THE COMMERCIAL FACTOR

Newsletter for the Factoring Industry
W05
• Volume 7
• Number 1
• Winter 2005

International Factoring Association

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A Publication of:

THE INTERNATIONAL FACTORING ASSOCIATION
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2005 FACTORING CONFERENCE INFORMATION

VANCOUVER, BC CANADA

The 11th Annual Factoring Conference, to be held in Vancouver, is shaping up to be the largest and most interesting conference to date. We are anticipating our largest Factoring Conference ever.

The conference will be held March 16th - 19th at the Hyatt Regency Resort & Spa in Vancouver, BC, Canada. This beautiful hotel has recently undergone an $18 million renovation. This is the foremost urban hotel in Vancouver providing you with a true West Coast look throughout.

If you are thinking about attending, here is some important information for you:

Registration:

Register soon, early registration ends January 31, 2005. Early registrants will save $50 per attendee. You can register via:

- Web Site at www.factoringconference.com
- Phone at 800-563-1895 or 805-773-0011
- Email at conference@factoring.org
- Fax to 805-773-0021
- Mail to: 2005 Factoring Conference, 2665 Shell Beach Road, Suite 3, Pismo Beach, CA 93449 USA

Hotel:

The Hyatt Regency is centrally located, within walking distance to restaurants and attractions. We suggest reserving your room early, or you may find yourself unable to stay at this beautiful property. Room rates are only $130, but you must reserve by February 21, 2005. The Hyatt Regency can be contacted by calling 888-421-1442 or 604-639-4820. You must indicate that you are with the "Factoring Conference".

Airlines:

United Airlines has been designated as an official airline for the conference and is offering a group rate on all flights. Additional discounts are available if tickets are purchased 60 days in advance. To take advantage of the discount call United Airlines at **800-521-4041**. Refer to the following: **Meeting ID Code: 531CB**.

We have appointed Air Canada as an official airline of the Factoring Conference. Simply contact Air Canada's North America toll free number at **1-800-361-7585** or local number **514-393-9494** or your travel agent and take advantage of Special Discounted Airfares. Refer to the following: **Convention Number: CV053046**.

Rental Car:

Although transportation is provided for all conference activities, you may wish to do additional sightseeing around Vancouver. 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 BC, Canada while networking with other conference participants. This year we will be featuring:

- **Golf** - Wednesday March 16 from 11:00 am to 5:00pm at McCleery Golf Course. With its many water hazards, gently

CONTINUED ON PAGE 2

sloping fairways and large greens, McCleery is nestled on the north banks of the Fraser River in southwest Vancouver. Featuring well sculptured and meticulously maintained fairways and greens, Canadian architect Ted Baker designed this par 71, 18-hole course that offers a target-style golf challenge. Your $125 fee includes transportation and lunch. We will be featuring a shotgun start.

• **Deep Sea Fishing** - Wednesday March 16 from 12:00pm to 5:30pm. Fishing in Vancouver in March is excellent! You will be fishing in the scenic inshore waters of Barkley Sound for Winter Chinook (8-18 pounds) amongst frolicking gray whales, sea lions, and soaring eagles! An abundance of rockfish and lingcod have accumulated over the winter and 50+ pound halibut have begun their inshore migration. The $150 fee includes the boat trip, transportation to the boat, fishing license, bait and lunch.

• **Welcome Reception** - Wednesday March 16 from 5:30pm to 7:30pm.This year's welcome reception will be hosted by Distinctive Solutions and is open to all conference participants. Appetizers, drinks and entertainment will also be provided.

• **Guest Tour** - Thursday March 17 from 9:00am to 3:00pm. Our guest tour will be a tour of Vancouver. The tour will highlight many of the most beautiful and interesting areas of the diverse city. The $115 fee will include transportation, guided tour and lunch.

• **Hospitality Suite** - Thursday March 17 from 5:30pm to 7:30pm. Sponsored by Bibby Financial Services, Inc. the Hospitality Suite is open to all conference participants. Appetizers, drinks and entertainment will be provided.

• **Banquet Dinner** - Friday March 18 from 7:00pm to 10:00pm. The banquet dinner is one of the highlights of the Factoring Conference. This year's dinner will be held at the Vancouver Aquarium located in Stanley Park. Appetizers, drinks and dinner will be provided. Transportation will be provided.

• **Operational Round Table** - Saturday March 19 from 8:30am to 12:00pm. 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.

• **Skiing/Snowboarding** - Saturday March 19 from 7:00am to 6:00pm. Chosen as the site for the 2010 Olympic Games, Whistler/Blackcomb has been rated as the number one ski resort in North America by Skiing Magazine. The fee is $35 for transportation and refreshments on the bus.

• **Butchart Gardens & Victoria Tour** - Saturday March 19 from 9:30am to 7:00pm. The Butchart Gardens offers fifty-five acres of wonderful floral display with spectacular views as you stroll along meandering paths and expansive lawns. Victoria has the mildest climate in Canada, known as The Garden City. Victoria remembers its colorful history with First Nations totem poles, heritage architecture and afternoon tea. The $185 fee includes bus & ferry transportation and admission to the Gardens.

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NEWSLETTER FOR THE FACTORING INDUSTRY

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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.

To receive this newsletter via e-mail, please send e-mail to info@factoring.org and type the words "subscribe IFA" in the subject line.

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

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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, March 17

8:30 - 9:00	IFA Update	Bert Goldberg
9:00 - 10:30	Economic Projections affecting the Factoring Industry	Dr. David Henderson
11:00 - 12:30	Legal Issues affecting Factors	John Beckstead, Esq., Mike Ullman, Esq., Steve Kurtz, Esq., Brian Van Nevel
2:00 - 3:30	Deal Analysis	Roger Allen, Kathleen Dasal, Lew Faber, Jason Floyd
2:00 - 3:30	Maximizing Potential	Cary Mullen
2:00 - 3:30	Factoring 101	Gail Schulte
4:00 - 5:30	Nuances of Canadian Receivables	Martin Fingerhut, Esq.
4:00 - 5:30	Body Language	Patti Wood
4:00 - 5:30	Factoring 102	Ron Winicour

Friday, March 18

8:30 - 9:00	Technology and Factoring	Bert Goldberg
9:00 - 12:30	The Law of Factoring – In Depth and Dirty	Bob Zadek, Esq.,
2:00 - 3:30	How fine is the line between Operations and Marketability? More than you think!	Jay Atkins, Darla Auchinachie
2:00 - 3:30	Case Studies	Allen Frederic, Pat Haney
2:00 - 3:30	InfoMaker Custom Reporting	Ginamarie Gaughan, Gail Winther
4:00 - 5:30	Initial & On-going Client Evaluation	Debra Wilson, Wade Hladky
4:00 - 5:30	Properly Marketing Your Company	Tom Siska, Peter Aransky

As attendees in previous conferences can attest to, anyone involved with the factoring industry, this conference is a must attend event. We are looking forward to seeing you there.

