MERCHANT CASH ADVANCE – A LIFELINE OR A COFFIN NAIL

WHAT IS A MERCHANT CASH ADVANCE, (MCA)? (See, NerdWallet.com)

An MCA is an alternative type of business financing in which a provider gives the borrower an upfront sum of cash that is repaid using a percentage of the borrower's debit card and credit card sales, plus a fee. On many occasions, the provider attempts to structure the financing transaction as if it were purchasing the borrower's sales receipts or receivables. In reality, when all of the factors of the transaction are carefully examined, many court decisions have concluded that the MCAs are not purchase/sales agreements, but, in actuality, are disguised loans.

MCAs are one of the most expensive types of business financing. They are not federally regulated, which often results in marketing and confusing contracts that lead borrowers to predatory lenders. MCAs typically fund faster and more easily with less qualification requirements than other types of financing. MCAs are attractive to small businesses that need capital immediately to cover cash flow shortages or short-term expenses. The cost of the financing to the borrowers can be exorbitant and create an almost unbearable cycle of debt.

An MCA transaction is traditionally structured to allow the provider to automatically deduct a daily or weekly percentage of the borrower's debit card and credit card sales until the amount advanced is repaid in full. The MCA provider may deduct these payments from the borrower's bank account or it can deduct them directly from the borrower's payment processing account.

The predetermined percentage of sales is called the "holdback rate" or "retrieval rate," and typically ranges from 5% to 20%. The exact rate will depend on the provider, the amount advanced, and the borrower's sales volume. Unlike other types of business loans, MCAs do not have typical repayment terms. Repayment periods are based on the volume of sales and can range from 3 to 18 months. If the volume of sales is high, the MCA advance will be paid more quickly. A fixed repayment amount is generally determined based on an estimate of the borrower's monthly revenue.

Rather than a traditional interest rate, MCA providers charge their fees as a "factor rate." Factor rates typically range from 1.1 to 1.5, varying on the provider's assessment of the borrower's business. The borrower's business history, financial statements, and the volume of the debit and credit card transactions all play a role in the determination of the factor rate. Businesses, whose ability to repay appears risky, will likely receive a higher factor rate and pay higher fees as a result.

The factor rate also may not include additional fees that the provider may charge, such as administrative fees or underwriting fees which will obviously increase the total cost of the financing.

An example of an MCA depicting two repayment scenarios:

- Advance amount: $50,000.00
- Factor rate: 1.4 ($50,000 x 1.4 = $70,000 total to be repaid; thus the borrowing cost is $20,000)
- Holdback rate: 10% of monthly credit card sales.

If the monthly credit card sales are $100,000.00:

- Payment amount: $333 daily.
- Repayment term: Seven months.
- Total repaid: $70,000.00.
- Estimated APR: 125%.

If the monthly credit card sales are $70,000.00:

- Payment amount: $233 daily.
- Repayment term: 10 months.
- Total repaid: $70,000.00.
- Estimated APR: 87.3%.

In the aforesaid example, paying off the debt faster actually leads to a higher APR, (Annual Percentage Rate). IF your sales are lower, your APR decreases, but it takes longer to pay off the debt. In either instance, you still pay the same in fees. However, the different APRs show how expensive an MCA can be regardless of the terms. These rates would be usurious in most states that have usuary prohibitions.

Pros and Cons of MCAs:

Pros:

Fast to Fund – You can apply for a merchant cash advance online – and get approved quickly – usually with minimal documentation required. Many MCA providers offer funding within 24 hours.

Flexible requirements – MCA companies may work with businesses facing credit challenges, startups, and those with previous financial difficulties. Plus, MCAs don't typically require physical collateral. Providers will likely consider traditional business loan requirements, but primarily will focus on debit and credit card transactions or business revenue. Of course, the better the qualifications, the better factor rate.

Collateral not required – Because an MCA is an advance based on future sales, a borrower doesn't usually need to provide physical collateral to secure financing. Additionally, some MCA providers don't require a personal guarantee.

Cons:

Expensive – Compared with other types of business loans, like online term loans or business lines of credit, whose APRs typically range from 14% to 99%, MCAs are one of the most expensive forms of financing. APRs on merchant cash advances can reach 350%, depending on factors such as the lender, size of the advance, fees, time it takes to repay and business revenue. Plus, unlike traditional interest rates, factor rates can make it more difficult to determine exactly how much an MCA will cost.

Frequent repayment and debt cycle danger – Merchant cash advances are repaid daily (sometimes weekly) and payments are deducted directly from incoming sales, which can seriously impact cash flow. The high cost, coupled with frequent repayments, can easily trap a borrower in a cycle of debt that's hard to break, especially if one advance is not enough and the borrower can't qualify for other types of financing.

No benefit to repaying early – Since you have to repay a fixed amount of fees no matter what, you can't save on interest by repaying early, unlike traditional amortizing loans.

