


THE FACTORING AGREEMENT: OUR GUIDE

SALE OF DEBT AND TRANSFER OF OWNERSHIP IN A UK AGREEMENT

LIST OF RELEVANT DOCUMENTS

- **Sales contract**  ▪ **How are sales documented**
- **Invoice / Notice of Assignment**  ▪ **How can an invoice be designed to be more effective**
- **Factoring Agreement**
- **Introductory letter**

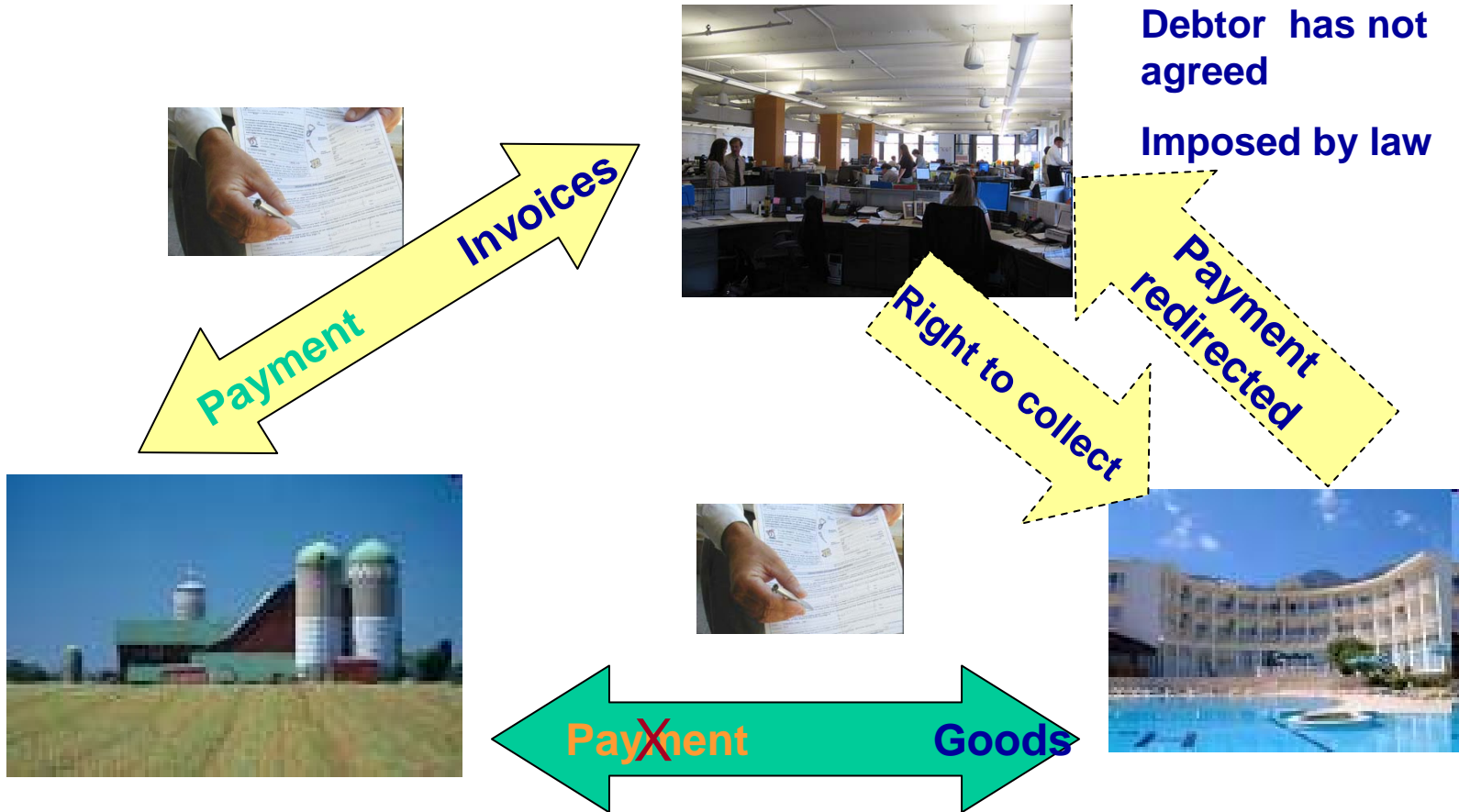
DO YOU THINK YOU WILL FIND THESE TERMS IN THE FACTORING AGREEMENT

- LOAN
- ADVANCE
- INTEREST
- FACILITY
- LEND

PARTIES TO THE CONTRACT

- This Agreement is made between **FFF Commercial Finance Limited** (incorporated in England with the number 123123123) of [address] ("we" or "us") and **the client ("you")** named in section 1 of the particular terms attached to and forming part of this Agreement ("the Particulars ").
- Which key party is not a party to this agreement?
- What is this party's interest?
- What needs to be done about it?