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IFA TRAINING COURSES - A COLOSSAL SUCCESS

In October, 2004, the IFA conducted four different training courses specifically designed for the Factoring Industry. These courses proved to be a huge success for the factoring community garnering rave reviews.

Our first course was Credit and Underwriting for Factors. Instructors were Debra Wilson from Vertex Financial and Wade Hladky from Gulf Coast Business Credit, this course was the first of its kind to teach the importance of underwriting procedures and running credit on debtors. The first day was spent on underwriting procedures such as Financial Statement Analysis / Ration Analysis while the second day was spent on procedures to determine credit. Comments from the attendees were:

"Great program, highly experienced instructors."

"Speakers were experienced & credible, touching on a variety of topics that can be applied to several functions & responsibilities in the office place."

"Loved the insight from both parties. They both articulated the issues very well."

Our second course was a repeat of our Loan Officer / Account Executive course. Instructors were Jay Atkins from Bibby Financial and Darla Auchinachie from Liquid Capital. This course covered a variety of aspects related to factoring and was our highest rated class offered. Some comments were:

"Jay & Darla are an amazing team! Entertaining and informative."

"This was a great opportunity to get clarification on questions that were not fully answered or questionable. It also was a great way to network and see how other factors are operating."

"I think this program was great. I really learned a lot and I feel it reminds you of what you should be doing. It was also good to hear how everyone else works. I think everyone should come to this, not only AE's, because it really goes over what everyone should be doing. As AE/s we have an important job and I now realize that we have more control than I realized."

"Outstanding! Very informative and motivating. Looking forward to returning to the office and making portfolio stellar!"

Our third course was our President/ Senior Executive Meeting and Case Studies. This meeting ended up more successful than anyone anticipated. Our moderators were Allen Frederic from Gulf Coast Business Credit in New Orleans, LA and Pat Haney from Commercial Capital in Baton Rouge, LA. Also in attendance were Bob Zadek, Esq. from Buchalter, Nemer, Fields & Younger and Michael Ullman, Esq. from Ullman, Ullman & Vazquez.

Two avenues of discussion were planned. The first was to be case studies. Each attendee submitted an interesting case write up. Whether it was a positive or negative outcome, the case should be something that they learned from. This produced a wide variety of interesting cases to choose from for our discussions. As the cases were introduced, discussion flowed easily causing more detailed discussion to be introduced.

The second goal of the meeting was free form discussion on any topic that was of interest to the group. During this portion, the attendees were extremely open which produced some of the most honest and direct discussion regarding the running of a factoring operation that I have ever heard. Some of the topics were marketing, hiring, procedures, etc. Comments from the attendees were:

"Well worth the price of admission.... A first class event. I will not miss in the future."

"Every minute was informative and very educational! Thanks so much!"

"Very informative. Everyone was a lot more open and honest than I was expecting."

"Great discussion and flexibility in the discussion of various topics."

Our final meeting was Sales & Marketing for the Factor. The instructors for this course were Tom Siska from FactorHelp and Peter Aransky from The Hamilton Group. This is one of the most difficult topics to teach and the instructors did an amazing job. The first day of the course was dedicated to marketing. Topics were covered from creating a company and setting up your marketing plan to various marketing techniques. The second day we concentrated more on how to sell. We focused on specific techniques that Factors can use to sell and close more deals. Comments from the attendees were:

"It was extremely valuable. Highly informative, very practical.

"Great program. Learned a lot from it."

"Tom & Peter are a great team that complements each other."

CONTINUED ON PAGE 5

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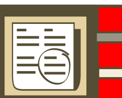
"Very informative and comprehensive program."

Due to the success of these courses, they will all be offered again. We will also be adding a case study workshop that will be open to everyone. If you are interested in attending future courses, we suggest signing up early as space is limited. The next courses will be offered in 2005 on:

- May 12 & 13 Sales & Marketing
  Monte Carlo Hotel, Las Vegas
- June 9 & 10 Account Exec / Loan Officer Training
  Monte Carlo Hotel, Las Vegas
- June 13 & 14 Case Study Workshop
  Monte Carlo Hotel, Las Vegas
- June 16 & 17 Credit & Underwriting
  Monte Carlo Hotel, Las Vegas
- Aug 25 & 26 President & Senior Executives Meeting
  Costa Rica Marriott, San Jose, Costa Rica

For additional details, check the events section of the IFA web site at www.factoring.org.



UPCOMING IFA EVENTS

REGISTER ON-LINE AT: www.factoring.org

2005 FACTORING CONFERENCE

HYATT REGENCY,
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March 16-19, 2005

TELECONFERENCE CALLS

CREDIT INSURANCE AND THE FACTORING INDUSTRY
1pm PST, Thurs.,
January 13, 2005
Cost: $40 ($50 Non-IFA members)

LABOR LAWS... WHAT YOU DON'T KNOW WILL HURT YOU!
1pm PST, Thurs.,
February 10, 2005
Cost: $40 ($50 Non-IFA members)

TRAINING COURSES

SALES / MARKETING TRAINING FOR FACTORS
MONTE CARLO RESORT & CASINO,
LAS VEGAS
9am - 5pm, Thurs. & Fri.,
May 12-13, 2005
Cost: $995 ($1045 for Non-IFA Members)

ACCOUNT EXEC/ LOAN OFFICER TRAINING
MONTE CARLO RESORT & CASINO,
LAS VEGAS
9am - 5pm, Thurs. & Fri.,
June 9-10, 2005
Cost: $695 ($745 for Non-IFA Members)

CASE STUDY WORKSHOP
MONTE CARLO RESORT & CASINO,
LAS VEGAS
9am - 5pm, Mon. & Tues.,
June 13-14, 2005
Cost: $995

CREDIT EVALUATION TRAINING
MONTE CARLO RESORT & CASINO,
LAS VEGAS
9am - 5pm, Thurs. & Fri.,
June 16-17, 2005
Cost: $695 ($745 for Non-IFA Members)

PRESIDENTS & SENIOR EXECUTIVES MEETING
MARRIOTT RESORT, SAN JOSE, COSTA RICA
9am - 5pm, Thurs. & Fri.,
August 25-26, 2005
Cost: TBA

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INVESTIGATING EMPLOYEE COMPLAINTS [last updated February 2000]

By Susan Waag

When someone needs to have assets tracked or a person followed, they may call a licensed, private investigator. But when an employer is wondering how to investigate an employee's complaint of sexual harassment, race discrimination or some form of employee misconduct, whom should they call?

Most private investigators do not understand the sensitive legal issues involved in handling a situation that could result in litigation. Instead, employers and their attorneys will often engage an independent human resources (HR) consultant to investigate a workplace complaint. While such consultants may have the expertise necessary to do an excellent job, there may be some hidden legal problems.

