

The Commercial Factor

Newsletter for the Factoring Industry

Volume 5 • Number 2 • Summer 2003



International
Factoring
Association

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A Publication of:
**The International
Factoring Association**

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New IFA Board

The International Factoring Association has just completed another successful year. Membership is growing continuously and we are proud of the fact that we are able to offer our members so many services. Our main change this past year was the addition of the shopping cart feature on the website.

We'd like to thank our 2002-2003 Board Members for their time and effort. Those members are: Wayne Coker from Advantage Business Capital, Bert Goldberg from Distinctive Solutions, Randy Ontiveros from Resource Business Partners, Gail Schulte Coulthred from Abingdon Business Capital, Ken Walsleben from The Hamilton Group, and Carlos Weil from Capital Solutions.

Our new Board of Directors for 2003-2004 includes four returning Board Members from last year, Gail Schulte Coulthred, Bert Goldberg, Ken Walsleben, and Carlos Weil. In addition, we have added Allen Frederic with Gulf Coast Business Credit in New Orleans, David Marrin with Capitol Resource Funding in Alexandria, VA and Randy McCall with KRM Capital in Fort Worth, TX.

Allen Frederic is President and Chief Executive Officer and founder of Gulf Coast Bank & Trust's factoring company with offices in New Orleans and Houston. He has had thirty plus years of secured lending experience in commercial banking, asset based lending and factoring. In the past he has worked with several large companies including American Bank & Trust, Credit DuNord, First Bank & Trust and KBK Financial. He has an MBA from Louisiana State University and has been with Gulf Coast since 2000. Gulf Coast Business Credit acquired the factoring portfolios of Strategic Finance, Houston in 2001 and Hibernia National Bank, New Orleans in 2002. Gulf Coast Business Credit is currently the largest factoring company in the gulf coast area with net funds employed of \$35 million plus annual purchases exceeding \$300 million.

Bert Goldberg is President of Distinctive Solutions, the nation's leading software provider for Factors. Bert has been associated with Distinctive Solutions for over 20 years. He holds an MBA degree from California Polytechnic University-San Luis Obispo and a B.S. degree in Accounting Information Systems.

David D. Marrin is the Executive Vice President of Capitol Resource Funding, Inc. ("CRF"), an accounts receivable factoring company with offices in Virginia, Pennsylvania, Illinois, and California. David has twenty years of experience in the accounts receivable industry.

Since joining CRF in 1992, he has created and successfully managed many areas of the organization including sales, marketing, credit and operations. He has enhanced and expanded CRF's presence by spearheading business acquisitions, portfolio purchases, and field-office expansion. Most recently he has developed CRF's new wholesale funding program. CRF's Wholesale Division provides both rediscount financing and participation funding to asset-based lenders and factors. He holds degree in Business Administration from the Claiborne Robbins School of Business at the University of Richmond. He lives with his wife and three children in Alexandria, Virginia.

Randy McCall is the president of KRM Capital of Fort Worth, Texas. While new to the factoring business, Randy is not new to finance and small to medium business management. Prior to forming KRM, Randy was president of Wheeler Oil Company in Fort Worth and a former CFO of that company. He also owned a successful business consulting practice for several years and began his career in accounting and gained his CPA certificate while working at Coopers & Lybrand in the income tax department. He is a 1976 graduate of Abilene Christian University with a BBA in accounting. KRM Capital is a business factor, offering traditional factoring services to small to medium sized companies in a variety of industries.

Gail Schulte Coulthred is President of Abingdon Business Capital and has been involved in factoring for over 20 years. Originally working for a start-up factoring company, she then formed her own company, Astra Financial, Inc. which was the original Beta site for Distinctive Solutions. In addition to managing and marketing her current factoring company, Abingdon Business Capital in San Jose, California, Gail also provides operations training to management and staff of factoring companies and banks. She is a past Board member of the National Association of Women Business Owners, Silicon Valley Chapter, is a member of Hewlett Packard's "Tactical Mentoring Team," is a member of the Industry Council for Small Business Development and provides short-term corporate planning training for NAWBO.

Ken Walsleben is Principal and co-founder of The Hamilton Group. Hamilton was started in 1994, and has enjoyed rapid growth thereafter. Active in the commercial finance industry since 1983, Ken has been employed in the banking industry (as a lender and Bank Officer with Marine Midland Bank, N.A.), the equip-

[continued on page 2](#)

ment leasing industry (as a VP of Financial Services for United Computer Capital Corp., and Manager of Debt Programs for CIS Corp.), and currently, the factoring industry. Well known in Central New York, Ken has served as a Director of the Syracuse Executives Association for the last 5 years, and is currently their President. Ken holds a B.A., Economics from Syracuse University, 1983.

