously filed financing statements which were in compliance with state law. The worst part about the ruling is that the IRS gets it both ways. It is not held to the standards which other creditors are held to, and can take advantage of UCC Secs. 9503 and 9506 if the other creditor files a seriously misleading financing statement.

The problem in this instance is due to the restrictive nature of the Michigan State official search logic system. The majority of the states have adopted the Model Administrative Rules in their filing offices, which establishes the official search logic system. Most state's official search logic systems are restrictive, meaning that they do not pick up some common abbreviations and name variations. Most commercial search logic systems such as Westlaw or Lexis-Nexis would have picked up the IRS filing.

While the Spearing Tool case is wrong on many different levels, and at most, should be limited only to IRS liens, it presents a problem to the industry. The unfortunate solution at this time is that in order to prevail against an IRS lien, parallel searches need to be conducted. One using the state's official search logic system and the other using a commercial search logic system which is more comprehensive in nature. Although it makes sense to use the more comprehensive commercial search logic system, this may not suffice as Official comment No. 2 to UCC Sec. 9506 provides that using any search logic other than the filing offices' official search logic system may not be good enough if it fails to disclose something that the state's standard search logic would have produced.

Hopefully there will be a legislative fix to this problem, but until that happens, the prudent thing to do is conduct parallel searches.

*** This case has recently been reversed. Details to follow in a future IFA update.**

 Steven N. Kurtz of Levinson Kaplan Arshonsky & Kurtz, APC can be reached at 818-382-3450 or email him at skurtz@levkaplawyers.com.



CORPORATE NEWS

Freedom Financial, Inc., a rapidly growing provider of factoring, purchase-order financing and additional asset-based lending services, today announced the appointment of Mark Olfson as Vice President for Business Development.

Business Wire, December 15, 2003



*This is a new feature in **The Commercial Factor**. To have your corporate news printed, please send it to info@factoring.org*



UPCOMING IFA EVENTS



AMY BRESLIN, CPA & BRIAN YOUNG, CPA

FROM BRESLIN & YOUNG FINANCIAL CONSULTANTS, LLC

"After the Deal is Done, Periodic Accounting, Operational and Credit Reviews."

1PM PST, Thursday, January 22, 2004

Cost: \$40 (\$50 for Non-IFA Members)



STEVE KURTZ, ESQ.

LEVINSON, KAPLAN, ARSHONSKY & KURTZ, APC

"UCC vs. Other Areas of the Law."

1PM PST, Thursday, March 11, 2004

Cost: \$40 (\$50 for Non-IFA Members)

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 TELECONFERENCE CALLS

As Capital Factors pursues its claims of a \$30 million fraud, there is talk in South Florida and on Wall Street that parent Union Planters Corp. (NYSE: UPC) might sell its Boca-Raton based factoring subsidiary.

Javier Holtz, Capital Factors' president, late last week said those reports are not true.

"The company is not looking to sell Capital Factors," he said. "We plan to continue to grow next year."

Holtz said Capital Factors hopes to recover some of the \$30 million it lost through what it claims were fraudulent transactions arranged by a New York City jewelry wholesaler.

Capital Factors made that claim against Cosmopolitan Gem Corp. and 13 co-defendants in a civil suit filed Aug. 13 in U.S. District Court for the Southern District of New York.

Holtz and Victor Rocha, a spokesman at Union Planters' headquarters in Memphis, Tenn., said their companies are not commenting on the suit.

Two South Florida financial executives, who asked not to be identified, said they have heard the loss led Union Planters to determine it does not need its factoring division, even though it never previously had major problems.

The executives, a factoring executive and a banker familiar with Union Planters, said they had heard those reports from officials within Union Planters and factoring industry officials.

Jason Goldberg, an analyst at Goldman Sachs, said he has not heard Union Planters management mention a possible sale of Capital Factors.

But he said that "selling Capital Factors might fit" into Union Planters' announcement on Dec. 15 that it is considering a restructuring that could include reducing the overall risk profile of its business.

Union Planters that day reported that volumes in its mortgage banking business were dropping significantly during this year's fourth quarter and that it expects the trend will continue in 2004.

