

Desperation Finance: Merchant Cash Advances in Bankruptcy and Beyond

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Emory Bankruptcy Developments Journal, Forthcoming 2026

Abstract

Over the last several years, Merchant Cash Advances (MCAs) have risen in prominence as a form of short-term financing for distressed small businesses. MCA transactions are distinct from most small-business lending because they are not structured as loans at all. Rather, in exchange for a lump sum of cash, the merchant purports to sell to the funder an unidentified percentage of its future receipts or receivables. This structure allows funders to sidestep the application of lending regulations and usury protections, but it strains the foundations of commercial law and generates a host of interpretive challenges.

Bankruptcy, district, and circuit courts across the nation are grappling with the true nature of MCA transactions to determine what rights in the underlying receivables are transferred and when that transfer occurs. These issues rise in prominence if a merchant seeks bankruptcy protection, as the extent of the estate's interest in property—and by extension the application of any number of bankruptcy provisions—hangs in the balance.

This essay provides a comprehensive analysis of MCA agreements and other forms of revenue-based financing. Drawing from a robust literature involving recharacterization of financial transactions, this essay advances an analytical framework for evaluating the nature of MCA transactions. It explores how recharacterization affects both bankruptcy and non-bankruptcy entitlements and offers commentary on related issues faced by courts.

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¹ The author thanks Hons. Paul Baisier, Ashley Edwards, Benjamin Kahn, Pamela McAfee, and Teresa Pearson, as well as the late Juliet Moringiello, Richard Cook, David Cox, Melissa Jacoby, Christopher Odinet, Chrystin Ondersma, Stephen Sepinuck, Andrea Tosato, and Jill Walters for helpful conversations and feedback on this project. Judge Baisier coined the phrase “desperation finance.” The participants at the Federal Judicial Center’s Annual Bankruptcy Seminars in April 2022 and April 2025, the Western District of NC Bankruptcy Workshop in May 2025, the Middle District of NC Bankruptcy Seminar in May 2025, the Judge Joe Lee Bankruptcy Workshop in June 2025, and several webinars have challenged and developed my thinking on these topics, and I look forward to more discussions to come. I also thank the University of North Carolina School of Law for support of my research, as well as the UNC law library, particularly Ellie Campbell at the LibRA program, for providing research support.

INTRODUCTION

Merchant cash advances (MCAs) are an alternative form of small business financing. An MCA is structured not as a loan, but as a sale of a fractional interest in a merchant's revenue stream. MCAs are advertised as “boutique” devices offering fast access to cash and flexible repayment schedules,² but the fine print reveals a more troubling reality. These financing devices carry effective interest rates that routinely exceed 100%³ and include aggressive default and remedial provisions. Due to their exorbitant costs and onerous terms, MCAs operate principally as funding of last resort.⁴

MCA obligations are typically repaid through automated clearing house (ACH) sweeps from the merchant's operating account.⁵ These sweeps occur irrespective of the origin of funds in the deposit account—the funds withdrawn might not be business revenue at all. And, if a merchant's revenue is insufficient to satisfy these obligations, the merchant might take out additional MCAs to avoid overdrafts.⁶ This can lead to a debt spiral that leaves MCA funders deeply indebted to various MCA companies, while also creating priority contests with preexisting secured creditors.⁷

This state of affairs has engendered no shortage of litigation, both in bankruptcy and civil courts. Likewise, over the last several years, regulators have pursued actions against some of the most unscrupulous MCA financiers⁸ and many more MCA agreements have been voided on the basis of usury. In many of these cases, a gateway legal issue is simple to identify but difficult to resolve: What is an MCA and what sorts of rights in the debtor's property do MCA funders obtain? Answering this question

² *Elevate Your Business with Revenue-Based Financing*, ELEVATE FUNDING, <https://elevatefunding.com/elevate-your-business-with-revenue-based-financing> (last visited Aug. 26, 2025).

³ By “effective interest rate,” I mean the simple interest that would be charged if the transaction were recharacterized as a loan secured by the receivables purportedly sold.

⁴ For more information on the structure and pricing of these transactions, see *infra* Part I(A).

⁵ *See id.*

⁶ *See, e.g., Anderson v. Koch*, No. A18-0685, 2019 WL 1233700, at *4 (Minn. Ct. App. Mar. 18, 2019).

⁷ *See infra* Part I(A).

⁸ News reports have colorfully traced the major players in the MCA industry to crime-adjacent individuals. *See Zachary R. Mider & Zeke Faux, Sign Here to Lose Everything: Fall Behind on These Loans? You Might Get a Visit from Gino*, BLOOMBERG (Dec. 20, 2018), <https://www.bloomberg.com/graphics/2018-confessions-of-judgment-visit-from-gino/>.

determines the applicability of usury laws, the scope of a bankruptcy estate, and any number of additional legal questions.⁹

Identifying the true character of an MCA agreement is a complicated undertaking for several reasons. First, the doctrinal inquiry on classifying a transaction as a sale versus a loan is a notoriously murky corner of commercial law. Second, recharacterization is a factually nuanced endeavor. Third, MCA agreements are drafted to obscure transactional realities. As a result, litigation involving MCAs can be very challenging, and the case law involving MCAs has been subject to significant variance.

This essay encapsulates my earlier speaking and writing on MCAs. Its primary goal is to offer an analytical roadmap through the thicket of revenue-based financing transactions. Drawing from a robust literature involving recharacterization of financial transactions, as well as an extensive study of existent case law, this essay advances an interpretive framework for evaluating the nature of an MCA.¹⁰ It explores how recharacterization affects both bankruptcy and non-bankruptcy entitlements of the merchant, funder, and affected third parties, and offers commentary on current market, litigation, and legislative trends.

This essay proceeds as follows: Part I provides background on the structure of revenue-based finance and explores the legal issues that have arisen surrounding MCA agreements in civil litigation and bankruptcy cases. It observes that many (though not all) issues involving MCAs require courts to assess whether their structure as a sale withstands judicial scrutiny. Part II grounds the question of MCA characterization in the broader recharacterization literature and traces an evolution of MCA case law from a misguided formalist approach to a more accurate assessment of economic reality. Part III takes current stock of the legal landscape affecting MCAs and forecasts future developments. The article concludes by offering commentary on the role of individual litigation and academic writing in this space.

⁹ See *infra* Part I(B).

¹⁰ This analysis builds on several essays that I published in the Bankruptcy Law Letter. See generally Kara Bruce, *Revenue-Based Finance in Bankruptcy and Beyond*, BANKR. L. LETTER, Apr. 2025, at 1 [hereinafter *Revenue-Based Finance*]; Kara Bruce, *The Murky Process of Characterizing Merchant Cash Advance Agreements*, BANKR. L. LETTER, Apr. 2022, at 1 [hereinafter *Recharacterizing MCAs*].

I. Introduction to Revenue-Based Finance

A. Structure and Current Use

Revenue-based finance transactions, often termed “merchant cash advances” or “business cash advances” are a difficult to categorize financial product. These transactions are offered primarily by fintech companies, rather than traditional banks,¹¹ and are aggressively marketed to small businesses.¹² In an MCA, the merchant receives an immediate infusion of cash. In exchange, the merchant purports to *sell* to the funder a percentage of the merchant’s daily receivables, revenue, or receipts.¹³ In early iterations of these transactions, merchants directed their credit card processors to allocate a portion of their credit card receivables for transfer to the financier.¹⁴ In more recent transactions, the financier makes regular—often daily—ACH sweeps from the merchants’ deposit accounts.¹⁵ Although

¹¹ See Adam Levitin, *Predatory Small Business Lending: Market and Regulatory Failures*, 42 YALE J. REGUL. 732, 738 (2025) (“MCAs are provided solely by fintechs; it is not a product in which banks deal.”).

¹² See *United Cap. Source, LLC v. Benisvy*, No. 602122/15, 2015 WL 3889460, at *2, *4 (N.Y. Sup. Ct. June 24, 2015) (describing the aggressive advertising practices of MCA brokers); see also *Doyle v. JTT Funding, Inc.*, No. LA CV18-06145 JAK (ASx), 2019 WL 13037025, at *1 (C.D. Cal. Dec. 2, 2019) (alleging that MCA company engaged in robocalling and repeated telephone solicitations).

¹³ While receivables are rights to payment for goods sold or services rendered, receipts could be intended to sweep more broadly to encompass anything deposited into a borrower’s bank account. Further, even if the transaction is characterized as a sale of revenue or receivables, the repayment comes from any funds in the deposit account, not necessarily those tied to revenue from goods sold or services rendered. See, e.g., *Fleetwood Servs., LLC v. Ram Cap. Funding, LLC*, No. 20-CV-5120 (LJL), 2022 WL 1997207, at *2–3 (S.D.N.Y. June 6, 2022). This article generally uses the term “receivables” to discuss the property subject to an MCA transaction but observes that the type of property subject to an MCA can vary depending on the terms of the agreement.

¹⁴ See, e.g., *In re R&J Pizza Corp.*, No. 14-43066-CEC, 2014 WL 12973408, at *1 (Bankr. E.D.N.Y. Oct. 14, 2014) (describing a transaction that required the merchant to enter into an agreement with its credit card processor to allocate a percentage of receivables to the financier); Adam Torkildson, *Traditional Loans: Which Is Right for Your Business?*, SCORE (Sep. 24, 2024); see also Grant Phillips, *Merchant Cash Advance: A History*, GRANT PHILLIPS L. PLLC, <https://grantphillipslaw.com/who-created-a-merchant-cash-advance-a-short-history/> (tracing these types of transactions to the more modern MCA structures) (last visited Sep. 2, 2025). Some funders still structure MCAs as a percentage of credit card sales.

¹⁵ See, e.g., *Gecker v. LG Funding (In re Hill)*, 589 B.R. 614, 618 (Bankr. N.D. Ill. 2018). Some MCA agreements provide for weekly deposit-account sweeps. See, e.g., *Williams Land Clearing, Grading, & Timber Logger, LLC v. Apex Funding Source LLC*

these transactions increasingly go by other names,¹⁶ I will use the terms “MCA” or “Merchant Cash Advance” to describe any transaction that purports to sell a percentage of future revenue.

A hallmark of MCAs is their advertised flexibility: the merchant’s daily repayment obligation is theoretically adjustable to reflect the merchant’s actual revenue. This adjustment is often termed “reconciliation,”¹⁷ and occurs according to a procedure specified in the funding agreement.¹⁸ This is an example of a typical reconciliation provision:

The Initial Daily Amount is intended to represent the Specified Percentage of [Merchant’s] daily Future Receipts. For as long as no Event of Default has occurred, once each calendar month, [Merchant] may request that [Funder] adjust the Daily Amount to more closely reflect the [Merchant’s] actual Future Receipts times the Specified Percentage. . . . No more often than once a month, [Funder] may adjust the Daily Amount on a going-forward basis to more closely reflect the [Merchant’s] actual Future Receipts times the Specified Percentage After each adjustment made pursuant to this paragraph, the new dollar amount shall be deemed the Daily Amount until any subsequent adjustment.¹⁹

(*In re* Williams Land Clearing, Grading, & Timber Logger, LLC), Ch. 11 No. 22-02094-5-PWM, Adv. No. 23-00024-5-PWM, 2025 WL 1426503, at *29 (Bankr. E.D.N.C. May 16, 2025).

¹⁶ See *Revenue-Based Finance*, *supra* note 10, at 1 (observing that as judicial opinions and public sentiment has turned against the MCA industry, these products have adopted new monikers).

¹⁷ See, e.g., *J.P.R. Mech. Inc. v. Radium2 Cap., LLC* (*In re* J.P.R. Mech. Inc.), Ch. 7 Case No. 19-23480 (DSJ), Adv. No. 21-07079 (DSJ), 2025 WL 1550541, at *1 (Bankr. S.D.N.Y. May 30, 2025) (MCA agreements “generally provide for reconciliation of the daily draw amounts against the company’s actual revenues.”).

¹⁸ See, e.g., *Anderson v. Koch*, No. A18-0685, 2019 WL 1233700, at *4 (Minn. Ct. App. Mar. 18, 2019).

¹⁹ *GMI Grp., Inc. v. Unique Funding Sols., LLC* (*In re* GMI Grp., Inc.), 606 B.R. 467, 485 (Bankr. N.D. Ga. 2019). Reconciliation clauses are often excerpted in MCA opinions, and there are many varieties.

Other notable features of these transactions include default and acceleration clauses, which open up a range of property to the funder if the merchant is unable to satisfy its daily payment obligation. MCAs are commonly accompanied by confession-of-judgment clauses, which allow the funder to obtain judgment upon the counterparty's default without the formalities of bringing suit.²⁰ MCAs are also typically supported by personal guaranties of the merchant's principals. Early MCA funders have become notorious for their aggressive, even "mafia-style," enforcement activity.²¹ One court's summary of an MCA's remedial structure appears here:

Upon an Event of Default, the full amount of the outstanding Purchased Amount plus any additional fees, including legal fees, became immediately due and owing In that case, the counterparty to the Agreement had the ability to exercise all rights or

²⁰ D. H. Overmyer Co. v. Frick Co., 405 U.S. 174, 176 (1972) (describing confession-of-judgment clauses as an "ancient legal device by which the debtor consents in advance to the holder's obtaining a judgment without notice or hearing ...with the appearance, on the debtor's behalf, of an attorney designated by the holder"). Under New York law, which applies to many MCA transactions, a contracting party signs an affidavit of confession that consents to the entry of a judgment upon a future breach. N.Y. C.P.L.R. § 3218(a) (MCKINNEY 2022). Confession of judgment clauses are barred in consumer credit transactions, and many jurisdictions have eliminated their use entirely. *See* Unfair Credit Practices, 16 C.F.R. § 444.2(a)(1) (2025); Agreements authorizing confession of judgment, 7 WILLISTON ON CONTRACTS § 15:14 (4th ed. 2025) (collecting examples of jurisdictions that bar enforcement of these clauses by statute). New York law permits them. Yet New York's Civil Practice Law and Rules were modified in 2019 to prohibit confessions of judgment against out-of-state defendants, an amendment intended to "remedy abuses," ostensibly of the MCA industry. *See* Memorandum from Senator Brad Hoylman-Sigal, 2019 Legis. Bill Hist. NY S.B. 6395 (June 10, 2019) (introducing the act prohibiting confessions of judgment "by creditors against out-of-state debtors"); N.Y. C.P.L.R. § 3218(b) (MCKINNEY 2022).

