



*Transportation Lawyers
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Factoring Basics - What is it?

- ▶ Carrier is selling and the Factor is essentially purchasing (receiving an assignment and ownership) an Account Receivable (the right to receive payment) at a discount.
- ▶ Carrier receives a high % of invoice now.
- ▶ Factor receives full amount of invoice later.
- ▶ In transportation, we typically deal with “Recourse Factoring”
- ▶ Difference between “Recourse” and “Non-Recourse Factoring”

What Industries or Industry Players?

- ▶ Factoring can be involved in nearly every industry, especially commercial
- ▶ Common in transportation, construction, many others
- ▶ Not only can/do CARRIERS factor their invoices
- ▶ BROKERS can factor their invoices too
 - ▶ Typically, the factor will want to manage payments to carriers to assure that they are paid.

Benefits to Carrier

- ▶ Receives almost immediate payment for freight bills
 - ▶ Example: 98% now, rather than 100% in 30 days
- ▶ Typically, less discount than broker quick-pay programs
- ▶ Ability to manage cash-flow better
- ▶ Might avoid fuel or other advances and fees that might be associated with advances

Benefits to Brokers (Brokers that Factor)

- ▶ Reduces calls requesting payment from carriers
- ▶ Reduces fuel & other advances
- ▶ Reduces A/P burden
- ▶ Receive almost immediate payment of freight bills
- ▶ Ability to better manage cashflow
- ▶ Transfer A/R and A/P functions to Factor
 - ▶ Simplify business
 - ▶ Reduce Administrative Overhead

Risks to Factoring Company

- ▶ Non-payment by the Account Debtor (Carrier's Customer)
- ▶ Customer offsets (cargo claims, delay claims, etc.)
- ▶ Advances made to carrier not reflected in the invoice
- ▶ Solvency of carrier if customer does not pay (recourse)
- ▶ Fraud of other kinds

Differences in A/R Financial Products

- ▶ Difference between Factoring and A/R Credit Line/Facility
 - ▶ A/R Credit Line/Facility
 - ▶ Governed by the “security interest” granted
 - ▶ Notice of the “security interest” through the UCC-1 (financing statement) filing
 - ▶ Payment still goes to CARRIER, unless there is a default and the “secured creditor” gives you a notice of default and demand to pay directly
 - ▶ Factoring
 - ▶ Factor company takes an actual “assignment” of the A/R, not just a “security interest” (Factor becomes “owner” of the right to receive payment)
 - ▶ Governed by the Notice of Assignment (“NOA”) - UCC 9-406
 - ▶ Payment must go directly to the FACTOR

Factoring Governed by Uniform Commercial Code (“UCC”) § 9-406

► UCC 9-406(a)

“(a) [Discharge of account debtor; effect of notification.] Subject to subsections (b) through (i), an *account debtor* on an *account*, chattel paper, or a payment intangible may discharge its obligation by paying the *assignor* until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that the payment is to be made to the *assignee*. *After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.*”

Who is Who - Terminology

- ▶ “Account Debtor” = Carrier’s Customer (often 3PL)
- ▶ “Account” = Freight Invoice - right to receive payment
- ▶ “Assignor” = Carrier
- ▶ “Assignee” = Factoring Company
- ▶ “Notification” = Notice of Assignment (NOA)

Whom to Pay When?

▶ UCC 9-406(a)

“After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.”

*Once you receive an NOA, you must pay the Factor Company.

Or potential for double-payment liability.

Can you prohibit the carrier from factoring?

- ▶ Customer/Broker (“Account Debtor”) cannot prohibit a carrier/assignor from assigning accounts to a Factor Company. 9-406(d)
 - ▶ Some differences on government accounts. 9-406(f)

Request for Proof of Assignment

- ▶ Request for Proof of Assignment

- ▶ “Authenticated” - does not mean that carrier must sign it. The “assignee” (Factor Company) can sign.
- ▶ If Account Debtor (broker/customer) requests, then the Assignee (Factor) must “seasonably furnish reasonable proof that the assignment has been made.”
 - ▶ Most of the time, they will have an NOA signed by the carrier.
 - ▶ If not “seasonably” furnished, carrier can be paid directly.

