

Preface

Factors have been an important source of commercial financing in the United States since the country's founding, and internationally at least as far back as the Roman Empire. Shakespeare wrote about factors in his plays,¹ and few realize that the Pilgrims contracted with London factors to finance settlement in the New World. Yet, even though the volume of factored accounts in the U.S. exceeded \$136 billion in 2008, very little has been written about this area of commercial law. As a result, factoring is sometimes misunderstood by American lawyers, judges, accountants, businesspersons and, on occasion, even by factors themselves. The authors hope this treatise will be a useful addition to the literature of commercial finance.

Factoring is the purchase of trade accounts receivable at a discount where title to the accounts passes from the seller (the factor's client) to the purchaser (the factor) as a matter of law, *ab initio*. Under prevailing American jurisprudence, this generally occurs where the factor's purchase of accounts is without recourse to the client. "Without recourse" means that the factor bears the credit risk, has no *credit* recourse, and cannot charge back the credit loss to its client if a purchased account is uncollectible *solely* by reason of the bankruptcy, insolvency, or financial inability of the client's customer (the account debtor) to pay at maturity. The factor, however, retains *quality* recourse to its client; that is, the factor can charge back the purchased account if the account is not

¹See *Cymbeline*, Act I, Scene VI:

Iachimo: Some dozen Romans of us, . . .
[H]ave mingled sums
to buy a present for the Emperor,
Which I, the factor for the rest, have done
And I am something curious, being strange

Quoted in Carroll G. Moore, *Factoring—A Unique and Important Form of Financing And Service*, 14 BUS. LAWYER 703 (April, 1959), noting that factors are also mentioned by the Bard in *King Richard III*, *King Henry IV*, *Antony and Cleopatra*, and *The Comedy of Errors*.

collected because the account debtor disputes the quantity or quality of goods or services received, or if the client sold the account to the factor in breach of contractual representations and warranties. Generally, a factor will notify the account debtors that their accounts have been sold and require that they make payment directly to the factor. Beyond this, whether there has been a “true sale” of accounts when they are sold with full or partial recourse, or on some other basis such as partial nonrecourse or split risk, has been a question of significant debate in U.S. courts. To further complicate matters, in common American commercial parlance, as distinct from the prevailing jurisprudence, factoring includes any transaction structured in form as a sale of accounts at a discount, whether with or without recourse. This treatise is intended to provide clarity and focus on a multitude of issues in American factoring law and practice, including the question of what constitutes a “true sale.”

In the U.S. and throughout the industrialized world, significant economic problems have frozen credit markets and curtailed the ability of many businesses to access traditional bank lending. In this environment, a sound understanding of factors and the credit protection, collection, and other financial services they provide is more important than ever. Factors remain a significant source of financing for American businesses, both as a stand-alone source of financing through advances on purchased accounts and in concert with commercial banks.

This treatise was several years in the writing, and grew out of the co-authors’ mutual interest in the subject matter. The authors look forward to providing periodic supplements as American factoring law and practices continue to evolve. We urge our readers to provide us with comments and criticism. You may contact us in care of the BNA Books, The Bureau of National Affairs, Inc., 1801 South Bell Street, Arlington, VA 22202, or by email at books@bna.com. We have no doubt that your comments will assist us in maintaining the high standards which we expect of ourselves professionally. We have endeavored to produce a carefully researched and comprehensive review of American factoring law and practices in this, our first joint effort.

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