CONTRACTUAL AGREEMENTS



OPTIONS IN THE AGREEMENT

1. Full Factoring with Recourse

2. Full Factoring without Recourse

3. Confidential Invoice Discounting with Recourse

4. Confidential Invoice Discounting without Recourse

5. Disclosed Invoice Discounting with Recourse

6. Disclosed Invoice Discounting without Recourse

7. Disclosed Delayed Dunning with Recourse

8. Disclosed Delayed Dunning without Recourse

9. Undisclosed Delayed Dunning with Recourse

10. Undisclosed Delayed Dunning without Recourse

Dunning: process of methodically communicating with customers to insure the collection of accounts receivable, progressing from gentle reminders to almost threatening letters as accounts become more past due. It is generally unlawful to harass or threaten consumers. It is ok to issue firm reminders and to take all allowable collection options.

VARIATIONS

	BAD DEBT COVER	NOA at issuance	AGENCY	PPMT
1. FF-R	N	Y	Y	Y
2. FF-NR	Y	Y	Y	Y
3. CID-R	N	N	N	Y
4. CID-NR	Y	N	N	Y
5. DID-R	N	Y	N	Y
6. DID-NR	Y	Y	N	Y
7. DDD-R	N	Y	N	Y
8. DDD-NR	Y	Y	N	Y
9. UDD-R	N	N	N	Y
10. UDD-NR	Y	N	N	Y

**OWNERSHIP OF THE DEBT:
*THE HEART OF FACTORING***



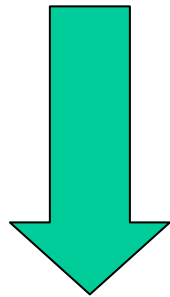
6. SALE AND PURCHASE OF DEBT

You will sell to us and we shall purchase all Debts coming into existence during the period of this Agreement

...those Debts will belong to us automatically as soon as they come into existence without the need for any other act of transfer.

WHY THE EMPHASIS ON SALE & PURCHASE?

COMMERCIAL EFFECT



ESSENTIALLY SAME AS IF CLIENT TOOK
OUT A BANK LOAN SECURED AGAINST
RECEIVABLES

LEGAL FORM



**DIFFERENCE EMERGES WHEN BUYER
DOES NOT PAY; HAVING PURCHASED
THE DEBT GIVES MORE RIGHTS**

FACTOR HAS A STRONGER LEGAL POSITION

- Purchase of Debt gives Factor **benefit of direct recovery**
 - Do not need to go through Seller
 - Security intact upon Seller's insolvency
 - Do not need to appoint a receiver

SECURED LENDING

SALE OF DEBT

Receivable as security
Buyer a better risk?

Charge against asset
(English law)

No ownership transfer
(no assignment)

Rights only exercisable
when seller defaults; **no
right to act alone**

Buyer not notified
until default

Receivable/
invoice sold

Right to receive
payment transferred
to financier

Ownership transferred
(through assignment)

Notice to buyer of
key legal importance

Financier has full rights
to act in own name



ASSIGNMENT IS THE KEY INSTRUMENT IN FACTORING

- **Assignment = right to transfer debt to a third party**
- **Factor wants the Law to provide unencumbered ownership—sole right to collect in full**

Invoices result from sales contract; **they have no legal status on their own** (unlike a **bill of exchange**, which has a whole legal act The Bills of Exchange Act)

