

THE COMMERCIAL FACTOR

Newsletter for the Factoring Industry



Code of Ethics

Volume 2 Number 3
Fall 2000

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A Publication of:

The International Factoring Association

555 Chorro Street, Suite B
San Luis Obispo, CA 93405
800-563-1895

www.factoring.org
info@factoring.org

As their first order of business, this years Board of Directors has implemented a Code of Ethics for IFA members. This document outlines the IFA's goals and objectives and establishes guidelines by which members should do business.

Now that the IFA is offering its services to firms needing funding through FactorSearch, it is important that those firms are comfortable doing business with IFA members. The Code of Ethics will help to establish the IFA's credibility and it's members integrity.

If your firm is listed on the IFA web site, it is assumed that you will abide by the Code of Ethics. If you are unable to subscribe to the Code, please e-mail us at info@factoring.org.

By adhering to the code, you will may use the IFA logo and membership on your web site and in advertisements. This will let your clients know that you operate in a forthright manner. For instructions on how to use the IFA logo on your website and printed materials, please e-mail info@factoring.org.

The Code of Ethics is as follows.

GOALS & OBJECTIVES

The International Factoring Association (IFA) is an organization comprised of lenders and factors engaged in providing funds to businesses primarily through the purchase of commercial accounts.

The IFA's goals and objectives are:

1. *To promote the growth of the factoring industry by educating the general business community as to the nature and benefits of factoring.*
2. *To provide education and training to the industry through courses and seminars.*
3. *To encourage cooperation, communication and interaction between factors.*
4. *To maintain a code of ethics to which members will adhere.*

THE INTERNATIONAL FACTORING ASSOCIATION CODE OF ETHICS

1. *Members will aspire to the highest level of professional ethics, as generally expected by the business community.*
2. *Members will aspire to the highest level of industry competence through continued education, and by sharing ideas and experiences with other IFA members.*
3. *Members shall be honest and thorough in all business dealings, including dealings with clients, client's customers, lenders, and others in our industry.*
4. *Members shall utilize and maintain accurate accounting systems to track each client's transactions.*
5. *Members shall treat all client information as confidential. This information shall not be disclosed to any person or entity, other than at the client's direction or by court order.*
6. *Members will facilitate the move from one factor to another, should a client wish to make a change.*
7. *Members shall abide by all local, state, and federal laws.*
8. *No member shall engage in any activity constituting or leading up to a conflict of interest.*
9. *Members shall treat all persons fairly and equally, regardless of race, religion, gender, disability, age or national origin.*
10. *Members shall assist one another in all industry aspects, except for proprietary information. Members shall not use or take advantage of information which may have been obtained in the process.*
11. *Members shall subscribe to truth in advertising standards.*
12. *Members shall strive to promote the International Factoring Association and its goals and objectives, as well as the commercial finance industry as a whole, through educational venues, public relations opportunities, and member advertising media.*
13. *Members shall communicate non-confidential information relating another members violation of this Code of Ethics to the IFA Board of Directors. In the event of such a violation, the member will be required to change their behavior.*

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November 1, 2000 - Las Vegas
December 6, 2000 - New Orleans
December 11, 2000 - Las Vegas

- The Law & Business of Factoring**
October 30-31, 2000 - Las Vegas
December 7-8, 2000 - New Orleans

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The Commercial Factor

Newsletter for the Factoring Industry

The International Factoring Association
555 Chorro Street, Suite B
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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 the 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 of 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.

To receive this newsletter via e-mail, please send e-mail to listserver@dissol.com and type the words "subscribe IFA" in the subject line. To receive the newsletter via standard mail, please call 800-563-1895 or write to the address above.

To stop receiving this newsletter via e-mail, send an e-mail to listserver@dissol.com and type the words "unsubscribe IFA" in the subject line.

YOU HEARD RIGHT:

You can factor a client who sells you invoices for its real estate construction jobs, you just have to watch out for ...

By Mike Ullman, Esq.

