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What CIT Group's Bankruptcy Will Mean For You

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1. **Background:** The furniture industry is heavily dependent on CIT Group Inc.'s factoring and lending services. CIT is in financial distress and its fate will be determined in about two weeks as the deadline looms for the bondholders to agree to accept a plan that would either restructure about $31 billion of debt or put CIT into a prepackaged bankruptcy. As of today, some bondholders have objected to the restructuring terms presented by CIT.

2. **What is factoring:** Factoring, which is the most common service provided by CIT to the furniture industry, consists of the sale of accounts receivable to CIT who then assumes the responsibility for collecting such accounts and the credit risk of non-payment. CIT will also usually advance, in its discretion, 80% to 90% against open receivables prior to collection. The borrower pays a factoring commission which is a percentage of factored volume plus an interest rate on the amounts that CIT advanced against receivables. If you would like to see a sample CIT Factoring Agreement, please email me at jcohen@homefurnishingslaw.com.

3. **What can borrowers expect if CIT files for bankruptcy:** If CIT obtains financing from a third party or from its existing lenders to continue its operations in bankruptcy, there should be no significant adverse affect to its borrowers. If, however, CIT is faced with a liquidity squeeze then, subject to a government bailout (which is not forthcoming), there are several possible outcomes: a third party may purchase the profitable loans and financing operation and assume CIT's obligations, resulting in little interruption to its borrowers, or CIT may be liquidated forcing its borrowers to search for alternative financing.

Although borrowers who have term loans may not be significantly affected in the event of a bankruptcy, customers with revolving lines of credit or factoring arrangements may find their access to funds limited. In addition, CIT's factoring clients have sold their invoices and accounts receivable to CIT and therefore the amounts to be delivered by CIT to the client (i.e., the amount of the account receivable net of the advance, if any, received from CIT) are merely unsecured claims against CIT. Technically such clients would have to stand in line for their funds along with other unsecured creditors of CIT.

4. **What to do:** Borrowers with revolving lines of credit should continue to draw down on their lines as much as possible to ensure adequate liquidity. Of course this additional demand has put a strain on CIT's ability to fund and therefore CIT is tightening credit availability.

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Borrowers who are factoring should review the Factoring Agreement with respect to the termination provision (usually CIT can terminate for any reason upon 60 days notice; the Borrower can only terminate if it provides written notice within 60 days of the anniversary date of the agreement), the default provisions and other fine print including any minimum fees that may be due upon early termination. Borrowers should then investigate alternative sources of financing in case CIT is unable to provide sufficient credit to the Borrower. It's time consuming and currently difficult to find a new lender and to satisfy the new lender's borrowing criteria, therefore, its never too early to start the process.

Some manufacturers are curtailing shipment of goods to some retailers because they're worried they won't get paid by CIT, or asking their customers to pay them directly rather than through CIT. Resist either strategy because the former is unsustainable, and the latter legally indefensible.

Have our loyal readers felt a tightening of credit availability from CIT. How are you coping with the uncertainty surrounding CIT and its future. Please share with us on the comments below or by emailing me at jcohen@homefurnishingslaw.com.

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