²¹ *See, e.g.,* Erin Arvedlund & Jeremy Roebuck, *Par Funding Threatened Violence, Trashed Reputations After Businesses Took out Loans at Brutal Interest Rates, Borrowers Say*, PHILA. INQUIRER (Aug. 30, 2020, 5:00 AM), <https://www.inquirer.com/business/par-funding-sec-joseph-laforte-fraud-merchant-cash-advance-fbi-20200830.html>; *see also* Gretchen Morgenson, *FTC Official: Legal 'Loan Sharks' May Be Exploiting Coronavirus to Squeeze Small Businesses* NBC NEWS (Apr. 3, 2020, 7:07 AM), <https://www.nbcnews.com/business/economy/ftc-official-legal-loan-sharks-may-be-exploiting-coronavirus-squeeze-n1173346> (displaying threatening text messages allegedly received by merchants who fell behind on payments, as well as a photo of a disemboweled rat apparently left on the mailbox of an attorney representing troubled merchants). Verified Petition ¶¶ 405–10, *People v. Yellowstone Cap. LLC*, No. 450750/2024 (N.Y. Sup. Ct., Mar. 5, 2024).

remedies available at law or in equity or as a secured creditor under the Uniform Commercial Code. . . . In addition, upon an Event of Default, it had the right to: (i) obtain insurance, (ii) collect monies due and owing from [Merchant's] account debtors; (iii) receive, endorse and collect any checks, notes, drafts of other chattel paper; (v) sign [Merchant's] name to any invoice and direct that Fleetwood's customers pay the counterparty and (vi) file any claims or pursue any actions to collect upon a [Merchant] receivable.²²

MCA default clauses provide that the following types of events, among others, trigger an MCA's remedial provisions:

- (a) A merchant or guarantor violates any term or covenant in the agreement;
- (b) Any representations or warranties are later determined to be incorrect, false or misleading;
- (c) The merchant admits in writing its inability to pay its debts;
- (d) The merchant's business is suspended or terminated, or substantially all of its assets are sold;
- (e) the merchant uses multiple deposit accounts or moves deposit accounts without written consent of the funder; and
- (f) the merchant defaults on another agreement with the funder.²³

Finally, MCA transactions often include New York forum selection and choice of law clauses. Application of New York law initially ensured that the characterization questions described in Part II occurred against the backdrop of favorable case law.²⁴ The availability of confession of judgment

²² *Fleetwood Servs., LLC v. Ram Cap. Funding, LLC*, No. 20-CV-5120 (LJL), 2022 WL 1997207, at *3 (S.D.N.Y. June 6, 2022). The New York Attorney General alleged in a complaint that certain MCA funders sought to reach guarantors' unrelated AirBnB, Uber Eats, and Grubhub income. Verified Petition ¶¶ 388, 405, 693, *People v. Yellowstone Cap. LLC*, No. 450850/2024 (N.Y. Sup. Ct., Mar. 5, 2024).

²³ *Fleetwood Servs., LLC*, 2022 WL 1997207, at *3.

²⁴ *See, e.g., Wilkinson Floor Covering, Inc. v. Cap Call, LLC*, No. 160256/2016, 2018 WL 2293196, at *2 (N.Y. Sup. Ct. May 16, 2018) (collecting cases).

clauses under New York law is another feature attractive to MCA funders, although its availability has been limited by recent legislation.²⁵

MCAs might be attractive to small businesses for three primary reasons: first, they offer fast access to cash. Because MCA funders undertake virtually no underwriting before extending funds, merchants can receive a financial lifeline more quickly than traditional lenders can provide.²⁶ Indeed, funders advertise that funding can arrive within a few hours of application.²⁷ Second, and relatedly, MCA funders offer financing to businesses that might not be eligible for loans from traditional sources.²⁸ Finally, MCA providers advertise flexible payment arrangements, which can be attractive to merchants with seasonal businesses or volatile cashflow.²⁹

Yet these attributes come with significant costs, including effective interest rates in the triple *or even quadruple* digits.³⁰ Consider, for example, an MCA transaction that provided a distressed merchant with \$75,000 in exchange for the purported sale of \$111,750 in future receivables, payable in daily ACH transfers of \$1,117.³¹ The effective interest rate of this transaction is 115%, not including fees and costs, which can also be

²⁵ Confession of judgment clauses are no longer available against out-of-state defendants. N.Y. C.P.L.R. § 3218(b) (MCKINNEY 2022). This legislative change likely relates to the extensive use of confessed judgments in MCA transactions in recent years. *See supra* note 20.

²⁶ As one funder has advertised, “[s]ince MCAs aren’t *technically* loans, they don’t require the same strict eligibility standards that loans do—so you can score capital with low credit and zero collateral in no time.” *Merchant Cash Advance Guide for Small Businesses*, FUNDING CIRCLE, <https://www.fundingcircle.com/us/resources/merchant-cash-advance/> (last visited Feb. 26, 2022).

²⁷ *See, e.g.*, KAPITUS FUNDING, [kapitus.com/business-financing-options](https://www.kapitus.com/business-financing-options) (last visited Sep. 3, 2025). For one company’s description of the MCA underwriting process, see Richard Wilson, *Merchant Cash Advance Underwriting* (May 23, 2025), <https://www.mcashadvance.com/resources/mca-underwriting/>.

²⁸ Levitin, *supra* note 11. (collecting authority).

²⁹ *See Revenue-Based Financing: Is It Right For Your Small Business?*, PURSUIT (May 31, 2024), <https://pursuitlending.com/resources/revenue-based-financing/>.

³⁰ *See, e.g.*, Lateral Recovery LLC v. Funderz.Net, LLC, No. 1:22-CV-02170 (JLR), 2024 WL 216533, at *35 (S.D.N.Y. Jan. 19, 2024) (noting allegations of interest rates on six MCAs ranging from 250% to over 1000%); *see also* Verified Petition ¶¶ 388, 405, 693, People v. Yellowstone Cap. LLC, No. 450850/2024 (N.Y. Sup. Ct., Mar. 5, 2024) (alleging similar rates); Verified Petition ¶ 67, New York v. Richmond Cap. Grp. LLC, No. 451368/2020 (N.Y. Sup. Ct., June 10, 2020) (alleging interest rate, inclusive of fees, of 3910%).

³¹ GMI Grp., Inc. v. Unique Funding Sols., LLC (*In re* GMI Grp., Inc.), 606 B.R. 467, 473 (Bankr. N.D. Ga. 2019).

substantial.³² If such a transaction were structured as a loan, it would be wildly usurious under any applicable state usury law.³³ Not only that, but the advertised repayment flexibility often is belied by the fine print of MCA agreements. As discussed further below, several courts have found reconciliation provisions to be illusory in nature, either because they are subject to the discretion of the MCA funder, available for a limited amount of time during the month, or saddled with conditions that put them functionally out of reach.³⁴

Merchants that enter into MCAs often struggle under the weight of their high costs, as well as the often daily deposit account sweeps. This state of affairs can lead to a snowball effect in which merchants enter into subsequent MCAs to make payments on the earlier transactions.³⁵ There are many reports of merchants struggling with multiple contemporaneous MCA obligations, sometimes having pledged over 100% of their anticipated revenue to various finance companies.³⁶ These merchants can easily find themselves on the wrong side of a confessed judgment, in bankruptcy, or otherwise in litigation with their MCA funders.³⁷

Such litigation often requires courts to identify the true character of an MCA transaction. As this section description might suggest, MCA transactions are structured as sales, but have many trappings of a loan: in exchange for a cash infusion, the merchant agrees to transfer a sum of funds

³² *Id.* at 489 (“[These amounts are calculated by first estimating the time period in which] provides for an advanced principal amount (the Purchase Price) of \$75,000.00 in exchange for a repayment price of \$111,750.00 (the Purchased Amount) to be made by daily debits in the amount of \$1,117.00 (the Daily Amount) until the full Purchased Amount is collected. Based upon this payment schedule, Defendant would receive the Purchased Amount within approximately 150 days (101 business days on which payments could occur). Such a payment structure results in interest accruing at approximately 115 percent per annum, which far exceeds the 25 percent annual threshold for criminal usury under New York law.”). Default costs in this transaction were also quite high. After a judgment was entered against the merchant in this case (44 days after the transaction closed), it reflected attorney’s fees of \$33,928.62 and other miscellaneous costs totaling \$225.00. *Id.* at 475. A more recent case recorded default fees and costs exceeding \$75,000.

³³ State usury laws vary greatly and do not always extend to commercial loans. Westlaw aggregates statutory authority regarding interest rate limitations on commercial loans. *See generally Allowable Fees on Commercial Loans*, 0090 SURVEYS 82, THOMSON REUTERS (2025).

³⁴ *See infra* text accompanying notes 133-40

³⁵ *See* Verified Petition ¶¶ 433-35, *People v. Yellowstone Cap. LLC*, No. 450750/2024 (N.Y. Sup. Ct. Mar. 5, 2024).

³⁶ *See id.* at ¶ 368.

³⁷ *See* Recharacterizing MCAs, *supra* note 10, at 2 (charting litigation trends); Revenue-Based Finance, *supra* note 10, at 1-3 (same).

and its failure to do so will trigger default and acceleration clauses embedded in the agreement. The uncertain economic nature of MCA transactions has generated a wide range of judicial opinions on characterization, with some courts finding that MCA are loans and others preserving their stated character as sales. The following subsections explore litigation trends involving MCA agreements, providing the legal framework in which the recharacterization issues discussed in Part II arise.

B. The Legal Landscape of Non-Bankruptcy MCA Disputes

MCA agreements have spawned a great deal of litigation both inside and outside of bankruptcy. Outside of bankruptcy, litigation involving MCAs has focused predominantly on the application of usury laws.³⁸ New York law, which governs many MCA transactions, provides:

A person is guilty of criminal usury in the second degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty-five per centum per annum or the equivalent rate for a longer or shorter period.³⁹

Under New York law, usurious contracts are void, and borrowers are entitled to recover interest paid over the legal rate.⁴⁰ The court is directed to “enjoin any prosecution thereon, and order the same to be surrendered and canceled.”⁴¹ This language has been interpreted to mean that a “borrower can simply keep the borrowed funds and walk away from the

³⁸ See, e.g., *Wilkinson Floor Covering, Inc. v. Cap Call, LLC*, No. 160256/2016, 2018 WL 2293196, at *1 (N.Y. Sup. Ct. May 16, 2018) (action to vacate confessed judgment on the basis of usury, among other things); *Bus. Credit & Cap. II LLC v. Neuronexus, Inc.*, No. 1:18-CV-03374 (ALC), 2019 WL 1426609, at *2 (S.D.N.Y. Mar. 29, 2019) (raising usury as a defense to a breach of contract action filed by MCA financier). Usury can also form the basis of a RICO action. See *infra* notes 44-46 and accompanying text.

³⁹ N.Y. PENAL LAW § 190.40 (MCKINNEY 2025) (classifying criminal usury in the second degree as a Class E felony).

⁴⁰ N.Y. GEN. OBLIG. LAW § 5-511 (MCKINNEY 2025). If the lender is a bank, the borrower is entitled to recover twice the amount of interest paid. *Id.*

⁴¹ *Id.*

agreement.”⁴² But recall that MCAs are structured as *sales*, not loans, and usury laws apply only to lending transactions.⁴³ As such, a central pillar of usury challenges to MCAs is the assertion that MCAs should be recharacterized as loans.

It is important to note that usury is an affirmative defense under New York law and cannot be used offensively to void an agreement. Yet merchants have used usury as the predicate act for class action claims under the Racketeer Influenced Corporations Organization Act (RICO).⁴⁴ RICO provides for extensive civil and criminal liability for entities that, among other things, collect unlawful debts.⁴⁵ Here, the merchant-plaintiffs argue that MCA funders operate an enterprise that engages in usurious lending and improper debt collection tactics that supply the predicate act for RICO liability.⁴⁶ As with usury defenses, a gateway issue to these actions is whether an MCA agreement is a loan to which usury laws apply.

In a more modest number of cases, senior secured lenders have sued MCA funders on theories such as conversion or tortious interference with a

⁴² *Seidel v. 18 E. 17th St. Owners, Inc.*, 598 N.E.2d 7, 9 (N.Y. 1992). Banks, however, forfeit only interest as a consequence of usurious loans. N.Y. GEN. OBLIG. LAW § 5-511 (MCKINNEY 2025).

⁴³ Pending legislation in New York would extend the scope of New York usury laws to cover a broader range of financing arrangements, including merchant cash advances and other forms of revenue-based financing. Assemb. B. 4918, 2025 N.Y. Assemb., 2025–26 Reg. Sess. (N.Y. 2025).

⁴⁴ 18 U.S.C. § 1961.

⁴⁵ 18 U.S.C. §§ 1962–1964. The RICO statute provides that it is “unlawful for any person employed by or associated with any enterprise engaged in . . . interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise’s affairs through . . . collection of unlawful debt.” 18 U.S.C. § 1962(c).

“[U]nlawful debt” is defined in pertinent part as a “debt (A) . . . which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with . . . the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate[.]” 18 U.S.C. § 1961(6).

Notably, a RICO violation premised upon the collection of unlawful debts “may be predicated on a single instance of collection of unlawful debt[.]” *United States v. Grote*, 961 F.3d 105, 119 (2d Cir. 2020). But the definition of unlawful debt “does not reach the collection of a loan that is made occasionally and not as part of the ‘business of lending money’ at a usurious rate.” *Fleetwood Servs., LLC v. Ram Cap. Funding, LLC*, No. 20-CV-5120 (LJL), 2022 WL 1997207, at *18 (S.D.N.Y. June 6, 2022).

⁴⁶ Some merchants also assert claims for wire fraud. *See, e.g.*, *Haymount Urgent Care PC v. GoFund Advance, LLC*, 609 F. Supp. 3d 237, 245 (S.D.N.Y. 2022).

business relationship.⁴⁷ These lenders argue that the MCA funders have withdrawn funds over which the lenders had first-priority security interests.⁴⁸ For example, a recent decision from the bankruptcy court of the Eastern District of North Carolina dealt with a constellation of issues surrounding MCA transactions, including claims by the merchant against the funder to avoid and recover preferences and fraudulent transfers.⁴⁹ The senior secured lender intervened in the action, asserting that it was entitled to payment from the proceeds of any recovery in the avoidance actions, and also asserting claims against the funder for conversion of its collateral and tortious interference with contract.⁵⁰ The court denied the lender's motion for summary judgment, finding first that postpetition avoidance actions are not subject to postpetition liens, and second that the lender had not met its burden on the conversion or tortious interference claims.⁵¹ The court's conversion analysis rested largely on the lender's lack of prepetition enforcement activity. Specifically, the lender had not declared a default or taken other action to assert an interest in the receivables in question. The funder had also failed to make a demand to recover the funds from the MCA funder.⁵² This analysis suggests that lenders might need to assert their

⁴⁷ See *BMO Harris Bank N.A. v. Radium2 Cap., LLC*, No. 22 Civ. 8328 (DEH), 2024 WL 1216580, at *2 (S.D.N.Y. Mar. 21, 2024) (dismissing claims as time-barred); *Franklin Cap. Funding, LLC v. Ace Funding Source, LLC*, No. 2:20-CV-12059-TGB-APP, 2021 WL 1224917, at *3 (E.D. Mich. Mar. 31, 2021) (dismissing claims for lack of personal jurisdiction).

