Financial Services Flash

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Factoring in Recent Jurisprudence Regarding Estoppel Certificates

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In the recent Ontario Court of Appeal decision, *TFS RT Inc. v. Shoppers Drug Mart Inc.* ("**TFS v. Shoppers**"),[1] Lauwers J.A., *et al* clarified the requirements and scope of estoppel certificates and "hell or high water" clauses. Factors should take note of this decision and ensure that all estoppel certificates obtained satisfy the requirements of the Court.

Factoring involves the sale by a seller of its accounts receivables, at a discount, to a factor. The factor assumes the credit risk of the seller's customer(s), and is entitled to all payments received pursuant to the receivables. Generally, the factor requires a "hell or high water" clause in the factoring agreement whereby the seller states that the factor is entitled to payment pursuant to the receivables despite any right of abatement, defense, set-off, compensation, counter-claim or the like which the customer may have against the seller. Similarly, sellers often include a corresponding provision in their agreements with their customers, so as to facilitate their right to assign such receivables come "hell or high water." These clauses are generally found to be enforceable, barring unconscionability.[2]

Owing to the doctrine of privity of contract, however, a factor seeking to use a hell or high water clause against a customer cannot simply assert the rights granted by the clause in its factoring agreement. Rather, the factor usually obtains an estoppel certificate from the customer.

In the estoppel certificate, the customer states certain facts that the factor will rely upon, and which the customer will be estopped from denying. In the recent *TFS v. Shoppers* decision, the Court clarified exactly what a factor should include in such estoppel certificates to ensure their enforceability as against the third-party customer.

In this case, Shoppers Drug Mart Inc. ("**Shoppers**") was the customer, Self Breathalyzer Ltd. ("**SBL**") was the seller, and TFS RT Inc. ("**TFS**") was the factor. Shoppers entered into a contract with SBL for the supply and delivery of self-breathalyzer devices. Under the contract, Shoppers was entitled to return any unsold product to SBL for credit and to deduct allowances totalling 11.78% of the total purchase price of units sold.

When invoices became due, Shoppers renegotiated its payment terms as they considered it likely that large amounts of credits would be available. SBL, responding to cash flow issues resulting from Shoppers' delayed payments, assigned and sold its Shoppers' receivables to TFS. SBL signed and sent a Notification Letter to Shoppers regarding the assignment. The Notification Letter told Shoppers to direct payment to a specific bank account, of which TFS was a beneficiary. SBL also sent Shoppers a document titled "Acceptance of Goods" in which Shoppers was to acknowledge receipt of the products and accept a hell or high water clause whereby Shoppers would agree " … to make all payments in respect of [SBL's invoices] to TFS … without setoff or deduction of any kind whatsoever." Shoppers acknowledged the assignment to TFS and agreed to make further payments to TFS.

Shoppers ended up returning approximately 3/4 of all products as unsold. Once the allowances and credits for

returned inventory were accounted for, Shoppers owed $25,477 out of the total $279,402.61 originally invoiced by SBL. TFS sought payment by Shoppers of the face value of the invoices, whereas Shoppers was only willing to pay the lower amount, taking into account allowances and credits.[3]

The Court held that TFS was not entitled to the face value of the invoices. The Court viewed the Acceptance of Goods document as simply an acknowledgment by Shoppers that, when it made payments to SBL, to which SBL was entitled under the terms of the agreement with Shoppers, Shoppers would on SBL's request direct those payments to TFS without "set off or deduction." It did not constitute a promise by Shoppers to pay the face amount of the invoices regardless of the amount actually owing by Shoppers to SBL.

The Court stated that "more precise language is required" to constitute a representation by Shoppers to pay the full amounts of the invoices. The Court, in other words, would not expand Shoppers' liability beyond that originally owed to SBL under the contract, especially without clearer language. A factor may therefore wish to conduct further due diligence so as to ascertain the rights of the customer under the contract from which the purchased accounts receivable originated.

The factor should also ensure that any representation regarding amounts owed is clear and precise. Here, TFS could have sought the inclusion of the actual dollar amount for the face value of the invoices. Shoppers may not have agreed to such an inclusion, but the ensuing negotiations would have clarified Shoppers' scope of liability under the contract.

The Court then adopted the recommendation of Belobaba J., the application judge, that factors should now:

1. get the customer to acknowledge the amount that is actually owing,
2. get the customer to acknowledge the factor's reliance on the representation, and
3. get the customer to promise to pay the amount owing to the purchaser.[4]

Lauwers J.A. noted that the document would ideally be titled "Estoppel and Acknowledgment" rather than "Acceptance of Goods," as this would constitute express notice to the customer as to the purpose of the document.

Belobaba J. had also found it significant that TFS was "a stranger" to the payment direction statement. Factors should therefore ensure that they deal directly with customers in seeking estoppel certificates.

Factors can still protect themselves through the use of estoppel certificates. They must, however, ensure that they satisfy all the requirements to make it effective or they may be caught with a bad bargain.

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1 2015 ONCA 85.
2 See for example *Key Equipment Finance Canada Ltd. v. Jacques Whitford Limited*, 2006 N.S.S.C. 68.
3 Facts alleged in the Factum of the Respondent, Shoppers Drug Mart Inc.
4 See also *Pacific Sunset Development Corp. v. 380372 B.C. 733*, 1997 Carswell 733 (BCSC).