

Riviera Finance is a commercial finance company who is soon to be celebrating its 50th anniversary. Riviera's corporate office is in Redondo Beach, and it has offices throughout the state. Riviera is an interested party who is and will be affected by the regulations adopted by the DBO pursuant to the passage of SB 1235, specifically sections 22802 through 22804 of the Financial Code.

Riviera hereby submits the following comments for consideration in the DBO's rulemaking process.

**COMMENT 1; BUYING vs LENDING.** *The DBO should make a distinction in definitions between financing through "Buying" and financing through "Lending."*

*i. Federal and State Law make this distinction.*

Both state and federal law recognize a fundamental distinction between creditors who are "purchasers of accounts" and creditors who are "lenders." An example of federal law is helpful. Under 26 U.S.C. § 6323, Congress provided a carve-out to specific parties that are entitled to priority of their security interest in collateral over and above the priority of the Internal Revenue Service. This statute, in subsection (a), states that a lien for unpaid federal taxes "shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof [...] has been filed with the Secretary. (Emphasis added.) Congress specifically separates a "purchaser" of property from other forms of creditors. Similarly, §9318 of the California Commercial Code states, "[a] debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold." (Emphasis added.) The Annotated Uniform Commercial Code references purchasers as a distinct category of secured party 64 times. If purchasers and lenders indistinguishable, such references would be surplusage.

*ii. The 'True Sale' Distinction*

Because a purchase from an outright sale of accounts receivable is not a loan for which repayment is expected from the receiver of the money, sections 22802(b)(6) and 22803(a)(6) are inapplicable. However, a legal distinction exists between "recourse" and "non-recourse" factors. Non-recourse factors are viewed by courts as being true purchasers. For example, a recourse factoring company will seek repayment of the purchase price of an undisputed receivable that does not pay in a set number of days. That seeking of repayment of an undisputed but aging receivable is not a true sale - unilateral right to be repaid makes the purchase a disguised financing transaction. See also *In re Siskey Hauling Co., Inc.*, 456 B.R. 597 (Bankr. N.D. Ga. 2011): "When a buyer of accounts receivable holds substantial recourse against the seller, thereby shifting all risk of non-collection on the seller, courts have routinely held the transaction to be a financing arrangement and not a sale. *Major's Furniture Mart, Inc. v. Castle Credit Corp., Inc.*, 602 F.2d 538, 544-45 (3d Cir. 1979); *Lange v. Inova Capital Funding, LLC (In re Qualia Clinical Serv., Inc.)*, 441 B.R. 325, 329-31 (8th Cir. BAP 2011) (finding an invoice purchase agreement that shifted all risk of non-collection to the seller to be a "disguised loan rather than a true sale." Emphasis added. See also *American Factoring Law*, Ch. 1, IV, B, Ch. 4.II.E.

The law provides established distinctions of a purchase from a loan and a true sale from disguised financing. Because a company has the choice to either "borrow" money from a "lender" OR, alternatively, "sell" assets to a "purchaser," any regulation or rule adopted by the DBO should reflect, and not confuse, purchasers and lenders. More specifically, any regulation adopted by the DBO related to factoring should reflect and reinforce the legal distinction of nonrecourse factoring that is a "true sale" as distinct from recourse factoring as a financing arrangement.

**COMMENT 2; THE PROBLEM WITH ANNUALIZED RATES.** *The DBO should adopt a rule, pursuant to section 22804(b)(2), that an offer for financing through factoring is either exempt from a calculation of an annualized rate or should disclose the range in which a factoring fee may be charged.*

The sale of a receivable is different from a loan in many respects. For example, a sold receivable transfers one party's right to receive payment from a third party to another party, whereas a loan is only a two-party transaction. As a result, the purchase price of a receivable depends on variables such as 1) when the receivable will be paid by the third party, 2) how old the receivable is when it is sold, 3) what quantity/amount of receivables are sold in a transaction, 4) whether the third party withholds percentages under the contract, and 5) the creditworthiness of the third party. A receivable may pay in 10, 15, 30, 45, 60, 90 days or more. A seller may want to incorporate the temporal quality of a receivable into the sale price, or lower the price by selling the receivable after it is over 45 days old. A seller may also ask for incentives from the buying factoring company (the more receivables are sold, the smaller the factoring fee), or elect to sell only a single receivable. A seller may even only want to sell receivables billed to a new and unproven customer, shifting risk of nonpayment to the factoring company. As a result of these components (time value of money and volume), Annualized Rates are inapplicable.