Assure that Factor is set-up in Accounting or TMS payables system

- ▶ If not set up correctly in your software, you may pay the carrier despite the NOA and face double-payment.
 - ▶ Consider establishing the Factor at carrier set-up (but be sure to get an NOA)

Defenses to payment to an Assignee

- ▶ Typically, the factor has “stepped into the shoes” of the carrier in terms of right to payment.
 - ▶ Some exceptions depending on whether you acknowledge waiver of defenses in the NOA
- ▶ Offsetting
- ▶ But factors do NOT take on the liability of the carriers/assignors

Extension of Credit by Factors

- ▶ Factors monitor payment history by brokers, shippers and other very carefully
- ▶ If Brokers/Shippers do not pay timely, it will still severely impact their carrier network, because Factors will refuse to purchase accounts receivable/invoices owing by delinquent account debtors
 - ▶ Factors track payment history through their own records and through credit reporting agencies, such as Ansonia and others
 - ▶ Consider payments using ACH, wire or other methods to reduce your “days to pay” and your costs (check printing, postage, etc.): THIS WILL IMPROVE YOUR CREDIT

Other Potential Issues

- ▶ Advances to carriers
 - ▶ you can since the payment is not yet a receivable; but, be cautious
- ▶ Verifications from Factoring Company
 - ▶ Be sure you advise the factoring company of the advance
- ▶ Termination of NOA (change of factoring company)
 - ▶ Be sure that you manage termination/releases of the NOA properly as well.
 - ▶ Once released, you should pay the carrier OR MORE LIKELY the new/substitute factoring company
- ▶ Merchant Credit Agreements (MCAs)

What is a Merchant Creditor Agreement (“MCA”)?

- Fairly new financing product
- Finance company/merchant creditor takes assignment of FUTURE accounts receivable
- Often require daily automatic withdrawals from carriers bank account
- Usually extremely high rate (if converted to APR) - some 100% or even much higher
- Often signal financial distress of carrier

Merchant Creditor Agreements

- ▶ Like factoring, you will receive an NOA, typically only after the carrier has defaulted on the MCA
- ▶ Normally, instead of being one page, they are many pages

Merchant Creditor Agreements

- ▶ You must honor the NOA under an MCA just the same as an NOA from a factor company
- ▶ Be sure you have procedures in place to change the payment instructions for the payment of the carrier's invoices
- ▶ Priority among competing NOAs (first in time; first in right)
- ▶ Be sure that prioritization is correct

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The ABC's of Factoring in the Transportation Industry

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Litigation Trends

1. Factors (for Carriers) fighting Factors (for Brokers)
2. Factors fighting Bankruptcy Trustees
3. Factors fighting Broker-Carrier Agreement Waivers

Litigation Trends

Preference Claims

- There have been four significant brokerage insolvencies this year.
- Bankruptcy Trustees are readying for preference claims.
 - But....
 - Factors/Carriers are special, right?

Freight Charge Priority

Bankruptcy Preferences

- In *In re Computrex* (No. 01-53755, ADV. NO. 02-5024 (Bankr. E.D. Ky. May 24, 2002)) the trustee for the debtor third party intermediary/broker claimed payments made to a motor carriers were preferences that should be reimbursed to the broker's bankruptcy estate.
- Factors and Carriers argued broker was held to be a mere conduit for freight charges due to the motor carriers. The payments were not preferential transfers because they never became part of the broker's bankruptcy estate since the broker was merely a disbursing agent without sufficient control and dominion over the funds to constitute part of its estate.
 - The Computrex Court agreed and ruled the carrier amounts were not preference payments.

Freight Charge Priority Factor v. Factor

- In 2023, primarily in bankruptcy contexts, Factors will be fighting Factors for priority to the proceeds of brokerage collections.
 - More and more freight brokers are factoring their accounts receivable.
 - Factors for the brokers say the gross invoice is theirs based on the collateral pledged by the broker and certain UCC Article 9 provisions.
 - Factors for the carriers say that everyone knows the majority of the invoice is for carrier payables for motor carriage services and those proceeds should be segregated and held in trust for the carriers based on federal regs and case law (in reality, the Factors who have already advanced on the invoices).
 - Notes: This same principle applies if the broker has a traditional secured lender. Also, this argument is being posed in multiple interpleader actions with Factors for the carriers claiming priority vs. the Factor for the broker claiming priority.