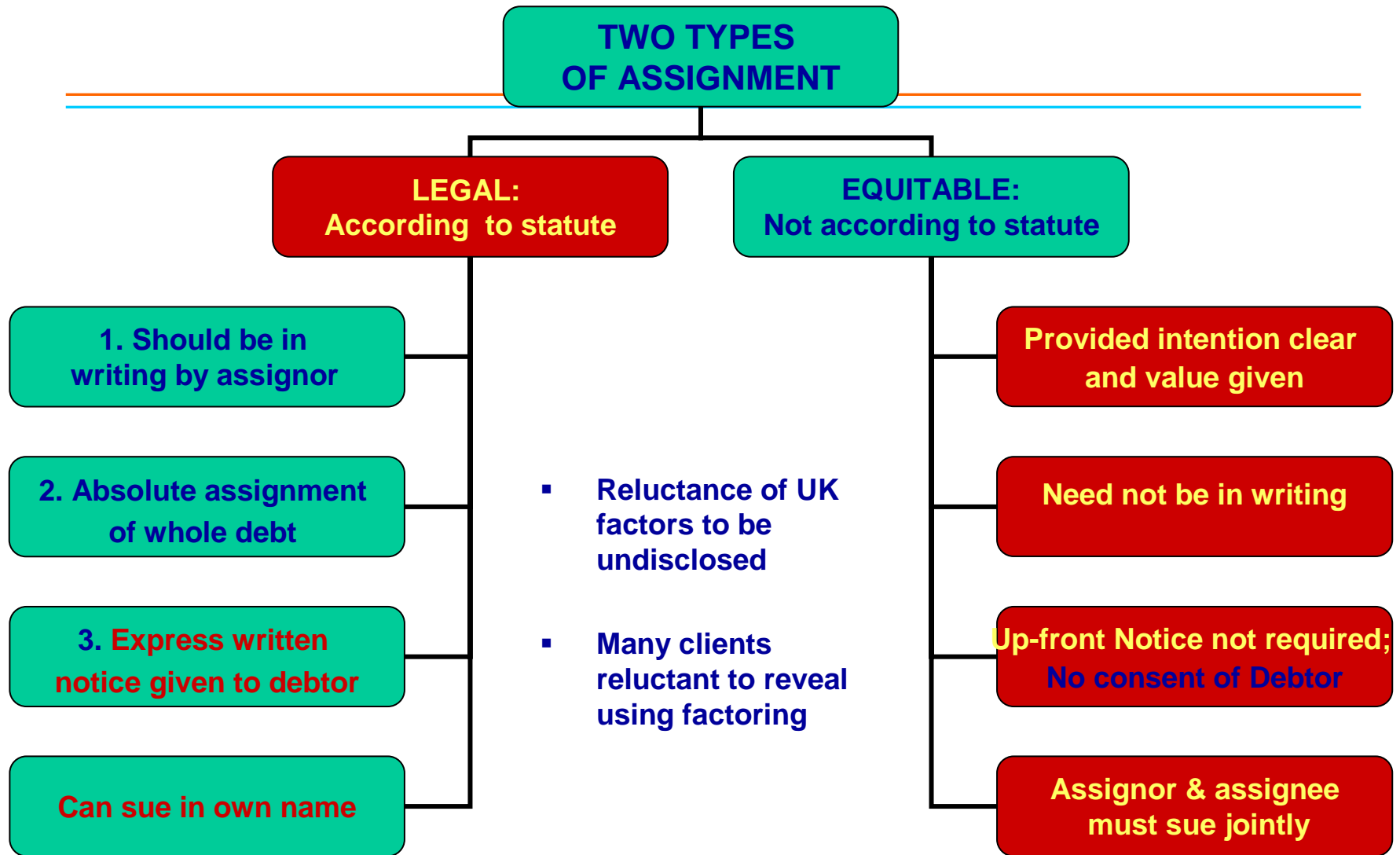
Invoice is the Seller's presentation of what he thinks is owed

- To physically possess a B/E is to have rights
- To physically possess an invoice gives no rights

US LAW

- **Uniform Commercial Code (UCC)**
Art 9: **requires registration** which **serves as notice**; **PERFECTION** of security interest--valid defence against 3rd party claimants
- **Disclosure to Buyer not required** (even if sales contract prohibits assignment)
- **HENCE: US law allows automatic assignment of receivable** separate from other contract rights

ENGLISH LAW MORE COMPLICATED



NOTICE OF ASSIGNMENT: LEGAL EFFECTS

- English law: *No comprehensive legal dealing as with US UCC*
- Grey areas vis-à-vis priorities of rights & interest
- Complex for intangibles (such as invoices)
- General rule established by **Dearle v Hall (1828)**
- Assignee 1st in time: if there exists an earlier assignment, 2nd assignee can still preserve assignment **by providing notice first** (relevant date – receipt by Debtor)
- **Importance of getting notice as fast as possible** (superior legal position)