Our real estate construction factoring teleconference held on June 27, 2000, was a hit. I want to thank each of you personally for participating in that teleconference and making it so rewarding. For those of you that missed the teleconference, here is your chance to learn about and consider if, and when, you want to break into factoring a real estate construction client's accounts.

The concerns applicable to the real estate construction factoring arena are different from those in the regular factoring industry. The primary differences between the real estate construction business niche and other areas of factoring include: (1) potentially unfavorable contract terms between the general contractor and your most likely client, the subcontractor or sub-subcontractor, and (2) the contractors' never-ending efforts to withhold payments for work done – and done well.

I. Business Issues:

Some business planning issues that arise in the real estate construction factoring area include:

1. To monitor or not to monitor:

The factor needs to assure itself that the services performed or to be performed by the client are done correctly or that the goods supplied are proper. Such assurance may come after-the-fact by getting what we all know to be “no offset” or “invoice verification” letter agreements. If advances are being made on yet-to-be-completed work, however, the process gets trickier the risks substantially increase. From a business perspective, one question you might ask is, whether you are willing to hire or specially engage someone who has expertise in the real estate construction field to monitor your client's work?

2. The Contract Stream (and we ain't talking about fishing):

No matter how well your client performs, the real (and only) test is whether work done in-progress and/or completed conforms to the contract between the **owner** and the **general contractor**. If you only review the agreement between your factoring client, let's say the sub-sub contractor, and his upstream party, let's say the subcontractor, you are asking for trouble. Sure, your client needs to comply with the terms of his or her contract between that subcontractor and sub-subcontractor, but he or she must comply with the prime contract, or risk losing all lien rights and your not getting paid timely. From a business perspective, get a copy of each and every upstream document from your factoring client and review each to verify the work done or to be done. Under Florida law, for example, there are specific statutory rights to gain access to these records from the contractors themselves if your Factoring Agreement gives you those rights and is properly drafted.

3. Your Factoring Agreement:

The Factoring Agreement you use in the textile or other routine niche industries just does not do the job in the real estate construction field. Some examples, in addition to those mentioned above, include: under Florida law, a factor does not automatically receive mechanic lien rights applicable to the work done under an invoice just by being sold/assigned a client's invoices. In addition, a point of concern in the real estate construction field is your exposure to civil

and criminal penalties for filing a fraudulent or overstated lien. A Factoring Agreement designed for the real estate construction field should be drafted to protect you against these and various other atypical contingencies.

II. Legal Issues:

In conjunction with business concerns, there are legal issues specific to factoring the real estate construction field. These include:

1. Lien perfection:

Although critical for perfection of a lien in accounts, the filing of a UCC-1 in the real estate construction field is not enough. A UCC-1 gets you no further toward perfecting a construction lien against the real estate (or, as noted below, a surety bond) your client improves. Questions to ask yourself here include: (1) what are the critical dates that documents must be sent or filed in order to file any lien; (2) what are the forms of documents required, and (3) who should be the one to file, I or my client.

2. Assignments:

Within the Factoring Agreement itself and in a separate “**recordable**” document you should have your client assign to you its right to a lien and all associated rights. You may want the assignment form or another document to provide that no change orders will be permitted without your written consent. Under Florida law, for example, the factor is given a right to get the client's construction liens assigned even before the client is entitled to any lien rights. Beware, drafting is critical. You still want your client to retain the *primary* duty to file all applicable documents in order to perfect its lien rights. A form that I referenced in our teleconference entitled Assignment of Existing and All Prospective Lien Rights is hereby provided so that each of you may see how documents need to be modified when you factor accounts in the real estate construction industry.

3. Verification of Performance and No-Offset Letters:

Your verification and no-offset letter agreements need to be tightly drawn and give the general contractor no way out if the work described in the invoice you purchase is done properly. Watch out for that prime contract language that says something like, “General Contractor has no duty to pay subcontractor until General Contractor is paid in full by Owner.” Your verification and no-offset letter agreements should modify any prime contract to insure you do not get caught in that trap.