The company said: "The impact on 2004 is expected to be a decline in earnings, excluding

any restructuring charge, of 5 to 10 percent below 2003."

A sale of Capital Factors could help Union Planters reduce the shortfall.

"It has been a decent business for them and it is one of the largest in the country, but it is still not one of their core components," he said. "But not too many banks have it, and there is a risk element."

Goldberg estimates a sales price "could be slightly over \$100 million," based on ratios financial companies use to value assets.

Capital Factors was part of Miami-based Capital Bancorp from 1985 until 1998. Union Planters bought Capital Bancorp in 1998, putting its name on the bank but keeping the Capital name for the factor.

Factors purchase accounts receivable at discounts from clients and are then responsible for collecting payments.

Capital Factors, which promotes itself as one of the country's 10 largest factors, has 340 employees. The company has offices in Boca Raton, Fort Lauderdale, New York, Atlanta, Dallas, Los Angeles, Charlotte, N.C., and San Remo, California.

Capital Factors represents about 2 percent of the parent bank's business.

Invoices reportedly falsified

In its suit, Capital Factors said it was Cosmopolitan's exclusive factor from 1993 until May, when Cosmopolitan ceased operations.

Capital Factors maintains that Cosmopolitan and several of its retail jeweler clients arranged a system in which, from early 2001 until May, when Cosmopolitan ceased operations.

Capital Factors maintains that Cosmopolitan and several of its retail jeweler clients arranged a system in which, from early 2001 until May, clients either sent Capital Factors falsified invoices or made payments directly to Cosmopolitan.

Late last year, Capital Factors detected a pattern in under-payments and non-payments, and in May it placed the total at \$30 million.

Capital Factors' suit has been stayed, pending the outcome of a related suit in New York State's Supreme Court.



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What? Why? Who? When? Where?

Sounds like the game of Clue we played when we were kids. Who did the murder? Where? When? In this case, to avoid having to answer the question of who committed fraud, where and when, most factors engage in some type of verification procedure. Let's examine the five W's of verification.

I. What?

Since factoring is simply the purchasing of accounts receivable to provide working capital, the verification process is designed to simply check the validity of the accounts receivable. Verification is a procedure to ensure that the A/R will be collected. By verifying we can ascertain the following:

1. Are the receivables, in fact, valid receivables for work done or goods delivered?
2. Has the work completed or the goods delivered been subject to any type of dispute?
3. Are there any contra items or other offsets, discounts?
4. Was the service only partially completed with additional work needing to be done?
5. Has the entire shipment been delivered?
6. Are the goods or services subject to any future warranty claim?

In talking to factors over the years, I am surprised that many focus only on determining if the invoices are bogus or fraudulent. Their verification calls would go like this:

Factor: My name is Allen with Gulf Coast Business Credit and I'd like to know if you have received the invoice from Apex Corporation # 1001 for \$1,000.00.

Debtor: Yes, we received the invoice and have it in our system.

Factor: Thanks very much for your help.

The above verification illustration simply shows that the U.S. mail does get delivered. It does not tell the factor whether or not the invoice is for work completed, goods delivered, or whether there is any dispute, claim, or offset. Furthermore, it does not state that the invoice has been matched against any purchase order. It simply states that the invoice was received and entered into the system. Remember, verification is a procedure used to determine that the debtor will pay.

Verification may be verbal or written. I have

always preferred written verification because I believe that this upholds better in court when a debtor decides not to pay for whatever reason. This avoids having to pull out notes, reach for a scratch pad, and have the ensuing "he said, she said" discussion. Rather, in court the factor simply pulls out a signed and returned written verification faxed to the debtor. There are other issues involving written verification, which will be discussed later.

The second type of verification is verbal. When we first started in the factoring business we did approximately 50% of our verification on a verbal basis. As time went on, I preferred to do more written verifications after I heard war stories from many friends in the business. Today, I am comfortable with verbal verification, because we have added a digital telephone recording system which records all verbal verifications and stores them in the digital file by debtor date, client, etc. Within the past nine months we have installed the latter system. A good friend with another factor gave me the idea to do this by informing me of their success with the digital recording equipment. Now I feel more comfortable with a larger amount of verbal verifications. It comes down to what you can get by the easiest means. In verbal verifications, you must be sure that your script is always the same and all-inclusive.