Confusing contracts – Merchant cash advance contracts can be confusing, especially considering the nature of factor rates and repayment schedules that are based on percentages of a borrower's daily sales. MCA providers also don't typically provide APRs in their agreements, which makes it difficult to compare these products with other types of financing. Although some states have moved to force transparency among MCA companies in recent years, providers have historically been criticized for agreements that are unclear and hard to understand.

No federal regulation – Unlike traditional loans, MCAs, which are structured as commercial transactions, are not subject to federal regulation. Instead, MCAs are regulated by the Uniform Commercial Code in each state. This limited regulation has often led businesses to fall victim to predatory companies that use misleading marketing and sales tactics, offering instant approvals and funding.

Confession of Judgment – Many MCA providers will require the borrower to execute a confession of judgment at the transaction closing, which is an agreement that essentially waives the borrower's right to dispute or defend a cause of action initiated by the provider. Jurisdictions in many states allow a confession of judgment to be included in an initial contract document. So, if a borrower located in one state executes an MCA contract in another state that contains a provision that the law of that other state will control any disputes the parties might have, and further provides that a confession of judgment may be entered in the other state, the borrower may be completely unaware that a judgment has been taken in the other state, until the MCA provider initiates proceedings to have it domesticated in the state of the borrower's residence.

IS THE MCA A TRUE SALE OR A DISGUISED LOAN? SELECTED OPINIONS:

A. *CapCall LLC v. Foster (In re Shoot the Moon LLC),* 635 B.R. 797 (Bankr. D. Mont. 2021)

Facts:

The Shoot the Moon entities and CapCall entered into eighteen financing transactions. The parties detailed the terms in written Merchant Agreements and associated documents (including confessions of judgement, personal guaranties by Shoot the Moon's principals, and UCC-1 financing statements). The economic core of these transactions was that CapCall provided the Shoot the Moon entities with immediate cash (and hence liquidity to operate) upon closing. In exchange, CapCall received a portion of future receivables generated through the restaurant operations.

The amounts promised to be repaid to CapCall substantially exceeded the amount that cash CapCall paid, which created profit for CapCall and represented the costs to the Shoot the Moon entities of obtaining financing in this fashion. Return transfers to CapCall were effected via fixed daily ACH debits (in the "Specified Daily Amount") per each agreement against bank accounts. The debits continued regarding a given agreement until CapCall received a total "Receipts Purchased Amount" set forth in that agreement.

Once Shoot the Moon was in bankruptcy, CapCall commenced an adversary proceeding seeking declaratory relief that it owns the remaining balance deposited in the segregated account, a judgment against the Trustee for converting postpetition receipts, and other miscellaneous fees, costs, and interest components. The Trustee counterclaimed seeking declaratory relief about which state's law applied to the transactions and that the transactions were disguised loans rather than sales.

Holding: The Court concluded that the transactions were disguised loans, not sales.

Factors:

a. Whether the buyer has a right of recourse against the seller;
b. Whether the seller continues to services the accounts and commingles receipts with its operating funds;
c. Whether there was an independent investigation by the buyer of the account debtor;
d. Whether the seller has a right to excess collections;
e. Whether the seller retains an option to repurchase accounts;
f. Whether the buyer can unilaterally alter the pricing terms;
g. Whether the seller has the absolute power to alter or compromise the terms of the underlying asset; and
h. The language of the agreement and the conduct of the parties.

B. *In re R&J Pizza Corp.,* 2014 Bankr. LEXIS 5461 (Bankr. E.D.N.Y. Oct. 14, 2014)

Facts and Holding:

Credit card receivables purchased by the creditor qualified as "accounts" within the meaning of N.Y.U.C.C. Law § 9-102(a)(2). Debtor had no interest in purchased accounts and thus the bankruptcy estate similarly had no interest in the purchased accounts. An examination of the Purchase Agreements reflected that consideration of the factors identified in the case law established that the transaction between the parties was a true sale and that debtor retained no rights in the purchased accounts.

Debtor had no right to control the processing of its credit card receivables and no right to commingle the credit card receivables with those credit card receivables that were purchased by the creditor. The Purchase Agreements represented a true sale and not a disguised financing arrangement. Debtor was obligated to turnover the purchased accounts to the creditor.

Factors:

a. All of the underlying documents consistently referred to the transaction as a "purchase" and "sale" and to the parties as "Buyer" and "Seller," and did not include any provision allowing for interest to be paid;
b. The agreement did not provide for recourse against the business for non-collection and the personal guarantee was effective only under a limited set of circumstances;
c. The debtor had no right to process or repurchase the accounts, and no ability to commingle proceeds; and
d. The Buyer had no right to alter the price or terms of the purchase.