Private Investigator's Act: The California Department of Consumer Affairs (DCA) requires that anyone who investigates alleged misconduct or makes determinations of credibility for the benefit of an employer must obtain a private investigator's license. The Act does not apply to investigations conducted by a bona fide employee of the employer or to an attorney at law.

Consultant-Led Investigation: Although HR consultants who conduct investigations without a private investigator's license may be fined by the DCA, the law does not impose any specific penalty on the employer who hires the unlicensed investigator. Of potentially greater significance, however, an employee fired for misconduct may be able to challenge the validity of a harassment or discrimination investigation that was not conducted by a legally qualified investigator. This makes any actions or decisions by the employer based on the investigation vulnerable to attack.

Attorney-Led Investigation: The employer could avoid this problem by having a licensed attorney conduct the investigation. However, even assuming that the attorney is sufficiently comfortable with employment law issues to do this, the issue of attorney-client privilege is an important concern. If the situation is ever the subject of litigation, the employer will almost certainly need to present all or part of the investigation as evidence at trial. If the investigating attorney is also advising the employer as to what actions to take as a result of the investigation, the attorney may also be forced to testify about privileged matters. Even if the privileged matters could be compartmentalized, as a witness in the case, the attorney would be precluded from representing the employer at trial.

Fair Credit Reporting Act: The federal Fair Credit Reporting Act (15 U.S.C. §§ 1681 et seq.) requires disclosures to employees before an employer can obtain or use a consumer report or an investigative consumer report obtained through the use of a third party.

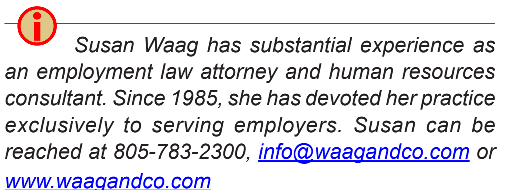
New Twist: In 1999, the Federal Trade Commission published an opinion letter concluding that a sexual harassment investigation conducted by a third party is an investigative consumer report, and compliance with the Act is required. The opinion says that the report must be provided to the employee in unredacted form if it is used in any employment decisions. Several other notice and disclosure requirements would also apply, including a requirement to inform the subject of the investigation of the intent to gather information. The employer must also obtain the employee's advance authorization to gather the information.

Applicability to California employers: This is an opinion of the FTC's counsel, and is not binding on the FTC. The letter's applicability to California employers is uncertain. However, such an application of the Fair Credit Reporting Act would give rise to numerous concerns that could hamper legitimate investigations (e.g., workplace violence risk assessment; undercover theft investigations; chilling effect on witness cooperation; intimidating harassment victims from complaining).

So, what should an employer do if it needs to conduct an investigation? There are a few choices.

1. Find a licensed investigator who has specific expertise in workplace harassment and discrimination issues;
2. Identify an employee who could conduct the investigation (with the close and privileged advice of qualified employment counsel); or
3. Find an independent employment attorney who can conduct the investigation with the understanding that his/her activities may be subject to litigation discovery.

Employers should also consider having all employees sign an authorization to investigate any issues of misconduct; this could be done in a handbook receipt. Any third party used to conduct an investigation should be familiar with the FCRA requirements. Since the employee being investigated may be entitled to receive a copy of the third-party's report, the investigator should be careful about how much detail is included. The amount of information in the report should balance the ability of the accused person to meaningfully respond to any accusations with the need to protect witnesses against intimidation. The investigator must know how to navigate in an area that presents a legal minefield.



Susan Waag has substantial experience as an employment law attorney and human resources consultant. Since 1985, she has devoted her practice exclusively to serving employers. Susan can be reached at 805-783-2300, info@waagandco.com or www.waagandco.com

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FINANCIAL STATEMENT ANALYSIS: THE WHAT, WHERE & HOW

By Allen E. Frederic

Many factors whether they are recourse or non-recourse fail to see the value of financial statement analysis. There position is that they are not lenders, but purchasers of quality receivables. Hence, there only considerations are:

1. Is the receivable which they are purchasing a true receivable supported by a quality paper trail?
2. Does the debtor have adequate financial strength to have the capacity to pay?
3. Are there adequate safeguards against fraud to prove that the receivables are valid?

I agree wholeheartedly with the above stated factoring principles. However, I do believe that factors that do not rely on any financial statement analysis put themselves at risk and certainly expose themselves to more workout and collection activities.

Financial Statement Analysis - The What

To conduct a proper financial statement analysis, we normally ask for the companies last three annual financial statements plus the most current interim statement. These would include:

1. Balance sheet
2. Profit and loss statement
3. Sources and uses for funds
4. Footnotes to financial statements

In addition, we always ask for and receive the following supporting schedules.

1. Most recent accounts receivable aging
2. Most recent accounts payable aging

Additionally, in certain circumstances, we may ask for a listing of inventory and a detailed listing of fixed assets. Normally, the latter too will not be requested unless the company is heavily inventory and/or fixed asset dependent and an all assets filing is being taken for additional protection.

Financial Statement Analysis – The How

For a quick current financial analysis, we normally use the following.

1. Ratio analysis
2. Common size
3. Trend analysis
4. Industry analysis
5. Audit and verification test

A. Ratio Analysis

In ratio analysis, we attempt to measure the following.

1. Liquidity
2. Leverage
3. Receivable and inventory activity
4. Profitability

Liquidity

The two easiest measures of liquidity are the working capital ratio and current ratio. These are as follows:

Working capital

Working capital = current assets minus current liabilities.

Current ratio

Current ratio = current assets/current liabilities.

Liquidity measures a company's ability to meet its current obligations.

The current ratio should be at least equal to one although industry comparisons are helpful. A company's inability to meet its current obligations is a red flag of impending bankruptcy.

Leverage

Two measures of leverage are the tangible net worth calculation and the debt to worth calculation. These are as follows:

Tangible net worth = total equity plus subordinated debt – intangibles – due from related parties.

Debt/net worth = (total liabilities – subordinated debt)/tangible net worth.

Leverage shows the degree to which a company may be adequately or under capitalized. Leverage measures how much debt is used to finance a company. If the economy is sagging and sales are declining there will typically be less cash flow, however, obligations to creditors remain the same.

Activity

Three measures of activity are the day's receivables, the day's payables, and the day's inventory. In short, these tell how many days on average it takes to collect receivables, the average age of the days payable, and how many days of inventory are on hand. Activity ratios measure how efficiently the company collects receivables, turns its inventory, and pays its bills. If any of these ratios are out of line, it is obvious that management is not paying adequate attention to this portion of the companies business. The activity measures for these as follows:

1. Days receivable = (trade AR/revenues) x number of days
2. Days payables = (trade payables/cost of goods sold) x number of days
3. Days inventory = (inventory/cost of goods sold) x number of days

*Number of days equals 365 (number of days in a year).

