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// BANKING & FINANCE

Invoice Finance – A Vital Source of Liquidity as Irish Businesses Emerge from the COVID-19 Lockdown

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Following the 2008/2009 global financial crisis, businesses at home and abroad increased their use of invoice finance as a critical tool to manage cash flow. The Irish Asset and Invoice Finance Association recently commented that we should expect a similar trend as businesses emerge from the COVID-19 lockdown. In this briefing, our leading receivables finance team examine legal and other factors which could help support that growth in the Irish invoice finance industry.

WHAT IS INVOICE FINANCE?

Invoice discounting is a commercial arrangement where a trading business obtains an immediate cash advance on approved customer invoices from an invoice discounter, up to a specified percentage (usually 80 or 85%) of the face value of those invoices. The trading business retains day to day control of its sales ledger and collections procedures, but customers are instructed, usually on the relevant invoice, to pay the invoiced amount directly into a bank account controlled by the invoice discounter.

The contractual arrangements for invoice discounting are structured so that the invoice discounter purchases all book debts of the trading business as and when they come into existence and the purchase price payable by the invoice discounter for such book debts comprises the invoiced amount less a discounting charge and other administration fees.

THE LEGAL STRUCTURES FOR INVOICE FINANCE ARE NOW FIRMLY ENTRENCHED IN IRISH LAW

Before the 2019 Court of Appeal decision in ***The Governor and Company of the Bank of Ireland v Eteams (International) Limited (in voluntary liquidation)* [2019] IECA 145**, legal commentators often speculated that invoice finance arrangements could carry an inherent "re-characterisation risk". This is the risk that, if their legal basis was challenged in court, the transfer of the book debts to the invoice discounter could be re-characterised as nothing more than a registerable charge.

Eteams (International) Limited (**Company**) availed of an invoice finance facility from Bank of Ireland and subsequently went into liquidation. The liquidator brought an action on behalf of the Company to the High Court and argued that the invoice finance arrangement was nothing more than a loan secured on the book debts of the Company and that such security was now invalid because it had not been registered in the Companies Registration Office (**CRO**) within 21 days, as required by legislation. Were the Court to agree with such argument, the book debts would not be the property of Bank of Ireland but would instead become part of the general pool of assets available to the liquidator for distribution among all unsecured creditors. Not only would Bank of Ireland, as invoice discounter, not own the book debts, it would not even have a valid security interest over them if such security was not registered in the CRO, meaning that Bank of Ireland would rank only as an unsecured creditor in the liquidation of the Company.

The High Court, following a line of persuasive English case law dating back to the 1930s, rejected the liquidator's argument and recognised that the invoice finance agreement did what it purported to do; that is, it effected a valid purchase by Bank of Ireland of the Company's book debts and was not merely the creation of a registerable charge.

The liquidator appealed that decision to the Court of Appeal. The Court of Appeal refused the appeal and approved the reasoning and decision of the High Court. The liquidator then sought to appeal that decision to the Supreme Court (the highest court in Ireland) but, as the law on the validity of the invoice finance agreement had been clearly determined by the Court of Appeal, the Supreme Court would only grant leave for appeal in relation to specific issues around legal standing to bring the original case and liability for costs. That Supreme Court decision was delivered on 8 May 2020 and the liquidator was held personally liable for the costs of Bank of Ireland in defending the case.

The Eteams decisions are extremely important to the receivables finance industry in Ireland as they recognise the concept of a "true sale" of receivables under Irish law and they confirm, beyond any doubt, that an invoice finance arrangement (to quote the famous Ronseal advertisement): *"does exactly what it says on the tin"*.

STATE GUARANTEE OF CREDIT INSURANCE

Credit insurance (also known as debtor insurance or export credit insurance) insures businesses against the risk of their customers not paying their invoices.

Particularly in the case of non-recourse invoice finance (where, with certain exceptions, the invoice discounter does not have recourse to the company for invoices that are not paid), credit insurance plays a key role as the availability of that invoice finance facility will be conditional on the company maintaining credit insurance for its book debts up to a certain level.

The increased non-payment risk and the expected increase in credit insurance claims arising out of the COVID-19 pandemic have forced some credit insurers to reduce or completely withdraw cover on customers in certain sectors.

In response to this, many countries including Germany, the Netherlands, France, Canada and the United Kingdom have announced state guarantee schemes to support domestic credit insurance markets. Those schemes aim to ensure the continued availability of trade credit insurance to all businesses in those markets, avoiding the need for purchasers of goods and services from those companies to pay for them in advance.

While the Irish government has not, as of early July 2020, taken any action to introduce such supports, it is coming under increasing pressure from insurers and business representatives to do so. This is because a significant number of Irish companies avail of trade credit insurance as an essential tool in managing cash flow for their businesses.

The introduction and implementation of any such state guarantee scheme in Ireland would be a very welcome support for Irish businesses generally and not just the invoice finance industry. Any such scheme would be subject to EU state aid rules and subject to the approval of the European Commission.

LEGISLATION TO DEAL WITH BAN ON ASSIGNMENT PROVISIONS IN CUSTOMER CONTRACTS

Unlike some other countries, Ireland has not, as of early July 2020, introduced legislation to help businesses wishing to avail of invoice finance, but are prevented from doing so because the terms of their supply contracts prohibit it.

In 2018, the United Kingdom introduced *The Business Contract Terms (Assignment of Receivables) Regulations 2018* to deal with this issue.

The aim of these UK regulations is to make it easier for small to medium-sized enterprises to access invoice finance by nullifying non-assignment provisions in their supply contracts which prohibit or impose a condition, or other restriction, on the assignment of receivables.

Certain types of contracts are excluded from the scope of the regulations including contracts entered into prior to 31 December 2018 and contracts concerning land and financial services.

Although legal practitioners in the UK have picked up on various technical issues with the UK regulations that do not work well in practice, or could be clarified by amendment, the UK regulations are, on the whole, broadly welcomed in the UK and the UK government have estimated that they should, in the long term, provide a £1 billion boost to the UK economy.

While the Irish government's focus, for the foreseeable future, will undoubtedly be on other more pressing issues in the economy, we believe the introduction of legislation in Ireland similar to the regulations introduced in the UK and other jurisdictions would, in the medium to long term, be a welcome boost to the Irish invoice finance industry.

CONCLUSION

Recent Irish case law has provided significant legal certainty for invoice finance in Ireland. Consequently, the industry is well placed to support Irish businesses and to grow in the difficult months ahead. The absence of state support for credit insurance presents an immediate problem, not just for invoice finance providers, but for Irish businesses generally. However, we believe it is reasonable to expect positive developments on this issue in the short term. Other possible developments, such as the introduction of legislation to deal with ban on assignment provisions in customer contracts, would be a welcome boost but are likely to be longer term initiatives.

CONTACT US

William Fry have a market leading receivables finance practice and regularly act for domestic and international invoice finance providers and large corporates on all types of receivables finance products. For more information, please contact any member of our receivables finance team below or your usual William Fry contact.

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