⁴⁸ Similar arguments can be made by first-position MCA funders against MCA companies that extend funding later. For a discussion of that legal theory, see Robert Cook et al., *Stacking: Is It Tortious Interference?*, DEBANKED (Apr. 16, 2015), <https://debanked.com/2015/04/stacking-is-it-tortious-interference/>. The Uniform Commercial Code's provisions involving deposit-account transfers underscore the vulnerability of senior secured creditors to MCA activities. Under § 9-332(b) of the UCC, a transferee of money or funds from a deposit account takes free of a security interest in the funds unless the transferee acts in collusion with the debtor to violate the rights of the secured creditor. U.C.C. § 9-332(b). This provision allows MCA funders use daily ACH transactions to collect free and clear of existing security interests, unless collusion is demonstrated. See, e.g., *Gecker v. LG Funding (In re Hill)*, 589 B.R. 614, 626 (Bankr. N.D. Ill. 2018).

⁴⁹ *Williams Land Clearing, Grading, & Timber Logger, LLC v. Apex Funding Source LLC (In re Williams Land Clearing, Grading, & Timber Logger, LLC)*, Ch. 11 No. 22-02094-5-PWM, Adv. No. 23-00024-5-PWM, 2025 WL 1426503, at *9–10 (Bankr. E.D.N.C. May 16, 2025).

⁵⁰ *Id.* at *2.

⁵¹ *Id.* at *13, *15. It is important to observe that the court rejected the MCA funder's argument that it lacked knowledge of the senior lien, finding that the existence of a perfected financing statement provided constructive knowledge. *Id.* at *14.

⁵² *Id.* at *14 (noting “[t]here is nothing inherently unlawful about a junior lienholder taking possession of its collateral”). The lender conceded that its tortious interference claim lacked evidence. *Id.* at *15.

interests in the collateral more aggressively before commencing suit against an MCA funder.

Governmental authorities have also pursued MCA companies in recent years. Specifically, the Federal Trade Commission, the New York Attorney General, and the New Jersey Attorney General each have filed suit against industry leaders including Yellowstone Financial, Richmond Capital, and Ram Capital funding, together with their affiliates. These lawsuits have resulted in large-dollar settlements against several industry participants.⁵³ Settlements with Yellowstone alone have involved over \$1 billion in restitution, canceled debts, and other payments.⁵⁴ Several industry leaders have agreed to cease participation in the MCA market and cancel all outstanding debts.⁵⁵ Meanwhile, sales of participations in MCAs have drawn the attention of securities regulators, which have charged MCA

⁵³ See Consent Order and Judgment at 4–5, *People v. Yellowstone Cap. LLC*, No. 450750/2024 (N.Y. Sup. Ct. Jan. 16, 2025); Stipulated Order for Permanent Injunction and Monetary Judgment at 7–8, *FTC v. Yellowstone Cap. LLC*, No. 1:20-CV-06023-LAK (S.D.N.Y. May 4, 2021) (order granting permanent injunction and monetary judgment); Press Release, State of N.J., Dep’t of L. and Pub. Safety, AG Platkin Announces \$27.375-Million Settlement With Yellowstone Capital LLC and Related Entities Over Allegations of Unlawful Lending, Servicing, and Collection Practices (Jan. 3, 2023) (providing the consent order); Stipulated Order for Permanent Injunction, Monetary Judgment, and Civil Penalty as to Defending RCG Advances, LLC and Robert L. Giardina at 8–9, *FTC v. RCG Advances, LLC*, No. 20-CV-04432-LAK (S.D.N.Y. June 2, 2022); Stipulated Order for Permanent Injunction and Monetary Judgment as to Defendants Ram Capital Funding LLC and Tzvi Reich at 8, *FTC v. RCG Advances, LLC*, No. 20-CV-04432-LAK (S.D.N.Y. Jan. 5, 2022). Actions against Richmond Capital and its various affiliates have resulted in final judgments against the funders, with findings that the transactions were not sales but usurious loans. *People v. Richmond Cap. Grp.*, No. 451368/2020, slip op. at *1–2 (N.Y. Sup. Ct., Feb. 6, 2024) (granting \$77 million judgment against MCA companies Richmond Capital Group, Ram Capital Funding, Viceroy Cap. Funding, and their principals for violations of New York Executive Law, resulting in rescission of unlawful contracts and restitution of account draws); *FTC v. Braun*, No. 20-CV-4432 (JSR), 2024 WL 449288, at *12 (S.D.N.Y. Feb. 6, 2024) (jury award exceeding \$20 million in monetary relief and civil penalties against the Richmond’s owner after summary judgment was granted against the MCA).

⁵⁴ See sources cited *supra* note 53.

⁵⁵ See, e.g., Consent Order and Judgment, *People v. Yellowstone Cap. LLC*, No. 450750/2024 (N.Y. Sup. Ct. Jan. 16, 2025); Stipulated Order for Permanent Injunction and Monetary Judgment, *FTC v. Yellowstone Cap. LLC*, No. 1:20-CV-06023-LAK (S.D.N.Y. May 4, 2021); *Richmond Cap. Grp.*, slip op. at *1–2.

companies with selling unregistered securities⁵⁶ or operating Ponzi schemes.⁵⁷

C. The Legal Landscape of Bankruptcy-Based MCA Disputes

It is not uncommon for a debtor to enter bankruptcy with several MCA obligations outstanding, sometimes having pledged more than 100% of the business's receivables to various funders.⁵⁸ Many MCA funders lie low through the bankruptcy case, failing to file a notice of appearance or a proof of claim.⁵⁹ This might be strategic, for example, to avoid having a legal claim on which a usury defense could be mounted, or to reinforce the notion that it does not seek recourse in bankruptcy, which is relevant to some judicial tests on characterization.⁶⁰ Or, it could simply be a business decision to cut losses in the event of a bankruptcy. Yet MCA funders are not monolithic, and some aggressively assert their interests in bankruptcy

⁵⁶ See, e.g., SEC v. Complete Bus. Sols. Grp., Inc., No. 20-CV-81205-RAR, 2024 WL 4826059, at *1 (S.D. Fla. Nov. 18, 2024); Press Release, N.J. Off. of the Att'y Gen., New Jersey Bureau of Securities Orders Philadelphia-Based Small-Business Funding Company to Stop Selling Unregistered Securities in the State (Dec. 27, 2018), (discussing enforcement actions by both the New Jersey and the Pennsylvania regulators); cf. Jennifer Bennett, *SEC Lands Partial Early Win in Merchant Cash Advance Fraud Fight*, BLOOMBERG L. (Dec. 3, 2021, 4:24 PM), https://www.bloomberglaw.com/bloomberglawnews/securities-law/X8H3GBJ0000000?bna_news_filter=securities-law#jcite (summarizing SEC action against MCA firm for the sale of unregistered securities, in which a court found genuine issues of material fact precluding summary judgment on the question of securities violations).

⁵⁷ See, e.g., SEC v. Duarte, No. 0:24-CV-61772-WPD, 2025 WL 1568297 (Bankr. S.D. Fla. Jan. 29, 2025); Complaint ¶¶ 5–6, SEC v. Natario, No. 25-CV-00895 (D. Nev. May 21, 2025); Amended Complaint ¶ 1, SEC v. MJ Cap. Funding, LLC, No. 0:21-CV-61644-AHS (S.D. Fla. Mar. 21, 2022); Press Release, U.S. Att'y's Off., S.D. Fla., Owner of E-Card Lending Charged with Operating a Ponzi Scheme (Apr. 3, 2025).

⁵⁸ See, e.g., Verified Petition ¶ 388, People v. Yellowstone Cap., LLC, No. 450850/2024 (N.Y. Sup. Ct. filed Mar. 5, 2024) (detailing several concurrent MCAs advanced by Yellowstone and affiliates, many of which totaled to over 100% of the merchants' receivables).

⁵⁹ See, e.g., *In re McKenzie Contracting, LLC*, No. 8:24-BK-01255-RCT, 2024 WL 3508375, at *3 (Bankr. M.D. Fla. July 19, 2024) (“The Court notes at the outset that MCA claimants Capybara Capital, LLC, Vox Funding, LLC, and Fox Capital Group, Inc. have not: (i) objected to Debtor's Subchapter V designation, (ii) briefed the issue of whether their MCA agreements are true sales or loans, or (iii) participated in this contested matter in any way.”).

⁶⁰ See *infra* Part II.

litigation against the merchant or its guarantors.⁶¹ So too, merchant-debtors have raised avoidance claims and usury defenses against MCA companies in bankruptcy. As was the case with non-bankruptcy litigation, the characterization of MCAs as a true sale or disguised loan can affect the application of many bankruptcy matters. This section surveys the landscape and offers commentary on bankruptcy issues involving MCAs.

1. *The Scope of the Estate*

The characterization of an MCA agreement, as well as the timing of the transaction, directly affects the extent to which a debtor's revenue becomes property of the bankruptcy estate. A bankruptcy filing creates an estate that includes "all legal and equitable interests of a debtor in property."⁶² Some funders have asserted that because a fraction of the debtor's receivables have been "sold" to a funder prepetition, the receipts

⁶¹ Many MCA funders have sought to declare their obligations non-dischargeable, alleging that the merchant made misrepresentations concerning other outstanding MCA transactions as part of the origination process. *See, e.g., In re GFS Indus., L.L.C.*, 99 F.4th 223, 226 (5th Cir. 2024) (discussing MCA funder seeking adjudication of non-dischargeability, alleging that the borrower made material misrepresentations concerning whether a bankruptcy filing was imminent); *Simply Funding, LLC, v. Werman (In re Werman)*, No. 22-11618, Adv. No. 22-1070, 2023 WL 4038586, at *2 (Bankr. N.D. Ohio June 15, 2023) (discussing the same, except that the creditor also alleges the debtor failed to disclose the existence of other MCA lenders from which she obtained funding); *Strategic Funding Source, Inc. v. Dockum (In re Dockum)*, No. 23-10049, Adv. No. 23-01007, 2024 WL 3633220, at *6 (Bankr. D. Vt. Aug. 1, 2024) (discussing the same, except that the MCA funder had received a default judgment on its fraud claim against the debtor); *Velocity Cap. Grp., LLC, v. Trapp (In re Trapp)*, No. 21-10140-7, Adv. No. 21-19, 2022 WL 1437645, at *4, *7, *9 (Bankr. W.D. Wis. May 5, 2022) (holding amounts owed to MCA funder non-dischargeable due to fraud and conversion). Some guarantors have been denied a discharge due in part to actions they have taken on behalf of their companies to avoid ruinous MCA drafts. Those attempts, including stopping payment on MCA drafts or moving bank accounts, have been characterized as attempts to hinder, delay, or defraud creditors rendering an individual debtor ineligible for a discharge in bankruptcy. *See, e.g., In re Devine*, 633 B.R. 626, 636 (Bankr. C.D. Cal. 2021), *aff'd*, No. CC-21-1238-LGT, Adv. No. 8:19-ap-01095, 2022 WL 2444993 (B.A.P. 9th Cir. June 30, 2022), *aff'd*, No. 22-60028, 2023 WL 5453139 (9th Cir. Aug. 24, 2023) (denying discharge to debtor who, among other things, opened a new bank account to avoid the daily levies from MCA funders).

⁶² 11 U.S.C. § 541(a).

allocable to that fraction are not property of the estate and are not subject to the Code’s cash collateral procedures.⁶³ This is almost certainly incorrect.

Let us focus, first, on postpetition earnings generated by the business. The conception that receivables that have not yet been generated have already been sold to the funder is inconsistent with the property principle *nemo dat quod non habet*: one cannot give what they do not have. A transaction to assign future receivables can be a valid promise, but the sale would not technically occur until the receivables themselves are generated and become property of the debtor.⁶⁴ Indeed, Article 9 of the Uniform Commercial Code (UCC) treats sales of receivables as secured transactions and requires, among other things, the debtor to have rights in the property before the buyer’s interest attaches.⁶⁵

As such, a prepetition agreement to transfer an interest in post-petition receivables would experience one of two treatments in bankruptcy,

⁶³ See, e.g., *M Design Vill. v. Versant Funding LLC, et. al.* (*In re M Design Vill., LLC*), No. 24-21406, Adv. No. 24-01639, 2025 WL 2088887, at *6 (Bankr. D.N.J. July 24, 2025) (concluding that funds subject to an MCA were property of the estate); *In re Watchmen Sec. LLC*, No. 24-00087-JMC-11, 2024 WL 4903363, at *2, *8 (Bankr. S.D. Ind. Nov. 20, 2024) (same); *In re R&J Pizza Corp.*, No. 14-43066-CEC, 2014 WL 12973408, at *6 (Bankr. E.D.N.Y. Oct. 14, 2014) (concluding that because the transaction was a true sale, the funds collected were not cash collateral). MCA funders support their arguments by reference to U.C.C. § 9-318(a), which provides that “[a] debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold,” but that provision does not provide guidance on when the sale occurs. As described in the text, the sale does not occur until the receivables themselves are generated. Further, U.C.C. § 9-318(b) substantially reduces the effect of U.C.C. § 9-318(a) by providing that a seller is deemed to have rights in the receivables sold when the buyer fails to perfect. For a recent and thorough discussion of U.C.C. § 9-318 in the context of MCA transactions, see *In re IVF Orlando, Inc.*, No. 24-05475-TPG, 2025 WL 2831400 (Bankr. M.D. Fla. Oct. 3, 2025).

⁶⁴ See John F. Hilson & Stephen L. Sepinuck, *A “Sale” of Future Receivables: Disguising A Secured Loan as a Purchase of Hope*, 9 TRANSACTIONAL LAW. Aug. 2025, at 15–16 (suggesting it is both legally and metaphysically impossible to transfer property before it exists, and concluding that an MCA transaction could amount to either “a future sale of receivables” or “a loan that would become secured by future receivables”); *In re Watchmen Sec. LLC*, 2024 WL 4903363, at *4–5 (citing John F. Hilson & Stephen L. Sepinuck, *A “Sale” of Future Receivables: Disguising A Secured Loan as a Purchase of Hope*, 9 TRANSACTIONAL LAW. Aug. 2025, at 14, 15) (supporting the court’s holding that an MCA agreement “could not effect a pre-petition sale or transfer of post-petition receivables (that did not exist pre-petition)”; *In re M Design Village, LLC*, 2025 WL 208887, at *6 (quoting Hilson & Sepinuck).

⁶⁵ See U.C.C. § 9-203(b)(2) (AM. L. INST. & UNIF. L. COMM’N 2023).

depending on whether the agreement is classified as a loan or a sale.⁶⁶ If it is a loan secured by receivables, then § 552 of the Code would prevent the prepetition security interest from attaching to the receivables acquired by the estate.⁶⁷ If the transaction were a sale, then it would likely be a postpetition transfer avoidable under § 549 of the Code.⁶⁸

Prepetition receivables are a different analytical matter. If an MCA agreement effectuates a sale of a percentage of receivables as they arise—a result at odds with this essay’s analysis— then receivables arising prepetition could be excluded from the estate.⁶⁹ There are several reasons why this outcome is unlikely to occur in an MCA transaction. First, as Part II discusses, MCA agreements ought to be recharacterized as loans, an outcome that courts have increasingly reached.⁷⁰ If the agreement is recharacterized, then the funder would be deemed to have a *lien* on the receivables, and the receivables would therefore enter the estate.⁷¹ Second, even if a court recognizes an MCA as a sale, the agreement could be found to be invalid because it fails to properly identify the property sold. Recall from Part I that MCA agreements allocate to the funder a *percentage* of future revenue, rather than specific receivables. There is a credible argument that this structure violates the identification requirements of Article 9.