Mr. Weil is CEO of Capital Solutions in Ft. Myers, Florida. He was born in Buenos Aires, Argentina. After obtaining his MBA, Mr. Weil was recruited by Phillip Morris, Intl. where he quickly rose through the ranks to assistant to the CFO. He subsequently worked for Simko S.A as head of the International Trading department. While there, Mr. Weil was first exposed to the basic concepts of factoring (in this case, in the international arena). In 1989 Mr. Weil was transferred to the U.S, where he was in charge of all operations relating to the opening of the U.S market for sales of Agricultural commodities for an important Far Eastern Group. For the next few years, Mr. Weil was the man in charge and responsible for all aspects of bringing into the U.S millions of pounds of raw materials for Fortune 500 companies. Four years ago and after a very thorough research, Mr. Weil together with his partner started Capital Solutions. Mr. Weil has participated in numerous seminars related to the factoring field.

We are all looking forward to another successful year with the IFA. Please remember, this association is here to serve you. Any suggestions and/or feedback would be greatly appreciated. E-mail us at info@factoring.org, or call 800-563-1895.

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The Commercial Factor

Newsletter for the Factoring Industry

The International Factoring Association

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The Hamilton Group

Carlos Weil
Capital Solutions

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.

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Another Point of View

by Kei Lehigh

I am writing you because I felt it was important to provide a secondary point of view from the author of the article entitled "Non-Factored Invoices and Other Haircuts". I would like to address several areas of the article as I felt the author brought up many points in which there is a counter point. The first is the notion that Non-Factored Funds are "free money we can play with?". Someone new to this industry may look at this as if you only have a claim and ownership to invoices that are factored, when in reality if you have a properly secured UCC filing and supporting contract you are a senior secured party on all receivables. The notion that certain receivables are not factored should certainly not alter your workout strategy and in my opinion gives an excellent collateral cushion for not only principal recovery but collection on exit and termination fees.

In the Horror Story #1 scenario the authors conclude that using Non Factored Funds to charge back invoices is a HUGE mistake. In this scenario the factor was on the hook for the offset from "Home Improvement" regardless of what funds were utilized for chargeback as payment was unknowingly sent to the factor to credit the wrong client that had a shortfall. The factor unknowingly utilized the NFF to credit the account but that does not give Home Improvement the right to offset a debt owed to another vendor that happens to utilize the factors services as the factor is simply a conduit for payment for the client. The Notice of Assignment that I would assume was presented to Home Improvement grants assignment of proceeds, but not an assignment of the vendor agreements that would make the factor a party to the contract of the two entities. I understand they consulted an attorney who advised them it would be too costly to battle Home Improvement but speaking from experience these are winnable cases and in prior experience I have not been taken to court once legal counsel from all parties consulted each other. In my

opinion not utilizing NFF is much more of a risk than worrying about an illegal offset claim situation that is very uncommon.

In Horror Story #2 the author concludes that when being taken over by an incoming lender or factor, get an indemnification clause in order to cover yourself from the instance in Horror Story #1. While I agree with getting an indemnification clause and would hope most factors are practicing this, it is certainly common for a Payoff Agreement to limit the term in which the old factor will forward funds to the new lender or factor. Reasonable time frame is 60-90 days. This allows for adequate time to change remittance information with the account debtors and should get the factor 1-3 billing cycles of having to remit payments. If the factor uses a lockbox and cannot remit the check to the factor, or return to the maker in the form received, the risk of a claim is again low as they are acting as a conduit of payment. Again this issue has arisen a number of times in my experience and we have prevailed on all claims with little to no negotiations.

The conclusion that Non Factored Funds are more of a risk than free money is a statement that I disagree with and severely dilutes the factors ability to collect shortfalls on invoices purchased as well as using the excess collateral created from NFF to cover fees. Obviously there is a risk with any venture or decision and this one can only really be determined through the factors confidence in their policies and procedures, as well as their legal rights.

On a side note I would like to comment on something that Bob Zadek said during our most recent conference in reference to receiving forwarded monies from a previous factor. While I have an immense amount of respect for Mr.Zadek, his voice carries so much influence that I fear people would take his comments as complete gospel. Mr.Zadek advised that when receiving forwarded payments from a previous finance source you should hope it gets lost in the mail for a couple of weeks to prolong payment and increase fees. It should be noted that this industry is based on A/R turn and the faster it turns, the better the yield. By letting or hoping the payment is prolonged is flawed thinking just because your fees increase. Even if the factor has tiered pricing that increases yield over time, the ability to reinvest your funds or not draw down on your Line of Credit to fund future business is much more advantageous than waiting for additional fees. Also should be kept in mind that several factors have fixed pricing and the longer payments are held, the worse their yield becomes.

My concern here is that the IFA is looked at as a beacon for people in the factoring industry and articles, as well as speakers, have a big influence in their policy and operation practices. If factoring companies are led to believe that one specific incident from one of their brethren is the "holy grail" for how to handle a situation because it was published in The Commercial Factor or was presented at a conference, I think the IFA would be doing this industry a great disservice.