C. *Nickey Gregory Co., LLC v. AgriCap, LLC,* 597 F.3d 591, 601-03 (4th Cir. 2010)

a. The Fourth Circuit concluded that a purported "sale of receivables" to be a disguised loan when certain parts of documents described the agreement as financing, when the agreement shifted the risk of the account debtor's insolvency to the "seller," when the "account purchaser" filed UCC statement, when "account purchaser" was secured by more than just receivables, when "seller" was prohibited from paying other debts before the "account purchaser," and when a full personal guarantee was required.
b. The buyer, which purchased produce from the sellers on credit, obtained funds from the financing company, using its accounts receivable as collateral. The buyer later filed for Chapter 7 bankruptcy. On appeal, the court held that under 7 U.S.C.S. § 499e(c), purchased perishable agricultural commodities and their proceeds had to be maintained in a trust until the sellers were paid, and failure to do so was a violation of 7 U.S.C.S. § 499b. Sale of trust assets was permitted, but if the assets were merely transferred as collateral and not converted to cash, they remained trust assets, and the financing company's interest was subject to the superior claim of the sellers. The district court properly found that the arrangement between the buyer and the financing company was a loan, not a sale. While the risk of non-collection remained with the buyer, several contract documents referred to the "debt" and a security interest in the accounts receivable. The financing company did not have a bona fide

purchaser defense because it had notice of the trust obligations, and it was not a purchaser of the accounts for value because it never owned them.

D. *In re Willams Land Clearing, Grading, & Timber Logging, LLC,* 2025 Bankr. LEXIS 1201 (Bankr. E.D.N.C. May 16, 2025).

Facts:

Williams Land entered into a MCA Agreement with Apex, under which Apex provided $250,000 to Williams Land in exchange for $337,500 of Williams Land's future receivables. Apex filed a UCC-1 financing statement asserting a security interest in all of Williams Land's assets, including accounts receivable. Williams Land made payments totaling $228,941.48 to Apex pursuant to the MCA Agreement.

Within 90 days before Williams Land filed for bankruptcy, Domtar Corporation paid $30,159.42 directly to Apex pursuant to the MCA Agreement. CFI asserted that it held a senior perfected security interest in Williams Land's accounts receivable, including the Domtar receivable paid to Apex.

Holding:

The MCA Agreement was a loan, not a true sale, because Apex retained significant recourse against the Debtor in bankruptcy, indicating Apex did not bear the full risk of non-payment. As a usurious loan under New York law, the MCA Agreement was void ab initio. The Debtor, Williams Land, received reasonably equivalent value from Apex in the amount advanced ($250,000), which was more than the total payments made by Williams, so those payments are not avoidable as constructively fraudulent. The $30,159.42 payment by Domtar, made within 90 days before bankruptcy, allowed Apex to receive more than it would have in a Chapter 7 case, satisfying the preference elements. CFI did not establish the required elements for conversion, including a present right to possession of the funds paid by Domtar.

E. *J.P.R. Mech. Inc. v. Radium2 Cap., LLC* (*In re J.P.R. Mech. Inc.*), Nos. 19-23480 (DSJ), 21-07079 (DSJ), 21-07082 (DSJ), 2025 Bankr. LEXIS 1319 (Bankr. S.D.N.Y. May 30, 2025)

Facts:

JPR Mechanical, Inc., and J.P.R. Mechanical Services, Inc., ("Debtors") filed for Chapter 7 bankruptcy on August 16, 2019. Prior to filing for bankruptcy, the Debtors entered into several agreements with Radium2 Capital, LLC ("Defendant"), styled as "Agreement for the Purchase and Sale of Future Receipts."

Under these agreements, the Defendant lender, Radium2 Capital advanced money to the Debtors in exchange for a specified percentage of the Debtors' future revenues, with the Defendant collecting daily transfers from the Debtors' bank accounts. The Trustee sought to

avoid three transfers made by the Debtors to the Defendant under these agreements as avoidable preferences.

Holding:

a. The Agreements between the Debtors and Radium2 Capital, LLC, constituted loans rather than true asset sales, despite being styled as agreements for the purchase and sale of future receipts.
b. The Trustee established that the transfers made by the Debtors to the Defendant under the Agreements qualified as avoidable preferences under 11 U.S.C.S. § 547(b).
c. The Defendant failed to establish the applicability of the ordinary course of business defense under 11 U.S.C.S. § 547(c)(2).

BANRUPTCY APPLICATIONS (The following comments were extracted with permission from a paper entitled An Analysis of Merchant Case Advances prepared by Craig M. Geno, Law Office of Craig M. Geno, Ridgeland, MS, and David W. Houston, IV, Burr & Forman LLP, Nashville, TN).