Article 9 of the UCC governs the formation of receivables-sales contracts and treats them as secured loans for formation and perfection

⁶⁶ See discussion *infra* Part II (discussing this question and advocating that MCAs should be characterized as loans).

⁶⁷ Section 552(a) provides that “property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.” 11 U.S.C. § 552(a). This rule does not apply to proceeds, products, and offspring of property. 11 U.S.C. § 552(b)(1).

⁶⁸ See *In re Watchmen Sec. LLC*, 2024 WL 4903363, at *8 (“If we concede that the Agreement effects, as it purports, a ‘true sale’ of Debtor’s receivables and does not constitute merely the purported grant of security interests therein, then any purported transfer of post-petition receivables that was not approved by the Court using the law and procedure provided by 11 U.S.C. § 363, is an *unauthorized post-petition transfer of estate property and avoidable pursuant to 11 U.S.C. § 549*. Were there to be any such unauthorized transfer, then Creditor’s claim would be fully disallowable pursuant to 11 U.S.C. § 502(d).”) (emphasis added).

⁶⁹ Bankruptcy’s avoidance powers could result in these transfers or their value being recovered to the estate. See 11 U.S.C. §§ 544–550.

⁷⁰ See *infra* Part II.

⁷¹ Another impact is that the transaction might be void on the basis of usury.

purposes.⁷² Article 9 requires as a condition to attachment that the agreement identifies the property subject to the interest.⁷³ It further provides that a security agreement's description of property is sufficient if it "reasonably identifies what is described."⁷⁴ Although § 9-108(b) suggests that a "computational or allocational formula or procedure" can provide a sufficient description,⁷⁵ Stephen Sepinuck has argued compellingly that a percentage-based formula is insufficient if you cannot read it and clearly identify which collateral can be repossessed.⁷⁶ That rationale might support a court ruling that an MCA agreement, even if characterized as a sale, is not enforceable by the MCA funder because it does not sufficiently identify the property sold. In such a case, the prepetition receivables would enter the estate and the funder would have no enforceable interest in them.

Third, even if an MCA agreement is characterized as a sale and is found to be enforceable despite not identifying the property sold, only the specified percentage of receivables would be excluded from the estate. In attempting to trace those receivables to the MCA transaction, a court might interpret the percentage of receivables due as of the petition date to be equal to the percentage of receivables drawn as of the petition date, meaning that no prepetition funds in the debtor's deposit account constitute property of the MCA funder. This analysis presumes that the debtor had not defaulted on the MCA before filing for bankruptcy relief. As noted in Part I, default typically results in the acceleration of the amounts due, although the language of default clauses can vary. Determining the funder's interest in the deposit account in that circumstance would depend on the terms of the default and enforcement provisions, the nature of other parties' rights in the funds, and the question of characterization discussed in Part II.

Mapping the principles of property of the estate onto MCA agreements is challenging because the structure of MCA agreements is an uneasy match with commercial realities. Not only is the concept of a future sale unachievable as a matter of law, but also the sale of an undefined percentage of property creates difficult—perhaps untenable—identification problems. If MCAs are recharacterized as secured loans; however, this analytical knot untangles. The property enters the debtor's estate and the

⁷² See U.C.C. § 9-109(a)(3) (AM. L. INST. & UNIF. L. COMM'N 2023) (providing that article 9 applies to sales of accounts, chattel paper, payment intangibles, and promissory notes).

⁷³ See U.C.C. § 9-203(b)(3)(a) (AM. L. INST. & UNIF. L. COMM'N 2023).

⁷⁴ U.C.C. § 9-108(a) (AM. L. INST. & UNIF. L. COMM'N 2023).

⁷⁵ U.C.C. § 9-108(b) (AM. L. INST. & UNIF. L. COMM'N 2023).

⁷⁶ See generally Stephen L. Sepinuck, *Describing Collateral by Quantity, Formula, or Procedure*, TRANSACTIONAL LAW., Aug. 2020.

funder's lien will be addressed according to well-trodden bankruptcy pathways.

2. *Avoidance Litigation*

The question of MCA classification as a loan or a sale has also arisen in the context of preference and fraudulent transfer litigation. Taking preferences first, the Code permits certain prepetition transfers to creditors to be avoided and recovered for the benefit of the debtor's bankruptcy estate.⁷⁷ To recover a preference, the transfer must have been 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, (3) made while the debtor was insolvent, with insolvency presumed within the 90 days preceding the petition date, (4) made within the preference period, which is 90 days for non-insiders and 1 year for insiders, and (5) the transfer allows the creditor to receive more than it would in a hypothetical liquidation had the transfer not been made.⁷⁸

MCA funders have argued that because they purchased the subject receivables at the outset of the transactions, later ACH sweeps from the merchant's account do not constitute "a transfer of an interest in property of the debtor."⁷⁹ Instead, they argue the transfers involve only the funder's property. But this argument is in some tension with the *nemo dat* principles described in subsection (C)(1) above, at least with respect to receivables generated after the contract was executed. Relatedly, because MCA funders typically purport to buy only a percentage of future receivables, most courts have found that the debtor retained some residual interest in the receivables. Accordingly, courts have found that the transfers constitute the debtor's property in some respect.⁸⁰

MCA funders have also sought to avoid preference liability by arguing that because the MCA transaction is a sale, they are not "creditors" owed "antecedent debts." But it is not clear why obligations owed under an

⁷⁷ See 11 U.S.C. § 547; CHARLES JORDAN TABB, KARA J. BRUCE & LAURA NAPOLI COORDES, *THE LAW OF BANKRUPTCY* 507 (6th ed. 2024) (discussing the Bankruptcy Code's avoidance powers).

⁷⁸ 11 U.S.C. § 547(b).

⁷⁹ See *Williams Land Clearing, Grading, & Timber Logger, LLC v. Apex Funding Source LLC* (*In re Williams Land Clearing, Grading, & Timber Logger, LLC*), Ch. 11 No. 22-02094-5-PWM, Adv. No. 23-00024-5-PWM, 2025 WL 1426503, at *5 (Bankr. E.D.N.C. May 16, 2025).

⁸⁰ See, e.g., *GMI Grp., Inc. v. Reliable Fast Cash, LLC* (*In re GMI Grp., Inc.*), Ch. 11 Case No. 19-52577-PMB, Adv. No. 19-5137, 2019 WL 3774117, at *13 n.13 (Bankr. N.D. Ga. Aug. 9, 2019).

MCA transaction, even if it is a true sale, would not qualify as a debt. The Code defines “debt” as “liability on a claim.”⁸¹ “Claim” has a capacious definition that sweeps in obligations beyond those created in traditional loans. As discussed more below, the loan/sale distinction in an ordinary case is tied to whether the seller/borrower has residual obligations to the buyer/lender. But if the bankrupt seller owes some residual obligation to the buyer, then that obligation would qualify as debt.⁸² All told, there is nothing inherent in the structure of an MCA transaction that excludes its repayment from avoidance as a preference. As such, the dominant questions in preference litigation should be whether the other requirements of preference liability are met, and whether the MCA funder can rely on a preference defense, such as the ordinary course of business defense.⁸³

Similar characterization issues can arise in fraudulent transfer litigation. The Code, like state law, permits the avoidance and recovery of transfers made with actual intent to hinder, delay, and defraud creditors, as well as transfers for less than reasonably equivalent value made while the debtor has some markers of insolvency.⁸⁴ Bankruptcy trustees have sought to avoid both the MCA transaction and subsequent daily payments on the

⁸¹ 11 U.S.C. § 101(12).

⁸² For a detailed exploration of the term “debt,” see Kate Sablosky Elengold, *Descending the Debt Ladder* 7–14 (Aug. 31, 2025) (unpublished manuscript) (on file with author). See also *Bircher v. Funding Metrics, LLC (In re A Goodnight Sleepstore, Inc.)*, Ch. 7 Case No. 17-03274-5-JNC, Adv. No. 17-00056-5-JNC, 2019 WL 242577, at *5 (Bankr. E.D.N.C. Jan. 25, 2019) (“The Bankruptcy Code does not require a court to decide whether these MCA transactions constitute ‘sales’ or ‘loans,’ just whether a ‘debt’ exists (or existed). . . . The terms of the Agreements give rise to a right to payment, through either the daily transfers, or the confessions of judgment and default fee. The right to payment under the Agreements thus gives rise to a ‘claim’ under the Bankruptcy Code and provides the foundation for a ‘debt’ for purposes of this adversary proceeding.”).

⁸³ *J.P.R. Mech. Inc. v. Radium2 Cap., LLC (In re J.P.R. Mech. Inc.)*, Ch. 7 Case No. 19-23480 (DSJ), Adv. No. 21-07079 (DSJ), 2025 WL 1550541, at *11–12 (Bankr. S.D.N.Y. May 30, 2025) (finding certain MCA drafts that occurred prepetition were not made in the ordinary course of business).

⁸⁴ 11 U.S.C. § 548(a)(1). The insolvency element of constructive fraud can be satisfied in a variety of ways. The Code provides the following alternatives: (1) the debtor was insolvent on the date of the transfer or became insolvent as a result, (2) the debtor was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital, (3) the debtor 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 (4) the debtor made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business. 11 U.S.C. § 548(a)(1)(B). State voidable transactions laws also operate in bankruptcy via section 544 of the Code.

latter ground. As was the case with preferences, funders have argued that no transfer of the debtor's property has occurred because the transferred funds were purchased earlier by the funder.⁸⁵ That argument has not seen much success, which is appropriate considering the timing issues discussed above⁸⁶ and recharacterization analysis discussed in Part II.⁸⁷

Instead, a key issue in MCA fraudulent transfer actions is not the characterization of the transaction as a loan or a sale, but rather whether the merchant receives reasonably equivalent value for the rights the MCA funder obtains. Some courts have been reluctant to find that the transfers are for less than reasonably equivalent value,⁸⁸ acknowledging that the merchant receives a vital cash infusion in the transaction. As one court stated:

An assessment of reasonably equivalent value must take into account any intangible value that a party receives. Funding Metrics provided a funding option to the Debtor when no other lender would, providing Goodnight 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.⁸⁹

But at least one court has held that an MCA to a deeply insolvent debtor lacked reasonably equivalent value, and that holding was affirmed on appeal.⁹⁰ In *Anderson v. Koch*, a Minnesota state trial court emphasized

⁸⁵ See, e.g., *Williams Land Clearing, Grading, & Timber Logger, LLC v. Apex Funding Source LLC (In re Williams Land Clearing, Grading, & Timber Logger, LLC)*, Ch. 11 No. 22-02094-5-PWM, Adv. No. 23-00024-5-PWM, 2025 WL 1426503, at *9 (Bankr. E.D.N.C. May 16, 2025).

⁸⁶ See *supra* text accompanying notes 64-65.

⁸⁷ See *In re Williams Land Clearing, Grading, & Timber Logger, LLC*, 2025 WL 1426503, at *9 (holding that because the MCA transaction was recharacterized as a loan, the funder's "'no transferred interest' argument in defense of the § 548 claim necessarily fails").

⁸⁸ See, e.g., *Gecker v. LG Funding, LLC (In re Hill)*, 589 B.R. 614, 629–30 (Bankr. N.D. Ill. 2018).

⁸⁹ *Bircher v. Funding Metrics, LLC (In re A Goodnight Sleepstore, Inc.)*, Ch.7 Case No. 17-03274-5-JNC, Adv. No. 17-00056-5-JNC, 2019 WL 342577, at *11 (Bankr. E.D.N.C. Jan. 25, 2019).

⁹⁰ See *Anderson v. Koch*, No. 27-CV-16-15134, 2018 WL 8621743, at *4–5 (Minn. Dist. Ct. Feb. 27, 2018), *aff'd*, No. A18-0685, 2019 WL 1233700 (Minn. Ct. App. Mar. 18, 2019).

that the MCA agreement’s effective interest rate of about 84% was “significantly higher” than the rate for similar transactions and thus not reasonably equivalent to the value received.⁹¹ In affirming the lower court, the appeals court observed that a large portion of the funding extended was immediately used to pay off the daily payment obligations of pre-existing MCA creditors.⁹² It acknowledged that the merchant’s cashflow was temporarily improved from the latest MCA, as the company’s daily payments were reduced, but the payment obligations were extended over a longer period of time. Taken as a whole, the appeals court concluded that the latest MCA effectively extended the terms of the prior loans at a cost of an additional \$700 per day.⁹³

3. *Debts, Claims, and Subchapter V Eligibility*

Although MCA funders sought to avoid characterization of MCA obligations as “debts” for preference purposes, merchants themselves have argued that MCA obligations are not “debts” when asserting that MCA transactions do not count toward the debt ceiling for seeking relief under the small business provisions of Chapter 11 of the Code.⁹⁴ To be eligible for Subchapter V of Chapter 11 of the Code, a debtor must, among other things, have “aggregate noncontingent liquidated secured and unsecured debt as of the date of the filing of the petition . . . in an amount no more than \$3,424,000.”⁹⁵ One court has held that “[f]or eligibility purposes, a proof of claim filed as a true sale would not generally be included in the Subchapter V debt limit calculation.”⁹⁶ This holding is in tension with the Code’s definition of “debt.”⁹⁷

As discussed in the context of preferences above, the characterization of an MCA as a sale or a loan should not have any impact

⁹¹ *See id.* at *6.

⁹² *Anderson*, 2019 WL 1233700, at *2.

⁹³ *Id.*

⁹⁴ This can be a dispositive factor. *See, e.g., In re McKenzie Contracting, LLC*, No. 8:24-BK-01255-RCT, 2024 WL 3508375 (Bankr. M.D. Fla. July 19, 2024). In *McKenzie*, the debtor had \$8,074,372.57 of filed claims, but \$1,631,540.97 arose from MCA transactions. If the MCA debts were factored into the debt-limit calculation, then the debtor would be eligible for relief. If they were not, then the debtor would be over the debt limit in effect at the time. *Id.* at *2.

⁹⁵ 11 U.S.C. § 101(51D). This number recently reverted back from its COVID-era increase of \$7.5 million and is periodically adjusted for inflation pursuant to 11 U.S.C. § 104.

⁹⁶ *In re McKenzie Contracting, LLC*, 2024 WL 3508375, at *2.

⁹⁷ *See supra* text accompanying notes 81-82.

on whether amounts due and owing qualify as “debts.”⁹⁸ The terms “debt” and “claim” are drafted to have the broadest possible definition, and include a right to be paid whether it originates from a loan or sale transaction. The loan/sale distinction is commonly tied to whether the seller/borrower has residual obligations to the buyer/lender. But where the bankrupt seller owes some residual obligation to the buyer, as is the case with an MCA transaction, then that obligation would qualify as “debt.” Thus, the relevant question for Subchapter V eligibility purposes is whether the obligations owed to the MCA funder are noncontingent and unliquidated.⁹⁹

Determining whether an MCA should count toward the debt limit is intellectually challenging because our intuition is that a sale of receivables should not be accompanied with residual liability. Not only that, but MCA funders take pains to state in the MCA agreement that they are taking on the risk of the merchant’s business not generating sufficient receivables to repay the advance.¹⁰⁰ All of this leaves readers with the reasonable intuition that if a merchant’s revenue tapers or the business enters bankruptcy, the merchant would not owe anything to the funder and there would be no debt in a later bankruptcy case. The MCA’s default and acceleration clauses, among other terms in the MCA agreements, simply do not operate as expected. Instead, they strap merchants and their principals with extensive residual obligations. The following sections explore how this feature is a strong indication that recharacterization of MCA transactions as secured loans is appropriate.