As can be deduced for the above, one of the benefits that I have enjoyed through the IFA is meeting new people in the industry with whom we can share thoughts, ideas and perhaps learn improvements, refinements and that which others may do better than us. I guarantee that no matter how smart you think you are, there is a lot to learn from other factors in the business. Networking through IFA conventions always gives me ideas on how to improve our operation.

Any of you who have attended factoring seminars probably have a copy of an estoppel letter provided by one the several IFA attorneys. Typically, the estoppel letter, which is used in construction type factoring, has estoppel language with offsets from the debtor and an unequivocal promise to pay. As I define "verification letter", I actually combine the concepts of verification and estoppel into one. Following is the "offset" language that we use in the verification letter.

We request your irrevocable acknowledgement that the (1.) goods and/or services described in the Invoice(s) were acceptable, (2.) Invoice(s) will be paid to us without any setoff, defense, counterclaim or recoupment and (3.) Invoice(s) will be paid the earlier of (i.) the due date set forth on the Invoice(s) or (ii) sixty (60) days from the date as set forth below.

In the verification letter, it is first stated that we are providing working capital financing upon reliance of specific invoices. Invoices are listed by invoice date, number and dollar amount for our client. We ask that these invoices, which are itemized, be verified and the verification letter be signed by an authorized party. If the verification is verbal, the same items are included.

Many clients will say that their customers will not sign the verification letter. I have found that when most people are approached respectfully, with courtesy and professionalism they are amenable to the verification process. There are some large companies that will not sign letters or verbally verify, but will let you check the information on receivables through an internet tracking process or some other method. Some debtors will verbally verify weekly; others will verify in writing, but not verbally; and others will only verify verbally upon request, etc. The rule that I use in the verification process is get as much as you can. In every factoring relationship there is a risk reward ratio. The greater the risk, the greater the verification, both in the number of invoices verified and the completeness of the verification information.

II. Why?

Why do you verify A/R? It's simple. In factoring, there are only two principles that matter:

- A complete paper trail (i.e., have all terms of contract been fulfilled and is it valid A/R)
- Does the debtor have the capacity to pay?

For our purposes, let's assume the debtors all have the capacity to pay. The only thing that matters is the completeness of the paper trail. That is, have the goods or services been delivered subject to the same terms of the purchase order or contract such that the debtor accepts the goods/services and is willing to pay. Most of us factor a mix of clients. In our case, these include manufacturers, distributors, and service companies. Since we are located in an oil & gas producing state, many of our service customers provide some type of service to the major oil companies. This may include labor and materials and work of a fairly complicated, precise and non-repetitive nature. Accordingly, there is a lot of room for dispute.

In a simple manufacturing company for example, a brick manufacturer, this is a very low-tech operation. A brick is a brick. If one brick is shorter than the other by one one-hundredth of a millimeter, it is not really a big deal. A coupling on a pipeline three hundred feet deep in the Gulf of Mexico is more precise. Accordingly,

I like to tailor the verification process to the following items:

- Financial stress of the client
- Complexity of the transaction
- Dilution
- Concentration

III. When?

The when to factor is based on the aforementioned. Typically with the manufacturer, you have a purchase order, invoice, and bill of lading or delivery ticket. It is easy to match these three items and do verification to see if the bricks were delivered. Since all the bricks are manufactured the same way the chances of a quality issue are remote and dilution in this type of account is typically small. On the other hand, when a one of a kind precision instrument is manufactured, this is much more precise since there is no repetitiveness in the manufacturing process and quality standards are much more stringent; therefore, the chance of dilution is greater. While looking at past dilution as one indicator, you must also look at the complexity of the process to judge whether or not future disputes are a risk. I also get concerned over concentration in large dollar invoices. A dispute on a million dollar invoice is a lot more serious than a dispute on multiple thousand-dollar invoices whereby you have many debtors instead of one.