Profitability and Cash Flow Measures

The profitability and cash flow ratios are simply a measure of the degree to which a company is profitable and creates positive or negative cash flow. Three measures to be used are:

1. Gross margin
2. Profit margin
3. EBITDA

Calculations for these are as follows:

1. Gross margin = gross profit/revenues
2. Profit margin = net income/revenues
3. EBITDA = net income + interest expense + taxes + depreciation + amortization

Profitability ratios are best used to compare year to year performance or quarter to quarter from the same quarters paying attention to trends. Additionally, comparison to industry averages in a further comparison; using common size usually show in what areas the company is mismanaged or lacking control.

In addition to ratio analysis, another common way to analyze financial statement is by using the common size. On the balance sheet, the common size would use total assets at 100% with each component a certain percentage depending on its relationship to the total assets.

Trend Analysis can measure either ratio analysis or common size on a year to year basis.

Industry Analysis uses common size or trend analysis and then compares it to the RMA industry averages. RMA is the Robert Maurice Associates, a bank reporting mechanism to give industry averages by SIC code.

Both the common size and trend analysis when used in conjunction with industry averages show where improvements can be made to increase the company's liquidity and/or profitability. For example, if the industry average for a particular distributor of building products shows that inventory makes up 33% of assets, and this particular distributor has

CONTINUED ON PAGE 8

inventory which makes up 53% of assets, obviously there is either a lack of inventory control or the company is speculating with its inventory buying more than required betting that the prices will increase and they will have inventory profits. This is exceedingly common where companies fall in love with inventory and forget that they are in the distribution business but think that they are in the speculative inventory business. In addition to the financial statements, one should review the footnotes to financial statements if they are available. In the case of in house financial statements where there are no footnotes, dialogue with the chief financial officer should be used to determine the following.

1. Do the financial statements conform to generally accepted accounting principles? (GAAP)
2. Are the statements on a cash or accrual basis?
3. What is the policy for charging off uncollectible receivables?
4. How is inventory valued? I.e. What method is used and is this consistent with others in the industry?
5. What is the policy for determining obsolete inventory?
6. Do the accounting practices tend to understate asset value and reduced reported earnings, such as large allowance for uncollectibles or conservative inventory valuations or heavy depreciation charges.
7. Do the practices overstate assets and inflate earnings such as a minimal allowance for uncollectibles, liberal inventory evaluations, capitalization of certain costs that should be expensed.
8. What is the depreciation method?
9. Is there an auditor's opinion which raises any red flags?

In addition to the above 4 analysis tools, simple audit and verification tests may also be used. The first and simplest audit procedure is to add all the financial statements and make sure they foot. Believe it or not, on numerous occasions we have gotten financial statements from clients that simply don't add up. Additionally, you may make simple verification tests, for example, on the receivables which simply lend accuracy to the financial statements.

In addition to the financial statements and footnotes, one should review an accounts receivable aging and accounts payable aging dated the same date as the latest interim statement. On many occasions, we have gotten this material only to discover that the agings and the financials statements did not agree. This, of course, indicates that either the agings or the financial statements are inaccurate and sometimes worse that one or the other is fraudulent. The agings will further show the extent of very aged receivables which should have been written off and were not. This would indicate that the company has inflated their profitability. A review of the accounts payable aging is a bankruptcy indicator depending on the extent of aged payables, how many payables are seriously past due and whether or not these represent the company's major suppliers which if put on a COD basis would effectively put them out of business.

Financial Statement Analysis – The Why

Now we come to the real question, why? Why do we bother to spend time even looking at the financial statements when we have good valid receivables as evidence by the paper trail and very financially strong debtors that we expect will pay? Essentially, financial statement analysis can help us determine the following.

1. Financial viability of the company
2. A predictor of imminent bankruptcy
3. Determine amount of financial stress
4. Identify unencumbered assets and collateral
5. Assessing systems and controls
6. Assessing management strength and competence

Most of financial analysis is to determine the financial viability of the company and predict its imminent bankruptcy. In most cases, if the factor believes the company is a viable bankruptcy candidate in the short term, it is better to let the company file for bankruptcy and then have the factor provide DIP financing. First of all, this gives you a superior lien going forward and puts to rest certain other claims. Isn't is troublesome and time consuming and costly to have to deal with a bankruptcy within months after signing on a new factoring client only to have the creditors fighting over the cash collateral account and debtors that did not sign the complete no offset verification claiming there was some deficiency hence, the total amount of the receivable is not actually owed. Even is you get paid 100 cents on the dollar, just look at how much time and effort might have been taken up that could have been used for development of new business.

Accordingly, I believe financial analysis is a valuable tool in determining the financial viability and predicting an imminent bankruptcy. A look back at the ratio, common size, and trend analysis may show that a company simply has the inability to meet all of its obligations going forward. If a company shows a significant amount of payables past due in the 90-120 day column or worse, remember it only takes 3 creditors to force the company into a bankruptcy. Or perhaps there is an equipment lender whose debt has matured and is seriously past due who is threatening to seize all of the equipment which helps generate the receivable in the first place. What is the future of the company and its ability to generate business going forward? A simply industry analysis in many cases may show that the company has simple exercised bad management and is not controlling their costs or perhaps they built up inventory far too rapidly and simply need to reduce the amount of inventory that they are holding in order to create additional cash flow and operate more efficiently.

An additional reason for financial statement analysis is to determine the amount of financial stress. Remember, as the financial stress of a company increases so does their propensity for both conversions of funds away from the lockbox as well as the sale of fraudulent, questionable, or slightly inflated receivables or prebilling or some other method of defrauding or taking advantage of the factor. In our company, we use financial statement analysis to determine how much verification will do CONTINUED ON PAGE 9

IFA HAS MOVED

The IFA has relocated to new offices. Our new address is:

2665 Shell Beach Road, Suite 3, Pismo Beach, CA 93449-1778

Phone: **800-563-1895**
805-773-0011

Fax: **805-773-0021**

The IFA will continue its separation from Distinctive Solutions. This will enable the IFA to better serve the Factoring community. If you have any questions, please contact Bert Goldberg at bert@factoring.org

CONTINUED FROM PAGE 8

on a particular client. Where there is significant financial stress, we may determine that we have to do 100% full written verification or else not factor that client due to the risk. Where financial statement analysis shows significantly less financial stress, spot verification may be used.

An additional reason for doing the financial statement analysis is to assess the systems and controls which a particular company has and also assessing its management strength and competence. We have several clients who simply don't even have the ability to produce a financial statement on any consistent basis. They may be able only to provide very sketchy information in a year end tax return. This doesn't mean that we will not factor that particular company, however, it is an indication that they have very little in the way of systems and controls and hence, in order for us to purchase receivables, we must exercise control by insisting on 100% written verification with all of the appropriate offset language and estoppel language.