II. The Murky Process of Characterizing MCA Agreements

MCAs take on attributes of a variety of financial products but do not fall neatly into an existing transactional category.¹⁰¹ They purport to resemble traditional receivables sales, also known as factoring transactions, but are distinct in a number of respects: MCA funders purport to buy a percentage of a merchant’s future revenue stream, rather than any identified

⁹⁸ See *supra* text accompanying notes 81-82.

⁹⁹ The Bankruptcy Court for the District of Colorado considered this question for MCAs that were stipulated as loans and held that the amounts owing under several transactions were not contingent and not unliquidated. *In re Heart Heating & Cooling, LLC*, No. 23-13019 TBM, 2024 WL 1228370, at *20, *22, *25, *27–30 (Bankr. D. Colo. Mar. 21, 2024).

¹⁰⁰ See *infra* text accompanying note 132 (providing an example and discussing how this language helps a funder satisfy a common recharacterization test).

¹⁰¹ See *supra* Part I.

receivables. The collections typically are drawn from the merchant's bank account, rather than (directly or indirectly) from the account debtors, as occurs in many factoring transactions. Funders typically undertake no due diligence regarding the creditworthiness of the account debtors, as some factors may do.¹⁰² MCAs' repayment structures and remedial provisions closely match the terms of loans secured by receivables. Yet MCAs are overtly structured as sales, and the transaction purports to shift risk onto the funder in a manner analogous to a sale.¹⁰³ As such, many courts have found that the sale characterization is appropriate.

The UCC governs both sales and loans involving receivables, obviating the need for precision in characterizing many transactions.¹⁰⁴ But the foregoing part made clear that there are many circumstances under which the characterization of an MCA as a sale or a loan has impact on the legal rights and entitlements of the merchant, funder, and other third parties. These circumstances, among many others, demand an accurate characterization of the transaction.¹⁰⁵ This section explores recharacterization doctrine, which commenters have described as "confusing, inconsistent, and often incoherent."¹⁰⁶ It critiques early formalist approaches to the characterization of MCAs and argues that MCAs are, despite contractual window dressing suggesting otherwise, the economic equivalent of a loan secured by the business's receivables.

¹⁰² As noted below, factoring transactions often divert from this standard, allocating servicing duties, diligence, and risk in a manner inconsistent with these norms. *See infra* text accompanying notes 119-122.

¹⁰³ *See infra* Part II(B).

¹⁰⁴ *See* U.C.C. § 9-109(a)(1), (3) (AM. L. INST. & UNIF. L. COMM'N 2023).

¹⁰⁵ There are many non-bankruptcy circumstances under which the characterization of a transaction is relevant. *See, e.g.*, U.C.C. § 9-309(3)–(4) (AM. L. INST. & UNIF. L. COMM'N 2023) (providing for automatic perfection of sales of payment intangibles and promissory notes); U.C.C. § 9-406(e) (AM. L. INST. & UNIF. L. COMM'N 2023) (restricting the applicability of section 406(d) to certain sales of receivables); U.C.C. § 9-408 (restricting the applicability of section 406(a) to certain sales of receivables); U.C.C. § 9-607(c) (AM. L. INST. & UNIF. L. COMM'N 2023) (providing that a secured party must act in a commercially reasonable manner only when it has a right of recourse against the debtor, typically in a secured-lending arrangement and not a sale); U.C.C. § 9-608(b) (AM. L. INST. & UNIF. L. COMM'N 2023) (providing that when a transaction is a sale of receivables, "the debtor is not entitled to any surplus, and the obligor is not liable for any deficiency" after the proceeds of collection are applied).

¹⁰⁶ Steven L. Harris & Charles W. Mooney, Jr., *When is a Dog's Tail Not a Leg?: A Property-Based Methodology for Distinguishing Sales of Receivables from Security Interests That Secure an Obligation*, 82 U. CIN. L. REV. 1029, 1040 (2014).

A. Distinguishing Between Sales and Loans

Recharacterization is a centuries-old doctrine,¹⁰⁷ yet neither the UCC nor the Code set out a test for distinguishing between a sale and a loan.¹⁰⁸ The Code, for its part, relies on applicable non-bankruptcy law to establish the nature of a debtor's interest in property unless a federal interest requires a different result.¹⁰⁹ As noted, the UCC avoids the question in many respects by treating most sales of receivables as secured transactions.¹¹⁰

When recharacterization is necessary, the process for articulating the distinction is no easy task. Judicial tests for characterizing receivables transactions have not coalesced around a single framework.¹¹¹ Most courts approaching the issue adopt a totality of the circumstances approach, placing weight on some collection of factors to draw the distinction.¹¹² Scholars have criticized courts' approaches on any number of grounds, advancing a variety of alternative frameworks for deciding the issue.¹¹³

¹⁰⁷ 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 2.6, at 47 (1965); Kenneth C. Kettering, *True Sale of Receivables: A Purposive Analysis*, 16 AM. BANKR. INST. L. REV. 511, 527 (2008).

¹⁰⁸ See U.C.C. § 9-109 cmt. 4 (AM. L. INST. & UNIF. L. COMM'N 2023) (“Although [Article 9] occasionally distinguishes between outright sales of receivables and sales that secure an obligation, neither this Article nor the definition of ‘security interest’ . . . delineates how a particular transaction is to be classified. That issue is left to the courts.”). As Grant Gilmore stated, “Given the infinite number of points which are situated along the line which runs from ‘full recourse’ to ‘no recourse,’ the decision to leave the distinction between security transfer and sale to the courts is a wise one.” 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 44.4, at 1230 (1965).

¹⁰⁹ *Butner v. United States*, 440 U.S. 48, 54–55 (1979). For a thoughtful discussion of when federal law requires a different result, see Juliet M. Moringiello, *When Does Some Federal Interest Require a Different Result?: An Essay on the Use and Misuse of Butner v. United States*, 2015 U. ILL. L. REV. 657 (2015).

¹¹⁰ *But see* Harris & Mooney, *supra* note 106, at 1030.

¹¹¹ See Heather Hughes, *Reforming the True-Sale Doctrine*, 36 YALE J. ON REGUL. BULL. 51, 51–52 (2018) (“Despite the fact that the true-sale doctrine governs transactions that are central to the multi-trillion-dollar securitization market, the doctrine is inconsistent, lacks normative direction, and is under-theorized.”); Thomas E. Plank, *The True Sale of Loans and the Role of Recourse*, 14 GEO. MASON U. L. REV. 287, 290 (1991) (“[U]ncertainty arises because courts do not rely upon any universally accepted set of factors in determining whether a purported sale is a true sale or merely a transfer as security for a secondary loan.”).

¹¹² See, e.g., *Major's Furniture Mart, Inc. v. Castle Credit Corp.*, 602 F.2d 538, 545–46 (3d Cir. 1979) (a leading case for recharacterization).

¹¹³ See, e.g., Steven L. Schwarcz & Isabelle Stewart, *Recharacterizing Contracts: The Sale-versus-Loan Problem of Receivables Financing*, 100 AM. BANKR. L.J.

Several scholars have acknowledged that usury challenges are driven by distinct policies and rationales, making recharacterization appropriate even if their proposed analytical framework is ill suited to resolve them.¹¹⁴

But while there is substantial divergence in *how* to conduct a recharacterization analysis, there is a fair degree of consensus on the goal of the inquiry. It is to assess the economic reality of the transaction: whether “the interest transferred to the purported buyer is in fact not the functional and economic equivalent of ownership but rather the functional and economic equivalent of a security interest that secures an obligation.”¹¹⁵

(forthcoming Apr. 2026) (manuscript at 16, 20), <https://ssrn.com/abstract=5293601> (arguing that the current approaches are “seriously flawed as well as inconsistently applied” and proposing an approach that focuses on the expressed intention of the parties and the transfer of risks and benefits associated with the property); Hughes, *supra* note 111, at 52–53 (advocating for a codified approach to recharacterization that emphasizes the price of the transaction as central to the inquiry); Harris & Mooney, *supra* note 106, at 1049–53 (2014) (proposing a framework that focuses on whether the seller has retained a meaningful interest in the property, and whether the interest transferred secures an obligation); 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, 186–87 (1991) (reviewing factors that have been relevant in judicial opinions and focusing on the price of the transaction and existence of recourse as particularly relevant); Plank, *supra* note 111, at 328–29 (advocating an approach focusing on the documents and conduct of the parties, whether the buyer assumes some of the burdens of ownership, and whether the buyer pays “fair value” for the receivables).

¹¹⁴ See, e.g., Kettering, *supra* note 107, at 544–45 (attributing a split in recharacterization case law to the fact that certain cases involved usury and suggesting that courts could recharacterize transactions for usury purposes only); Schwarcz & Stewart, *supra* note 113, at 12 n.58, 27 (arguing that usury cases should be kept separate from the analysis in the asset securitization context).

¹¹⁵ Harris & Mooney, *supra* note 106, at 1050, 1052–53 (noting that this inquiry is analogous to the approach codified in the UCC with respect to distinguishing between leases and secured loans). Heather Hughes has argued for the codification of an economic-substance approach. Hughes, *supra* note 111, at 55. Robert D. Aicher and William J. Fellerhoff observe from a review of the case law that “the most important factor in obtaining sale treatment in a bankruptcy case is the ability to demonstrate that most or all of the economic risks and benefits of the receivables . . . have been transferred.” Aicher & Fellerhoff, *supra* note 113, at 211. Thomas Plank likewise, as noted above, focuses on which party bore the benefits and burdens associated with ownership. See Plank, *supra* note 111, at 328–29. While these parties differ in their emphasis on which factors are most relevant to the inquiry, they are united by a sense that the economic reality is the goal. With that said, Ken Kettering diverges somewhat from the norm, suggesting that the factors-based approach should give way to a strong presumption in favor of a true sale, recharacterizing only when necessary to prevent a forfeiture. See Kettering, *supra* note 107, at 531. Kettering suggests courts might recharacterize more broadly in the case of usury, however. See *id.* at 544–45.

If we approach that question impressionistically, we can observe a basic distinction between a sale of receivables and a loan secured by receivables: “When property is sold, the buyer takes on the upside and downside risk of that item’s future performance.”¹¹⁶ In a secured loan, in contrast, the lender extends a sum of money and expects repayment of that amount, usually with interest. Critically, a lender’s contractual entitlement to payment does not depend on the underlying performance or value of the property securing the loan.¹¹⁷ With this distinction in mind, a purported sale could be recharacterized as a loan when the agreement is tantamount to vesting the “buyer” with its investment plus an agreed-upon rate of return, regardless of the performance of the receivables purportedly sold.¹¹⁸

Even with this analytical guidepost, contracting parties can add complexity to the inquiry. Consider that in a pure sale of a tangible item, such as a used car, we would expect the buyer to do some diligence as to the car before purchasing. After purchasing, the buyer would store the car at their home or work, pay for service and insurance, supply the gasoline or electricity to operate it, and so on. The buyer would bear the risk of depreciation and reap gains if the car were to appreciate. So, too, we would expect a buyer of receivables to undertake some pre-transaction diligence, take on the responsibility for servicing and collecting the receivables, and bear the risk that account debtors might not pay on time or in full. But commercial actors have the contractual freedom to bifurcate indicia of ownership, transferring some of the benefits and burdens associated with property, and retaining others.¹¹⁹ A buyer of receivables could rely on representations and warranties of the seller relating to the creditworthiness of its account debtors rather than conducting its own diligence inquiries. Likewise, the seller could retain the duties of servicing as agent for the buyer. Such arrangements should not, standing alone, support recharacterization of a sale as a secured loan.¹²⁰ Only arrangements that

¹¹⁶ *Recharacterizing MCAs*, *supra* note 10 at 1, 4.

¹¹⁷ *Id.*

¹¹⁸ *See, e.g.*, *Home Bond Co. v. McChesney*, 239 U.S. 568, 575–76 (1916) (affirming the recharacterization of a sale of accounts as a loan where the buyer acquired the right to recover a fixed amount plus a predetermined rate of interest); *In re Grand Union Co.*, 219 F. 353, 361 (2nd Cir. 1914) (affirming recharacterization of a sale of leases as a loan where the seller “made itself responsible for every conceivable loss” and guaranteed the buyer’s return notwithstanding the amounts collected).

¹¹⁹ *See* Schwarcz & Stewart, *supra* note 113, at 21 (noting that property rights can be “disaggregated and reorganized”).

¹²⁰ *See* Harris & Mooney, *supra* note 106, at 1042 (arguing that these factors are “unreliable proxies”).

reallocate the risk relating to the underlying performance of the receivables should alter the inquiry.¹²¹

This observation stands in tension with some scholarly writing, which argues that factors such as servicing obligations and diligence inquiries are irrelevant to the recharacterization inquiry because sophisticated parties often reallocate these duties in true sale transactions.¹²² I agree with these contributors that, in a transaction that otherwise functions like a true sale, such contractual arrangements should not compel a different result. But where a purported sale has economic hallmarks of a loan, in that a seller's obligations are not determined by the value or performance of the underlying property, indicia such as limited diligence inquiries or the non-allocation of servicing obligations can function as "badges" of a loan to further support recharacterization.

Recharacterization analysis is further complicated by the reality that contracting parties might add layers of complexity to a transaction to obscure its true characterization. Indeed, the technique of cloaking a loan as a sale in order to avoid usury restrictions has a very long lineage.¹²³ Consider, for example, the Supreme Court's 1916 decision in *Home Bond Co. v. McChesney*.¹²⁴ The question presented was whether accounts receivable purportedly sold to Home Bond, a financier of last resort, ought to be excluded from the debtors' bankruptcy estates and whether Home Bond by extension had a right to the proceeds of the accounts collected postpetition.¹²⁵ The Supreme Court held that recharacterization as a secured loan was appropriate, the matter being "so entirely clear that . . . we deem it unnecessary to discuss [it] at any length."¹²⁶ It continued, "[i]n so far as

¹²¹ Even this standard is difficult to apply. For example, a seller can retain some risk involving a transaction by providing warranties relating to the performance of the property. Whether such warranties support recharacterization of a purported sale as a secured loan ought to depend on the degree of risk retained by the purported seller.

¹²² See, e.g., Schwarcz & Stewart, *supra* note 113, at 18.

¹²³ See, e.g., RESTATEMENT (FIRST) OF CONTRACTS § 529 (AM. L. INST. 1932) ("Where the intent of a party to a bargain is to make a loan of money or an extension of the maturity of a pecuniary debt for a greater profit than is allowed by law, the agreement is illegal though the transaction is put in whole or in part in the form of a sale, a contract to sell or other contract.").