4. Public Works or Bonded Jobs:

Different rules apply to the improvement of real property owned or improved by a public authority, whether a state, municipality or county. Similarly, the rules generally change when a real estate job is bonded. The authority of the person to bind the public authority to pay under 9-308 can be tricky. Moreover, under these circumstances, you are no longer looking to the client's customer and possibly the real estate for payment; your rights against the real estate are substituted by a surety company.

The factoring of accounts in the real estate construction industry can be profitable and rewarding. Careful upfront analysis and established procedures can reduce risk of losses.

If you have any comments or questions about this article, please e-mail me at ullmanpa@msn.com.

Mike Ullman is a Principal with Ullman & Ullman, P.A. in Boca Raton, Florida. He can be reached at 561-338-3535.

A Factoring Agreement designed for the real estate construction field should be drafted to protect you ...

FACTORIZING NEWS

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According to the **Factors & Discounters Association**, Factoring continues to grow as a preferred financing option for small firms. The amount of funds provided to clients was up by 26% on last year. In the first half of this year, the value of transactions grew by almost 20%, due to a demand for invoice discounting and international services.

Sunday Times (London), September 17, 2000

Finatra Capital, Inc. a wholly-owned consumer finance subsidiary of **Travelers Investment Corp.**, announced that it has signed a letter of intent to acquire **Premium Asset Recovery, Inc.** **Premium** is involved in the purchase and collection of consumer and commercial delinquent paper at discounts and collects bad debts on a contingency basis for third parties. **Finatra** specializes in commercial and consumer finance. The acquisition will add expanded capabilities to their backend collections operations and will provide other collection services the company does not offer currently. The acquisition is anticipated to close by September 30, 2000 pending due diligence and definitive agreements.

Business Wire, September 5, 2000

Finova Group Inc.'s stock slid 17% after a credit-rating agency downgraded the finance company's debt. Shares of the Scottsdale-based company were trading at \$44.63 in October. After the announcement on August 18th, the stock traded as low as \$6.50 per share. **Finova's** loan write-off in March and subsequent loan woes have cut off some financing sources and raised other borrowing costs, causing the agency to feel that **Finova** remains financially unstable. The action also raised doubts about **Finova's** ability to find a buyer because of the number of companies seeking a partner and the overall depressed market for finance companies.

The Arizona Republic, August 19, 2000

RFC Capital Corp. is suing Las Vegas-based **Colorado River Communications Corp.** for \$300,000, saying the business siphoned money from its accounts receivables. **RFC** alleges **Colorado River** began telling its subscribers to send payments to a difference lockbox in January and then kept the money. **RFC** President Steven Jaffee said the money in dispute was "less than significant" to the company's annual revenue stream, but they want to send a message that they intend to enforce contracts.

Business First-Columbus, August 18, 2000

Liberty Seafood Co. has cost Houston-based **MetroCorp Bancshares** \$5.3 million in losses and New Jersey-based **The CIT Group** \$15 million in 1998 and 1999. Richard Williams, who owned **Liberty** told **MetroCorp** officials that he created false business records for two years to cheat a **MetroCorp** subsidiary out of money. Williams

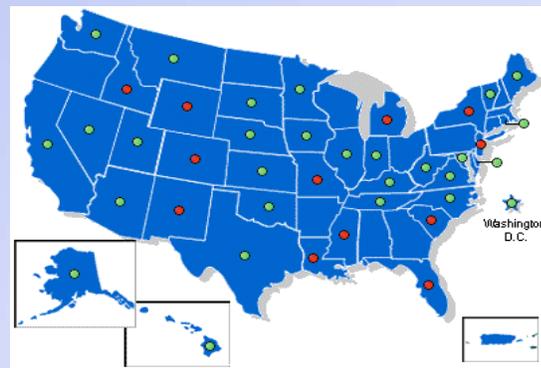
claims former Liberty owner Marion Duzich helped to defraud **MetroCorp** and also schemed to bilk **CIT** out of money. Duzich denies the allegations. Both are suing for shares of a \$26 million business interruption claim by **Liberty** that is under litigation in a state district court in Galveston, Texas.