Use of Case Collateral:

A debtor's use of accounts receivable, (AR), sold to an MCA, as cash collateral could occur on certain occasions without MCA consent. First, if the AR, purchased by the MCA, was already pledged to a conventional lender before the MCA entered into its merchant cash advance agreement, then the AR might be fully encumbered by the pre-existing security interest of the conventional lender under the traditional "first in time, first in line" rule applicable to establishing the priority of security interests. In that situation, if a debtor received authorization from the conventional lender holding the first position security interest, or from the bankruptcy court, then the debtor might utilize cash collateral despite a claim by an MCA to have purchased future AR, as the MCA would be "out of the money" and thus, arguably, lack standing to assert an interest in cash collateral.

Additionally, a debtor might argue that AR generated post-petition is not subject to the security interest claimed by an MCA. See *In re Cross Baking Co., Inc.* 818 F.2d 1027, 1029 (1st Cir. 1987).

> Section 552 of the Bankruptcy Code concerns the post-petition effect of pre-petition security interests. Its purpose is to prevent a creditor's pre-petition security interest in "after-acquired property" (a "floating lien"), such as the creditor's interest in Cross' receivables, from attaching to property acquired by the estate or debtor-in-possession after the filing of a bankruptcy petition. See H.R.Rep. No. 595, 95th Cong., 1stsess. 376-77 (1978), reprinted I 1978 U.S.Code Cong. & Admin.News 5787, 5877 ("Senate Report"). Section 552(a) plainly states this general rule: "[P]roperty acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from a security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. § 552(a). This subsection is subject to the exceptions set forth in 11 U.S.C

§ 552(b), which offers protection to conventional lenders who hold pre-petition security interests that extend to proceeds, products, offspring, and profits of the collateral.

If a lender has been pledged an interest in accounts receivable not yet in existence on the bankruptcy petition date, such an interest might not constitute an interest in cash collateral, because the filing of the petition generally prevents the extension of a pre-existing security interest to assets acquired post-petition. 11U.S.C. § 552(a). MCA agreements that purport to buy receivables not yet in existence might be especially vulnerable to such arguments.

Avoidance Action Issues Regarding MCAs:

A debtor might consider asserting avoidance action claims regarding MCAs, including asserting constructively fraudulent transfer claims, as well as asserting preferential transfer claims.

Constructively fraudulent transfers:

The relatively steep differences between amounts advanced by an MCA relative to the amount received by an MCA could support a claim that the sale of AR was not for "reasonably equivalent value," thereby making it constructively fraudulent pursuant to 11 U.S.C.A § 548(a)(1)(B). That code sectionprovides:

> **(a)(1)** The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
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> (B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
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> (ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (II) was engaged in business or a transaction, or was about to engage in business or transaction, for which any property remaining with the debtor was an unreasonably small capital;
>
> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an inside, under an employment contract and not in the ordinary course of business.

11 U.S.C.A § 548 (a)(1)(B).

The crux of the dispute under Section 548(a)(1)(B) might be whether the amount advanced by the MCA to the merchant was reasonably equivalent value for the amount of AR purchased by the MCA, or whether the amount paid to the MCA was reasonably equivalent for what the MCA advanced to the merchant.

At least two courts have focused on whether the amount paid to the MCA was reasonably equivalent to the amount that the MCA advanced to the merchant, rather than on the amount of receivables sold to the MCA. In that regard, a bankruptcy court held that the debtor had received reasonably equivalent value when prior to its Chapter 7 filing, the debtor sold $176,432 of accounts receivable to an MCA in exchange for a merchant cash advance of only $125,000, but when the MCA company had debited only $112,979 from the debtor's bank account as of commencement of bankruptcy case. *In re Steele, No. 17-03844-5-JNC* 2019 WL 3756368, (Bankr. E.D.N.C. Aug. 8, 2019).

Similarly, the Bankruptcy Court for the Northern District of Georgia held when "the Debtor received $75,000.00 from Defendant pursuant to the Agreement and the Debtor has paid Defendant $16,755.00", then "[w]hether or not the Agreement is valid, it appears that the Debtor received reasonably equivalent value for the $16,755.00 transferred to Defendant in exchange for the $75,000.00 received from Defendant. Thus, the Debtor has failed to show that it received less than reasonably equivalent value under Section 548(a)(1)(B)(ii)(I). GMI Group, Inc. v. Unique Funding Solutions, LLC (*In re GMI Grp., Inc.)* 606 B.R. 467 (Bankr. N.D. Ga. 2019) The same court similarly held, in a related case involving a different MCA, that a cause of action for fraudulent transfer could not be maintained when "the fats asserted by the Debtor in the Complaint are that the Debtor received $150,000.00 from Defendant pursuant to the Agreement, and the Debtor has paid a total of $123,860.96 towards the Purchased Account of $210,000.00", as it "appears that the Debtor received reasonably equivalent value for the $123,860.96 in transferred funds to Defendant. GMI Group, Inc. v. Reliable Fast Cash, LLC (*In re GMI Grp. Inc. No 19-52577. PMB, 2019 WL 3774117* (Bankr. N.D. Ga. Aug. 9, 2019.