Kei Lehigh is Vice President - Sr. Relationship Manager with Wells Fargo Business Credit. He can be reached at: (303) 964-7414 or (800) 336-6234, or by fax at (303) 433-2540.

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Factoring News

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A bankruptcy judge in Michigan rejected the argument of Crestmark Financial Corp. Crestmark entered into a factoring agreement with Spearing Tool and Manufacturing Co. and did periodic lien searches against Spearing using the company's exact registered name. The IRS subsequently filed two notices of federal tax lien against Spearing in Michigan, naming the company as "Spearing Tool & MFG Company, Inc." Spearing filed a Chapter 11 bankruptcy petition and the IRS claimed its tax lien was superior to Crestmark's interests. The judge claimed that requiring the IRS to comply with filing requirements of each individual state would run counter to the long-followed principle of uniformity in the field of federal taxation. The judge also noted that Crestmark sometimes used the "MFG" abbreviation in Spearing's credit documents.

Commercial Lending Litigation News, June 12, 2003

Here is a listing of the top factors based on estimates of their annual factoring volume according to the Daily News Record, May 5, 2003.

1. CIT Commercial Finance, New York, NY.

Estimated annual factoring volume: \$20 billion. CIT maintains that they are the oldest factoring firm in the US at 90. Their clients ranged from small companies with \$2 million in annual sales to publicly held corporations. The majority have less than \$10 million in annual sales.

2. GMAC Commercial Finance, Factoring division, Tucker, GA

Estimated annual factoring volume: \$10 billion. GMAC's loan facilities range from \$5 million to \$200 million and clients include manufacturers, distributors, retailers and service companies in the aircraft, apparel, automotive, transportation, electronics and grocery industries.

3. SunTrust Bank, Atlanta, GA

Estimated annual factoring volume: \$5 billion to \$6 billion. SunTrust is known mainly for its work with Southern mills and it's services include credit extensions, accounts receivable management, credit risk outsourcing, and international factoring.

4. Century Business Credit Corp., New York, NY

Estimated annual factoring volume: \$5 billion. Century is a subsidiary of the Foothill Group Inc. and a Wells Fargo company. They service firms with annual sales ranging from \$5 million to several billion dollars. They provide credit approval, credit protection, collection and information reporting.

5. HSBC Business Credit (USA) Inc., New York, NY

Estimated annual factoring volume: \$4 billion to \$5 billion. HSBC operates 6,500 offices in 70 countries. They provide collection factoring, non-notification factoring and advance factoring, inventory financing and letters of credit.

6. Capital Factors, Fort Lauderdale, FL

Estimated annual factoring volume: \$3 billion. Capital is part of the Union Planters Bank group. They have ties to the Apparel Technology & Research Center of California-Polytechnic University in Pomona, CA. and claims that many ATRC graduates that start apparel firms become clients.

7. GE Capital Commercial Finance Inc., Norwalk, CT

Estimated annual factoring volume: \$2.5 billion to \$3 billion. GE Capital was founded in 1933 as a finance company to help consumers purchase GE appliances during the height of the Depression. Currently, it has \$66 billion in receivables and factoring accounts for a tiny portion of its business. However, the company is said to be trying to reestablish itself in the New York manufacturing community.

8. Milberg Factors, Inc., New York, NY (tie)

Estimated annual factoring volume: \$2.5 billion. Milberg says its clients are able to sell to customers to whom they might not consider selling on their own due to its credit approval/protection, collections, bookkeeping and three different payment options.

9. Rosenthal & Rosenthal Inc., New York, NY (tie)

Estimated annual factoring volume: \$2.5 billion. Through its Rosenthal Business Credit division, R&R provides distributors, manufacturers, retailers and importers unable to secure traditional bank financing with solutions such as customized bridge loans and collateralized loans.

10. Sterling Bancorp/Sterling National Bank, New York, NY

Estimated annual factoring volume: \$750 million. Sterling specializes in small to midsize companies, and, in addition to traditional factoring, has a hybrid service that provides advances against sales and receivable management services without credit protection; borrowings are capped only by receivables growth.

11. IDB Factors, New York, NY

Estimated annual factoring volume: \$250 million to \$500 million. IDB Factors, a division of the Israel Discount Bank, specializes in midsize apparel, accessories, textiles, electronics, jewelry, food and commodities companies based in New York. It is one of the few to offer facilities as low as \$1 million.

Daily News Record, May 5, 2003

Private Business, Inc. announced the sale of the assets of its InsuranceManager™ business to a newly formed entity, InsurManager, LLC. James Arnold, the current President of InsuranceManager and 2nd Generation Capital, LLC formed the new entity. 2nd Generation specializes in principle investments, placements, mergers and acquisitions, advisory services and valuations.