I have adopted the following procedures:

- The greater the concentration, the greater the verification
- The more complex the manufacturing, distribution or service process, the more verification
- The longer and more detailed the contract to purchase order, the more verification
- The greater financial stress on the client, the more verification

Especially in service companies, we typically encounter contracts instead of purchase orders. Verification becomes more important simply because of the complexity of the contract. A good friend and competitor of mine has a good rule that is followed. He says that if the contract is more than five pages, he doesn't read it; he simply does the full verification letter or he doesn't buy the invoice. His point, of course, is that the longer the contract, the more outs the debtor has for non-payment. Remember that long contracts done by in house attorneys for large debtors are not meant to protect the factor nor the company that does the work for the debtor. The contract is strictly for the debtor's protection.

IV. Where?

Through the verification process, we either call a telephone number or fax a verification form to

be signed. Typically that number is taken from our client's master customer list or it may be supplied by the client. The question is how do we know the person we are talking to at ABC Company actually works for ABC Company. Or is the person who signed the fax at ABC an employee with authority to do so? There are many factors that used to be in business that were trotted in collusion schemes in the old "boiler room" operation where sophisticated phone switching equipment was used. In the latter case, the factor may call six different debtors with six different area codes and through sophisticated switching equipment; all of these calls were routed to one office, which was in essence bogus. There are several checks to make sure that you are in fact calling the debtor. First, look to see if you have called that debtor before for another client and check the phone or fax numbers. Secondly, call directory assistance and/or look up the number on the Internet. The third test would be to call the headquarters of the company through directory assistance and ask the operator if the person whose name and number you have been supplied actually works for ABC Company and if you have the correct number and extension. This should answer the question of where you call.

V. Who?

I saved the best part for last. The issue with verifications, which potentially is the most contentious, is who should sign the verification or provide verbal verification. Currently, there is an outcry in the factoring community because of the number of legal cases whereby the debtor and his attorney have taken the position that the person who verified was not authorized to do so and the factor's counsel counters that the person who verified had "apparent authority". At a recent conclave with a number of factors, one person mentioned "I have been to a seminar where @#\$\$#* said 'as long as the janitor signs it, you are ok.'" While I cannot verify that @#\$\$#* made that statement, I will assume that it was an attempt at humor. Regardless of what the attorney said the factor needs to realize the risk on this issue. There is no sure way to keep the debtor from trying to use any defense not to pay including the issue of apparent authority. Recently we have utilized the following legend at the bottom of our verification letter in an attempt to give us some degree of comfort on the apparent authority issue.

By signing below, you hereby confirm that you meet at least one of the following authorization criteria: (i) have the authority to issue checks for payment of the Invoice(s); (ii) have the authority to approve the Invoice(s) for payment; or (iii) are a Vice President or Treasurer, or other fiscal officer of the company hereby represented.

We have discussed this with three factoring counsel, each of whom has a different degree of comfort with the language. The important point here is that we simply need to recognize that this can be a defense by the debtor not to pay and we should do the best we can to protect ourselves. Obviously, with an invoice from Shell Oil Company, I cannot get a special resolution passed by its Board of Directors, which authorizes payment of my invoice. Very typically, I would go to someone in accounts payable. With a smaller company, I may talk to the Corporate Treasurer or another financial officer. In any case, we must identify with whom we are talking, find out if they are authorized to approve invoices for payment and/or issue checks and what other levels of authority they may have within the company.

The greater the invoice amount, the larger the debtor, the more care that must be taken in the verification process. Remember, our clients are all financially stressed. The only thing we are depending on is that our debtors have the capacity and the will to pay.

