



2009 Factoring Conference Speaker Handout



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BANKRUPTCY: To Boldly Go Where Few Have Gone Before (OR) Everything You Wanted to Know and Things You Did Not Realize You Need to Know

15th Annual International Factoring Association Factoring Conference

Orlando, Florida

April 22 - 25, 2009

Presentation By:

**The Honorable Caryl E. Delano
United States Bankruptcy Judge
Middle District of Florida
Tampa Division**

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I. Does the Client (Debtor) or the Factor own the accounts that are outstanding and unpaid on the date that the bankruptcy petition is filed?

II. The Factor that unwittingly serves as a DIP Factor!!!!

III. Factor Co.'s exposure to Preference Actions due to Account Debtor Payments and its Defenses.

IV. The Factor's Reclamation Rights.

V. We Saved the Best for Last. The Most Powerful New Tool Given To Factors – The 503(B)(9) Administrative Expense.

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I. Does the Client (Debtor) or the Factor own the accounts that are outstanding and unpaid on the date that the bankruptcy petition is filed?

A. The assumed facts:

Factor, as a Purchaser, enters into a factoring agreement with Client. Factor's factoring agreement with the Client has the following provisions:

It is the express intention of the Parties that their relationship shall be that of Client and Purchaser of Accounts, that Client shall, once acquired by Purchaser, no longer have any rights or title to any Purchased Account pursuant to § 9-318(a) of the UCC.

As collateral securing the Obligations, Client grants to Purchaser a continuing first priority "ownership" interest in the Purchased Accounts and security in the Collateral.

9-318(a) of the UCC reads as follows:

A debtor that has sold an account . . . does not retain a legal or equitable interest in the collateral sold.

11 U.S.C. § 541(a) of the U.S. Bankruptcy Code reads:

The commencement of a case . . . creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) . . . all legal or equitable interests **of the debtor in property** as of the commencement of the case.

* * * *

(6) Proceeds . . . of or from property of the estate, . . .

(7) Any interest in property that the estate acquires after the commencement of the case.

B. Let's add another fact.

The factoring agreement also contains the following provision:

Seller's sale of accounts to Factor, as absolute owner, is with full recourse in the event, for whatever reason, the Account Debtor fails to pay.

11 U.S.C. § 363(a) defines “Cash Collateral” to mean:
... cash, negotiable instruments or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds . . .

11 U.S.C. § 363(c)(1) says the following:
(1) If the business of the debtor is authorized to be operated ... and unless the court orders otherwise, the trustee (or Debtor) ... may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee (or Debtor) may **not** use . . . cash collateral under paragraph (1) of this subsection unless—
(A) each entity that has an interest in such cash collateral consents; or
(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

II. The Factor that unwittingly serves as a DIP Factor!!!!

A. The assumed facts:

The Client's principal, Mr. Scam, applies to Factor to obtain a factoring facility for the first time ever. In order to apply for the factoring facility the Client fills out an application. The part of the application important to this issue reads as follows:

Question: Have you at any time within the last seven (7) years filed for or been made involuntarily subject to any form of bankruptcy relief and if so, when?

Answer: NO, NEVER.

(a) If the trustee (or Debtor) is authorized to operate the business of the debtor unless the court orders otherwise, the trustee may obtain **unsecured credit and incur unsecured debt** in the ordinary course of business allowable under section 503 (b) (1) of this title as an administrative expense.

(b) The court, after notice and a hearing, may authorize the trustee (or Debtor) to obtain **unsecured credit or to incur unsecured debt** other than under subsection (a) of this section, allowable under section 503 (b) (1) of this title as an administrative expense.

(c) If the trustee (or Debtor) is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, **the court, after notice and a hearing**, may authorize the obtaining of credit or the incurring of debt—

- (1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title;
- (2) secured by a lien on property of the estate that is not otherwise subject to a lien; or
- (3) secured by a junior lien on property of the estate that is subject to a lien.

(d) (1) The **court, after notice and a hearing**, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if—

(A) the trustee is unable to obtain such credit otherwise; and

(B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.

(2) In any hearing under this subsection, the trustee has the burden of proof on the issue of adequate protection.

11 U.S.C. § 363(c)(1) states:

If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204 or 1304 of this title and unless the court orders otherwise, the trustee (or Debtor) may enter into transactions, **including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing**, and may use property of the estate in the ordinary course of business without notice or a hearing.

11 U.S.C. § 363(b)(1) states:

The trustee, **after notice and a hearing**, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . .

11 U.S.C. § 362(d) provides, in pertinent part, as follows:

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by . . . **annulling**, . . . such stay -

In the matter of *In Re Albany Partners Ltd.*, 749 F.2d 670 (11th Cir 1984) the court wrote:

It is true that acts taken in violation of the automatic stay are generally deemed void and without effect ... Nonetheless, § 362(d) expressly grants bankruptcy courts the option, in fashioning appropriate relief, of “annulling” the automatic stay, in addition to merely “terminating” it. The word “annulling” in this provision evidently contemplates the power of bankruptcy courts to grant relief from the stay which has retroactive effect; otherwise, its inclusion, next to “terminating,” would be superfluous.

“In addition to the obvious power to ‘terminate’ the stay, [§ 362(d)] also gives the bankruptcy court the power to ‘annul’ the stay. The difference between the two is that an order annulling the stay could operate retroactively to the date of the filing of the petition which gave rise to the stay, **and thus validate actions taken by the party at a time when he may have been unaware of the existence of the stay.** On the other hand, an order terminating the stay would be operative only from the date of its entry.”