Notably, in that latter case the same court stated "The Debtor does not assert in the Complaint that the entire Agreement is a fraudulent transfer (i.e., that entering into an agreement to get $150,000.00 now in exchange for $210,000.00 to be paid a short time in the future is itself a fraudulent transfer, as $150,000.00 may not be "reasonably equivalent value" for $210,000.00). That leaves the door open for a claim that entering into the MCA agreement itself was constructively fraudulent transfer due to the amount of receivables sold, as opposed to the amount of money paid to an MCA pursuant to such an agreement. Entering into an agreement may constitute a "transfer" for purposes of applying the constructively fraudulent transfer provision. But as the Bankruptcy Court of the Eastern District of North Carolina noted in another case, "[a]n assessment of reasonably equivalent value must take into account any intangible value that a party receives." The Court found the creditor "provided a funding option

to the Debtor when no other lender would, providing the Debtor a tenuous lifeline to remain in business. However, draconian the terms of that funding may seem in hindsight, that lifeline is a value received by the Debtor. *In re A Goodnight Sleep Store, Inc., No. 17-03274-5-JNC.* 2019 WL 342577 (Bankr. E.D.N.C. Jan. 25, 2019)

Preferential Transfers:

A debtor might also seek to avoid and recover payments made to a MCA prepetition on the basis that such payments were preferential transfers pursuant to 11 U.S.C 547(b). That Code section provides:

> (b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property –
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made-
> (A) on or within 90 days before the date of the filing of the petition;
> or
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
> (5) that enables such creditor to receive more than such creditor would receive if –
> (A) the case were a case under chapter 7 of this title;
> (B) the transfer has not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C.§ 547(b).

Because one element of a preferential transfer is that the transfer was "for or on account of an antecedent debt," an initial question regarding preferential payments to an MCA is whether the transaction at issue was a loan or a sale of accounts receivable. Courts have looked to numerous factors to determine whether a transaction is a "disguised loan" or a "true sale," focusing on which party bears the primary risk of nonpayment as a determinative factor:

> "To constitute a bona fide factoring agreement under New York law, the factor need only assume the risk that the seller's account debtor will be unable to pay." *Dryden Advisory Group, LLC v. Beneficial Mut. Sav. Bank (In re Dryden Advisory Group, LLC),* 534 B.R. 612, 621 (Bankr. M.D. Pa. 2015) (footnote modified) (citing *Wechsler v. Hunt Health Sys., Ltd.,* 198 F. Supp. 2d 508, 519-20 (S.D.N.Y. 2002)).
>
> Other courts look to additional factors when conducting a sale-or-loan analysis:

The factors identified by various courts to find that a sale of receivables is in reality a loan are:

1. Language of the documents and conduct of the parties.
2. Recourse to the seller.
3. Seller's retention of servicing and commingling of proceeds.
4. Purchaser's failure to investigate the credit of the account debtor.
5. Seller's right to excess collections.
6. Purchaser's right ot alter pricing terms.
7. Seller's retention of right to alter or compromise unilaterally the terms of the transferred assets.
8. Seller's retention of right to repurchase asset.

Wawel Sav. Bank v. Jersey Tractor Trailer Training, Inc. (In re Jersey Tractor Trailer Training, Inc.), No. 06-02003 (MBK), 2007 WL 2892956, at *7 (Bankr. D.N.J. Sept. 28, 2007) citing Robert D. Aicher & William J. Fellerhoff, *Characterization of a Transfer of Receivables as a Sale or a Secured Loan Upon Bankruptcy of the Transferor,* 65 Am. Bankr. L.J. 181, 186-94 (1991)), aff'd, No. ADV 06-2003 (MBK), 2008 WL 2783342 (D.N.J. July 15, 2008), *aff'd in part, vacated in part, remanded,* 580 F.3d 147 (3d Cir. 2009).

No single factor is conclusive to the analysis and all the attributes of the transaction mush be examined, but the allocation of risk is primary to the determination. *Classic Harvest LLC v. Freshworks LLC,* Case No. 1:15-CV-2988-WSD, 2017 WL 3971192, at *8 n.15 (N.D. Ga. Sept. 7, 2017) (citing *Dryden* 534 B.R. at 620).

Matter of Cornerstone Tower Servs., Inc. No. A17-4051, 2018 WL 6199131, at *5 – 6 (Bankr. D. Neb. Nov. 9, 2018).

If a transaction is characterized as a sale rather than a loan, one of the prima facie elements of a preferential transfer is lacking. For that reason, the characterization of the transaction is of great importance.