In summary, I can relate pages of war stories of factors that lost substantial monies simply because they did not pay close attention to the verification process. I remember a case several years ago with a factor whose client manufactured tennis shoes made in Mexico had large debtor companies such as FedEx, Cintas, and Lowes. All the debtors had the capacity to pay. Then there was a problem that \$500,000 worth of shoes that were delivered but were not the right color blue. Guess what? The factor went to court and spent six figures in legal fees and collected less than .40 cents on a dollar. How about the factor that wanted to book the deal before a competitor stole it. He did only limited verification on the \$2 million of fraudulent receivables he purchased. Then there was the oil service company that welded a pipeline in the Gulf of Mexico. When there was a faulty weld, which created an environmental disaster, the oil company offset all future payments on A/R's. Then there are the stories about spoiled seafood, imported bananas from Honduras which went bad, broken china wear, defective electronics boards, water damage on merchandise, merchandise delivered too late for the Christmas season, and a host of other issues where the factor put himself at risk because of the lack of adequate verification procedures. The factor that follows the five W's will likely save himself from the sixth W – **WIPE OUT!**



Allen E. Frederic is President of Gulf Coast Business Credit. He can be reached at 504-412-2027 or email him at allenfrederic@gulfbank.com



CIT Group Inc. announced Wednesday, Dec. 31, that it is buying HSBC Holdings plc's U.S. factoring business. The terms of the deal were not disclosed, it is reported that the HSBC unit has net assets of \$270 million. Moshe Orenbuch, an analyst at Credit Suisse First Boston, predicts that there will be a premium paid on those assets. The price is expected to be in the \$300 million range.

The deal continues CIT's growth as the largest player in the sector. (It is twice the size of GMAC Financial Services, its main competitor.) In September, CIT acquired the factoring assets of GE Commercial Services for \$446 million. Over the past five years, the company has also bought the factoring business of First Union Corp., now Wachovia Corp., Barclays plc and Heller Financial Inc.

Daily Deal/The Deal, January 1, 2004

Nine men were indicted on charges of stealing \$170 million from a Portuguese bank branch in Florida through what prosecutors said was a sophisticated conspiracy that lasted nearly a decade. All defendants were employees or customers of E.S. Bankest. Except for the Orlansky brothers, all defendants were granted bail at a court hearing

The Associated Press State & Local Wire, December 6, 2003

BIBBY Factors Scotland, the financing company, yesterday said it had acquired Abbey National's factoring business. The value was not disclosed. The company

said that the agreement includes the transfer of (pounds) 32m worth of assets "relating to Abbey's factoring and confidential factoring business operating out of Leeds and Poole". The deal does not include Abbey's invoice discounting operation.

The Herald (Glasgow), December 2, 2003

Espirito Santo Bank of Florida faces a possible reprimand from bank regulators and the chance of a tarnished reputation with clients, but little else is expected to come of the state-chartered bank's unwitting involvement in an alleged \$170 million loan scam, local experts say. The scandal may ultimately rank as one of Florida's largest, but the impact on Espirito Santo Bank should be limited, banking experts said. Unlike some other local banking scandals, Espirito Santo Bank - which is part of a conglomerate in Portugal controlled by the Espirito Santo family - was allegedly duped, and ultimately ended up the victim.

Broward Daily Business Review, December 12, 2003

Capital Factors of Boca Raton claims it lost \$30 million because of fraudulent transactions arranged by a New York City jewelry wholesaler. In a federal civil suit filed in New York, Capital Factors maintains that Cosmopolitan Gem Corp. set up those transactions beginning in 2001 to help its president, Joshua Kestenbaum, recover \$12 million that he lost in the stock market.

South Florida Business Journal, November 21, 2003

Whitehall Jewellers Inc. said Thursday it fired Chief Financial Officer Jon Browne as a result of an ongoing internal fraud investigation. The investigation stems from charges of fraud brought by a receivables factoring company and the related inquiry by government authorities. In early October, Whitehall, a Chicago-based jewelry chain, said it was among several defendants in a lawsuit filed by Capital Factors Inc.

The Associated Press State & Local Wire, December 11, 2003

Private Business Sets January 19 as Date of Special Meeting of Shareholders to Approve the Sale of \$20 Million in Preferred Stock to the Lightyear Fund.

Business Wire, December 29, 2003

Greenfield Commercial Credit (Canada) Inc. ("Greenfield Canada," Symbol: GRF) announced today that it has completed its previously announced intent to acquire a U.S.-based loan portfolio from Textron Financial Corporation, a financial services company headquartered in the United States. Following extensive due diligence and portfolio analysis, Greenfield Canada purchased seven loans from Textron Financial Corporation, which have an aggregate committed credit of approximately \$14,000,000 (Canadian).