The Houston Chronicle, August 15, 2000

The FINOVA Group Inc. signed a definitive agreement to sell its Commercial Services business line to **GMAC Commercial Credit LLC**. Matt Breyne, president & CEO of **FINOVA** says they made the decision to exit the factoring business because it has become "intensely price competitive." He believes that the sale will allow **FINOVA** to focus resources in its core lending business. The boards of directors of both companies have approved the transaction and it is expected to close in the third quarter of 2000.

PR Newswire, August 9, 2000

Revised Article 9 by State



● - Passed = 28 ● - Introduced (Pending) = 12

Map and information courtesy of Intercounty Clearance Corporation - www.intercountyclearance.com

If you have any news items you would like to include in the next issue of The Commercial Factor, please e-mail them to info@factoring.org.

ASSIGNMENT OF EXISTING AND ALL PROSPECTIVE LIEN RIGHTS

State of _____
County of _____

Before me, the undersigned notary public, personally appeared _____, who was duly sworn and says that (Client Name), is or in the event a Claim of Lien is hereafter recorded shall be the lienor herein (or is the agent of the lienor)

_____ ("Lienor"), whose address is _____; and that in accordance with a contract with (General Contractor or Subcontractor), Lienor has and/or will furnish labor, services, or materials consisting of _____ on the following described real property in _____ County, Florida:

(Legal description of real property)

owned by (Owner) . As to that labor, services, or materials performed or supplied to date, the total value of the labor, services, or materials furnished is \$ _____, of which there remains unpaid \$ _____, and furnished the first of same on _____, (year) and the last of the items on _____, (year); and (if the lien is claimed by one not in privity with the owner) that the Lienor served the notice to owner on _____, (year), by _____; and (if required) that the Lienor served copies of the notice on the contractor on _____, (year), by _____ and on the subcontractor, (Subcontractor), on _____, (year), by _____. As to that labor, services, or materials yet to be performed, this assignment is further intended to apply to any future lien rights that may insure to the benefit of Assignor under and/or related to the above-described contract.

This Assignment is recorded in accordance with _____ of the Florida Statutes and constitutes an assignment of any previously recorded Claim of Lien which, as to any Claim of Lien so recorded, was recorded in the Official Records Book _____, at Page _____, in the office of the Clerk of the Circuit Court of _____ County, State of Florida, against the above-described real property. This Assignment shall likewise be deemed applicable to any and all prospective lien rights that may arise in favor of Lienor or subsequently recorded Claim(s) of Lien in favor of Lienor.

Assignor acknowledges and represents to Assignee that: (1) this assignment is made pursuant to the parties having entered into a Factoring Agreement whereby Assignee purchased certain accounts together with all lien rights with respect thereto, (2) upon the execution of this Assignment, Assignee shall be the sole and exclusive successor-in-interest to Assignor as to any lien rights under that contract referenced above and Assignee shall hold all of Assignor's right, title and interests in and to each existing lien right as well as any prospective rights to any lien, (3) as a result of this Assignment, Assignee shall henceforth neither take, nor seek to take, any action to collect, enforce, satisfy, compromise, waive, or release any rights under any existing or any prospective lien or rights related thereto, (4) Assignee is not and shall not be deemed, as a result of this Assignment, to have assumed any obligation(s) or liabilities of the Assignor to any other party or parties pursuant to any underlying contract and if, for whatever reason, Assignee is required to defend itself against any action as a result of the taking of this Assignment, Assignor shall indemnify Assignee against any loss and expenses, including, but not limited to, court costs and attorneys' fees, (5) in the event any recorded Claim of Lien requires amendment, Assignor shall, upon Assignee's request, provide Assignee with such amended claim of lien in a form that may be executed in the name of Assignee and duly recorded in the same manner as the original Claim of Lien, (6) as to any Claim of Lien recorded to date, assignor has timely and properly served each Claim of Lien in the manner provided in Florida Statutes, (7) in addition to Assignor's lien rights, this Assignment shall be deemed to constitute an assignment to Assignee of all other remedies and nothing contained herein shall be construed to prevent Assignee from maintaining an action at law as if no lien for the security exists, (8) henceforth, unless Assignor is given Assignee's written consent to do so, Assignee shall be the sole and exclusive party entitled to seek any statutory entitlements relating to any Claim of Lien or lien rights such as the right to demand a copy of any contract or statement of account, (9) in the event an owner serves a demand for a written statement under oath of Assignor's account, Assignor shall immediately furnish such statement to Assignee so as not to deprive Assignee of any lien or other rights, (10) any Claim of Lien recorded to date has been recorded in the applicable clerk's office or if the real property is situated in two or more counties, the Claim of Lien has been recorded in the clerk's office in each of such counties, and (11) if any Claim of Lien has been recorded, the Claim of Lien has been timely recorded such that in no event has the claim been recorded later than 90 days after the final furnishing of the labor or services or materials by the Lienor; or, with respect to rental equipment, within 90 days after the date that the rental equipment was last on the job site available for use.

