

Strafford

---

*Presenting a live 90-minute webinar with interactive Q&A*

# Collateral-Based Financing Using Accounts Receivable and Inventory

Strategies for Lenders and Borrowers Crafting Commercial Loan and Security Agreements

---

THURSDAY, DECEMBER 16, 2010

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

---

Today's faculty features:

Paul B. Hahn, Partner, Golenbock Eiseman Assor Bell & Peskoe, New York

Harvey C. Guberman, Ballon Stoll Bader & Nadler, New York

---

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

## *Continuing Education Credits*

FOR LIVE EVENT ONLY

---

For CLE and/or CPE purposes, please let us know how many people are listening at your location by completing each of the following steps:

- In the chat box, type (1) your name, (2) your company name and (3) the number of attendees at your location
- Click the arrow to send

## *Tips for Optimal Quality*

---

### *Sound Quality*

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory and you are listening via your computer speakers, you may listen via the phone: dial **1-866-873-1442** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail **[sound@straffordpub.com](mailto:sound@straffordpub.com)** immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press \*0 for assistance.

### *Viewing Quality*

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

# Collateral-Based Financing Using Accounts Receivable and Inventory

---

Paul B. Hahn

Golenbock Eiseman Assor Bell & Peskoe

phahn@golenbock.com

212.907.7338

Harvey C. Guberman

Ballon Stoll Bader & Nadler

hguberman@ballonstoll.com

212.575.7900

# Mechanics of Inventory/Accounts Receivable Financing

- Formula Advances.
- Advance rates against eligible Accounts.
- Advance rates against eligible Inventory.
- Know the quirks in the Industry/business you are financing.
  - Perishable Agricultural Commodities Act (“PACA”) 7 USC Chapter 20A Section 499.
  - Construction Industry issues – bonding companies.

# Mechanics of Inventory/Accounts Receivable Financing

---

- Airplane parts –certifications.
- US Assignment of Claims Act Assignment of Claims Act of 1940, 31 U.S.C. § 3727, 41 U.S.C. § 15.
- Is the inventory subject to licensing (trademark, patent, copyright).
- Is inventory consigned (UCC 9-319).

# Determination of what type of accounts financing to choose

## Factoring – Purchase of Accounts Receivable

### Advantages

- Credit Risk Assumption.
- Customers may only offset against the invoice which is the subject of the disputed merchandise or service.

# Determination of what type of accounts financing to choose

## Factoring – Purchase of Accounts Receivable

- Documentation typically much simpler/ less expensive.
- Factors are generally willing to finance more financially troubled companies.
- Borrowers balance sheet reflects accounts due from factor rather than individual customers.



# Determination of what type of accounts financing to choose

## Factoring – Purchase of Accounts Receivable

---

### Disadvantages

- Have to pay a commission for servicing the Accounts and assumption of credit risk.
- Customers notified on Invoice that it is sold to Factor and to pay the factor directly.
- Under UCC 9-406 once notified customer may only pay assignee/factor and pays vendor at its peril.

# Determination of what type of accounts financing to choose

## Factoring – Purchase of Accounts Receivable

---

- Not always looked upon with favor outside of garment textile/electronics industry.
- Customers resist the restrictions on offsets for disputes.
- In the event of a Chapter 11 automatic stay may not prevent the Factor from collecting the accounts purchased prior to the filing.

# Determination of what type of accounts financing to choose

## Asset Based Financing with full recourse

### Advantages

- All things being equal is less costly than factoring.
- Generally accounts are invoiced on a non-notification basis (may have payments directed to a lock-box).
- Accepted by customers in all industries.
- Generally less reports issued to the lender.
- Borrower generally conducts its own collection efforts.

