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Invoice Finance

ABFA ASSET BASED FINANCE ASSOCIATION
AFFILIATE

Briefing

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Rebates: Set off - some thoughts

There was considerable disappointment amongst invoice financiers who operate factoring facilities when the Court of Appeal rejected the recent attempt to strengthen a funder's position against a debtor who remained silent about a historical rebate claim which only emerged after the demise of the client.

We acted in the case in which the issue arose, *Bibby Factors Northwest Limited v (1) HFD Limited (2) MCD Group Limited,* which involved a claim by Bibby against a debtor who had been fully aware of the invoice finance facility and made numerous verifications over a period of 13 years without any reference to a rebate, but had then sought to claim a 10% contractual rebate on annual sales after the insolvency of the client.

The judge in the High Court ruled against Bibby, basically on the ground that the debtor had no "duty to speak", and that the risk in these circumstances must be taken by the invoice financier.

That decision was then the subject of a Court of Appeal judgment which essentially upheld the reasoning of the judge to the effect that a debtor owes no obligation to an invoice financier in these circumstances: see [2015] EWCA Civ 1908.

There has been quite a bit of ill informed comment about the Bibby case from lawyers and even some academics in the various online legal portals which now exist for all and sundry to express their views.

Whilst none of these comments dispute the undoubted fact that Bibby's conduct was unimpeachable and totally in accordance with industry best practice, some commentators have rather naïvely suggested that Bibby should perhaps have made enquiries with the client as to the existence of a rebate arrangement with the debtor.

Of course such enquiries were made in the take on process which had been undertaken by Bibby, and the issue was also covered in specific warranties given in the Receivables Finance Agreement.

It is unfortunate that points such as these and the precarious position in which invoice financiers find themselves when clients conceal the true facts seem to be lost not only on some of the lawyers and academics who commented, but also on the courts who are not always familiar with all the nuances of invoice finance which remains a highly specialised product in the context of UK commercial law.

Distinguishing the case on the facts

What is important moving forward is for lawyers advising invoice financiers to be able to distinguish the narrow decision in the Bibby case from different facts and circumstances.

It is one of the strengths of English law that case law decisions are made on the narrow facts of the particular dispute before the court, and this was clear in the Bibby case: all that the Court of Appeal decided was that on the particular facts before them it could not be said that the debtor was under any duty to volunteer to Bibby the fact that it had a rebate arrangement with the client.

One reason for the court's decision in the Bibby case was that the debtor's verifications had been made by a series of relatively lowly employees across 17 sites nationwide, who in the court's view could not be expected to have knowledge of a centralised rebate arrangement.

Thus the position might well be different in the more typical situation where the invoice financier's verifications take place with one point of contact in a central location which could be expected to be well aware of any rebate arrangement with the client.

It may also be possible to distinguish the Bibby case on the grounds that in that case there was no evidence of any knowledge by the debtor that the client had misled the financier as to the existence of the rebate, whereas in many cases there may well be evidence that at the very least the debtor had turned a blind eye to the fact that the financier was being misled by the client.

It is also important for financiers to hold to the position that in any event the Bibby case should not be extended to cover situations beyond the peculiar facts of a rebate arrangement agreed with the client before the inception of the factoring arrangement.

Thus we recently settled a case on favourable terms which the financier was prepared to take to trial which had some similarities to the Bibby case and in which the debtor's lawyers were of the view until a very late stage shortly before trial that the Bibby case provided them with a complete defence.

In essence we were able to establish in our detailed legal argument prepared for the trial that the facts were very different and that the financier was not bound by a set-off agreement made between the client and the debtor after notice of assignment of future debts had been given in the usual take on letter.