USURY ISSUES

"Usury" is the charging of interest beyond a legally permissible rate. The legally permissible interest rate varies from state to state, and MCAs often select choice of law provisions from states with favorable usury laws. The rates of return received by MCAs may be in the range of 70% or 90% or higher.

When an MCA agreement is a "true sale", as opposed to a "disguised loan", the transaction may avoid usury laws applicable to loans.

In a decision issued on August 9, 2019, the United States Bankruptcy Court of the Norther District of Georgia, Paul M. Baisier, J., held that it was procedurally proper for a corporate Chapter

11 debtor to object to a proof of claim filed by creditor, to which the debtor had sold its future receipts at a discount, on the basis of the transaction being usurious. In that case, the court found that the agreement was a disguised loan transaction and that it violated New York's criminal usury law, *In re GMI Grp., Inc.,* No. 19-52577-PMB, 2019 WL 3776047 (Bankr. N.D. Ga Aug. 9, 2019).

Similarly, in *Cap Call LLC v. Foster (In re Shoot the Moon LLC),* the chapter 11 trustee challenged the characterization of the transactions, arguing that the funding provided was a loan. 635 B.R. 797, 813 (Bankr. D. Mont. 2021). The Bankruptcy Court found that the characterization of the transaction as a loan allowed it to apply non-bankruptcy law and consider the usurious nature of the transaction.

MCA contracts typically contain choice of law provisions stating that the agreement is to be construed under the laws of a specific state which the MCA has selected due to its prior favorable treatment of MCA agreements or favorable usury laws. A court, however, will not necessarily honor such choice of law provisions.

The *GMI Group* decision highlights the importance of the "true sale" versus "disguised loan" characterization issue. If the lender had prevailed on the claim that the transaction was a true sale of receivables, it could have avoided the usury implications that only apply to a loan agreement and not to an asset sale. Because MCAs charge very high imputed interest rates in most instances, an MCA transaction has indicia of being a disguised loan rather than a true sale of receivables. Analyzing applicable usury laws (those of the state controlling the contract) could be fruitful territory to explore.

CONFESSED JUDGMENTS

As noted above, MCAs have frequently utilized confessed judgments as a tool for enforcing their agreements. While New York is recognized as the incubator for the MCA industry, and was a leading location for entry of confessed judgments, a number of other states permit confessed judgments. New York has recently enacted legislation that now prohibits the use of confessed judgments against non-New York State residents.

A debtor might attempt to assert a public policy defense to domestication of a confessed judgment in a state other than where the judgment was entered. Such a defense could be based on the argument that services of process was invalid, that local laws prohibit confessed judgments, that the statute of limitations period had passed, that the judgment creditor did not prove ownership of the debt, or other grounds.

Such defenses to enforcement of confessed judgments appear to have had limited success in the past. That is one reason that confessed judgments have triggered bankruptcy filings in some instances, and a party faced with the entry of a confessed judgment might have more powerful arguments under bankruptcy law than state law. For instance, a debtor in bankruptcy can seek to avoid an MCA transaction as constructively fraudulent under the right circumstances, or can assert that entry of a confessed judgment was a preferential transfer (converting the MCA entity from an unsecured creditor to a secured creditor on the eve of bankruptcy) under the right circumstances.

DISCUSSION OF THE SETTLEMENT OF PEOPLE OF THE STATE OF NEW YORK, BY LETITIA JAMES, ATTORNEY GENERAL OF THE STATE OF NEW YORK V. YELLOWSTONE CAPITOL, LLC, ET. AL, CAUSE NO. 450750/2024, NEW YORK SUPREME COURT. (Prepared by Parag Patel, Mik Bushinski, Connor Jobes, and Deric Behar, Latham & Watkins, LLP, Posted February 7, 2025.)

On January 22, 2025, New York Attorney General (NYAG) Letitia James **announced** a judgment and settlement against cash advance provider Yellowstone Capital, its officers, and two dozen affiliates (Yellowstone) for more than $1 billion for predatory loans disguised as merchant cash advances (MCAs) made to over 18,000 small businesses.

The settlement also includes barring Yellowstone from engaging in any business related to MCAs, cancels over $534 million in outstanding amounts owed by small businesses, and terminates any pending actions and liens against merchants or guarantors. Yellowstone did not admit or deny any of the allegations.

Additional lawsuits by New York and other states as well as government entities against Yellowstone successor organizations and individuals involved in the organization's merchant financing operations are ongoing.

Loans, Merchant Cash Advances, and Illegal Lending

NYAG initially **filed** suit against Yellowstone in March 2024, alleging that Yellowstone made short-term loans at "sky-high" interest rates to small businesses since 2009.

With a traditional installment loan, the borrower is responsible to repay the principal over a set term, with interest (up to a statutorily-defined limit), and failure to repay the amounts due results in the borrower being in default of the loan.