TWO CREDITORS CLAIM SAME INVOICE NOTICE OF ASSIGNMENT IS A MATTER OF TIMING

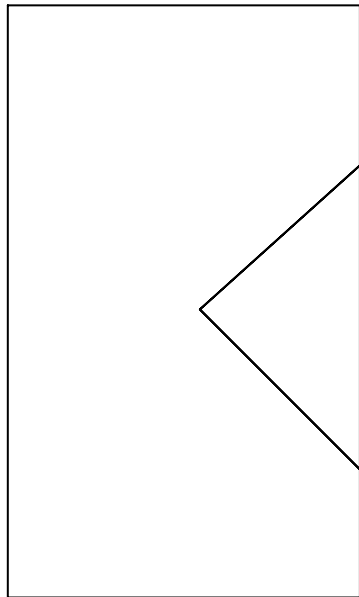


HOW IT CAN GO WRONG: SALES CONTRACT PROHIBITING ASSIGNMENT

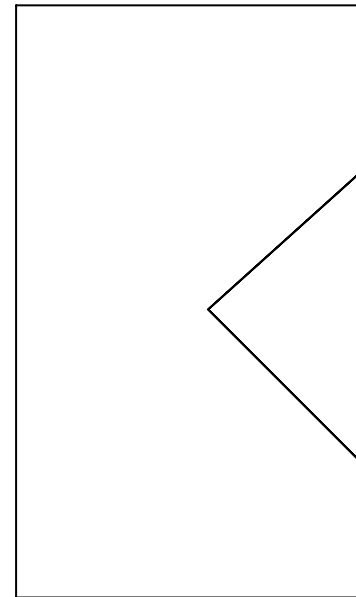
- **GB: Linden Garden Trust Ltd v Lenesta Sludge Disposals Ltd [1994]**
- **House of Lords: ‘*an assignment of contractual rights in breach of a prohibition against such assignment is ineffective to vest the contractual right in the assignee*’**
- **Effect: Prohibition against assignment of ‘the contract’ includes a prohibition against assignment of the creditor’s right to be paid**

ASSIGNMENT OF PAYMENT RIGHTS

US law: payment rights can be separated from other contractual rights



UK law: Payment rights integral part of contractual rights



SALES CONTRACT: ACTUAL ASSIGNMENT CLAUSE

TYPICAL



Neither party shall assign its rights and obligations under the Agreement, in whole or in part, without the prior written consent of the other party...

If such written consent is given and wherever the assignment is made, *the assigning party shall remain jointly and severally liable with the assignee for the full performance of its obligations* under the Agreement

EXTRA



Risk:

**Could be used by receiver of Client in bankruptcy
to challenge ownership of proceeds**

WHAT NEEDS TO BE DONE

Factor must review all sales contracts and check for the prohibition

Factors often request Client to get written permission

UK: include legal concept that Client is holding proceeds 'in trust'; added legal protection

EFFECT OF NOTICE: STATEMENT ON INVOICE

“The debt represented by this invoice has been purchased by and assigned to and is to be paid to [Factor’s Name and Address] of [City] or direct to their bank account at:

[Bank’s Name & Address]

Sort Code/IBAN: [.....]

Account Number: [.....]

Your obligations in respect of this debt will be discharged by payment only to [Factor’s name] who should be advised of any

EFFECT OF NOTICE: PRACTICALITIES

- **In practice: Debt in existence before invoice sent**
- **Assignment effected automatically in the coming into existence of the Debt**

CLAUSE 6.3: WHICH TYPE ASSIGNMENT DOES THIS REFLECT?

...those Debts will belong to automatically as soon as they come into existence without need for any other act of transfer.

**EQUITABLE
ASSIGNMENT**

SUMMARY: RECEIPT OF NOTICE

- 1. Establishes Factor's priority against competing interests**
- 2. Fixes the rights of parties in relation to the debtor's countervailing rights**
- 3. Prevents the discharge of the debtor by subsequent payment to the client**
- 4. Avoids changes in contract terms not authorised by the Factor from being enforceable against the Factor**
- 5. Enables the Factor to act in recovery in his own name**

A COUPLE OF MORE POINTS

- **Introductory letters**
- **At start of Factoring Agreement, a letter to all debtors informing them of the arrangement and assignment of debts**
- **Factoring Agreement: assignment is made by the Agreement (present assignment of future debts) but is **inchoate** until each debt comes into existence**

15.4 NOTICE OF ASSIGNMENT

- **Where assignment notices are required for the service chosen by you, you will ensure that:**
- **15.4.1** on the Business Day next following the Starting Date there is sent to every Debtor by whom any Debt is then owing a notice; and
- **15.4.2** every invoice representing a Debt and issued after the Starting Date bears a prominent and legible notice;
- in each case that the Debt has been purchased by and is payable only to us. Every notice shall be in a form specified by us.