Review of best practice

In addition, in our view there are a number of ways in which industry procedures could be modernised to improve an invoice financier's position should a similar issue arise in the future:

- Pre-take on audits should specifically search for evidence of rebates, and audit teams should be alive to the existence of rebates in particular industries;
- It would also be sensible to require express declaration of rebate arrangements as a continuing contractual obligation on the client;
- Take on letters should be reviewed to ensure that they expressly negate any right to a rebate, and electronic copies should always be stored;
- Notices of assignment on invoices and statements of account should request debtors to communicate "any reason for non-payment" rather than refer only to "disputes";
- Notices of assignment should also state that payment must (as opposed to "should") be made to the financier and that these instructions can only be revoked by the financier;
- Ongoing audits need to search for possible rebate payments; and
- If, despite these precautions, an invoice financier has funded the full purchase price of invoices and is subsequently met with a successful rebate claim, then in addition to any claims under guarantees or indemnities it may be possible to bring successful proceedings against relevant individuals at the client for the tort of knowingly inducing breach of the relevant warranties in the receivables finance agreement.

Invoice Finance and the Consumer Credit Act

There remains a degree of confusion as to the extent to which invoice financiers are affected by the provisions of the Consumer Credit Act 1974 as now amended by the Financial Services and Markets Act 2000.

This is not helped by the fact that some of the statutory provisions are amongst the most opaque anywhere on the statute book, which is largely as a result of the piecemeal way in which the various European directives have been incorporated into UK law over the last 30 years.

There are basically two important issues which arise when considering the impact of the Consumer Credit regime on invoice finance.

1) Regulation of invoice finance agreements

It is generally accepted that there is no question of a properly drafted invoice finance agreement being regulated by the CCA, because there simply is no element of credit to be provided by the funder.

Even a full recourse agreement in which the funder has the right to be reimbursed in relation to any debts which are not paid will not involve the provision of credit by the funder to the client, provided that the finance charges are drafted as discount rather than interest, and that the recourse provisions are properly drafted.

This point is occasionally raised by insolvency practitioners and others but it is authoritatively dealt with for example in Salinger, *the Law and practice of invoice finance* at para 10-49.

2) FCA authorisation of invoice financiers

Prior to April 2014 entities running a consumer credit business or a consumer hire business, or carrying out various related activities, required a consumer credit licence issued by the Office of Fair Trading. Since April 2014 the licensing system has been replaced by a requirement for those carrying out such activities to be authorised by the Financial Conduct Authority under the Financial Services and Markets Act 2000.

Invoice Finance and the Consumer Credit Act Continued

So in theory invoice financiers may require to be authorised if their clients are generating debts which are themselves regulated by the CCA.

In practice it is quite rare for invoice financiers to deal with such debts, because for example:

(1) debts with debtors who are companies or partnerships of four or more persons are never regulated, and

(2) even where the debtor is a sole trader or a partnership of two or three individuals, the vast majority of ordinary trade debts with such entities fall within an exemption for debts payable without interest or other charges and by 12 or less repayments within a period of 12 months: see article 60F of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

However, there are instances where invoice financiers take assignments of debts which are regulated by the CCA, for example where a portfolio of regulated consumer hire debts is acquired, and for this reason many invoice financiers have obtained the necessary FCA authorisation to enter into regulated consumer credit and consumer hire agreements, which also covers operating as assignee.

Separate categories of authorisation exist in relation to the activities of debt collection and debt administration, and carrying out these activities in relation to consumer credit and consumer hire agreements with sole traders/individuals or partnerships of two or three persons still requires FCA authorisation even when such agreements are exempt from regulation, for example under the business use criteria for credit in excess of £25,000.

However, this does not affect invoice financiers because there is a separate exemption from authorisation in relation to these activities for creditors and owners (including assignees) under article 39H(1)(a) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

Bermans solicitors are recommended in The Legal 500 2016 edition and the firm is ranked in the London (national) listings for Asset Based Lending.

Bills of Sale Reform

On 12 September 2016 the Law Commission published its final report containing proposals to modernise the archaic Bills of Sale regime.

The driver for reform was the increased use of logbook loans in the consumer vehicle finance market, but the registration of whole turnover invoice finance agreements with sole traders and partnerships as Bills of Sale also fell to be considered.

The Law Commission noted that:

"The registration regime under the 1878 Act is even more cumbersome than that for logbook loans. It normally requires three sets of solicitors: one to prepare the paperwork for the invoice financier; a second to advise the unincorporated business; and a third to administer an affidavit from the unincorporated business's solicitor.

It can cost between £480 and £1,735.