Summary

In summary, we use financial statement analysis as a tool to determine the level of administrative oversight regarding a particular client. This includes both initial financial statement analysis and ongoing analysis that sets guidelines for the administration of an account. This includes:

1. How much verification will we perform?
2. Does the verification need to be written or verbal?
3. Does the verification have to include all of the no offset estoppel language?
4. Do we insist on the entire paper trail i.e. purchase order, invoice, bill of lading, time tickets, etc.?
5. What is the advance rate?
6. How often will we release reserves?
7. As a recourse factor, when do we hold reserves and when do we charge back on the account?
8. Will we ever consider any over advances?
9. Will we set concentration limits regarding any of their debtors?

Last year we had our first IFA Presidents Council in Las Vegas and were fortunate enough to have approximately 30 factors attend. There were both recourse and non-recourse factors in attendance and I would dare say that there are an equal number who believed in financial statement analysis and an equal number who thought it was a waste of time. This is one of those philosophical questions where you will get a diversity of argument. I can only tell you that in our company we do and always will utilize some degree of financial statement analysis in assessing our factoring risk and at the end of the day are satisfied with our low loss history. I believe in it and will continue to utilize financial statement analysis as a valuable tool.

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

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We, a financial engineering firm, are looking for a **GM/CEO** for our Los Angeles office. Annual package will range from 80K to 125K depending on experience and qualification. CEO, reporting to group president in Hong Kong, will lead the office with initially 5 staff. Candidates should be equipped with:

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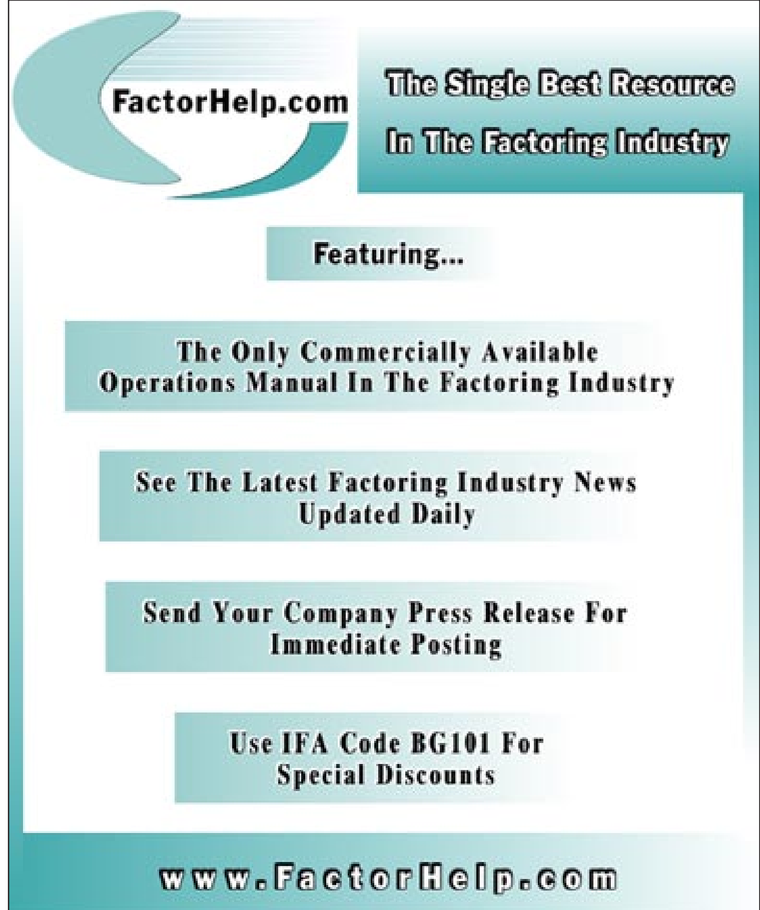

IFA FILES A SECOND AMICUS BRIEF

By Steven N. Kurtz

The IFA was recently called upon by one of its members for assistance in requesting the Supreme Court of Ohio to hear an appeal of an adverse decision in the lower appellate court. After reviewing the underlying facts and circumstances, the IFA decided to file an amicus brief, whose literal translation is "friend of the court." Our amicus brief, in a nutshell, requested that the Ohio Supreme Court hear the case because it will have a significant impact upon the factoring and secured lending communities. We further pointed out that Ohio is the only state which wrongly applies certain sections of the UCC as they relate to account debtors who are state government entities.

The case is MP Star Financial, Inc. v Cleveland State University. The facts are simple and straight forward. The factor entered into a financing arrangement with Metro Temps. Metro Temps was in the employee leasing business and supplied temporary workers to Cleveland State University. From the factor's viewpoint, this looked like a good deal. Cleveland State University, being a government entity (and presumably solvent), would pay its bills and therefore allow the factor client, who did not have a good and established credit history, to improve its cash flow. Upon approval of the account debtor, the factor sent Cleveland State University a proper notice of assignment, which directed the university to pay the factor on all accounts now or later owed to Metro Temps. The notice was to stay in place until the factor sent a properly authenticated notice to the contrary. Cleveland State University ignored the notice and paid Metro Temps directly. Unfortunately, Metro Temps did not turnover the payments it received and went into default. The factor then sued Cleveland State University for what is known as "double jeopardy" payments.

What seemed like a straight forward win for the factor was not meant to be. The trial court granted Cleveland State University's motion to dismiss. The intermediate appellate court upheld the trial court. Unfortunately, there was already prior case law in Ohio which held that Article Nine does not apply to state government entities. American Insurance Co. V. Cuyahoga Community College District, 119 Ohio Misc. 2d 118 (2002). The American Insurance case wrongly interpreted former Section 9104(e), which was one of the step back provisions of the prior Article Nine. The step back provisions state when Article Nine will not apply to a transaction and defer to different law.

Former Section 9104(e) stated to the effect that Article Nine did not apply to a transfer by a government subdivision or agency. The official comments to this former section reflected the drafters' intention that former Article Nine only excluded from its coverage situations when the state governmental agency is a borrower. All other published decisions which interpreted former Section 9104(e) held that this section only applies when the state government is a borrower and does not operate to protect the state government entity from situations when it is an account debtor. Revised Section 9109(c)(2) and (3) state to the effect that Article Nine does not apply to a state or state agency only if another statute of the state governs the creation, perfection, priority and enforcement of a security interest. The official comments to Revised 9109(c)(2) and (3) reflect the drafters intent that Article Nine does indeed apply to state governmental debtors, unless the state has a different statute which governs this situation. Moreover, Revised 9406(f) which prohibits the consent of account debtors to assignment of the accounts addresses state government agencies and prevents them from restricting assignment of accounts. The litigation was commenced after Revised Article Nine went into effect in Ohio. Both courts should have applied Revised Article Nine. The law and facts should have been stacked in favor of the factor, as it is clear that Revised Article Nine does apply to a state governmental agency as a borrower unless the state adopts a law to the contrary and always applies when the state is an account debtor.