¹²⁴ *Home Bond Co. v. McChesney*, 239 U.S. 568 (1916).

¹²⁵ The underlying sale of accounts receivable provided that the debtors would collect their accounts and remit their face amounts less a discount to the "buyer." The debtors guaranteed the payment of the amounts due to the "buyer," and agreed to repurchase any accounts if they were unpaid at maturity or if the debtor became insolvent. *Id.* at 569 n.1.

¹²⁶ *Id.* at 575.

the contracts in question here use words fit for a contract of purchase, they are mere shams and devices to cover loans of money at usurious rates of interest.”¹²⁷

All told, courts evaluating the characterization of MCA transactions must grapple with a convoluted doctrinal landscape, heterogeneity in contractual arrangements, and at times, transactional provisions designed to derail the analysis. With this starting point, it is not surprising that the characterization of MCAs is subject to significant variance. The following subsections explore how courts have approached the question of recharacterization in the context of MCAs.

B. The Formalist Approach to MCA Characterization

In early cases evaluating MCA transactions, courts focused their analysis on three dimensions of the agreement:

- (1) Whether the agreement includes a reconciliation provision, which purports to adjust the merchant’s payments if the merchant’s business falters;
- (2) Whether the agreement’s term is finite; and
- (3) Whether the funder has recourse if the merchant declares bankruptcy.¹²⁸

These factors have been embraced because they are thought to demonstrate whether the funder has taken on an absolute repayment obligation consistent with the risk profile of a secured loan.¹²⁹ Yet, as commercial law scholars increasingly observe, they are an ineffective measure for making such a determination.¹³⁰ There are at least three problems with courts’ focus.

¹²⁷ *Id.*

¹²⁸ *See, e.g.,* LG Funding, LLC v. United Senior Props. of Olathe, LLC, 122 N.Y.S.3d 309, 312 (N.Y. App. Div. 2020); Mazzoni Ctr. v. LCF Grp., Inc., No. 24-5921-KSM, 2024 WL 4821475, at *7 (E.D. Pa. Nov. 18, 2024) (quoting Lateral Recovery, LLC v. Cap. Merch. Servs., LLC, 632 F. Supp. 3d 402, 452 (S.D.N.Y. 2022)).

¹²⁹ As described below, the question of an absolute repayment obligation is slightly off the mark, as it is not the equivalent of a repayment obligation tied to the performance of the underlying asset.

¹³⁰ Stephen Sepinuck and John Hilson authored the earliest academic writing on MCA characterization, arguing that much of the prevailing case law is wrongly decided. *See* Hilson & Sepinuck, *supra* note 64, at 1, 1–2; Hilson & Sepinuck, *supra* note 64, at 14–

First, these factors can lead courts to elevate form over substance. Funders' standard agreements make overt representations about the existence of reconciliation, flexibility of the term, and recourse in bankruptcy, in an apparent effort to satisfy courts in subsequent litigation. Most MCA agreements feature provisions such as this:

[Merchant] is selling a portion of a future revenue stream to [Finance Company] at a discount, not borrowing money from [Finance Company]. There is no interest rate or payment schedule and no time period during which the Purchased Amount must be collected by [Finance Company].¹³¹

And this:

If Future Receipts are remitted more slowly than [Finance Company] may have anticipated or projected because [Merchant's] business has slowed down, or if the full Purchased Amount is never remitted because [Merchant's] business went bankrupt or otherwise ceased operations in the ordinary course of business, and [Merchant] has not breached this Agreement, [Merchant] would not owe anything to [Finance Company] and would not be in breach of or default under this Agreement.¹³²

It is perilously easy for courts to lose sight of the broader analytical goals of recharacterization analysis in favor of a check-the-box application of these factors to the contract language.

Second, and relatedly, courts that have looked behind MCAs' statements relating to these factors have often found that commercial realities are far different than what are represented. Take reconciliation provisions, for example. Numerous courts have found that the repayment

16. My analysis in several Bankruptcy Law Letter articles aligns with their approach. *See generally Recharacterizing MCAs, supra* note 10, at 1; *Revenue-Based Finance, supra* note 10, at 1. Adam Levitin offers a similar criticism of the prevailing approach in his paper on small business lending. *See Levitin, supra* note 11, at 739.

¹³¹ *GMI Grp., Inc. v. Unique Funding Sols., LLC (In re GMI Grp., Inc.)*, 606 B.R. 467, 473 (Bankr. N.D. Ga. 2019); *see also Gecker v. LG Funding (In re Hill)*, 589 B.R. 614, 619 (Bankr. N.D. Ill. 2018) ("Merchant and LG agree that the Purchase Price under this Agreement . . . is not intended to be, nor shall it be construed as a loan from LG to Merchant.").

¹³² *In re GMI Grp., Inc.*, 606 B.R. at 473.

flexibility ostensibly built into an MCA’s reconciliation provision is illusory, based on a finding that reconciliation was either wholly discretionary on the part of the funder,¹³³ tied to other contractual provisions that make it unachievable,¹³⁴ subject to unreasonable temporal limits,¹³⁵ or otherwise compromised by the fine print.¹³⁶ If reconciliation of payments are illusory, then the MCA transaction fails on elements one and two of the test: not only is reconciliation unavailable as a functional matter, but that reduces the term of the MCA to one that is finite.

¹³³ See *LG Funding, LLC*, 122 N.Y.S.3d at 312 (concluding that the funder did not assume any risk that the merchant would generate lower revenues than expected because the funder retained discretion over any payment adjustments); see also *In re AH Wines, Inc. v. C6 Cap. Funding LLC*, No. 127393-2020, 2020 WL 5028672, at *5 (N.Y. Sup. Ct. Aug. 19, 2020) (concluding that the reconciliation provision was solely in the discretion of the funder and, as such, is illusory and indicative of a secured loan).

¹³⁴ See, e.g., *In re GMI Grp., Inc.*, 606 B.R. at 487 (concluding that reconciliation was illusory where the merchant was required to maintain a bank account balance of twice the daily amount – the equivalent of 34% of its daily collections – which “would be virtually impossible for any business”).

¹³⁵ See, e.g., *Haymount Urgent Care PC v. GoFund Advance, LLC*, 609 F. Supp. 3d 237, 248 (S.D.N.Y. 2022) (reasoning that a reconciliation clause invocable only five days per month could be unworkable in transactions with repayment periods less than one month, or if a merchant hit a rough patch between reconciliation windows); *J.P.R. Mech. Inc. v. Radium2 Cap., LLC (In re J.P.R. Mech. Inc.)*, Ch. 7 Case No. 19-23480 (DSJ), Adv. No. 21-07079 (DSJ), 2025 WL 1550541 (Bankr. S.D.N.Y. May 30, 2025) (holding that reconciliation clauses available only once per month, which did not require the funder to return overcharges, were not true reconciliation provisions).

¹³⁶ Relatedly, the New York Attorney General has gathered testimony from MCA industry employees illustrating that reconciliation refunds were vanishingly rare. See Verified Petition ¶¶ 186–92, *People v. Yellowstone Cap. LLC*, No. 450850/2024 (N.Y. Sup. Ct., Mar. 5, 2024). Indeed, early MCAs had fully discretionary reconciliation provisions and certain businesses had no internal policies or procedures concerning reconciliation. See *id.* at ¶¶ 200, 204. When courts began to void agreements on this basis, funders began to alter the relationship between the specified percentage and the daily repayment amount to place reconciliation functionally out of reach. See *id.* at ¶ 210. Consider, for example, a merchant who anticipates a daily revenue of \$20,000 and purports to sell 10% of the receivables to an MCA funder. We might imagine, then, that the daily withdrawal would be \$2,000 (10% of \$20,000). We would also expect that if the merchant’s revenue fell to \$15,000 per day, it could obtain reconciliation to reduce its daily payment to \$1,500. However, if an MCA agreement instead states in the agreement that the daily payment amount of \$2,000 represents 15% of future revenue, it would have a profound effect on the merchant’s access to reconciliation. If, in this circumstance, the merchant’s revenue falls to \$15,000, the merchant would be unable to lower its payments through reconciliation. Indeed, reconciliation would find that the daily payment ought to increase 15% of the lower revenue, \$15,000, equals \$2,250. Thus, a merchant would not be eligible for a reconciliation-based reduction in payments until its revenue fell below \$13,350.

Likewise, provisions that state that the funder has no recourse in the event of a merchant's bankruptcy have also been found to be illusory. In a recent case, the Bankruptcy Court for the Southern District of New York evaluated an MCA agreement that, like many, expressly stated that a merchant's bankruptcy could not constitute a default under the agreement.¹³⁷ The court found that broader contractual realities belied these statements: although a bankruptcy filing itself was not an event of default, both actions that interfered with the funders right to collect and notifying the defendant that the ACH withdrawals would not be completed were listed events of default.¹³⁸ The court found that "[a]lmost any bankruptcy filing and the resulting automatic stay" would necessarily invoke those provisions.¹³⁹ Not only that, but the funder held extensive personal guaranties against the principal, as well as rights to accelerate and collect the entire amount due, which constituted recourse in the event of default or non-payment.¹⁴⁰ As such, the court held that the funder effectively had recourse in bankruptcy.

A third and most fundamental limitation of the three-factor test is that it does not actually speak to the goals of recharacterization analysis. As a reminder, most scholars and commenters agree that the goal is to identify the economic reality of a transaction. Courts purport to do so by identifying loans as transactions in which the repayment obligation is absolute, but a better characterization is that a loan's repayment obligations are untethered from the performance of the assets sold. Conversely, a key factor indicating a sale is that the buyer takes on the risks and benefits associated with the performance of the underlying assets.

Let us examine how this distinction plays out in a typical factoring (sale) transaction involving a merchant's receivables. This merchant provides goods or services to customers on thirty-day terms. We can expect that certain customers would pay on time, some would pay late, and some would not pay at all. In a factoring transaction, the factor obtains the supplier's rights to be paid from these customers and takes the benefits of

¹³⁷ O'Toole v. Radium2 Cap., LLC (*In re* J.P.R. Mech., Inc.), Ch. 7 No. 19-23480 (DSJ), Adv. No. 21-07079 (DSJ), 2025 WL 1550541, at *8 (Bankr. S.D.N.Y. May 30, 2025).

¹³⁸ *See id.*

¹³⁹ *See id.*

¹⁴⁰ *See id.* at *8-9.

payment and the risk of non-payment.¹⁴¹ This is a true a sale, and would remain a sale even if the merchant continued to service the accounts or provided warranties as to the credit-worthiness of the account debtors.

An MCA transaction, even one that satisfies the formalist test described above, does not match the risk profile of the factoring example because it fails to transfer to the funder the risk of the assets' non-performance. In an MCA, the funder takes an interest in the percentage of total receivables, "which means, quite simply, the funder always gets the good ones."¹⁴² If certain customers do not pay, it is irrelevant to the funder, because the funder is paid from whatever funds the merchant has available. These funds could include proceeds of outstanding accounts receivable, but could likewise include funds from other MCA companies or even an infusion of capital from the merchant's owner. Recent MCA agreements admit as much, often abandoning any notion that individual assets have been sold, but instead taking an interest in all of the business receipts, payable from any sums of money available.¹⁴³

All of this means that the MCA funder's recovery is in no way tied to the performance of any individual account, instrument, payment intangible, or other right to payment. If 20% of the merchant's receivables go uncollected, or 50%, or 70%, the funder's ultimate recovery remains payable from the funds in the merchant's deposit account. A reconciliation of the MCA, if available, could adjust the timeframe for repayment, but would not alter the principal amount owing.¹⁴⁴ And if the funder is not paid in full, the agreement might place the merchant in default, accelerating the obligation and triggering any remedies baked into the MCA. Conversely, if the receivables outperform expectations, the merchant would enjoy that upside. The funder's recovery always remains fixed, subject to possible adjustments of the repayment timeline through reconciliation. In all of these respects, the risk to the MCA funder "is derivative or secondary."¹⁴⁵ That is, the merchant remains liable for the MCA obligation and bears the risk of

¹⁴¹ Again, true sales can have recourse provisions or allocate servicing rights in a manner that diverges from this model and still be true sales. *See, e.g., Guttman v. EBF Holdings, LLC (In re Glob. Energy Servs.), LLC*, Ch. 7 No. 21-17305-NVA, Adv. No. 23-00188 2025 WL 1012721 (Bankr. D. Md. Mar. 31, 2025) (concluding that MCAs are true sales after thorough analysis).

¹⁴² *Revenue-Based Finance*, *supra* note 10, at 7.

¹⁴³ *Id.* at 1.

¹⁴⁴ *See Hilson & Sepinuck*, *supra* note 64, at 14–15.

¹⁴⁵ *Haymount Urgent Care PC v. GoFund Advance, LLC*, 609 F. Supp. 3d 237, 247 (S.D.N.Y. 2022) (quoting *Endico Potatoes, Inc. v. CIT Grp./Factoring, Inc.*, 67 F.3d 1063, 1069 (2d Cir. 1995)).

non-payment by the account debtors, while the MCA funder “only bears the risk that the account debtor's non-payment will leave the [merchant] unable to [pay].”¹⁴⁶ This is akin to the risk profile that a secured lender takes when making a loan secured by receivables.

C. The Emerging Functional Approach to MCA Recharacterization

Over the three years preceding this writing, a sea change has occurred in litigation involving MCAs. Courts have increasingly begun to broaden their inquiry beyond the formalist three-factor inquiry described above, observing that the factors are not exclusive and undertaking a deeper and more thoughtful analysis of the transactions. The trend appears to have taken hold in several actions filed in the U.S. District Court for the Southern District of New York, which confronted MCA characterization in the context of class actions for RICO violations.¹⁴⁷ Yet bankruptcy courts were responsible for some of the early decisions in this vein.¹⁴⁸

Haymount Urgent Care v. GoFund Advance, LLC is instructive of the newer analytical approach. There, the court noted that the formalist factors facially supported a sale characterization, but “the actual operation of the contracts muddies this picture.”¹⁴⁹ Namely, although the contract featured a reconciliation clause, the clause could be invoked only five days per month. This could be unworkable in transactions with repayment periods less than one month, or if a merchant hit a rough patch between reconciliation windows. Not only that, but the reconciliation clauses vested the funder with the discretion to request documentation as a condition to reconciliation, which the court noted could supply a pretext for denying reconciliation.¹⁵⁰ Looking beyond the reconciliation provision, the court emphasized that the receivables pledged were not identified in the contract, which means that “there is no transfer of ‘risk of nonpayment by any specific customer.’”¹⁵¹ Likewise, merchants had the responsibility of servicing the accounts and could use the revenue generated for any purpose, “so long as the daily remittances [were] made.”¹⁵² Finally, the MCA

¹⁴⁶ *Id.*

¹⁴⁷ *See, e.g., Queen Funding, LLC*, 2022 WL 2829913, at *1.

¹⁴⁸ *See generally Recharacterizing MCAs, supra* note 10, at 1 (collecting examples).

¹⁴⁹ *Haymount Urgent Care PC*, 609 F.Supp. at 247–48.

¹⁵⁰ *Id.* at 249.