Notwithstanding this Assignment, Assignee shall have no duty to take any action to protect or preserve any existing or prospective lien rights and in the event Assignee fails to take such action or preserve such rights, such failure shall not adversely affect or otherwise impair any rights Assignee has against Assignor under the Factoring Agreement.

(Signature)

Sworn to (or affirmed) and subscribed before me this _____ day of _____, (year), by _____ (name of person making statement).

(Signature of Notary Public—State of Florida)

(Print, Type, or Stamp Commissioned Name of Notary Public)

Personally Known _____ OR Produced Identification _____
Type of Identification Produced _____

2000 Factoring Conference

Cassette Order Form

Robert Zadek, Esq., Buchalter, Nemer, Fields & Younger

Current Factoring issues, Revised Article 9 of the UCC Code, Dealing with other Factors in takeovers, participations, sharing transactions and re-Factoring

Mike Ullman, Esq., Ullman & Ullman

Can you claim invoice payments your client deposited in their account? Update on usury and it's implications in Factoring

Marketing Panel

Panel discussion on how to use new marketing techniques to grow your portfolio

Dr. Bill Carner – University of Texas

Lewis Faber – Yale Capital Group, Ltd.

Laurence Pino, Esq. – Pino Training Organization

Melinda Murphy, IRS

Working with the IRS in relation to your clients

Funding Panel

Panel discussion on different funding options.

Larry Meek – Capitol Resource Funding

Paul Cottone – Summit Rediscount Finance

Andrea Petro – Transamerica Financial Services Funding

Matt Gravelle, FBI

Investigation of fraud claims

Dr. Edmond Seifried, Lafayette College

Economic analysis and projections

Gary Miller, Esq., Boyar & Miller

Purchase and sale agreements, Participation agreements

Okorie Ezieme, Deloitte & Touche

David Lowenkopf, Deloitte & Touche

Risk management and controls, Operational pitfalls, Improving efficiencies, Limiting exposures, The importance of audit oversight

Arnie Cavazos, Esq., Cavazos, Hendricks, Poirot & Dewey

Your clients file bankruptcy, what are your rights? DIP financing, how is it done?

Richard Worthy, Metro Factors

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The 10 Commandments of Factoring

by Richard Kort

1. Honor thy Banker and keep him informed.
2. Thou shall not overrule the "do-not-fund" decision of your credit manager.
3. Remember the UCC expiration date so not to lose thy priority.
4. Thou shall never vary from good factoring procedures for loses are sure to come if you do.
5. Always notify thy debtor as they are always a better source of payment than thy Client, no matter how bad their credit report.
6. Verify in writing as your word is as good as your industry's reputation.
7. Never shoot your Client unless you want to be in their business.
8. Respect your business development staff as they are the source of your continuing growth.
9. Listen to the needs of your Client, however heartbreaking the story may be, but never over-advance more than you can afford to lose.
10. Thou shall maintain the highest degree of integrity in thy business, but never disburse funds to a Client in trouble.

UPCOMING EVENTS

Tele-Conference Call

Thursday, October 25, 2000
1:00pm PDT

Pat Stiehm, Esq. from the [Stiehm Law Office](#)

Closing Transactions Electronically

Are you still requiring hard copies from your clients? We will be discussing the legal aspects of closing transactions electronically using the following mediums: fax, e-mail, internet and e-signatures.