Freight Charge Priority

The Rationale and Some Law

- ***WorldPoint Logistics 01-23448-SJS*** (Eastern District of Washington, Seattle Bankruptcy Court)
 - About 34 carrier companies won a lawsuit against WorldPoint and its Secured Lender, Deutsche for unpaid invoices for freight services.
 - The basis of the suit, was, much like Computrex, that the motor carrier portion of WorldPoint's collections were not part of the bankruptcy estate and did not belong to WorldPoint and/or the BK estate.
 - This case recognized bill of lading rights as being superior to WorldPoint or Deutsche's secured interest.

Broker-Carrier Agreement Waivers

- “Carrier and Broker expressly waive any and all rights and remedies allowed under 49 U.S.C. Section 14101(b) to the extent that such rights and remedies are in conflict with this Agreement.”
- Factors are litigating against brokers:
 1. Whether 14101 waiver means a valid waiver under 49 CFR 371.3, 10, and 13.
 2. Whether 14101 waiver means a waiver of Carmack (not otherwise specified).
 3. Whether language prohibiting Carrier/Factor from collection attempts against third parties is enforceable. And whether supposed carrier waivers saying Carrier has waived right to collect/be paid by any other party than the broker is enforceable.



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Regulatory Considerations

- Most regulations apply to either consumer lending or banking, factoring is exclusively B2B lending. The relationship is a “true sale” of a receivable as governed by Article 9 of the Uniform Commercial Code.
- Factors enter a contract with their clients, underwrite both the client and the account debtor (aka client's customer).
- These are commercial transactions.
- Special protected under the UCC change the nature of the relationship, such as the good faith purchaser defense.
- State case law is all over the map depending on jurisdiction, very little guidance at a Federal level.



Federal Regulations

- Consumer Financial Protection Bureau has passed requirements on credit facilities specifically expanding Dodd-Frank Act with reporting requirements on small business loans. They expressly included MCAs but expressly excluded Factors noting the distinction between factoring and a credit facility.
- Federal Proposed S.2021 proposed to amend the Truth in Lending Act to include all forms of alternative finance with a specific section applying to factoring. (Unlikely to go forward this Congress)
- Misc: TPA and collection laws do not apply in commercial transactions



State Laws: Disclosure and Licensing

State	Bill No.	Status of Legislation	Status of Regulation	APR Requirement
CA	-	Enacted	Final - Compliance Date of December 9, 2022	Yes
CA	SB 33 - Would Repeal 2024 Sunset on APR Disclosure and Make Permanent	Passed Senate; Pending in Assembly	-	-
NY	-	Enacted	Final - Compliance Date of August 1, 2023	Yes
UT	-	Enacted	No regulation will be issued; Compliance Date of January 1, 2023	No
VA	-	Enacted - Only applies to MCAs	-	Yes
GA	-	Enacted May 2023 - Compliance Mandatory on January 1, 2024	-	No
FL	-	Enacted June 2023 - Compliance Mandatory on January 1, 2024	-	No
CT	-	Enacted - Only applies to MCAs	-	Yes
MO	HB 584; HB 586; SB 187	Died in Conference	-	No
IL	HB 3064; SB 2234	Died in Committee	-	Yes
MS	HB 1271; SB 2619	Died in Committee	-	No
KS	SB 245	Died in Committee	-	No
MD	SB 496	Died in Committee	-	Yes
TX	HB 4359; SB 1918	Died in Committee	-	No
NC	SB 539; HB 662	Pending in House and Senate Committees	-	Yes



Why Does it Matter?

Piecemeal legislation with requirements that do not fit the structure have led numerous factors to leave certain markets.

Factoring is often the only bridge financing option for small business, like owner-operators, many of whom are deemed unbankable due to the short credit history or perhaps something in their back ground.

Factors leaving the highly regulated markets will have a major impact on trucking. Those factors who remain will have less competition which will drive rates up.