# Determination of what type of accounts financing to choose

## Asset Based Financing with full recourse

### Disadvantages

- Extensive criteria to determine eligibility.
- Much lengthier documentation and more expensive to document.
- Generally lender is less willing to finance troubled borrower

# Determination of what type of accounts financing to choose

Letter of Credit Financing a subset of Inventory and Accounts Receivable Financing

- Mechanics
- Reserves
- Pricing

Purchase Order Financing a subset of Inventory Financing

- Mechanics
- Pricing

## Account Debtor's Rights of Offset against Assignee

- Section 9-406 provides that the assignor is discharged from its obligations by paying the assignor, until, but not after, the account debtor is notified that the amount due has been assigned and that payment is to be made to the assignee.
- The account debtor has all defenses it would have against the assignor arising from the transaction that gave rise to the contract or any other defense arising prior to notification of the assignment (9-404)

## Remedies After Default

- If so agreed and in any event, after default, secured party may notify account debtors of its interest and to make payment directly to the secured party (9-607).
- Collection efforts must be “commercially reasonable”. For example, secured party cannot settle a \$500,000 account for \$100,000 merely because that amount pays its debt in full. The rights of subordinate secured creditors and the borrower are to be protected as well.
- As to Inventory, secured creditor has all rights under its agreement and under Section 9-610 (sale, lease or license of collateral).

# Remedies After Default

- Notice and commercial reasonableness of sale (safe harbor found in Section 9-613).
- Sale of Inventory subject to trademark or copyright (the necessity of waivers before default).
- Sale of Inventory subject to license requirements (alcohol, firearms, controlled substances, over the counter drugs, pesticides, etc.) Plan for liquidation before the default occurs.
- The sale transfers the debtor's interest in the property free and clear of all junior security interests in the property.



# Typical Eligibility Criteria

## Receivables

A Receivable shall not be deemed to be an Eligible Receivable if:

- The account debtor has failed to pay the Receivable within a period of ninety (90) days after invoice date, to the extent of any amount remaining unpaid after such period;
- The account debtor has failed to pay more than 25% of all outstanding Receivables owed by it to Borrower within ninety (90) days after invoice date;

# Typical Eligibility Criteria

## Receivables

- The account debtor is an Affiliate of Borrower;
- The goods relating thereto are placed on consignment, guaranteed sale, "bill and hold," "COD" or other terms pursuant to which payment by the account debtor may be conditional;
- The account debtor is not located in the United States, unless the Receivable is supported by a letter of credit or other form of guaranty or security, in each case in form and substance satisfactory to LENDER;

# Typical Eligibility Criteria

## Receivables

- The account debtor is the United States or any department, agency or instrumentality thereof or any State, city or municipality of the United States
- Borrower is or may become liable to the account debtor for goods sold or services rendered by the account debtor to Borrower

# Typical Eligibility Criteria

## Receivables

- The account debtor's total obligations to Borrower exceed \_\_\_\_ % of all Eligible Receivables, to the extent of such excess
- The account debtor disputes liability or makes any claim with respect thereto (up to the amount of such liability or claim), or is subject to any insolvency or bankruptcy proceeding, or becomes insolvent, fails or goes out of a material portion of its business;

# Typical Eligibility Criteria

## Receivables

- The amount thereof consists of late charges or finance charges;
- The amount thereof consists of a credit balance more than ninety (90) days past due;
- The face amount thereof exceeds \$\_\_\_\_\_, unless accompanied by evidence of shipment of the goods relating thereto satisfactory to LENDER in its Permitted Discretion;

# Typical Eligibility Criteria

## Receivables

---

- The invoice constitutes a progress billing on a project not yet completed, except that the final billing at such time as the matter has been completed and delivered to the customer may be deemed an Eligible Receivable;
- The amount thereof is not yet represented by an invoice or bill issued in the name of the applicable account debtor which lists Borrower's Connecticut office as the billing office.

# Typical Eligibility Criteria

## Inventory

- "Eligible Inventory" means Inventory which Lender, in its sole and absolute discretion, determines
- Is subject to the security interest of Lender and is subject to no other liens or encumbrances whatsoever (other than Permitted Liens)
  - Is in good condition and meets all standards imposed by any governmental agency, or department or division thereof having regulatory authority over such Inventory, its use or sale including but not limited to the Federal Fair Labor Standards Act of 1938 as amended, and all rules, regulations and orders thereunder

# Typical Eligibility Criteria

## Inventory

- Is currently either usable or salable in the normal course of Borrower's business
- Is not determined by Lender, in its sole discretion, to be ineligible for any other reason.