Canadian Corporate Newswire, November 25, 2003



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STOP THE BLEEDING

By Dr. Ron

P10

WOULD YOU LIKE TO KNOW HOW TO MAKE A SAFE INVENTORY LOAN AND A TON OF MONEY IN THE PROCESS?

SO WOULD I. But this has nothing to do with today's topic. Bert Goldberg told me that I needed to get my readership up, and I figured that a catchy title like this just might do the trick. What I am going to talk about today is how to properly take production equipment either as additional collateral to shore up a deal that would otherwise not fly, or to actually make cash advances against equipment and earn a few more bucks in the process.

When taking equipment as collateral there is a difference between using the equipment as a basis for making a cash advance and just taking the equipment to further secure your factoring advances. If you are making a cash advance against the equipment, then you should be concerned not only with the value of the equipment but you must also analyze your client's ability to remain in business and have the cash flow to repay the equipment loan. Therefore you must examine the client's financial statements. A proper and complete discussion on financial statement analysis would be beyond the scope of this article, but the rudimentary elements are as follows.

First, you must analyze the past 2 or 3 years of year end financial results plus the most recent interim financial statements. The year end financials should be prepared by a CPA even if the statements are not audited, which is most likely the case. The interim statements will most likely be internally prepared. There are several elements to a CPA prepared financial statement, the preamble, the statements themselves, and the notes to the financial statements.

The first element is the preamble as that sets the tone for the entire financial statement presentation. The CPA's preamble must be on the CPA's letterhead and signed by the CPA. The preamble, in part, discusses the method used by the CPA in preparation of the statements. The 3 methods are compilation, review and audit. In preparing a compilation, the CPA merely takes information from the client and repeats this information without much in the way of independent verification. A review is much more comprehensive and reliable than is a compilation; the CPA does a lot of work to confirm the numbers. An audit is still more comprehensive with a heavy emphasis on third party confirmations with lenders, customers, vendors and the like. For most factoring clients, a compilation or review is the most likely form of a CPA prepared financial statement we will see.

The notes are the final element found in a set of financial statements. Again, any discussion here as to the interpretation of these notes is beyond the scope of this article. The only guideline I can give you here is to use common sense and don't be afraid to ask questions. By the way, in a compiled statement, it would not be unusual not to find any notes at all.

Most importantly, there are the numbers themselves: the balance sheet, the profit and loss statement, and usually the statement of sources and uses of cash. While our space here is limited, I can give you a quick and dirty method to determine if there is adequate cash flow to repay your equipment loan. Simply add together your estimate of the client's annualized pre-tax profits and annualized non-cash expenses charged to earnings, e.g. depreciation and amortization. The result is annualized gross cash flow. From gross cash flow subtract all installment payments that will be made in the next 12

months, subtract a year's worth of your new equipment loan principal and interest payments, and subtract the cost of the new factoring facility you are providing. The result is net cash flow. If net cash flow is not comfortably positive, your client may have difficulty repaying your equipment loan.

OK, now that we think your client not only will remain viable long enough to repay your equipment loan but has the cash flow capacity to do so, let's talk about collateral evaluation. As collateral, I prefer production equipment as production equipment tends to hold its value; i.e. equipment used in a manufacturing process like machine tools, injection molding equipment, printing presses, etc. Equipment like computers, shelving, fixtures, telephone systems, testing equipment and the like tend not to hold their value very long. Other equipment like walk-in-coolers or big, heavy equipment attached to real estate in a major way may hold their value decently, but when considering removal, clean-up, storage, transportation and other costs associated with repossession and re-sale, their bottom line value is not there. The next step is to get the equipment appraised.