III. Factor's exposure to Preference Actions due to Account Debtor Payments and its Defenses.

Factor is getting regularly paid by Client's customers. Client terminates its factoring relationship with Factor. One year later Factor finds out that one of Client's customers filed for chapter 7 and did so sixty-five (65) days after Client terminated. Factor also investigates its files and determines that within ninety (90) days of that filing, Factor got paid \$200,000.00 by this Customer. A chapter 7 trustee sues Factor to recover all \$200,000.00 of the payments made within ninety (90) days of that customer's bankruptcy filing.

WHAT DEFENSES TO A PREFERENCE ACTION ARE AVAILABLE TO FACTOR UNDER THESE TYPE OF FACTS?

1. 11 U.S.C. § 547(c)(2). The Ordinary Course of Business defense.

ELEMENTS:

- A transfer is made by the Account Debtor;
- That was in payment of a debt;
- Incurred by the Account Debtor;
- In the ordinary course of business or financial affairs of the Account Debtor and Factor (or the Client); and
- The transfer was made in the ordinary course of business or financial affairs of the Account Debtor and the transferee; or
- Made according to ordinary business terms.

PREFERENCE DEFENSE ANALYSIS

Assume the Petition Date is : *August 21, 2006*

90 Days Prior to Petition Date would be: *May 23, 2006*

Invoice No.	Invoice Date	Invoice Amount	Check Number	Payment Amount	Date Check Received	Date Payment Cleared	Invoice Due Date	# of Days b-w Inv Date & Payment Date
11167	4-03-06	2,649.98	66877	2,649.98	5-15-06		5-3-06	43
11210	4-10-06	3,678.84	66923	3,678.84	5-22-06		5-10-06	43
11224	4-17-06	5,059.25	66995	5,059.25	6-02-06	5-31-06	5-17-06	47
11252	4-24-06	4,914.26	67032	4,914.26	6-05-06	6-7-06	5-24-06	43
11257	5-01-06	5,962.89	67032	5,962.89	6-05-06	6-7-06	5-31-06	36
11278	5-09-06	4,562.00	67032	4,562.00	6-05-06	6-7-06	6-8-06	28
11301	5-15-06	5,323.94	67140	5,323.94	6-26-06	6-21-06	6-14-06	43
11319	5-22-06	4,346.37	67197	4,346.37	7-05-06	6-28-06	6-21-06	45
11340	5-30-06	4,480.50	67252	4,480.50	7-13-06	7-5-06	6-29-06	45
11361	6-05-06	3,480.23	67252	3,480.23	7-13-06	7-5-06	7-5-06	39
11389	6-12-06	3,659.57	67297	3,659.57	7-24-06	7-19-06	7-12-06	43
11393	6-19-06	4,724.83	67297	4,724.83	7-24-06	7-19-06	7-19-06	36
11422	6-26-06	4,191.24	67403	4,191.24	8-07-06	8-8-06	7-26-06	43
11442	7-03-06	2,840.56	67461	2,840.56	8-15-06	8-15-06	8-2-06	44
11448	7-10-06	3,383.20	67403	3,383.20	8-07-06	8-8-06	8-9-06	29
11470	7-17-06	2,312.81	67461	2,312.91	8-15-06	8-15-06	8-16-06	30
11484	7-24-06	3,246.16	67461	3,246.16	8-15-06	8-15-06	8-23-06	23
11535	8-14-06	1,323.00	68188	1,323.00	9-27-06		9-13-06	45
11560	8-21-06	1,929.44	68188	1,929.44	9-27-06		9-20-06	38

11 U.S.C. § 547(c)(4). The New Value Defense.

ELEMENTS:

- A transfer is made by the Account Debtor;
- To or for the benefit of Factor (or the Client);
- After such transfer the Client given the Account Debtor new value;
- The new value is not secured (unless security interest is avoidable); and,
- The Account Debtor does not make an unavoidable transfer to Factor (or the Client).

11 U.S.C. § 546(c)(1) reads, in pertinent part:
. . . subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, **the rights and powers of the trustee** under sections 544(a), 545, 547, and 549 **are subject to the right of a seller** of goods that has sold goods to the debtor, in the ordinary course of such seller's business, **to reclaim such goods** if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

V. We Saved the Best for Last. The Most Powerful New Tool Given To Factors - The 503(B)(9) Administrative Expense.

11. U.S.C. § 503(b)(9) reads:

(b) After notice and a hearing, there shall be allowed **administrative expenses** . . . including –

(9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

Key Questions:

1. Does the Factor have to hold the reclamation rights we discussed earlier in order to have this protection?

NO

2. Does Factor lose its right to an administrative claim if the Account Debtor sold the goods after the case was filed?

NO

3. Does the Factor lose its right to an administrative claim if the goods sold to the Account Debtor cannot be identified?

NO

4. Does the Factor lose its right to an administrative claim if the goods are already subject to a senior security interest?

NO

5. What if the Factor issues a reclamation notice under 546(c)(1), does it lose its right to an administrative claim under 503(b)(9)?

NO

6. If the Factor gets this 503(b)(9) administrative expense priority claim, when does it get paid?

For chapter 11 cases, 11 U.S.C. § 1129(a)(9)(A) reads:

(A) with respect to a claim of a kind specified in section 507(a)(2) or 507(a)(3) of this title, **on the effective date of the plan**, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim.

For chapter 7 cases, 11 U.S.C. § 726(a)(1) reads:

(a) . . . property of the estate shall be distributed—

(1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title, proof of which is timely filed under section 501 of this title or tardily filed or before the earlier of —

(A) the date that is 10 days after the mailing to creditors of the summary of the trustee’s final report.

(B) the date on which the trustee commences final distribution under this section;

What are the risks to everyone here in a chapter 11 that its 503(b)(9) administrative expense priority claim will not get paid?