¹⁵¹ *Id.* (quoting *Plymouth Venture Partners, II v. GTR Source, LLC*, 37 N.Y.3d 591, 609 n.2 (2021) (Wilson, J., dissenting)).

¹⁵² *Id.*

featured aggressive loan-like remedies that sprung into effect if the merchant defaulted. All of these allegations, taken together, were sufficient to survive a motion to dismiss on a claim that the contracts were usurious loans.¹⁵³ Other Southern District of New York (SDNY) cases have reached similar outcomes.¹⁵⁴

Courts beyond the SDNY are similarly embracing a broader and deeper analysis. In *HiBar Capital v. Parkway Dental Services*, the Supreme Court of New York vacated its prior order that refused to set aside a default judgment obtained by the MCA funder. The court noted that “[f]ederal courts have engaged in a more thorough and exacting scrutiny of merchant cash advance agreements, looking at the agreements in a holistic and comprehensive manner and the conclusions they have reached are compelling.”¹⁵⁵ It ultimately concluded that “there are surely questions raised whether the agreement comports with the requirements necessary to be considered a genuine cash advance agreement.”¹⁵⁶

The trend has also continued in bankruptcy, with a growing number of bankruptcy courts finding recharacterization to be appropriate in a variety of circumstances.¹⁵⁷ To be sure, there is some diversity in the analytical approach, as well as outcomes—not all courts have found recharacterization

¹⁵³ *Id.* at 250.

¹⁵⁴ *See, e.g.*, *Lateral Recovery LLC v. Funderz.net, LLC*, No. 1:22-CV-02170 (JLR), 2024 WL 216533, at *11–12 (S.D.N.Y. Jan. 19, 2024) (looking beyond the agreement’s facial compliance with the three-factor test identified above, and concluding that the transaction was a secured loan); *Lateral Recovery LLC v. Queen Funding, LLC*, No. 21 Civ. 9607 (LGS), 2022 WL 2829913, at *6–8 (S.D.N.Y. July 20, 2022) (same); *Lateral Recovery, LLC v. Cap. Merch. Servs., LLC*, 632 F. Supp. 3d 402, 452, 462 (S.D.N.Y. 2022) (same). For a particularly thorough and thoughtful opinion on the allocation of risk in an MCA transaction, see *Fleetwood Servs., LLC v. Ram Cap. Funding, LLC*, No. 20-CV-5120 (LJL), 2022 WL 1997207 (S.D.N.Y. June 6, 2022) (taking a holistic review of the loan’s terms and prior performance, finding that the totality of the agreement indicated that the merchant took on an absolute repayment obligation in the nature of a secured loan).

¹⁵⁵ *Hi Bar Cap. LLC v. Parkway Dental Servs., LLC*, No. 533245/2021, 2022 WL 3757589, at *3 (N.Y. Sup. Ct. Aug. 25, 2022).

¹⁵⁶ *Id.* at *4.

¹⁵⁷ *See, e.g.*, *Williams Land Clearing, Grading, & Timber Logger, LLC v. Apex Funding Source LLC (In re Williams Land Clearing, Grading, & Timber Logger, LLC)*, Ch. 11 No. 22-02094-5-PWM, Adv. No. 23-00024-5-PWM, 2025 WL 1426503 (Bankr. E.D.N.C. May 16, 2025); *O’Toole v. Radium2 Cap., LLC (In re J.P.R. Mech., Inc.)*, Ch. 7 No. 19-23480 (DSJ), Adv. No. 21-07079 (DSJ), 2025 WL 1550541 (Bankr. S.D.N.Y. May 30, 2025); *In re Watchmen Sec. LLC*, No. 24-00087-JMC-11, 2024 WL 4903363, at *7 (Bankr. S.D. Ind. Nov. 20, 2024).

to be appropriate.¹⁵⁸ But the weight of authority has moved away from a formalist approach in favor of a deeper consideration of the transfer of risk associated with the merchant's receivables. The MCA industry is not sanguine about these changes, and several market- and litigation-based responses are currently afoot. The following section examines the reaction following the case law shift on recharacterization and offers final comments on the future of MCA litigation.

III. The Next Chapter of Revenue-Based Finance

The previous Part of this essay described a sea change in case law involving the characterization of MCA agreements. It observed that a growing number of courts are engaging in a thorough economic-reality analysis and, in so doing, have reached the conclusion that MCAs function as secured loans. This holding has, in some cases, resulted in voiding the agreements on the basis of usury. This Part profiles several recent developments involving MCAs, including shifts in choice of law, legislative activity, and market responses. Despite the growing convergence around the recharacterization of MCAs as secured loans, the landscape of MCAs nevertheless holds many uncertainties.

A. Choice of Law Battles

Before 2022, the great weight of New York law embraced the formalist, three-factor test discussed in Part II, under which MCAs were typically treated as true sales. As New York courts have increasingly recharacterized MCAs as secured loans, they have increasingly been found unenforceable on the basis of usury.¹⁵⁹ MCA funders have recently sought to avoid the legal repercussions of their standard form contracts by urging courts to apply a governing law other than the one embedded in the MCA agreement.¹⁶⁰ In a prominent New York case, the MCA funder advanced this argument, contending that the MCA's choice of law would be invalidated if the agreement were unenforceable on the basis of usury. The funder argued that North Carolina law would instead apply.¹⁶¹ Conveniently

¹⁵⁸ *Guttman v. EBF Holdings, LLC (In re Glob. Energy Servs.), LLC*, Ch. 7 No. 21-17305-NVA, Adv. No. 23-00188 2025 WL 1012721 (Bankr. D. Md. Mar. 31, 2025) (concluding that MCAs are true sales after thorough analysis).

¹⁵⁹ See *supra* Part II(C).

¹⁶⁰ I explore these and other legal issues that arise when a contract is found to be unenforceable on the basis of usury in Kara Bruce, *What Can You Do With a Voided Contract?*, 45 BANKR. L. LTR. No. 10 (Oct. 2025).

¹⁶¹ *Haymount Urgent Care PC*, 609 F.Supp. at 173.

for the funder, North Carolina’s usury laws do not apply to transactions exceeding \$25,000,¹⁶² and also exempt loans made to persons other than a natural person from rate and fee caps.¹⁶³ These provisions place MCA activity out of reach of state usury laws. In essence, the funder sought to use the merchant’s usury defenses to seek out a more favorable governing law than the one it originally selected for its standard form agreements.

The Second Restatement of Conflicts of Laws indicates that courts apply the law stated in the agreement unless the “chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice,” or application of the chosen state law “would be contrary to a fundamental policy of a state which has a materially greater interest” in the litigation.¹⁶⁴ Additionally, in cases in which one state’s law would invalidate a contract and another state’s law would not, courts often adopt a presumption that the parties intend their contract to be valid.¹⁶⁵ As a comment to the Restatement explains, “[t]he parties can be assumed to have intended that the provisions of the contract would be binding upon them.”¹⁶⁶ As such, “[i]f the parties have chosen a law that would invalidate the contract, it can be assumed *that they did so by mistake.*”¹⁶⁷

The District Court for the Southern District of New York agreed that a finding of usury would invalidate the entire agreement, including the choice of New York law,¹⁶⁸ in part because the merchant-plaintiffs had conceded the point at an earlier stage of litigation.¹⁶⁹ The court then adopted the presumption of validity described above, holding that because the selection of New York law might invalidate the contract, the choice of law provision defeated the expectations of the bargaining parties and could be attributed to mistake.¹⁷⁰ While that holding might be appropriate given the positions of all parties in the case, the overall pattern of MCA litigation suggests that parties entering into MCAs are not mistaken in their selection

¹⁶² N.C. GEN. STAT. § 24-1.1(a)(2) (2019).

¹⁶³ See N.C. Gen. Stat. Ann. § 24-9(a)(3)(b).

¹⁶⁴ RESTATEMENT (SECOND) OF CONFLICT OF L. § 187(2).

¹⁶⁵ 9 WILLISTON ON CONTRACTS § 20:44 (4th ed.).

¹⁶⁶ RESTATEMENT (SECOND) OF CONFLICTS OF L. § 187 cmt. e.

¹⁶⁷ RESTATEMENT (SECOND) OF CONFLICTS OF L. § 187 cmt. e, (emphasis added).

¹⁶⁸ *Haymount Urgent Care PC v. GoFund Advance, LLC*, 690 F. Supp. 3d 167, 173 (S.D.N.Y. 2023).

¹⁶⁹ *Id.*

¹⁷⁰ The merchants in this case apparently did not advance an argument that the MCA choice of law provision controlled, instead contending that standard choice-of-law provisions governed the analysis. *Haymount Urgent Care PC*, 609 F.Supp. at 173–74.

of New York law. Rather, the dominant chosen law has simply become less attractive to MCA funders after many MCA contracts were formed.¹⁷¹ A leading treatise on the law of contracts indicates that a presumption in favor of choosing a law that validates the contract should apply only in cases in which the parties' intent is in question, and absent circumstances indicating a contrary intent.¹⁷² In this respect, courts might instead view MCAs' choice of New York law through the lens of waiver. Courts do not allow one party to unilaterally waive a choice of law provision designed to benefit both parties.¹⁷³ In light of this construction, a court evaluating the consequences of invalidating a contract on the basis of usury could determine that New York supplies the residual authority after the contract is invalidated, or alternatively find that severance and enforcement of the choice of law clause, as occurs with regard to forum selection and arbitration clauses, is the appropriate relief under the circumstances.¹⁷⁴

Meanwhile, in North Carolina courts, MCA funders have argued that the state's public policy demands application of North Carolina's usury laws irrespective of the choice-of-law clauses in the funders' form contracts.¹⁷⁵ To support this argument, funders have relied on a series of consumer cases in which North Carolina courts refused to apply another state's governing law that would offer less protection to borrowers than North Carolina law provided.¹⁷⁶ At least one court has refused to apply this precedent to afford North Carolina borrowers fewer protections than they would be entitled to receive under their agreement.¹⁷⁷ In *Willims v. Land Clearing, Grading and Timber Logger*, the Bankruptcy Court for the

¹⁷¹ Bruce, *supra* note 160, at 10 ("Given New York's heightened approach to usury, the MCA industry's frequent designation of New York law in funding agreements appears to have backfired.").

¹⁷² 9 WILLISTON ON CONTRACTS § 20:44 (4th ed.).

¹⁷³ *Avicanna Inc. v. Mewhinney*, 487 P.3d 1110, 1115 (Colo. App. 2019) (holding that, the plaintiff could not unilaterally waive its choice of law by seeking to litigate in another forum, even if the chosen forum was more convenient to the opposing party).

¹⁷⁴ For a discussion of the effect of usury on choice of law, forum selection, and arbitration clauses, see Bruce, *supra* note 160, at 10.

¹⁷⁵ *Martinez Quality Painting & Drywall, Inc. v. Newco Cap. Grp. VI, LLC (In re Martinez Quality Painting & Drywall, Inc.)*, Ch. 11 No. 22-30357, Adv. No. 24-03039, 2025 WL 828882, at *4 (Bankr. W.D.N.C. Mar. 14, 2025) (describing these arguments, but deferring resolution of the issue until after discovery).

¹⁷⁶ Many jurisdictions refuse to enforce choice of law clauses when the outcome of enforcement would make usury protections unavailable.

¹⁷⁷ *Williams Land Clearing, Grading, & Timber Logger, LLC v. Apex Funding Source LLC (In re Williams Land Clearing, Grading, & Timber Logger, LLC)*, Ch. 11 No. 22-02094-5-PWM, Adv. No. 23-00024-5-PWM, 2025 WL 1426503, at *4 n.6 (Bankr. E.D.N.C. May 16, 2025).

Eastern District of North Carolina observed that the cited cases, decided in the consumer context, were premised on North Carolina policy to protect North Carolina borrowers.¹⁷⁸ It also observed that North Carolina typically does not police the bargaining of businesses. The court concluded that it would “bend North Carolina usury law beyond recognition” to apply the law in a matter that undermines the contracting parties’ bargain with usury provisions more favorable to the borrower.¹⁷⁹ The court therefore respected the contractual choice of law provision, finding the merchant’s allegations of usury survived the funder’s motion to dismiss.¹⁸⁰

As New York courts increasingly become the “worst place to litigate” MCA disputes,¹⁸¹ we may see this industry gravitate toward new locations, including jurisdictions with fewer usury protections.¹⁸² It remains to be seen how courts will respond to a loan-style contract with a triple-digit interest rate in the absence of an applicable usury law.¹⁸³ We could see challenges to MCA transactions migrate from usury to doctrines such as unconscionability,¹⁸⁴ Unfair, Deceptive, and Abusive Acts or Practices (UDAAP) or other contract defenses, assuming those protections are

¹⁷⁸ *Id.* at *18.

¹⁷⁹ *Id.* at *19.

¹⁸⁰ *Id.*

¹⁸¹ Jacob H. Nemon, *SDNY is the New Worst Place to Litigate MCA Disputes*, N.Y. L.J. (Mar. 10, 2023), <https://www.law.com/newyorklawjournal/2023/03/10/sdny-is-the-new-worst-place-to-litigate-mca-disputes/?kw=SDNY%20Is%20the%20New%20Worst%20Place%20To%20Litigate%20Merchant%20Cash%20Advance%20Disputes&LikelyCookieIssue=true>. This is an abrupt about-face from the prior view that New York was, by far, the best place for MCA funders to litigate their disputes. *See, e.g.*, Jacob H. Nemon & Jeffrey S. Boxer, *The Worst Place To Litigate Merchant Cash Advance Disputes Is out-of-State, So Fix Your Contracts Already!*, N.Y. L.J. (Aug. 18, 2021), <https://www.law.com/newyorklawjournal/2021/08/18/the-worst-place-to-litigate-merchant-cash-advance-disputes-is-out-of-state-so-fix-your-contracts-already/?slreturn=20250111165605>.

¹⁸² While funders of course do not have carte blanche to choose any governing state’s laws, there are well-documented practices of regulatory arbitrage that operate in adjacent spaces. *See, e.g.*, Adam J. Levitin, *Rent-a-Bank Partnerships and the Evasion of Usury Laws*, 71 DUKE L.J. 329 (2021); David Berman, *Lending Experimentalism: A New Regulatory Approach to Payday Loans*, 31 GEO. J. POVERTY L. & POL’Y 237 (2024).

¹⁸³ Some borrowers may be able to take advantage of usury laws in their home jurisdiction, even if their MCA agreement selects a governing law that is hostile to usury. For a summary of states in which usury is deemed to be a “fundamental policy” sufficient to override the selection of another forum’s law, see William B. Emmal, *Evading Prohibitions on Usury Through Choice of Law*, 9 TRANSACTIONAL LAW. Aug 2019, at 6.

¹⁸⁴ A similar shift has occurred in consumer lending. *See* Adam J. Levitin, *The New Usury: The Ability-to-Repay Revolution in Consumer Finance*, 92 GEO. WASH. L. REV. 425 (2024).

available to small businesses.¹⁸⁵ It is also worth noting that the existence or nonexistence of usury laws does not affect the application of avoidance-based theories of recovery, such as preferences or fraudulent transfers. Accordingly, bankruptcy courts may continue to see large numbers of MCA challenges, irrespective of the governing law.