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UPCOMING EVENTS

Tele-Conference Call

Thursday, December 7, 2000 at 1:00pm PST
Ted Holmes & David Wanetik
from [Intercounty Clearance Corporation](#)

Revised Article 9 goes into effect July 1st,
What do you do?

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Stop The Bleeding



By Dr. Ron

These are interesting financial times we live in. Many of the old rules no longer apply, but which ones? We are all guessing as to what will happen next. I am particularly concerned about the balance of trade, which will exceed \$350 billion this year, a 50% increase over 1999. Normally this would cause foreign money to leave this country at an alarming rate which would, in turn, cause financial havoc. But that is not happening. Why? Because there is no other country safe enough or large enough to absorb all the cash. Sooner or later something will give but who knows what. The "soft landing" seems to be working, but this country is running at extremely high levels of leverage. There cannot be much room for error. Greenspan probably received better grades than I did in economics, but I wonder how long can we keep going before something bursts.

What does this have to do with the factoring industry? Ladies and gentlemen, I think it is time to tighten our operations and our underwriting standards. It is certainly **not** time to abandon safety for volume. So send me all your turndowns (*just kidding*).

It has been said that crooks spend twenty-four hours a day trying to figure out how to beat us and we spend a scant eight hours a day to try and stop them. That usually means that we will lose the contest and take a loss. All we can do is try to mitigate that loss and get on to the next deal. Unfortunately, I have a recent example to share with you. In fact, we are still involved in the liquidation process.

About nine months ago we decided to take on a start up air freight forwarder. An air freight forwarder is one step removed from a trucking broker, and we all know that financing a truck broker can be a treacherous undertaking for factors. But, air freight is not quite the same as brokering in that most of the payables are to airlines and not to local haulers. We also had a lot of controls in place and we knew the borrower from previous dealings. So we plunged in head first.

The borrower hired a professional sales organization to do all the sales and marketing. Well, sell and market they did. After six months in business the volume exceeded \$500,000 per month and was still growing. We became concerned about their rapid growth, especially since their record keeping was something short of spectacular, and we decided to start lowering our exposure and building reserves despite the fact that the portfolio was performing nicely. Accordingly, we began imposing tighter credit limits on account debtors, which had the same effect as reducing the advance rate.

There was a lot of friction between the borrower and us during the next two months as they became cash tight. Several visits were paid to the borrower's location to try and ease the friction. We needed to continually lessen our exposure, and we did. During these two months our advance rate dropped from 90% to 75% and we felt a lot better.

We received a phone call from the client on the Friday before the fourth of July. During that call the client advised us that because it was the week before a holiday, his billings were low and he had no cash to operate with. It was also payday. According to our formulas we could not advance any cash, but the client advised us that by the following Tuesday, we should receive enough new paper to cover his request. The last thing we wanted to happen was for the client to go out of business, so we agreed to advance \$40,000. The following Tuesday, we learned that the client had closed his doors over the weekend. At that time we were still about 75% advanced. Of course, we received no invoices the following week.

During the next two weeks, we learned that the successful sales effort was due, in part, to the sales organization's relationship with key employees at some of the larger account debtors. Unbeknownst to us, the sales organization also did all the invoicing! Based on

information supplied by others, it is our belief that the sales organization, in collusion with those key account debtor employees, were submitting inflated invoices which were subsequently approved and paid in full. You can imagine what happened to the extra cash. Now that the client had no cash to pay the sales organization, the sales organization had no cash to pay those key employees. Management at those account debtors are now looking into the matter and we are continuing to negotiate with them and collect our money.

It is now seven weeks, several law suits and a temporary restraining order later. We are now less than 47% advanced but the "easy" receivables have all been collected. In the next issue I will let you know how we made out, but it appears that we will take a small but manageable loss.

This is as good a time as any to remind you to check the IFA web site for fraud warnings before you book new business. Go to www.factoring.org, click on Membership Services, enter your user name and password (contact the IFA if you do not have them), and then, under Membership Services, click on Forum, then Fraud.