In my opinion the only type of appraisal worth its salt for lenders is a forced liquidation appraisal. Such an appraisal should be conducted by an appraiser with experience in appraising exactly the same type of equipment you are financing. The real question is, how much will the equipment sell for in a distressed situation and in a short period of time? Once the value is determined, lending or relying in an amount equal to 70-80% of the appraised value is customary. Why 70-80%? You should assume that something will go wrong and that the equipment will not liquidate for the full appraised value. Some of the equipment may not even be there when you repossess or it may be in poor condition. Then come the legal fees, storage fees, guard services, insurance costs, auction costs and all the other costs that always seem to come out of the woodwork. This is where the risk lies in an equipment loan. Anyone can lend money and document the deal properly. The expertise comes in when trying to liquidate the equipment to get your money back. If you are not experienced in equipment liquidations, you could easily take a loss. Before we leave the area of appraisals, check with the appraiser before you decide on the amortization period of your loan. The age of the

[CONTINUED ON PAGE 11](#)



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equipment, its condition, and expected market conditions all play a role in setting the term of your loan. After the loan is made, the appraiser should be called in from time to time to inspect the equipment and conduct an informal reappraisal. The client customarily pays for all appraisal work.

Documentation. If you are lending against the equipment you will need a promissory note and security agreement. If you are not lending but merely taking the equipment as collateral to shore up a factoring facility, a properly referenced security agreement alone will suffice along with board resolutions, guarantees and other standard documents. Do not rely on the language in your factoring agreement and a UCC filing on all assets; you must use a security agreement designed for equipment loans since a good security agreement will require proper maintenance, insurance, and other protections not found in a typical factoring agreement that merely liens equipment. The security agreement must also contain wording that cross collateralizes and cross defaults the equipment portion of your deal with the factoring portion. A clause substantially increasing the interest rate upon default has recently become very popular with lenders. I always include a provision requiring that the equipment loan be paid off in the event the factoring facility is terminated. You must be named on the client's equipment insurance policy as Additional Named Insured and as Loss Payee with advance notice if the policy is about to be cancelled. Last, but certainly not least, a document called a Landlord's and/or Mortgagees Waiver must be obtained. This document provides, among other things, that the Landlord or Mortgagee will not place a lien on or hold the equipment ransom for unpaid rent.

As always, be sure to consult with counsel before doing your first deal. And if that deal is at all sizeable, it wouldn't be a bad idea to call a friendly competitor to participate in the loan with you to gain some valuable experience before venturing out on your own.

So, until next time, ta ta for now.



To contact Ron Winicour, a/k/a Dr. Ron, or to request copies of documentation, past articles, etc., please send an e-mail to: rwinicour@gibraltarfinancial.com. In the alternative, mail your request to Dr. Ron at Gibraltar Financial Corporation, 60 Revere Drive, Suite 840, Northbrook, IL 60062.

CAVEAT EMPTOR

LET THE BUYER BEWARE!

Presented by Dr. Ron

Doing business with clients that sell to retailers or mass merchandisers? Of course you read the purchase orders carefully to look for drop dead delivery dates or for rights of return. But be sure to also be on the lookout for slotting and advertising allowances.

What's slotting? Slotting is an allowance given to the retailer by the seller of goods in exchange for premium shelf space. Like advertising allowances, they are most often accumulated quarterly or annually and deducted from a later generated invoice. I believe the word best describing this situation is "insidious."

Be careful out there folks. Until next time, **Caveat Emptor!**



Dr. Ron needs all the ideas he can get for the Caveat Emptor series. Clue him in at rwinicour@gibraltarfinancial.com and get your name mentioned in this publication!

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FEDERAL ASSIGNMENT OF CLAIMS ACT - SEPARATING THE MYTH AND CONFUSION FROM THE FACTS

The Federal Assignment of Claims Act is one of the most misunderstood and misconstrued legal doctrines in the commercial finance business. The Act, found at 41 U.S.C. § 15, applies to all obligations owing by the federal government or any agency of department of the federal government. It is supplemented by the Federal Acquisition Regulations (“FAR”) found in Title 48 of the Code of Federal Regulations.

The Myths

Some of the myths surrounding the Federal Assignment of Claims Act:

- If I do not comply with the Act, my security interest is not perfected
- The Act does not apply to purchase orders – only contracts
- The Act does not apply to contracts below a certain dollar amount
- Government contract provisions prohibiting assignment of claims are unenforceable
- My standard form of Notice of Assignment is sufficient under the Act

Every one of these statements is false!