B. Emerging Legislative Responses

A key challenge to constraining the most egregious terms in MCA agreements is the relative lack of oversight over commercial financing. The fintech entities that provide MCA financing fall outside of the prudential oversight of banking regulators¹⁸⁶ and lack the market and reputational constraints of their traditional bank counterparts.¹⁸⁷ Likewise, public regulatory checks on financing are largely focused on consumer protection goals.¹⁸⁸ Usury laws do not always extend to business borrowers, and many state UDAAP protections are likewise limited to consumer borrowers. This can place small businesses in a regulatory gap, in that they enter the credit marketplace with protections equivalent to businesses with in-house legal departments and significant bargaining power, although they realistically face vulnerabilities more aligned with consumers.¹⁸⁹ What is more, it can be difficult for lenders to obtain reliable financial data on small businesses,

¹⁸⁵ Litigants could likewise explore formation challenges under Article 9. As discussed above, there is a credible argument that MCAs are invalidly formed under Article 9 because they do not identify the collateral subject to the transaction. *See* U.C.C. §§ 9-108(a), (b), 9-109(a)(3) and §§ 9-108 (AM. L. INST. & UNIF. L. COMM'N 2023).

¹⁸⁶ *See* Christopher K. Odinet, *Predatory Fintech and the Politics of Banking*, 106 IOWA L. REV. 1739, 1766–69 (2021).

¹⁸⁷ *See* Levitin, *supra* note 11, at 747–49 (2025) (noting that fintechs do not have brick-and-mortar presences and are easily able to rebrand if they face negative publicity); *Id.* at 767–70 (cataloguing informational and access limitations to small businesses and how they limit the market-based constraints on small business lending).

¹⁸⁸ Federal regulations such as the Truth in Lending Act, the Consumer Protection Act, the FTC Credit Practices' Rule, and the Fair Debt Collection Practices Act, among others, apply only to consumers or consumer transactions. *See id.* at 775–78 (collecting authority). The Equal Credit Opportunity Act and the FTC's prohibitions of unfair and deceptive acts and practices, in contrast, can constrain certain business transactions. *Id.* at 775–76.

¹⁸⁹ For a thorough discussion of this reality, see Levitin, *supra* note 11, at 732; Lenore Palladino, *Small Business Fintech Lending: The Need for Comprehensive Regulation*, 24 FORDHAM J. CORP. & FIN. L. 77, 91 (2018) (“Eighty-seven percent of small business owners are relying on their personal credit scores and using personal collateral to finance their small businesses, further blurring the line between consumer and business borrowing and demonstrating why protection is essential. The lack of protection of small business borrowers by the consumer protection statutes creates the opportunity for predatory lending.”).

and likewise to predict a business’s performance. These realities can result in limited credit options for small businesses, eroding the power of market-based constraints on pricing and other terms. More to the point, if the small business and its owner likewise have limited unencumbered assets, then receivables-based financing might be one of the only available financing options.

Recent state legislative responses, motivated at least in part by the MCA industry’s overreaching, have begun to close this gap by extending consumer-style protections to small business financing transactions. For example, California has recently extended its UDAAP protection to cover commercial financing.¹⁹⁰ Likewise, a growing number of state legislatures have enacted commercial finance legislation that would affect the MCA industry.¹⁹¹ Several of these statutes require covered financiers to provide Truth in Lending Act (TILA)-style disclosures relating to the costs of financing, so that merchants have the ability to compare products and make an informed decision when obtaining credit.¹⁹² Other statutes require finance companies to register with the state and, sometimes, provide periodic reports on their activities.¹⁹³ While these statutes do not address all access-to-credit challenges facing small businesses, and suffer from the well-discussed deficiencies of disclosure-based regulatory systems in general,¹⁹⁴ they provide some clarity and checks on MCA misbehavior.

Perhaps the most aggressive state regulation of the MCA industry to date comes out of Texas, which in June 2025 enacted a significant

¹⁹⁰ See, e.g., CAL. CODE REGS. tit. 10, § 1060 (2023). Note, the FTC’s UDAP prohibitions extend to small businesses, but do not cover *abusive* acts and practices. See generally 15 U.S.C § 45.

¹⁹¹ Currently California, Utah, Kansas, Missouri, Florida, Georgia, Virginia, New York, Connecticut, and Texas, have commercial finance disclosure laws that relate to the MCA industry. Similar legislation has been proposed in several additional states, including Pennsylvania, Illinois, North Carolina, Mississippi, New Jersey and Maryland. See H.B. 1792, 2023 Gen. Assemb., 207th Sess. (Pa. 2023); S.B. 2234, 103rd Gen. Assemb., 1st Sess. (Ill. 2023); H.B. 662, 2023 Gen. Assemb., Reg. Sess. (N.C. 2023); H.B. 1271, 138th Legis. Sess., Regular Sess. (Miss. 2023); S.B. 1397, 221st Legis. Sess. (N.J. 2024); S.B. 496, 2023 Gen. Assemb., 445th Sess. (Md. 2023).

¹⁹² CAL. CODE REGS. tit. 10, §§ 900–956 (2023); CONN. GEN. STAT. § 36a-861 to -872; FLA. STAT. §§ 559.961-.9615 (2023); UTAH CODE ANN. § 7-27-101 to -301 (West 2024); GA. CODE ANN. § 10-1-393.18 (2024); KAN. STAT. ANN. § 75-783 to 785 (2024); MO. REV. STAT. § 427.300 (2025); N.Y. FIN. SERV. LAW §§ 801–811 (Consol. 2022); VA. CODE ANN. § 6.2-2228 to -2238 (2022).

¹⁹³ § 427.300; §7-27-201 to -202; § 6.2-2230.

¹⁹⁴ See, e.g., Carl E. Schneider & Omri Ben-Shahar, *The Failure of Mandated Disclosure*, U. PA. L. REV. 67 (2010) (examining how disclosure mandates chronically fail to address their purpose and often backfire).

disclosure and registration law affecting MCAs and other forms of revenue-based financing.¹⁹⁵ Texas House Bill 700 requires sales-based financing providers and brokers to register with the Texas Office of Consumer Credit Commissioner and provide extensive disclosures in transactions for less than \$1 million.¹⁹⁶ It also excludes such transactions from a sales-based usury carveout.¹⁹⁷

The Texas law also addresses the interests of senior secured creditors in MCA transactions in a manner unique among recent legislation.¹⁹⁸ Significantly, it prohibits funders from making automatic debits of a merchant's deposit account unless the funder holds a "validly perfected security interest in the recipient's account . . . with a first priority against the claims of all other persons."¹⁹⁹ This provision will have a significant effect on the MCA industry, which typically relies on automatic deposit account transfers. It remains to be seen how the market will adapt to this limitation, but several scenarios are possible: MCA funders could theoretically follow Article 9's rules for obtaining priority over deposit accounts, but the mechanism for doing so is more complicated than filing a financing statement and requires the consent of the bank at which the deposit account is maintained.²⁰⁰ Perhaps more likely, MCA funders could divert payments from credit card processors rather than sweeping funds from deposit accounts.²⁰¹ It is also possible that funders might require merchants to make wire transfers manually, which would appear not to invoke the statute's restrictions on automatic debits. Examining this provision with a broader lens suggests that the interests of competing creditors might drive further legislative reform in the MCA industry.

As state commercial financing disclosure statutes began to take hold, the Uniform Law Commission began to study a possible uniform disclosure law to govern MCAs and other commercial financing

¹⁹⁵ H.B. 700, 89th Leg., Reg. Sess. (Tex. 2025).

¹⁹⁶ *Id.*

¹⁹⁷ *Id.* § 398.004.

¹⁹⁸ For another take on this recent legislation, see Stephen Sepinuck, *Texas Enacts a Disclosure Law . . . With a Twist*, 15 TRANSACTIONAL LAW. Aug. 2025, at 5.

¹⁹⁹ H.B. 700, 89th Leg., Reg. Sess. § 398.056 (Tex. 2025).

²⁰⁰ Section 9-327 of the Uniform Commercial Code delineates the order of priority over a deposit account. The highest possible level of priority occurs when a creditor becomes the bank's customer with respect to the bank account. U.C.C. §§ 9-104(a)(3), 9-327(4) (AM. L. INST. & UNIF. L. COMM'N 2023). All other security interests are potentially subject to any lien or setoff rights asserted by the bank at which the deposit account is maintained. U.C.C. §§ 9-327(3), 9-330 (AM. L. INST. & UNIF. L. COMM'N 2023).

²⁰¹ See *supra* text accompanying note 14 (noting that this is a historical practice and continues to occur in some MCA transactions).

transactions.²⁰² That process, which began in 2023, has recently culminated in a draft uniform law governing the disclosure of terms in a variety of financial transactions, including, but not limited to MCAs.²⁰³ When finalized, this uniform act could be adopted in whole or in part by state legislatures, bringing a more widespread and consistent approach to commercial finance disclosure.

There have also been some federal efforts to respond to the MCA industry's overreaching in recent years, but much of this activity may remain on hold under the current administration. For example, in March 2023, the Consumer Financial Protection Bureau (CFPB) finalized a rule to increase transparency in small-business lending.²⁰⁴ The rule requires covered small business lenders to report information about their transaction activity, including pricing and demographic data. As part of this rule, the CFPB expressly deemed MCA transactions and other sales of future receivables to constitute "credit."²⁰⁵ At present, implementation of the rule has been stayed against certain entities in pending litigation, and the CFPB has issued interim rules extending the compliance date for other entities as well.²⁰⁶ The earliest the rule will go into effect for any covered entities is June 2026.²⁰⁷ Separately, the CFPB's current leadership has communicated that it will not prioritize enforcement of the rule²⁰⁸ and that it seeks to reconsider the rule in the near future.²⁰⁹ As noted earlier, both the Federal Trade Commission and the Securities and Exchange Commission have pursued enforcement against the MCA industry in recent years,²¹⁰ but it is not clear whether these agencies will continue to view the MCA industry as an enforcement priority under the current administration.

²⁰² See UNIF. L. COMM'N, REPORT OF THE STUDY COMMITTEE OF COMMERCIAL FINANCING DISCLOSURE (2024).

²⁰³ See COM. FIN. DISCLOSURE ACT, (UNIF. L. COMM'N, Draft May 27, 2025).

²⁰⁴ 12 C.F.R. pt. 1002.101 to .111.

²⁰⁵ 12 C.F.R. pt. 1002.104(a).

²⁰⁶ See Small Business Lending under the Equal Credit Opportunity Act (Regulation B); Extension of Compliance Dates 2025, 95 Fed. Reg. 55024 (July 3, 2024).

²⁰⁷ See *id.*

²⁰⁸ Press Release, CFPB, CFPB Keeps Its Enforcement and Supervision Resources Focused on Pressing Threats to Consumers (Apr. 30, 2025), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-keeps-its-enforcement-and-supervision-resources-focused-on-pressing-threats-to-consumers/>.

²⁰⁹ Defendants' Response to Plaintiff's Unopposed Motion to Stay the Section 1071 Rule and Hold Proceedings in Abeyance at 2, Revenue Based Fin. Coal. v. CFPB, No. 1:23-CV-24882-DSL (S.D. Fla. Apr. 3, 2025), ECF No. 75.

²¹⁰ See *supra* text accompanying notes 53-57.

C. Market Responses

The foregoing subsections illustrate that the MCA market is in a state of significant transition in response to litigation and legislative enactments. But even in this new reality, the MCA market shows no signs of slowing down. Demand for small business financing remains high and could continue to grow in the current economic climate.²¹¹ Moreover, the types of entities offering MCAs likewise appear to be expanding. An increasing number of fintech providers, as well as financial platforms such as Shopify,²¹² Square²¹³ and PayPal,²¹⁴ are offering MCA-style products. Meanwhile, hosts of the popular investment television show “Shark Tank,” among many others, have been enticed by the high returns to invest in MCA funding companies. All of this represents a significant change from the MCA industry’s beginnings, which commenters have traced to criminally adjacent enterprises.²¹⁵

It is certainly possible that the relative mainstreaming of MCA devices, particularly following the litigation and legislative developments discussed above, will result in relatively more favorable terms for MCA-style products. Yet the profitability of these transactions and limited market and regulatory checks on lender behavior may continue to result in high transactional costs and onerous terms. So, too, developments in disclosure will provide more information on these products, but will not serve as a

²¹¹ For example, commenters suggest that current U.S. trade policy will have significant effects on small businesses’ financial health. See Neil Bradley, *Small Businesses, Big Burden: The Cost of Tariffs*, U.S. CHAMBER OF COM. (May 20, 2025), <https://www.uschamber.com/small-business/small-businesses-big-burden-the-cost-of-tariffs> (“A staggering 97% of U.S. importers are small businesses, so when tariffs rise these companies face steep costs that threaten their survival.”).

²¹² *Shopify Capital*, SHOPIFY, <https://help.shopify.com/en/manual/finance/shopify-capital> (last visited Sep. 28, 2025).

²¹³ *Square Loans*, SQUARE, <https://squareup.com/us/en/banking/loans> (last visited Sep. 28, 2025).

²¹⁴ *Working Capital*, PAYPAL, https://www.paypal.com/us/business/financial-services/working-capital-loan?utm_medium=google&utm_source=sem&utm_campaign=c11676&gclid=Cj0KCOjwm93DBhD_ARIsADR_DjHlpex0IKC0YHLr8ge5CEsN0ktXXGCK2x1qGUj4ZUIg8Y-IDsltQ38aAkfjEALw_wcB (last visited Sep. 28, 2025).

²¹⁵ See Mider & Faux, *supra* note 8; Maureen Tkacik, *Usury in the Water: There’s Never Been a Better Time to Be a Loan Shark for Small Businesses*, AM. PROSPECT (May 30, 2025), <https://prospect.org/economy/2025-05-30-usury-in-the-water/>.

standalone check on creditor terms, particularly when a merchant in distress has few to no options to compare.

IV. Conclusion

MCAs are a novel financing device, but they are grounded in a longstanding practice of cloaking usurious loans as sales. Still, determining how they should be treated in bankruptcy and civil litigation presents a number of interpretive issues that are difficult to resolve. This essay offers a descriptive overview of Merchant Cash Advance (MCA) transactions in both bankruptcy and non-bankruptcy litigation, while also weaving in normative commentary on recharacterization and related Code applications. Its core aim is to serve as a practical roadmap for practitioners navigating MCA issues in ongoing cases.

As I have mentioned elsewhere, bankruptcy courts have played a central role in correcting the misguided course of recharacterization analysis as it applies to MCAs. Their decisions have provided critical guidance on how to interpret opaque financial transactions and reorient the inquiry around economic reality, and the law has improved as a result. To continue this path toward consistency on the question of characterization and related issues, it is essential that courts continue to document their reasoning in written opinions that are accessible to judges, law clerks, and other practicing attorneys. Academic authors also have a vital role to play in these critical commercial law matters. By communicating directly with non-academic audiences and tailoring commentary to real-world litigation dynamics, scholars can significantly shape legal discourse and outcomes.