When a client's employee, or in this case, a sub contractor, is in collusion with an account debtor employee, you are bound to take a hit. In this particular case, when the sales began to mushroom we could have asked for "Agreements to Pay Without Offset" from the account debtors. Who knows what might have happened? It is hindsight, to be sure, and we may or may not have been in as good a position as we are today.

To share your experiences or to seek the advice of the author, Ron Winicour can be reached by e-mail to ron@gibraltarfinancial.com or by snail mail to Gibraltar's corporate address.

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Fraud

by Jim Lewis

The one constant in the factoring industry is that no matter how careful you are, sooner or later fraud will take its toll. Some are ingenious, some humorous, but all are painful. We share with you one from our experience in hope that some lesson can be learned.

The client had nearly perfect credentials. We were introduced to the company by an intermediary we knew and respected; the same was true of the counsel representing the business. The company was owned and managed by the founder's son and had been financed for over a year by a bank-owned factor. Allegedly, the factor wanted out of the credit due to tightening credit restrictions in the bank overall and the fact that the account debtors paid slowly. The company was local, so we felt comfortable that monitoring the credit would present no logistical difficulties. We were not terribly comfortable with management, however, we took some degree of comfort in the fact that the owner had grown up in the business and had been at the helm for several years.

The company was a paper and cardboard converter, taking light-weight cardboard stock and coating it with a quality finish paper suitable for printing, then cutting it to the customers' specifications. Customers ranged from numerous small print shops located in all parts of the U.S. to large retailers. There was good geographical diversity and no concentration issues. All in all, it appeared to be an excellent factoring prospect.

Things went smoothly for the first few months, although some of the original invoices we had taken over from the predecessor factor were beginning to become old. Collections, however, were sufficient for us to apply significant amounts from the reserve account to older invoices. At this point, we began to intensify our collection efforts. In response to our requests for written verification sent by fax and mail, the verifications were generally positive without an usual number of credits. Still, payments remained slow. The verifications confirmed (in writing) that the goods had been received, were acceptable and that the invoice would be paid. Other than the slowness of payments, there was no indication that something was wrong.

Early one afternoon, we received a call from a departmental manager for one of the larger account debtors, a national retailer. The agent was concerned that he had verified a number of invoices, but

that the goods had not actually been received. We began an immediate investigation that showed our client had made a general practice of calling his customers to tell them they must verify the invoices in order for him to get funds in order to produce and ship the goods. Virtually 100% of his clients went along with his request, presumably based on their long-standing relationship with the company.

Collection efforts produced a variety of results. Many of those who had received the goods paid, although some paid discounted amounts. Those who had not received goods resisted, however, some eventually paid. The others, despite having signed verifications, refused. We pursued legal remedies and obtained judgments in our local court. This was sufficient to bring in some additional dollars, although settlement was the norm. Others refused, forcing us to pursue collection in their local jurisdictions. In many cases, the amounts were not worth the expense of further pursuing collection. While we were successful in collecting a number of the invoices, the primary beneficiaries were the attorneys representing us in the proceedings.

There was nothing clever or cute about this fraud. Although it involved numerous and geographically diverse account debtors, it was simple...and terribly effective. Unlike fraud cases where the account debtor is benefiting along with the client, in this instance the account debtors thought they were doing a favor for their long time supplier. We looked long and hard at what we could have done differently. From the outset, we were not comfortable with management, but did the transaction anyway because all of the pieces seemed to fit into place. Our conclusion was that we should have listened to our own concerns rather than get caught up in the process.

Jim Lewis is with Philadelphia Factors and can be contacted at 610-341-9744.

Fraud Contest

As a new feature of The Commercial Factor, we are pleased to present our Fraud Column. We will be featuring an interesting fraud story each month in this column.

We are also running a contest for the best fraud story. The best story will receive a complimentary registration to the 2001 Factoring Conference in Scottsdale, Arizona. Judging by the IFA Board of Directors is strictly arbitrary and the stories themselves should not be fraudulent.

To enter the contest, please submit your story to the IFA by December 31, 2000 at the following address.

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See page 9 for more details.

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