Unfortunately, despite the clear weight of authority against Cleveland State University, the factor had the odds stacked against it, both at the trial court and intermediate appellate court. The factor and its counsel were left to the daunting task of telling the trial and intermediate appellate court that the American Insurance Case was wrong and that they should reverse themselves and properly apply the UCC as the drafters clearly intended – a difficult task to say the least. Courts rarely revisit their prior published decisions and admit that they were wrong.

The trial court has no power to reverse a higher court whose decisions are binding and did not find facts which distinguish our case from the case it was bound to follow. (Although it should have found for the factor applying Revised Article Nine). The Ohio Intermediate Appellate Court was not inclined to reverse itself and ruled in favor of Cleveland State University (part of the problem is that Ohio has not adopted the comments to Article Nine which are helpful in explaining how a statute should be applied). The factor filed a writ of certeriorari requesting that the Supreme Court of Ohio take a fresh look at the case. We believe that this case is of great importance to the secured lending and factoring community. Lenders frequently look upon state governmental account debtors as a strong source of collateral. Lenders should also feel comfortable that the UCC is a national body of law which will be applied uniformly in each jurisdiction. If the Ohio CONTINUED ON PAGE 11

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Supreme Court does not reverse the lower court, it will chill the ability of companies based in Ohio to obtain credit or create a "balkanization" of Ohio where astute lenders and factors will refuse to do business with any factor client or borrower who has an account debtor which is a state governmental entity based in Ohio. This is exactly the situation the UCC seeks to prevent.

On December 15, 2004, we learned that the Ohio Supreme Court accepted review of our case. We expect to receive a briefing and hearing schedule in the near future. Keep your fingers crossed. We expect to report more in the next issue.

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

FACTORING NEWS FLASHES

Merloni Elettrodomestici SpA said its board agreed yesterday to sell a 40 pct stake in the factoring company Faber Factor for 4.2 mln eur to Fineldo, the holding company of the Merloni family which controls the white product manufacturer.

AFX European Focus
December 1, 2004

THE consolidated turnover of Franco-German credit insurer Euler Hermes has remained relatively stable over the last year, while the company's factoring business, which is being sold to Credit Agricole, saw its turnover fall by 8.6% to E63.3m.

Insurance Day
November 5, 2004

M & V Marketing Corp. wrote a check for $30,000 payable to the attorneys of one of its employees. Subsequently, the attorneys factored the check to United Factoring. When United deposited the check with its bank, the check was dishonored because a stop payment order had been issued. United has now moved for summary judgment arguing, in part, that it was a holder in due course, under the Uniform Commercial Code §[3-302 [1], and it was entitled to recover from defendant regardless of the fact that it had stopped payment on the check. M & V responded that facts could exist that should have led plaintiff to inquire if the check might be dishonored. M & V contended that it should be allowed to conduct discovery. The court held that such speculation was insufficient to defeat summary judgment. Thus, M & V was directed to pay United.

New York Law Journal
October 8, 2004

Arbitration Award was Upheld in Joshua L. Baily & Co., Inc. v. Modeani of New York, Inc. The parties entered into a factoring agreement whereby petitioner extended a line of credit to respondent for sales to third-parties in exchange for the assignment of accounts receivables related to the sales. Respondent also extended credit directly to Debtor. Where both the seller and the factor extend credit to a purchaser for the sale of goods, the situation is called a "split risk". Petitioner withdrew from the factoring business and assigned the factoring agreement to Century Business Credit Corporation. Debtor failed to pay for a substantial portion of its purchases. Century collected $419,000 from Debtor. Both parties claim to have a right to the funds collected by Century to offset the debt each is owed from the sales. The arbitrator determined that respondent knew or should have known that the custom and practice in the industry is that in a split risk situation, where the factor withdraws a credit line, the factor's position is paid out first.

New York Law Journal
December 21, 2004

Brookridge Funding Corp., a factoring firm located in Danbury, Conn., sued Northwestern Human Services Inc., a nonprofit corporation in Pennsylvania, alleging that Northwestern Human Services breached a contract to pay Brookridge, pursuant to an acknowledgment. Northwestern Human Services allegedly owed $2.75 million on invoices that Brookridge purchased in connection with construction of a minor league baseball stadium. Brookridge advanced $1 million, based upon the acknowledgement signed by Northwestern Human Services. The District Court found in favor of Brookridge on the breach-of-contract claim.

Connecticut Law Tribune
October 4, 2004

Fred Steinberg was found not guilty of racketeering. Jurors deliberated for two hours in Lee Circuit Court before the decision.

The News-Press (Fort Myers, FL)
November 5, 2004

Larry Schwartz, who ran First Capital Services; Raphael Levy; Ronalee Levy Orlick and Edward Meyer were found guilty in West Palm Beach on Wednesday of conspiracy, mail fraud, money laundering and other charges. Investors were assured their money was being used to buy receivables that were obligations of either federal, state or local governments, or were insured by a reputable insurance company. Instead, most of the money went to line the pockets of the defendants or to fund risky loans to businesses, some with ties to Schwartz.

Palm Beach Post
December 4, 2004

THE 21ST CENTURY SALESPERSON - KNOW WHO & WHAT YOU ARE

By Thomas G. Siska

In the quest for 'the meaning of life', it has been said, "In order to understand others, people must first truly understand themselves". Notice that 'self-recognition' is a pre-requisite to 'outward enlightenment'. The same goes for Sales. One cannot effectively compete against able competition unless and until they truly understand their own 'strategic advantages'. While most companies utter these words, few 'live them'. Uncovering your firm's advantages is not 'a one time exercise' it is 'an ongoing process'.

In the Beginning…

The genesis of every new business is the idea that the entrepreneur can "fill a hole that exists in the marketplace" or "do it better, faster, cheaper". In other words, a competitive advantage is recognized and someone decides to go out and exploit this advantage for profit. Welcome to Capitalism. No rational person with limited capital would start a business knowing that the market was being satisfied adequately and that their product/service was no better/different than any presently being offered. So a recognizable advantage is the main reason a business exists in the first place.

In the End…

The business term 'we must reinvent ourselves or perish' arose as a result of companies that have evaluated their competitive position and realized how weak their position has become. GE is constantly moving into and out of business segments in order to remain the best company on the planet. This movement is a byproduct of the 'competitive positioning process'. Wisely, GE prefers to exit a business while it still has value, as opposed to allowing the competitive position to weaken to the point where the business is worthless.

In the Middle…

What happens in between is the Competitive Positioning Process (CPP). This Process should be part of the annual corporate budgeting and projections exercise. After all, how can you predict what will happen without discussing the 'how' and the 'why'? Most firms strictly relegate the CPP to the Sales & Marketing Department. However, while Sales is touting the firm's 'quick turnaround' as their major competitive tool, Credit & Operations is planning to initiate several risk mitigating processes which will double the new business processing time. As you can plainly see, for the Competitive Positioning Process to be effective it must be elevated to a corporate function, not a Sales & Marketing function.