Business Wire, July 1, 2003

Fred Steinberg, executive vice president of Sun Capital group and a national speaker for the American Cash Flow Institute, is back in bankruptcy court. His factoring business, Express Business Funding, is bankrupt and many investors are accusing him of concealment and fraud.

News-Press.com, June 29, 2003

In *Capital Factors v. KMart* (291 B.R. 18 (N. D. Ill 2003)) the U.S. District Court sitting as an appellate court in a bankruptcy case, held that a Chapter 11 debtor in possession may not pay "critical vendors" after the filing, on account of debt owed prior to the bankruptcy filing. It is common practice for Chapter 11 debtors to file several "first day" motions, which generally are heard immediately after the filing. These "first day" motions generally request the court to consider matters as permission for use of the lender's cash collateral, for permission enter into debtor-in-possession financing arrangements, pay employees, "critical vendor" motions, and other motions necessary for the debtor-in-possession's operations. The Capital Factors court held that the bankruptcy court erred when it used its equitable powers to allow payment of certain pre-petition creditors to the detriment of other pre-petition creditors. The case will have far reaching implications. For debtors in possession, it will restrict their ability to access trade credit and will likely find that it will be subject to cash terms. The case benefits "non-critical vendors" and those who may finance such vendors, in that they can expect to be treated equally with other unsecured creditors in accordance with the provisions of Title 11 of the U.S. Code.

The Legal Intelligencer, June 13, 2003

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

Stop The Bleeding

by Dr. Ron



THE "U" WORD

Usury. There, I said it. Usury, that dirty little word everybody likes to ignore but shouldn't. The dictionary defines usury as "the act of lending money at an exorbitant rate of interest". Change the word exorbitant to "unlawful" and you have the working definition for us factors. "Ah", you say, "we are indeed factors, not lenders. There are no interest charges, only fees or service charges or discounts. Therefore, Dr. Ron, usury does not apply to us, correct?" To that I say "all those that truly factor, you may tune out". To most of the remaining audience, I say "listen up".

First of all, to truly factor you must take the entire credit risk. That is to say you must factor on a truly non-recourse basis. To do otherwise is not really to factor but to loan. You may refer to your document as a "factoring document" but as my dear old mom used to tell me "If it looks like a duck, walks like a duck and quacks like a duck, it's a loan, not factoring."

Since most of us express our charges in terms other than an interest rate, what is the interest rate on a typical factoring arrangement? Let's assume a charge of 3 percent per month for the first 30 days and 1% every ten days thereafter. Let's also assume an advance rate of 80%. The "interest rate equivalent" for that type of pricing is 45% annually. (For those of us more marketing oriented folks that need help in the math department just take the apparent rate of 36% and divide by the advance rate). If the repayment day falls on any day except the last day of the measuring period, the interest rate becomes even higher. In any event, the rates we typically charge are high enough to trigger possible usury problems in most states.

So what if a factoring contract is usurious, what's the big deal? The big deal is the penalty, that's what. In some states there is no penalty. In other states the penalty can range from the forfeiture of the "excess interest" to the forfeiture of all charges since the beginning of your contract with the client. In some states the penalty can be the forfeiture of all "principal and interest", or there may even be criminal penalties. How then can we avoid this pitfall?

A good defense is to add a "localization clause" to your contracts. A localization clause is one whereby the parties agree that a certain state's laws will apply to the transaction. The state chosen must have nexus (connection) to the transaction, i.e. the factor or the client

be registered to do business in the chosen state, or perhaps there is a lock box in that state set up to receive collections. Sample wording might be something like this: "This Agreement shall be deemed executed and delivered in the State of Illinois and shall be construed and enforced in accordance with the laws of the State of Illinois." If you use the foregoing, it would be supportive to formally date and "accept" the contract at a location in the chosen state, for example, your office. However, be aware that the state of residence of the client may not allow the enforceability of such a clause or may contain certain restrictions or requirements. New York, for example, requires that if you want to rely on a localization clause, the documents must be executed in the chosen state. Ultimately, of course, the state chosen must have favorable usury laws.

Another option to avoid usury issues is to have two different types of charges in your factoring agreements, one for money and another for services. The language might look something like, "In consideration of the purchase of said invoices, Seller agrees to pay to Factor an amount equal to X percent of the face amount thereof. In addition to the foregoing and in fur-

ther consideration of Factor purchasing, handling, collecting, mailing, transmitting and performing certain data processing services with respect to the maintenance and servicing of said invoices, Seller agrees to pay Factor an amount equal to Y percent of the face amount thereof for each ten day period, etc." In fact, my lay opinion of the efficacy of this tactic is quite high as I believe the facts will, in most cases, support the language.