The Facts

The Act does not affect or govern validity of the assignment or security interest, perfection, or priority of the factor’s position against third parties or in bankruptcy. All of these issues are decided on the same principles and laws as for any other account debtor. The Act only governs notice of assignment and payment instructions. A factor may totally ignore the Act and have a valid assignment or security interest and prevail against other lenders, judgment creditors and bankruptcy trustees. However, if a factor does not comply with the Act and the government agency disregards payment instructions and pays someone other than the factor, the factor has no claim against the government agency.

Key Provisions of the Act:

- The government will not honor assignments if the aggregate amount owing on the contract is less than \$1,000.
- The government contract may prohibit any assignments.
- Except as expressly permitted in the government contract, the assignment must cover all amounts owing under the contract and cannot be assigned to more than one party.
- The Act specifies the form of the assignment document that must be executed and of the Notice of Assignment.
- You must submit an original and three copies of the Notice of Assignment and a copy of the assignment document to (i) the contracting officer or the agency head, (ii) the surety on any bond applicable to the contract, and (iii) the disbursing officer designated in the contract to make payment.
- The Notice of Assignment should be acknowledged by the government and returned to the lender.

There may be additional, special requirements applicable to assignments of amounts owing by certain departments or agencies. The provisions of the Code of Federal Regulations for the applicable department or agency should be reviewed in each instance.

Another common question is whether a Notice of Assignment can cover future purchase orders or whether a separate Notice must be given for each purchase order. There is nothing in the Act or FAR contemplating a blanket notice and no cases addressing this issue. Even if an agency is willing to accept a blanket notice, it may not be enforceable.

Form of Assignment and Notice of Assignment

There are forms of Assignment and Notices of Assignment for use under the Act in wide circulation and even in some form books which do not comply with the Act and create other issues. For example, a common form consists of a complete, independent document that stands alone, independent of the factoring agreement. Use of this form contradicts the factoring agreement. FAR provides an approved form, which should be modified to track the factoring agreement.

Priority of Surety on Government Contract

The Miller Act applies to federal construction contracts and requires the execution of performance bonds and payment bonds in connection with such contracts. The Miller Act also allows certain classes of labor and materialmen to recover under the payment bond. An assignee of a government contract is imputed with knowledge of the Miller Act’s payment and performance bond requirements and such requirements may take priority over an assignee of the contract.

Timing and Use of Loaned Funds

It should be noted that some courts have held that the Act requires that the financing institution must show

[CONTINUED ON PAGE 13](#)



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that it loaned money or at least made money available for the performance of the government contract. See Manufacturers Hanover Trust Co. v. United States, 590 F.2d 893 (Ct. Cl. 1978); Applied Companies v. United States, 37 Fed. Cl. 749 (Fed. Cl. 1997). In other words, the loan or advance of funds which is secured by the assignment must be made prior to performance of the contract by the borrower. The rationale behind these cases is that one of the purposes of the Act is "to make it easier for contractors to finance performance of their contracts to the government." Applied Companies, 37 Fed. Cl. at 762. While the holdings of these cases are questionable and not supported by the Act,

advances made under a factoring agreement are not generally made until after the account debtor has performed and therefore the loaned funds were not available to the account debtor for the performance of the government contract. The notice of assignment could be challenged on this basis. There have not been any instructive cases on this in the last 25 years, leaving a cloud over the issue.

The Solution

There continue to be practical problems with accounts owing by government agencies. Notwithstanding that the Act has been in effect for decades, agencies continue to refuse to acknowledge assignments or cooperate. If the agency violates the notice and fails to pay the

factor, the remedy is to sue the agency – which can be protracted and expensive.

Factoring accounts owing by a federal agency without compliance with the Act is basically factoring on a non-notification basis. If that is acceptable, the Act can be ignored (other than Miller Act and use of loaned funds issues). For most factors, this is the best solution. Compliance with the act is too cumbersome and cooperation lacking.



John A. Beckstead, Esq. is a partner in the Salt Lake City Office of Snell & Wilmer L.L.P. He can be reached at 801-257-1927 or email him at jbeckstead@swlaw.com.

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