So what exactly is this Process? The steps are as follows:

1. List all Perceived Advantages.
2. Quantify the Advantages.
3. Select those Advantages most easily exploitable.

List all Perceived Advantages – Advantages can come in two distinct forms: company and personal. The Company's Advantages in the Factoring Industry can be found among these aspects (and others you can list):

- Price
- Advance Rate
- Location
- Special "Industry Specific" Services
- Debtor Credit eligibility
- Turnaround Time
- Advance on other Collateral
- LEGAL
  - i. Non-Recourse
  - ii. No Personal Guaranty
  - iii. Non-Notification
  - iv. No Minimums
  - v. No Term Contract

Just as the Company itself has Advantages it offers its clients, so too do the individuals that work for the Company. These include:

- Previous Experience
- Location
- Technical Orientation
- Referral Source Contacts
- Personal Interests

Quantify the Advantages - Devise the method(s) by which you will 'demonstrate' the Firm's advantages. If you can't demonstrate, then you can't manipulate… the situation in your favor. You can still try to sell using the purported 'advantage'. You just have to realize the serious limitations involved.

To illustrate: If you have friendly Legal Documents or Collateral Statement, send a COPY out with your Proposal and encourage your Prospect to ask for a copy from the competition. 'Saying' you have an advantage is no where near as effective as 'showing off' the advantage.

Select those Advantages most easily exploitable - Align the Firm's Advantages with your Salespeople's Individual Advantages. The areas where there appears to be a good match become the highest priority.

Example: I had a highly technical salesman with 15 years in banking at the #1 market share bank in his territory. He knew everyone at the bank and had several former employees now working at other banks. Throughout his career, he met the 'movers and shakers' within the area's financial community (accounting firm executives, Industrial Council members, etc). Most of these 'high level contacts' (HLCs) frown on Factoring due to the cost. Our firm was not price competitive as it was. So my salesman called me to get some direction.

COMPANY ADVANTAGES – No Minimum/No Term Contracts, High Advance Rates (90%+), excellent customer service.

PERSONAL ADVANTAGES – Lots of High Level Contacts (that dislike the high cost of Factoring).

PLAN – Penetrate the HLCs by ignoring price and selling maximum flexibility.

He made this his number one sales push and continues to do very well with it to this day. Notice how he used the Competitive Positioning Process to formulate his Calling Plan. Everything you do must be done with these "Core Competencies" in mind. These areas, where Company and Personal Advantages combine, are your absolute best weapons.

Conclusion

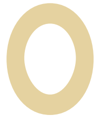
The Competitive Positioning Process is the single most important process the best companies in the world go through. It keeps them focused on all of the reasons responsible for them being in business in the first place. It allows them to keep in tune with the changes in the firm and its personnel and how these changes affect the firm's ability to thrive (or even survive). It further sets the stage for an analysis on the competition and changes in the Industry as a whole. You should (hopefully) be able to clearly see why this must be an annual process and a corporate process to be effective. And, in this case where 'business imitates life', a little soul searching can lead to a whole new "enlightened" approach to success!

Thomas G. Siska is the Managing Director of FactorHelp, Inc. He can be reached at tsiska@factorhelp.com or 847-498-9136.

STOP THE BLEEDING

By Dr. Ron

LESSONS FROM THE LEARNED



Old Mother Hubbard
Went to the cupboard
To fetch her poor doggie a bone;
But when she came there
The cupboard was bare,
'Cause she had concentrations in her portfolio.

Bert Goldberg recently had a great idea. "Why not have a Presidents/ Senior Executive Case Study Meeting in Las Vegas?", said Bert. Actually, that's two great ideas, but what goes on in Vegas stays in Vegas (almost). We are going to break that rule somewhat and share with you the most important doctrines that came out of that meeting of 25 or so successful, experienced factors.

Rule # 1- DO NOT CHANGE YOUR PROCEDURES- whether it's at the onset of a new deal or well into an existing client relationship, don't do it! More than one of us present at that meeting fell into the trap of listening to a well trusted client that had been on the books for a long time. More than one of us reacted to the fear of not booking a new account or losing an existing account because we would not comply with an unusual request. You cannot run your business or make decisions based on fear (or guilt either, for that matter). Learn to recognize these emotions and separate them out from your decision making process.

Rule # 2- YOUR FIRST LOSS IS YOUR BEST LOSS- usually what goes bad only gets worse with time. In addition, there is the intangible cost associated with the negative effect of expending energy worrying about and trying to manage a problem. It is difficult to be a creative and positive business person when you have an albatross hanging around your neck. Your employees will feel and respond to your emotions and be dragged down with you. Put your problems behind you and get on with life.

Rule # 3- YOUR INITIAL IMPRESSIONS ARE USUALLY VALID- whether it's about an existing account that needs special consideration or whether it's a new account you are trying to make a decision about, trust your initial impression. It is usually the correct thing to do. See Rule # 4.

Rule # 4- DON'T TRY TOO HARD UP FRONT- We all want to book as much business as possible but sometimes we stretch too far to do it. Stick to what you know and what you do best. If you foray into a new field, do it slowly and conservatively. Sometimes, with our standard, every day deals, we often find ourselves compromising and concluding, "OK, we need a 90% advance, what's the worst that can happen?", or "We can't get the deal done unless we fund before we get all the searches back, but his balance sheet and D&B are clean", or "So we'll stretch on account debtor credit a bit, we usually don't take credit hits", or "OK, we can't notify his largest account debtor, but we can get by with the verifying the rest". We have all done some or all of these things to book a new deal. But don't try too hard to accommodate. Don't stretch by giving in on too many exceptions. It may come back to bite you in the loss column.

Rule # 5- DO NOT RELAX WITH TIME- I have said it before in this column: By and large, we do business with clients that are operating under considerable financial pressure. If we do business with them long enough, sooner or later the client will have to make a decision on whether or not to push the "honesty envelope" to get what he needs. The length of time you have had a client on the books should have no bearing on your decision making process.

Rule # 6- ACCEPT THE EXPERIENCE OF OTHERS- this is a tough one, especially if like me, you have been factoring for a long time and think you have seen almost everything. Unlike others that would give pause before doing an unusual or difficult deal, you believe with all your heart that you can manage your way around the situation; you think you are smart enough to do what others cannot. If other factors have turned the deal down, or if others in your office are advising against it, LISTEN TO THEM- you should probably pass the business.

Rumor has it that the IFA will have another CASE STUDY MEETING soon and that Bert will open it up to whoever wants to participate. I hope so. I always learn something new at these meetings and this one in particular helped me re-orient my thinking.

Simple Simon met a pieman,
Going to the fair.
Said Simon to the pieman
"Let me taste your ware."

Said the pieman unto Simon,
"Show me first your penny."
Said Simple Simon to the Pieman,
"Indeed I have not any."