If there is no usury friendly state with nexus to the transaction and you choose not to rely on the above solution, you must then rely on the true nature of your contract as being non-recourse and therefore truly factoring. Since I am not an attorney, on this matter and for all other legal issues raised in this column, I urge you not to rely on my words, but rather to consult local counsel.

Last but not least, if you remain uncomfortable with respect to usury problems, refer the deal to another factor located in a state similar to Illinois where you can take advantage of local laws. In this way you may earn a fee without risk. If the transaction is large enough, you may even choose to participate in the transaction with the other lender.

I'd like to take this opportunity to tell you of a new feature to be regularly published in the IFA newsletter. It will be called "Caveat Emptor", which means "let the buyer (of invoices) beware". These short articles will highlight a particular problem or issue with respect to buying invoices within a specific industry. An example might be to watch out for lien priming supplier liens and progress billings when buying construction related invoices. Look for Caveat Emptor in this and subsequent issues of the Commercial Factor.

P.S. I need all the ideas you can give me for Caveat Emptor articles. Appropriate credit will be given the writer (you'll get to see your name in print). Please see below for Dr. Ron's email address.

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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Fraud Cases

by Ken Walsleben

Fraud Case #1

Federal Staffing, Inc. was a long-time client. Two of our core investors owned half of Federal, and made introductions for us. In addition to being on Federal's board, one of the investors was on our board, and that same individual was on-scene at Federal approximately 3 days per week. Because of this, we were somewhat loose in our continuing due-diligence oversight because we were one big, happy family.

Mid way through our relationship, Federal hired a new COO who was introduced to us as a well-connected, experienced guy, capable of taking Federal to the next level. He was wholeheartedly endorsed by our common investors. What we didn't know was that this new COO was a life-long con man, recently released from state prison, who was currently out on bail for a multi-million stock swindle! But our investors knew. They elected not to tell us because they felt that he was genuinely trying to turn his life around and didn't want his past indiscretions to color our view of him" (and presumably our willingness to keep funding Federal).

Rather predictably, the COO soon quarterbacked a large swindle of Hamilton by actively soliciting and converting factored payments. He has now pled guilty to the previous charge, will spend 8-10 years in federal prison for it, and Hamilton is left to fend for itself. Due to good (but not perfect) procedures concerning letters of redirection, Hamilton has recovered all of its principal loss, but will absorb substantial costs of interest and collection.

LESSON:

Trust no one, even people that you assume are on your team. Even investors! Further, never let your guard down. Never relax on your due-diligence standards and practices. Maybe institute a background search on new players? It would have made all the difference in this case.

Fraud Case #2:

Al Capone of Computer Networking (CN) was actively engaged in doing computer consulting with a municipality. He had been the long-standing incumbent on the account, and enjoyed a warm relationship with numerous department heads there. Al took advantage of the payor's confused back office and his personal friendships. He managed to convince them to ignore Hamilton's letters of redirection. He actively solicited the payor for delivery of payment and absconded with payments totaling over six figures within a two week period.

Hamilton will eventually get repaid due to its delivery of bonafide redirections, but not without substantial cost and delay as the payor actively tries to avoid liability.

Amazingly, Mr. Capone had done this (under the CN name) once before with another factor in the IFA!

LESSON:

If we as factors do not communicate amongst one another, predators like Capone will continue to pick us apart. Amazingly, to this day, the other factor has not elected to place a warning about this fraud artist on the IFA Fraud site. His inability/unwillingness to warn others could have cost my firm a big loss, and will at least cost my firm many dollars in legal fees.

Also, if we had initially conducted a lien search to see terminated liens, we may have picked this one up sooner. We would have seen the other factor's previous lien and called to find out Mr. Capone's true background.

Fraud Case #3:

We were approached by Barb Wire claiming to be a defense department contractor. She had the contracts to prove it and the deals looked good, fat, and clean. The contracts were completely bogus. Good due-diligence and a healthy dose of suspicion saved our bacon. She was a con-artist who had already beaten another factor for over \$200K using the same ruse with a company name only slightly different.

Her incorporation paperwork just didn't add up right. There were inconsistent spellings, seemingly altered dates, and stories that just didn't sound right. Her references checked out, and a call to the contract of-

ficer went well (they were her confederates). What saved us was a search of state records for some of the other variations of company name that had arisen. We searched those records and determined that she did indeed have a firm by another similar name. A lien search of that firm showed the presence of the previous factor.

A call to the other factor confirmed our worries and directed us to the investigative arm of the Secretary of Defense. Two days worth of wiretaps later, and 'ol Barb was looking at a lengthy prison term. She pled guilty and is now serving time.

Lesson:

Trust your instincts and don't let the promise of a big new deal cloud your perspective. If we had found an alternative, independent way to confirm a DOD contract, we would have known early on that this was a scam. So could the earlier factor.