MCAs are an alternative form of financing with different characteristics than traditional loans. An MCA often provides the merchant with a lump sum cash payment in exchange for a share of future business revenues (receivables). There is typically no set maturity date, and instead repayments are generally tied to the performance of the merchant's business, often as percentage deductions of the merchant's sales to customers. Since repayments are based on the merchant's sales, an MCA provider usually bears the risk of poor performance of the merchant's business — the merchant has no obligation to make repayments if it does not generate sales. In comparison, a business's lack of sales would not alter its repayment obligations under a traditional loan arrangement.

According to the NYAG, Yellowstone offered short-term and ultra-high-interest loans deceptively represented as MCAs. Yellowstone allegedly "collected payments at fixed daily amounts, which they debited directly from merchants' bank accounts over short repayment terms." In some instances, Yellowstone was able to obtain court orders against certain merchants, and forced others to shutter their businesses entirely.

New York civil usury laws cap interest rates on small loans at 16% — but, according to the NYAG, some of the predatory loans serviced by Yellowstone carried rates of up to 820% per year. In the NYAG's action against Yellowstone, the contracts are alleged to be MCAs in name only, whereas the economic and practical reality of these contracts indicated that they were loans with interest rates far above the legal limit.

Traditional Versus Alternative Financing in the Spotlight

MCAs have become a popular form of alternative financing for businesses that do not desire to, or may not be able to, access traditional loans. The global merchant cash advance market was **valued** at over $17 billion in 2023, and other non-traditional financing providers constitute well over $200 billion in global financing.

Many states regulate loans to small and mid-size businesses, including requiring licensure of the lender and subjecting such loans to disclosure requirements and limitations on interest rates and fees. However, MCA providers typically rely on the differences between MCAs and traditional loans as the basis for their MCAs not being subject to state lending and usury laws.

As MCAs have become more common, a growing number of states — including New York, California, and several others — have implemented laws or regulations specifically governing MCAs and other forms of sales-based financing. The rollout of legal regimes specifically focused on MCAs and other forms of sales-based financing suggests that many states recognize such forms of financing may fall outside the ambit of their lending laws applicable to traditional business loans.

Key Red Flags Highlighted by the AG

The NYAG's complaint alleged several issues with Yellowstone's services and business practices:

- Funding transactions falsely used MCA language (such as a "Purchase and Sale of Future Receivables") to describe what was actually a loan agreement. The NYAG's complaint alleges several instances of fraudulent language that made the agreements MCAs in name only, with contracts falsely referring to fixed payments as portions of actual receivables and Yellowstone taking no measures to ensure merchants understood that MCAs are not loans.
- Funding transactions were falsely labeled "open-ended" (i.e., payable over a long term, and variable based on the merchants' receipt of revenue), when they were in fact finite terms (such as 60 or 90 business days) at a fixed rate. Rather than contracting for a percentage of a merchants' future revenues, which can fluctuate based on the business's actual receivables, the agreements imposed by Yellowstone required fixed recurring payments, unrelated to the merchants' revenues.
- Funding transactions were financed at usurious interest rates, i.e., above the maximum civil usury interest rate of 16% or the maximum criminal usury interest rate of 25%.
- Hidden, undisclosed, or mischaracterized fees were charged or automatically debited from merchant accounts.
- Judgments were obtained in New York courts that were premised on false descriptions of the loan agreements or payment arrangements, with the purpose of obtaining judicial legitimacy for deceptive MCA labeling (e.g., that merchants defaulted on paying a "specified percentage" of the merchants' revenue).
- Overcollection from merchants was a frequent occurrence, such as daily payments debited from merchants' bank accounts even after the agreed amount was paid back in full.

While the NYAG's complaint broadly took issue with Yellowstone's business practices, it does not condemn MCAs more generally. The action against Yellowstone

specifically cited several factors as representative of loans rather than MCAs, including the discretionary nature of basing payments on actual receivables, the refusal to permit reconciliation, failure to make good-faith estimates of receivables, failure to provide prior notice before default, and provisions authorizing collections on personal guaranty. In essence, the NYAG focused on why Yellowstone's "MCAs" were not truly MCAs. They were in fact usurious loans, based on fixed terms with fixed repayment schedules, advertised and understood to be loans, that were falsely and deceptively dressed up as MCAs.

Conclusion

As various states continue to scrutinize MCAs, either from a legislative or enforcement perspective, MCA providers and other alternative financing providers would be well served to review their contractual arrangements and operations in light of the issues that the NYAG identified in the Yellowstone complaint.