Even when carried out promptly, registration takes three to five working days.

For unincorporated businesses, a delay in funding, even by a matter of days, may have serious consequences".

Recent statistics demonstrate that as a result of these complications registration of general assignments of book debts declined from 221 in 2010 to only 68 in 2015.

The Report then noted that the long-term aim of ABFA is "to achieve a unified register for general assignments of book debts made by both unincorporated and incorporated businesses", and set out its recommendations as follows:

"In the long-term, the solution is to establish an electronic register. In the short-term, we recommend simplifications to the High Court registration regime."

Our recommendations include the following:

(1) the business would sign the assignment document in the presence of a witness, but the witness would no longer need to be a solicitor;

(2) an affidavit would no longer be required;

(3) the invoice financier would be able to email documents to the High Court;

(4) the time limit for registration would be abolished; and

(5) re-registration would be required every 10 years, rather than every five years as under the current law."

These proposals are now in the hands of government, and the Law Commission has expressed the hope that they can be the subject of a short non-contentious Act of Parliament in the near future.

Bills of Sale Reform Continued

Is registration really necessary?

These proposals are undoubtedly welcome, but even under the present law does an invoice financier really need to register invoice finance agreements with sole traders and partnerships as Bills of Sale?

In our view the need for registration can easily be overcome by the simple device of ensuring that invoice notifications contain the language of specific assignments.

We can say this with confidence because of a key decision of the High Court in which we were involved in 2000, but which unfortunately still appears to be little known or understood even within the invoice finance industry.

Background

Section 344 (1) of the Insolvency Act 1986 renders *"a general assignment to another person of ...existing or future book debts, or any class of them"* void against a trustee in bankruptcy as regards book debts earned in a business which were not paid before the presentation of the Bankruptcy Petition, unless the assignment has been registered under the Bills of Sale Act 1878.

The intention is to discourage secret transfers of personal property which are then relied upon to defeat the interests of general creditors.

A whole turnover type of invoice finance agreement falls within the definition of a "general assignment of book debts" in section 344, and on the face of it is therefore liable to be avoided by a trustee in bankruptcy in the case of a sole trader or partnership client.

The Alex Lawrie case

We and some other industry lawyers saw a way of circumventing section 344 without the need to go to the delay and expense of registration of the invoice finance agreement as a Bill of Sale.

This involves the device of using a whole turnover agreement to effect an immediate assignment of debts as they come into existence, but providing wording in the nature of specific subsequent assignments in the notifications from the client to the invoice financier.

The point was tested as a result of an attack by insolvency practitioners in *Hill (As Trustee in Bankruptcy of Burfoot and Haynes) v Alex Lawrie Factors Limited* [1], in which a trustee in bankruptcy sought a declaration in reliance on s.344 that the assignment effected by the whole turnover factoring agreement was void for want of registration under the 1878 Bills of Sale Act.

Alex Lawrie (now Lloyds Bank Commercial Finance) and Bermans instructed leading insolvency counsel Gabriel Moss QC, and we accepted that the initial assignment effected by the factoring agreement itself was caught by Section 344 (1). However, we sought to rely on the fact that the agreement required the submission of regular invoice notification schedules by the client and which stated:

"Pursuant to the Factoring Agreement we have made with you we assign each of the Debts to which the invoices attached relate".

Since Section 344 (3) (i) of the 1986 Act expressly provides that the definition of *"general assignment"* does not include *"an assignment of book debts due at the date of the assignment from specified debtors or of debts becoming due under specified contracts"*, the invoice schedules effected specific assignments which were perfectly valid against the trustee.

In his judgment Jacob J ruled comprehensively in favour of Alex Lawrie:

"So the system as actually operated works on the basis of specific assignments rather than the general assignment. Only notice of the specific assignments is given to the debtor. Moreover the payments to the client are for value and are specifically related to each assigned debt. There is no question of payment at an undervalue or the like-the sort of thing that might be concealed by a general assignment. Under the scheme, the payments made or to be made by the factor go to the client's estate, either before or after the bankruptcy. Of course the value of the payments is reduced by the factor's turn, but no-one suggests this turn is extortionate or otherwise improper."