We weren't any smarter than the first factor, and it was the presence of their earlier UCC that broke this case open. Had the roles been switched, we may have fallen too. But we trusted our instincts and kept drilling down until we were either convinced of her legitimacy, or as we did in this case, we figured her out and arranged a sting in return.

Another, far smarter factor than I once said that "When they're prospects, you love them. When they become your client, they become the enemy!" Caveat Factor!

Ken Walsleben is Principal and Co-founder of The Hamilton Group. He can be reached at 800-351-3066.



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Ethically Challenged?

by Ken Walsleben

Ever wonder why we as factors don't always enjoy the best of reputations with the rest of the financial community? Happily, such criticisms are often unwarranted, but sometimes we really do earn our scarlet letters.

What I'm referring to is the issue of factor ethics and sometimes the lack thereof. Occasionally, someone needs to stand up and remind our community that we (like all other industries) are judged by our actions. When economic times get tough, some of us sometimes skirt the edge of propriety in our dealings with both our clients as well as fellow factors. Now I'm no Pollyanna nor choir boy, but I do believe that economic difficulties shouldn't change our moral compass for the worse!

For purposes of this column, I'd like to confine my comments to ethical interactions amongst fellow factors. Let me begin by examining two REAL case histories that I've had to deal with personally. For sake of propriety, I will not use real names, but I assure you that the circumstances are real.

The first is what I refer to as the "greater fool" theory. Unfortunately, like many of us early in our factoring careers, I was the greater fool. Back in August, 1998 my firm was approached directly by an account in the perishable produce industry. This prospect sold fresh fruit and produce to a large municipal school district on the east coast. I know many of you now know not to touch such a client due to PACA regulations. However, none of us are born with such wisdom, and back in 1998, I did not yet know of the economic quicksand created by PACA regulations.

This prospect was given our name (as well as other east coast factors) by their west coast incumbent factor. The incumbent had come to understand its PACA jeopardy and wanted this client out for good. As an additional complication, the client was dangerously in arrears with many of their suppliers, so PACA related problems loomed large to the incumbent factor. To assist the client's departure, the incumbent gave to the client a few names of regional factors and together they contrived a reason for the transition. Their cover story was that the incumbent factor was being bought by a west coast bank that did not want any of their factoring portfolio to be east of the Mississippi River.

Unfortunately for me, I 'won' the account. Like the rube that I was, I bought that story and confirmed it (via phone calls) with the dishonest incumbent factor. With the new school year fast approaching, we quickly transitioned the account and started funding in earnest. In retrospect, I imagine that the old factor was popping champagne corks upon receipt of our takeout wire! Within two weeks, old bills had been paid with our new fundings, and the original factor was out of jeopardy.

Predictably, my new client eventually crashed some 2 years later, and *then* I became educated on PACA. What an education! I assure you, *that* tuition bill was far in excess of my four year college tuition costs! Now, was the original factor responsible for my naiveté? Of course not. Was the original factor responsible for lying to me about an account they wanted 'out' of? You bet. Did that factor lie to me about their new parent company? Uh Huh. Would I ever give that factor the time of day? Not a chance!

More recently, we had another occasion that left us shaking our heads. We were factoring an account for a number of years. Our firm's standard practice is to lien only accounts receivable and general intangibles. Over time, our client fell on hard times and we had a tough work-out situation due to payment conversions. During this period, our client approached another factor and explained its predicament. The client disclosed our firm's priority to the new prospective factor. Without ever contacting us, the new factor authored a proposal letter and filed an all-assets blanket lien. Our troubled client had apparently signed their proposal letter, which in part, called for minimum monthly volumes of \$80,000. This new factor eventually walked away from the deal and we never knew of this attempted displacement. Eventually, when our client blew up, we seized all assets applicable to our lien. Our failed client was cooperative, and offered to allow us custody of the firm's furniture, fixtures, and com-

puters for eventual auction. Upon running a UCC search to ensure that the assets were free and clear of lien, we first came across the other factor's lien.

Although that factor never consummated a transaction with our failed client, by virtue of their blanket public filing, we needed to clear their lien to enable the auction of the client's other assets. I contacted this other factor to release their filing. Their answer? "Well... we had some unreimbursed expenses." Sensing what was about to happen, I hung my head in disgust and inquired what it would cost. I expected \$200-\$300 to cover their presumed expenses prior to rejecting the applicant. Their response? "We feel that we should be paid \$80,000 to release because that was the proposed monthly volume commitment that didn't materialize."! Can you imagine? Believe it! It's true...

Factors, ethics, and moral compasses don't always go together, but they should. I'm disturbed by stories that I've recently heard where factors concoct a far-fetched story to induce other factors to take over problem accounts. Given my two actual experiences as described above, I suspect that there may be some truth to those rumors. I hope not, but as we know, desperate people do desperate things. I just wish they'd knock it off. For our industry to continue to grow and flourish, these events need to stop.