DON'T BE LIKE SIMPLE SIMON, DON'T BREAK THE RULES.

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.

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A PRIMER ON PREFERENTIAL TRANSFERS IN BANKRUPTCY

Factors routinely have preferential transfer claims asserted against them by bankruptcy trustees. They usually arise from a bankruptcy filing by an account debtor. This Article is intended to cover only the basics of preferential transfers. The issues that arise are more complicated that set forth in this Article.

Claims for preferential transfers arise under Section 547 of the U.S. Bankruptcy Code (11U.S.C. § 547). The policy behind this provision is to insure that all unsecured creditors are placed on an equal footing when bankruptcy is filed. Section 547 voids payments made on the eve of bankruptcy that would prefer one unsecured creditor over another. Without this provision, a debtor would be able to pay off debts owed to family members or friends or to vendors with whom the debtor wants to maintain a relationship and then file bankruptcy, leaving the remaining unsecured creditors at a disadvantage.

Elements of a Preferential Transfer

A preferential transfer within the meaning of the Bankruptcy Code is (1) a transfer (2) of the debtor's interest in property (3) to or for the benefit of a creditor (4) for or on account of an antecedent debt (5) while the debtor was insolvent (6) made within 90 days before the bankruptcy petition is filed (or, if the creditor is an insider at the time of the transfer, within one year) (7) that allows the creditor to receive more than would have been received in a Chapter 7 bankruptcy if the transfer had not been made.

The courts have dissected and analyzed each of these terms in detail. A transfer can be a payment of money, granting a security interest, or perfecting a security interest. The transfer can be voluntary or involuntary.

"To or for the benefit of a creditor" has spawned much complicated litigation and resulted in an amendment to the Bankruptcy Code in 1996. When a debtor pays a debt which is guaranteed by an insider, it reduces the exposure of the insider guarantor. An insider is defined to include the debtor's relatives, general partners, partnerships in which the debtor is a partner, corporations in which the debtor is a director, officer or in control, or, if the debtor is a partnership or corporation, the debtor's general partners, directors, officers or persons in control of the debtor. Payment to the creditor constitutes a transfer of value from the debtor for the benefit of the insider guarantor and therefore may be a preferential transfer. Even though the guarantor received the benefit, the creditor received the payment and upon bankruptcy of the debtor the payment can be recovered from the creditor. The effect of this is to extend the period in which the payment can be recovered from a creditor as a preferential transfer from 90 days to one year. After much litigation, the 1996 amendment to the Bankruptcy Code limited recovery to those cases in which the creditor who received the payment is also an insider. As a result of the amendments to the Code, a creditor who receives payment will only be liable for a preferential transfer made within 90 days of filing the bankruptcy petition, unless the creditor itself is an insider.

The antecedent debt requirement means that the debt must have existed before the transfer was made and the transfer was made because of the debt.

The debtor is presumed to be insolvent within 90 days of filing the bankruptcy petition. This means the burden shifts to the creditor to prove the debtor was not insolvent at the time of the transfer. Insolvency will be determined by a balance sheet test (debts exceed assets) or fair valuation of the assets. If the business is still operating, value will be based on going concern value. If the business has ceased operations, value will be based on liquidation value.

The transfer occurs when it is effective between the parties. If payment is made by check, the transfer is effective when the payor bank honors the check.

The last element is demonstrating that the transfer allows the creditor to receive more than would have been received in a Chapter 7 bankruptcy if the transfer had not been made. This is done by estimating the amounts that will be distributed to unsecured creditors as the assets of the bankruptcy estate now stand and comparing that figure to the result reached by reversing the alleged preferential transfer.

Defenses to Preferential Transfer Claims

The Bankruptcy Code provides eight defenses to preferential transfer claims. The defenses most commonly asserted by factors are:

- Contemporaneous Exchange for Value: The transfer must have been intended by the creditor and the debtor to be a contemporaneous exchange for value and the exchange must have in fact been "substantially" contemporaneous (which will be determined by the intent of the parties and must be a short period of time). Additionally, the debtor must receive new value. This defense is typically raised when additional product is shipped by the creditor in exchange for payment on the antecedent debt.

- "Ordinary Course" Payments: The debt must have been incurred in the ordinary course of business for both the debtor and the creditor, the payment must have been made in the ordinary course of business of the both the debtor and creditor, and the transfer must be made according to ordinary business terms, i.e., industry practice. This defense requires showing the normal terms of payment offered by the creditor, the normal payment patterns of the debtor, and the ordinary terms in the industry. Records of both the creditor and the debtor must be scrutinized. The analysis can become complicated, especially when there is a long history of erratic shipments and payments. It is often necessary to engage experts in the industry to establish this defense.

- "Subsequent" New Value: This defense involves proving that after the challenged transfer was made, the creditor gave new value to the debtor on an unsecured basis and the creditor was not paid for the subsequent transfer. In other words, the creditor receives a payment on an antecedent debt which would otherwise be a preferential transfer and thereafter ships new product on an unsecured basis and the creditor is not paid for the new product.

- Floating Lien/Improvement of Position: This protects a factor with a floating security interest in inventory and accounts. The creditor will not be subject to preferential transfer claims except to the extent the creditor improves his position. Improvement of position is determined by measuring the amount by which the secured creditor's claim has been reduced on the petition date as compared to the later of 90 days before the petition date or the date of the first advance to the debtor.

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Procedural Matters and Practical Considerations

Actions to recover preferential transfers must be brought within the earlier of two years after entry of the order for relief (which normally occurs within a day or two of when the petition is filed) or one year after the appointment of the first trustee. Unfortunately, this means a factor will have sometimes terminated its relationship with the client and released all collateral before the creditor even has notice of the preferential transfer claim.

The plaintiff in a preference recovery action will be the debtor-in-possession or the trustee. The plaintiff has the burden of proving the elements of the claim. The creditor has the burden of proving the elements of any defenses asserted. Venue for preference claims is in the Bankruptcy Court where the debtor filed its bankruptcy petition. This often results in the factor being sued in a remote location where the factor's only contact is collecting an account. This is further complicated by the emergence in recent years of firms that specialize in preference claims litigation. These firms have developed systems that enable them to file large numbers of claims for small amounts which would not previously have been cost effective to pursue.

As a result of these circumstances, most preference claims are settled because it costs less to settle than to litigate, even if the factor has valid defenses. Unfortunately those pursuing collection of preference claims also understand this economic reality and often use it to advantage. The ability to demonstrate valid defenses is the key to negotiating a favorable settlement.

Techniques for a factor to avoid being in this predicament contradict the business model followed by many factors. Protective strategies include avoiding factoring invoices for smaller amounts and not purchasing invoices from account debtors who are weak financially. But eliminating this market segment is not an alternative for many factors. For those companies, preferential transfer claims become a cost of doing business.

Information provided in this article is general information only and is not legal advice. Readers are encouraged to consult an attorney for specific legal advice.

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