The judge went on to find that the intention behind the specific assignments was to convey anything that was not effectively conveyed by the general assignment, including an assignment effective as against a possible future trustee in bankruptcy:

"*What is not conveyed by the Factoring Agreement is an assignment effective as against a possible future trustee in bankruptcy. I see no reason in contract or equity why the parties should not create an assignment effective against such a contingency.*

The specific assignment can operate on anything not already conveyed. It operates to assign the specific debts if and to the extent the general assignment is ineffective.

As for the statute, its policy is aimed at mere general assignments. Specific assignments are valid as against the trustee. If the order of the assignments had been reversed, no-one questions that the specific assignment would be valid as against the trustee.

Why should the policy be different for a different order of assignments?"

The judge also pointed out that because notice of the specific assignment was given to the debtors, the specific assignment was a valid legal assignment within Section 136 of the Law of Property Act 1925.

The judge concluded by saying: "*So I think the specific assignments have legal effect and can be relied upon by Alex Lawrie against the trustee. I am gratified to reach this result because it also accords with common justice. Alex Lawrie paid (or committed to pay) for the specific debts. If they were deprived of their benefit they would have lost their money completely even though their clients had had the money."*

1 *The Times, August 17, 2000*

At the time of this decision in 2000 not all invoice financiers were widely using electronic transmission systems, but in this day and age it is a very straightforward matter for an invoice financier to ensure that the language of specific assignment is used during the notification process.

Therefore, provided that the invoice finance agreement requires notification and that the notifications contain language of assignment which is sufficiently clear, it is difficult to see how an insolvency practitioner or anyone else could challenge a whole turnover agreement with a sole trader or partnership on the grounds that it was not registered as a Bill of Sale.

Although only 68 registrations of general assignments of book debts took place in 2015 (the last year for which figures are available), at the cost of between £480 and £1,735 noted by the Law Commission this represents unnecessary expenditure on lawyers of between £32,640 and £117,980.

Delay in outlawing bans on assignment

The Department for Business, Innovation & Skills ("BIS") announced its intention to bring forward legislation outlawing bans on assignment in commercial contracts as long ago as December 2014.

The draft Business Contract Terms (Restrictions on Assignment of Receivables) Regulations 2015 included significant caveats for both supply chain financiers and for "terms giving rise to a duty of confidence", but following an extensive consultation process which involved both ABFA and groups of businesses from various industry sectors, including energy, retail and construction, it is understood that BIS has dropped any special protection for supply chain financiers and has taken on board at least some of ABFA's concerns that an unrestricted definition of "duty of confidence" could drive a coach and horses through the intended effect of the legislation.

The BIS response document indicating these changes was published in August 2015, together with a rather bombastic press release which indicated that *"Ban on anti-invoice finance terms in contracts will come into force early next year"* (ie. 2016.)

Unfortunately there have been no further developments, presumably as a result of the workload imposed on government lawyers by Brexit, so we must await publication of amended Regulations hopefully later this year before the impact of the legislation will begin to become clear.

New Edition of *Guide to Invoice Finance Law*

The New Year will see the publication of the fourth edition of our popular *Guide to Invoice Finance Law,* which brings the previous third edition published in 2012 right up-to-date with relevant legislative and case law developments, including an Appendix setting out differences between English and Scots law.

The *Guide* is written specifically for industry personnel in non-legal jargon and is designed to bring some clarity to what can seem to be complex and sometimes conflicting principles of law and legal practice.

Many ABFA members will recognise much of the material from the *Legal Aspects of Receivables Financing courses* we have run for the ABFA Educational Foundation over the past 25 years.

Click here to sign up to recieve the new Guide to Invoice Finance Law. Or visit: http://www.bermans.co.uk/new-edition-of-guide-to-invoice-finance-law/.

Did you know?

Liverpool and Manchester-based firm Bermans has 'very longstanding experience' in the area, [asset based lending] where it predominantly handles domestic invoice financing mandates. Alex Chapman and David Gledhill are the main practitioners on the transactional front, while Jonathan Berkson handles ABL litigation **(The Legal 500.)**

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