Aside from shining the light of day upon these 'games', I don't know how else to do that. Maybe if we put as much effort into the sharing of ideas, fraud alerts, and techniques as we seemingly do while conniving to 'mess' with fellow factors, we'd all be better off. That's what the IFA should be about. The IFA's internet discussion site ought to provide a great forum to express your thoughts. I'm curious. Have many of you had similar situations arise?

Ken Walsleben is Principal and Co-founder of The Hamilton Group. He can be reached at 800-351-3066.



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Legal Factors

by John A. Beckstead, Esq.



UCC Financing Statements: Are You Getting It Right? (Part 2)

In the last issue of *The Commercial Factor*, this column discussed methods of perfection, forms of financing statements, and where to file. In this Part 2, searches, impact of certain post-filing events, termination statements and the transition rules under Revised Article 9 will be reviewed.

Searches

For the first five years following adoption of Revised Article 9, a dual system of perfection by filing will exist. Filings under original Article 9 which were made before the effective date of Revised Article 9 (July 1, 2001 in almost all states) remain valid until the earlier of the date they lapse or five years after adoption of Revised Article 9 (which will be June 30, 2006 in all but a few states). The drafters of Revised Article 9 wisely adopted this approach to avoid the necessity of making new filings to preserve existing financing statements.

The result of this approach is that until July 1, 2006 (and later in a few states), searches must be done under both original Article 9 and Revised Article 9. The rules governing where to file – and hence where to search – are very different under these two versions of Article 9. The rules governing where to file where covered in Part 1 of this article.

Until July 1, 2006 (and later in those few states that delayed adoption of Revised Article 9), searches for UCC Financing Statements should be made in the following locations:

1. The jurisdiction in which the debtor's chief executive office is located.
2. Every jurisdiction where tangible goods are located.
3. If the debtor is a registered organization, the jurisdiction in which the debtor is incorporated or registered.
4. If the debtor is not a registered organization, the jurisdiction in which the debtor has its place of business if it has only one or, if it has more than one, the location of its chief executive office.
5. If the debtor is an individual, the jurisdiction in which the individual maintains his principal residence.

After July 1, 2006 (and later in those few states that delayed adoption of Revised Article 9), searches will no longer be necessary under Points 1 and 2.

Impact of Post-Filing Events

Change of Name: If a debtor so changes its name that a filed financing statement becomes seriously misleading (using the test described in Part 1), the financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change.

New Debtor: If a new debtor acquires rights to the collateral (such as when a sole proprietorship incorporates or a corporation merges with another corporation), and the difference between the name of the original debtor and the new debtor is seriously misleading (using the test described in Part 1), the financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months thereafter.

Transfer of Collateral. If collateral is transferred to another person and the transferred collateral remains subject to the security interest, and the transferee is located in a different jurisdiction, the security interest is no longer perfected one year after the transfer.

Bankruptcy. Financing statements will lapse upon their normal expiration date even if the debtor is in bankruptcy. Therefore, a continuation statement must be timely filed. This is a change from prior law.

Termination Statements

A secured party is required to file or send the debtor a termination statement within 20 days of an authenticated (signed) demand from debtor, so long as there are no outstandings or further commitment to lend.

In consumer transactions, a secured party is required to file a termination statement within one month after there are no outstandings or further commitment to lend or, if earlier, within 20 days of an authenticated demand from debtor.

A secured party who fails to file a termination statement will be subject to a \$500 fine per financing statement. The debtor may file a termination statement if the secured party fails to do so.

Transition Rules

Revised Article 9 contains several transition rules which determine whether a security interest perfected under the original Article 9 will remain perfected. While there seems to be a fair amount of confusion and fear of the transition rules, they are actually straight forward and not complicated:

Perfection by Filing. If a security interest was perfected by filing under original Article 9, and would also be perfected by filing under Revised Article 9 (even if place of filing would be different), the security interest remains perfected until the earlier of the expiration of the filing or June 30, 2006 (or later in those states that did not adopt Revised Article 9 on July 1, 2001).

Perfection Other than by Filing. If a security interest was perfected by means other than filing, and the method used to perfect the security interest is the same under Revised Article 9 as it was under original Article 9, then the security interest will remain perfected. If not, the security interest will remain perfected for one year. However, the security interest will be continuously perfected if the Revised Article 9 requirements are met within the 1 year period. The one year period has now expired in all states. If action was not taken, you are now unperfected.

Pre-Filing. Financing statements filed prior to Revised Article 9 becoming effective will perfect an interest in the collateral as of the date Revised Article 9 became effective.

Continuation.

1. If the filing office remains the same under Revised Article 9, file a continuation statement in the original filing jurisdiction.

