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BHL v. Leumi ABL Limited:
Collection Fees Charged Under Factoring Agreements

INTRODUCTION

BHL v. Leumi ABL Limited [2017] EWHC 1871 (QB) is a factoring case which was decided at the end of July 2017 by the High Court of Justice, Queens Bench Division, in London, England. Although the decision is not binding on the Canadian courts, it raises some interesting questions of law that may apply to factoring agreements in Canada.

FACTS

1. Leumi ABL Limited (the "**Factor**") entered into a factoring agreement with Cobra Beer Limited ("**Cobra**").
2. After Cobra began to suffer financial difficulties, Cobra's parent company BHL (the "**Parent**") signed an indemnity agreement in favour of the Factor, pursuant to which the Parent agreed to indemnify the Factor for all amounts due under the factoring agreement.
3. The factoring agreement contained a clause that authorized the Factor to charge a collection fee under the following circumstances:

   (a) If the Factor requires Cobra to repurchase any receivables and Cobra fails to do so within 7 days of such demand, then the Factor will be entitled to charge Cobra an additional collection fee at up to 15% of amounts collected by the Factor thereafter. This collection fee is in addition to any other fee payable by Cobra to the Factor under this Agreement. Cobra expressly acknowledges that such fee constitutes a fair and reasonable pre-estimate of the Factor's likely costs and expenses in providing such service to Cobra.

4. The Factor subsequently demanded that Cobra repurchase all of the receivables under the factoring agreement. When Cobra failed to do so within 7 days, the Factor took over the collection of the receivables and notified Cobra

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that it would be charging a collection fee of 15% on all receivables collected.

5. The Factor collected Cobra's receivables in the total amount of £8,000,000 and charged 15% of the amount collected, which resulted in a collection fee of £1,200,000.
6. Cobra's Parent initially paid a substantial portion of this collection fee, namely, £950,000 to the Factor pursuant to the indemnity agreement.
7. However, the Parent subsequently commenced a lawsuit against the Factor alleging that the Factor was not entitled to charge a collection fee of 15%, that the Parent had paid this money by mistake, and that the Factor should return the amount paid to the Parent.
8. The Court decided that the Factor was not entitled to charge a collection fee equal to 15% of the amounts collected.
9. The Court found that the Factor's actual collection costs and expenses for the collect-out were £33,260.
10. The Court held that the Factor should have charged a collection fee of no more than 4% of the amounts collected, which worked out to £320,000.
11. After the relevant adjustments, the Court ordered the Factor to repay £735,000 to the Parent plus interest.
12. In addition to the above payment, the Court ordered the Factor to pay £780,000 on account of the Parent's legal costs.

THE COURT'S REASONING

The Court first considered the "target" or the "purpose" of the collect-out clause. The Court held that the target of the clause was the recovery of future costs and expenses to be incurred by the Factor as the now collector of the receivables. The provision allowed the Factor to charge a fee, which was meant to represent or capture or estimate in some way the Factor's future costs and expenses in collecting the receivables. The language suggested that the fee could be charged prior to the Factor incurring these costs. There was obviously a margin of flexibility given to the Factor, since by definition, the Factor could not know in advance precisely what those collection costs would be.

Since this provision gave the Factor the power to set in advance a percentage fee, which would apply to all future recoveries, there had to be some restriction or qualifications on this discretion. Otherwise, this discretion could be exercised oppressively or abusively.

The Factor had a duty to follow a proper process in making its decision on the fee to be charged, including taking into the account the material points and not taking into account irrelevant considerations. According to the Court, the Factor needed to identify:

1. the amount of collectable receivables which needed to be recovered in order to repay the amount owing to the Factor;
2. the estimated likely costs of collection; and
3. such costs as a percentage of the sum to be collected.

It appeared from the evidence that the Factor had, as a matter of practice, always charged the maximum of 15% where the provision gave a fee which could be up to 15%. Since the Factor was automatically charging the maximum of 15%, the Court found that there was absolutely no exercise of discretion at all by the Factor, which was contrary to the law.

Where a discretion has not been exercised, the Court cannot substitute its own view of what fee would have been reasonable. The judge must put himself or herself in the shoes of the Factor and consider what decision, acting rationally, the Factor would have reached if the Factor had tried to apply the discretion in a lawful manner. The question was not what were the actual costs of collection incurred by the Factor. Rather, the question was what percentage could the Factor have chosen to charge, if the Factor was acting rationally, in order to cover its anticipated costs of collection.

The Court considered expert evidence as to the complexity of the

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collection and the likely timeframe for the recovery of the debts. Based on this evidence, the Court held that 4% was the maximum collection fee that the Factor could have charged in order to comply with the Factor's duty to exercise its discretion in a lawful manner.

CONCLUSION

So, what does this all mean for factors in Canada? In my opinion, this case has much wider implications for factors than the particular clause in question regarding the discretion to charge a percentage for a collection fee. It stands for the proposition that factors are required to act rationally and reasonably when exercising their powers or charging certain fees under a factoring agreement. If the factor attempts to exercise these powers arbitrarily and does not behave in a commercially reasonable manner, there is a real risk that the factor's actions may be challenged by its client or by the client's guarantor. If this happens, then there is also a risk that the Court may refuse to enforce these provisions in the factoring agreement. No one wants to get involved in a lawsuit, which can be very costly. If the factor loses, then not only will the factor have to pay its own legal expenses, but it may also be ordered to pay the legal expenses of the other party.

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