SUPPLEMENTAL CITATIONS OF SELECT ARTICLES, BANKRUPTCY AND NON-BANKRUPTCY CASES, AS WELL AS, SUMMARIES OF ENFORCEMENT ACTIONS

I. Select Articles

- Kara J. Bruce, *Revenue-Based Finance in Bankruptcy and Beyond*, 43 No. 4 Bankr. L. Ltr. (Apr. 2025).
- Kara J. Bruce, *The Murky Process of Characterizing Merchant Cash Advance Agreements*, 42 No. 4 Bankr. L. Ltr. (Apr. 2022).
- John F. Hilson & Stephen L. Sepinuck, *A "Sale" of Future Receivables: Criminal Usury In Another Form,* 9 Transactional Law. 1 (Aug. 2019).
- John F. Hilson & Stephen L. Sepinuck, *A "Sale" of Future Receivables: Disguising A Secured Loan as a Purchase of Hope*, 9 Transactional Law. 14, 15-16 (Apr. 2019).

II. Select Bankruptcy Cases

- *In re J.P.R. Mech. Inc.*, No. 19-23480 (DSJ), 2025 WL 1550541 (Bankr. S.D.N.Y. May 30, 2025).
- *In re Williams Land Clearing, Grading, & Timber Logger, LLC*, No. 22-02094-5-PWM, 2025 WL 1426503 (Bankr. E.D.N.C. May 16, 2025).
- *Guttman v. EBF Holdings, LLC (In re Global Energy Servs, Inc).,* No 21-17305, 2025 WL 1012721 (Bankr. D. Md. Mar. 31, 2025).
- *In re Watchmen Sec. LLC*, No. 24-00087-JMC-11, 2024 WL 4903363, at *7 (Bankr. S.D. Ind. Nov. 20, 2024).
- *In re McKenzie Contracting, LLC*, No. 8:24-BK-01255-RCT, 2024 WL 3508375 (Bankr. M.D. Fla. July 19, 2024).
- *In re Enpark Landscape, LLC*, No. BAP NV-23-1182-PLC, 2024 WL 4328581 (B.A.P. 9th Cir. Sept. 27, 2024).
- *In re Devine*, 633 B.R. 626 (Bankr. C.D. Cal. 2021), *aff'd*, No. 8:18-BK-10905-MW, 2022 WL 2444993 (B.A.P. 9th Cir. June 30, 2022), *aff'd*, No. 22-60028, 2023 WL 5453139 (9th Cir. Aug. 24, 2023).
- *In re Shoot The Moon, LLC*, 635 B.R. 797, 816 (Bankr. D. Mont. 2021).
- *GMI Grp, Inc. v. Reliable Fast Cash, LLC (In re GMI Grp., Inc.)*, No. 19-5137, 2019 WL 3774117 (Bankr. N.D. Ga. Aug. 9, 2019).

- *GMI Grp, Inc. v. Unique Funding Solutions, LLC (In re GMI Grp., Inc.)*, No. 19-5138, 606 B.R. 467 (Bankr. N.D. Ga. Aug. 9, 2019).
- *In re A Goodnight Sleepstore, Inc.*, No. 17-03274-5-JNC, 2019 WL 342577 (Bankr. E.D.N.C. Jan. 25, 2019).
- *In re Hill*, 589 B.R. 614, 619 (Bankr. N.D. Ill. 2018).

III. Select Non-Bankruptcy Cases

- *Lateral Recovery LLC v. Funderz.net, LLC*, No. 1:22-CV-02170 (JLR), 2024 WL 216533, at *11 (S.D.N.Y. Jan. 19, 2024)
- *Haymount Urgent Care v. GoFund Advance*, LLC, No. 22-1245, 2022 WL 836743 (S.D.N.Y. March 21, 2022).
- *Fleetwood Servs., LLC v. Ram Capital Funding*, LLC, 20-cv-5120, 2022 WL 1997207 (S.D.N.Y. 2022).
- *Lateral Recovery LLC v. Queen Funding LLC*, No. 21-9607, 2022 WL 2829913 (S.D.N.Y. 2022).

IV. Summaries of Select Enforcement Actions

- Press Release, January 22, 2025: *New York State Attorney General James Announces $1 Billion Settlement with Predatory Lender Yellowstone Capital for Harming Small Businesses: Yellowstone Capital Will Cancel $534 Million in Outstanding Debts for Small Businesses It Preyed on and Immediately Pay $16.1 Million to Affected Businesses More Than 1,100 Small Businesses in New York Will Have Over $36 Million in Debt Canceled .*
- Press Release, February 14, 2024: *Court Enters $20.3 Million Judgment in FTC Case Against Merchant Cash Advance Operator Jonathan Braun for Deceiving Small Businesses and Unlawfully Seizing Assets.*
- Press Release, February 8, 2024: *New York State Attorney General James Announces Historic Judgment Against Predatory Lender: Richmond Companies Required to Pay More Than $77 Million to Small Businesses for Usury and Outrageous Interest Rates.*
- Litigation Release, August 29, 2018: *SEC Charges Florida Cash Advance Company, Former CEO with Defrauding Thousands of Retail Investors.*