2. If the filing office has changed, file an "initial financing statement filed in lieu of a continuation statement" (known as an "in lieu filing") in the new jurisdiction. An in lieu filing must:

- (a) State that it is filed to continue a previous financing statement,
- (b) Identify the date, number and most recent continuation of the previous financing statement,
- (c) Identify the office in which the previous financing statement was filed, and
- (d) State that the previous financing statement remains effective.

An in lieu filing can be made at any time prior to expiration of the original filing. It is not limited to the six month window for continuation statements. An in lieu filing has its own life span and lapse date, independent of the original filing.

Amendment.

1. If the filing office remains the same under Revised Article 9, an amendment may be filed in the same office without any further action.

2. If the filing office under Revised Article 9 has changed, then either (i) file the amendment concurrently with, or after, the in lieu filing in the new jurisdiction; or (ii) include the amended information in the in lieu filing.

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Our IFA Attorneys

by Steve Kurtz

Mike Ullman and I are delighted and honored to serve as Co-General Counsel for the IFA. This is a new position and we confess that we will be learning and evolving as time goes on. Our primary functions will be to monitor and report on legal issues which effect the factoring industry, advise the board of directors, and assist with specialized legal projects and matters which affect the IFA and its members. We will report to the IFA in a regular column, and you guessed it, this is our first writing.

The factoring and asset based lending industry is fraught with legal challenges. You operate in a world where deals go bad with little or no warning, and often through no fault of our own. When things do go wrong, decisions must be made quickly. If the decision is made to resort to the legal system, or if you're dragged into the system, you may find yourself facing a judge who simply does not understand your business. If you are in the state court system, you may draw a judge who does not have a grasp on the commercial law issues which are now before her. Unfortunately, courts just don't always get it right.

In that regard, we encourage members of the association to report their more serious and complicated legal issues to the IFA. The IFA's board will consider the matter, and, if appropriate, pass on the matter to Mike and I. We will then endeavor to assist the member and its counsel in addressing the problem.

We also expect that as time goes on, we will be called upon to assist the IFA in other ways and appreciate each and every member's input in order to help us better serve the organization. Mike and I are enthused about our new positions, and look forward to the challenge of assisting the IFA grow and working with all of you.

Steve Kurtz is with Greenberg & Bass and can be reached at 818-382-6200. Mike Ullman is with Ullman, Ullman & Vazquez and can be reached at 561-338-3535.

Skip Tracing Before The Loss

by Frank M. Ahearn

The name Ahearn Group is synonymous with the words skip tracing, whether it be London, New York, Toronto or the lower reaches of Belize. In today's world of technology, we are finding that fraud or simply not choosing to pay a creditor is becoming easier than it used to be. Unfortunately, most corporations are under the misconception that technology and the internet have greatly reduced fraud. In fact, the internet has given birth to what we call easy access.

Your company has one of those great web pages where an applicant can apply for a credit card or a loan. What do you do? Process a credit report and base it on a scoring system. If it is a business, you run a Dun & Bradstreet. The problem here is that neither of those tools actually confirm the information they provide. Sure, they report public record filings, late payments etc. Your company will then decide who they want to do business with. I am sure it's safe to say your company will not choose the one with a bad score.

In reality your best scorers can have a bad year or two and stop paying. You call them and the number is disconnected. You write and as Elvis said "return to sender address unknown". Now its time to send it out to a collection agency. They take the job along with fifty percent of what they collect (ouch). A month goes by, two months and nothing from the collection agency. Most collection agencies will only replicate your actions, hoping that the debtors will be frightened by the letters of suit, etc.

The reason most debtors cannot be found is because when it comes to the application process, all decisions were based on a scoring system. No one took the time to determine; if the phone was real, the address a mail drop or the business only a front. In five easy minutes anybody can incorporate, have a phone number with any area code, and then set up a website.

If someone wanted to create a false residence or create a false company they could in only a few steps. Go to any state website www.anystate.gov register a new corporation in minutes. Next go to www.jfax.com or www.efax.com. From there they can get a phone number anywhere in the world for \$7.95 a month which will forward to an email address of choice. Then go to www.register.com and secure a domain name and set up a web page immediately all for a mere \$20.00. Go to Mail Boxes Etc. www.mbe.com and get an address to match the phone numbers. A business now exists, last but not least call Dun & Bradstreet and get listed.

A little information to ponder, especially if you are in the lending business. The following are a list of some of the most frequently used key words in internet searching; offshore, offshore banking, how to hide, how to disappear, hiding assets, new identity, false identity. That is only to name a few. Two of the most hit web sites are www.escapeartist.com and www.privacyworld.com. In this country a lot of people are concerned about their privacy and are utilizing the tools available.

What is your company doing to reinvent the application process?

Frank M. Ahearn is with Ahearn Group, Ltd. He can be reached at (212) 937-3565 or visit their website at www.Ahearn.bz.

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