The calculation of APR is inapposite for transactions that are not loans, and the regulations adopted by the DBO should reflect the comments of the California Senate Judiciary Committee during the legislative debate of SB 1235:

*"[T]he continued inclusion of APR or estimate APR arguably brings with it the possibility of misleading both the consumer and the provider. That is because **the calculation of the APR for different types of non-traditional financing options may vary greatly**, while the actual overall total dollar cost does not." [...] **"For factoring transactions, which involve the sale at a discount of multiple, pre-existing invoices with varying payment dates, the bill would not require the disclosure of an annualized cost of capital. These transactions are materially different from Merchant Cash Advances in that they involve existing, legally enforceable claims that are transferred to and collected by the finance provider. The inclusion of multiple due dates on these invoices with no guarantee of payment makes calculating even an estimated annual cost of capital problematic."** (Emphasis added).*

As was recognized by the Senate Judiciary Committee, annualized rates cannot be calculated in any meaningful way because 1) the variables involved in the sale are so uncertain, 2) the non-recourse (i.e., no guarantee of payment) nature precludes the character of the transaction from being described as annual, and 3) the purchase transaction is "materially different" from lending.

The DBO can be certain that, whatever the variables at play, sellers of a valid and undisputed receivables inherently negotiate for a rate that falls within an acceptable range in light of variables that are important to the seller. For example, a seller may agree to sell a \$1,000 receivable for \$950 but, if certain variables do not turn out as expected (slow pay or less volume), may be willing to sell that receivable for \$850. At no time, regardless of the final purchase prices paid, does the factoring company charge interest that can be calculated in a meaningful way over the standardized period of a year. Instead, the DBO could, in its regulation, create a rule that Annualized Rates for non-recourse factoring transactions are sufficiently disclosed if the buyer of receivables discloses the 'highest fee' and 'lowest fee' in the range and list the variables that affect that fee.

At a maximum, the DBO should regulate in a way that recognizes the upper and lower bounds of the amounts paid by the purchaser of accounts to a seller, in light of the variables affecting the rates.

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Riviera recognizes that the DBO is required to regulate under section 22804. However, Riviera believes that the DBO may determine that the "method" to express the "disclosure" is a qualitative disclosure rather than, as the Senate Judiciary Committee stated, a "misleading" and "problematic" mathematical calculation. Moreover, section 22804 empowers the DBO to determine "when" and "how" an estimated annualized calculation is disclosed. For those reasons, Riviera makes 2 proposals.

#### **PROPOSAL 1:**

**The DBO could require the following statements on an offer statement as satisfying disclosure of annualized rates under 22802(b)(6) and 22803(a)(6):**

**OPTION A (FOR NON-RECOURSE FACTORING OFFERS):** "The financing offered above is for the "true sale" and "purchase" of accounts receivable; Buyer assumes risk of nonpayment of undisputed accounts. Annualized Rates are not applicable."

**OPTION B (FOR RECOURSE FACTORING OFFERS):** "The financing offered above is for the purchase of accounts receivable that IS SUBJECT TO RECOURSE; BUYER DOES NOT ASSUME RISK of nonpayment of accounts that age beyond [\_\_\_\_\_] days from date of purchase. Annualized Rates are not applicable."

++The DBO could also require post-collection disclosure of APR for each invoice that is repurchased by the seller under Option B.

The proposed Options A and B fulfill the intent and purpose of SB 1235 (full disclosure) without confusing a purchase and a loan, while also properly distinguishing non-recourse factoring and recourse factoring.

**PROPOSAL 2:**

**If the DBO does not distinguish between non-recourse and recourse factoring in its rules and definitions, the DBO could require the following statement on an offer statement as satisfying disclosure of annualized rates under 22802(b)(6) and 22803(a)(6):**

"The financing offered above is the discounted purchase of undisputed accounts. If the accounts are not paid in full to Buyer by account debtor within terms, Seller will pay a minimum rate of [LOWEST FEE] and may pay a maximum rate of [HIGHEST] for undisputed accounts. Variables affecting this range of rates are: [LIST OF VARIABLES]."

This, or similar language, adequately discloses a purchase price within the range of potential rates, taking into consideration the variables foreseen by the Senate Judiciary Committee.

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**CLOSING**

Riviera Finance has been purchasing receivables on a non-recourse basis for 5 decades. During that time, Riviera has paid many sellers for receivables billed to third parties, only to see the third parties file for bankruptcy. Because the transaction is a "true sale," Riviera assumes the loss and does not seek repayment from the seller of the receivable. This testimony alone should inform the DBO that factoring is a sale of intangible personal property and completely incomparable to lending transactions. The DBO must not, in the effort of rule-making, adopt a regulation that suggests that buyers of bread at wholesale must be told by the wholesaler how much the purchase price would be if that sale were, instead, a loan. Just like buyers of accounts, wholesalers pay money for personal property - that does not make it subject to annualized rates. Purchasing of accounts receivable is, under federal and state law, distinct from the transactions which deal in the repayment of money lent.

If any portion of this comment is unclear or needs clarification, please contact the undersigned.

Respectfully,

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