



# MERCHANT CASH ADVANCE AND UCC ISSUES BROWN BAG CLE

Tuesday, September 12, 2023  
Noon - 1:00 p.m. via Zoom




# Introduction to Panel




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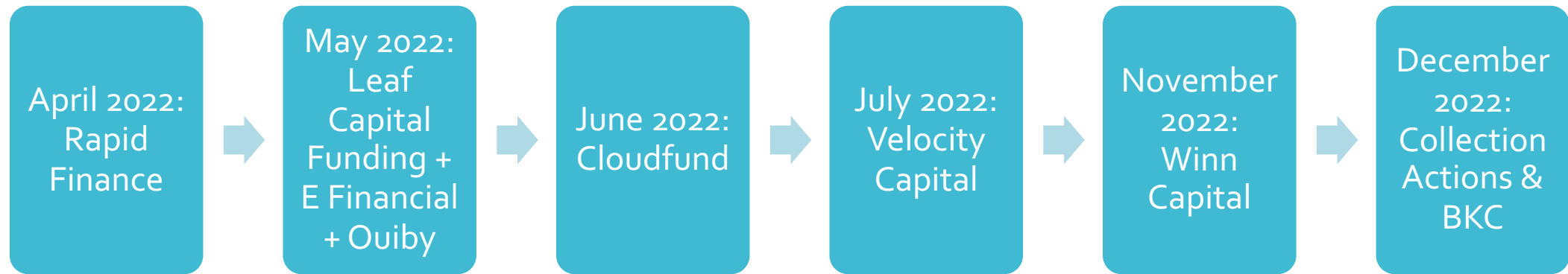
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## Introduction to Burke Brands

- *In re Burke Brands, LLC, dba Don Pablo Coffee*
- Case No. 22-19932-BKC-RAM
- Senior Secured Lender: US Century Bank
- Perfection: UCC-1 & Possession
- Standard Blanket Lien, “all tangible and intangible property and assets”

## 7 MCAs in 6 Months

4/7 MCAs → Collateral = Receivables Generally / Income Stream



“Revenue Purchase Agreement”  
“Business Funding Agreement”  
“Merchant Cash Advance Contract”  
“Agreement for Purchase and Sale of Future Receipts”

# What is an MCA, and Why Should You Care?

- Market: Small Businesses
  - SBA definition = fewer than 500 employees
- Rates and Risk
  - Cost of capital
  - Sale vs. Loan (Purchase vs. Finance)
- Legal & Public Policy Issues
  - Criminal usury versus freedom of contract
  - Impact to broader US economy
  - Client-driven concerns

## What is an MCA?

- AR Financing (“Factoring”)
  - Trade interest in billed but not collected accounts (receivables) for immediate cash
  - Conceptually similar to payday loan
- MCA = Merchant Cash Advance
  - Merchant bank accounts
  - Provides basis for direct draw flowing from credit card or debit card payments
- Sale vs loan (point of debate)

## Role of MCAs in the financial markets

- Alternative to commercial loan
  - Private financing, largely unregulated
- Targeted towards small businesses
  - Newer businesses (less than 2 years of financial statements)
- Access to cash
  - Inability to qualify for commercial loan
  - Quick approval

## Why do small businesses turn to MCAs?

- Theory
  - Opportunity to generate revenue in excess of cost of capital
- Reality
  - Daily pressures of business (payroll, equipment malfunction, etc.)
  - Gap-filler/emergency cash at a staggeringly high cost
  - Aggressive and targeted marketing



# Risky Business

- Defining feature of “sale” versus “loan” is allocation of risk
  - The less risk the MCA provider carries, the more the transaction looks like a loan
- Allocating risk
  - Personal guarantees
  - Reconciliation clauses
  - Events of default
- Label of the transaction or agreement is not determinative to a court

## New York, New York

- Governing law provision of MCA agreements (contract interpretation)
  - *Butner v US*, 440 U.S. 48 (1979)
- Two key points:
  - NY criminal usury standard
    - “Absolutely repayable” (risk)
  - Confession of judgment (recourse)
    - Note 2019 changes to law

## Why should you care?

- Public policy concerns
  - Commonality with MLM and Ponzi schemes
  - Broader implications for the US economy
- Client-driven concerns
  - Impact upon institutional lenders
  - Small business clients
  - Post-petition UCC issues

## Burke Brands, Cont'd

Case No. 22-  
19932-BKC-  
RAM

- Main Case Contested Matters
  - MCAs Issue UCC Lien Notices & Demand for Turnover of Receivables
  - Debtor Moves to Compel Customers and Vendors to Remit Payments to Debtor
  - MCAs Object to Cash Collateral Motion / Replacement Liens
  - US Bank and the Debtor Align

# Article 9 of UCC + § 552 of Bankruptcy Code

- Do Prepetition Security Interests in Collateral and Proceeds of Collateral Apply Post-Petition?
  - Debtor + Operating Lender V. MCAs
  - Meaning of “account” under Article 9 of the UCC
  - Limitations on pre-petition blanket liens under 11 U.S.C. § 552
  - Type of Collateral (real property v. account receivable)
  - Blanket v. Specific Liens
  - Timing of Sale
- Timing of Sale / Creation of Right to Payment (i.e. an “account”)
  - *In re Burts Construction, Inc.*, Case No. 22-31700 (Bankr. S.D. Tx. Jan. 24, 2023) (prepetition security interest in accounts does not attach to proceeds from postpetition sale of real property)
  - *In re Nittolo Land Dev. Assoc.*, 333 B.R. 237 (Bankr. S.D.N.Y. 2005) (prepetition security interest in accounts attaches to proceeds from prepetition sale of real property)

# Article 9 of UCC + § 552 of Bankruptcy Code

- True Sale v. Disguised Loan: MCAs in Bankruptcy
  - *In re R&J Pizza Corp.*, 2014 WL 12973408 (Bankr. E.D.N.Y. Oct. 14, 2014) (prepetition sale of accounts receivable includes post-petition receipts, which do not become property of the estate and are not “cash collateral” under § 363 of the Bankruptcy Code)
  - 3-Factor Test
    - Reconciliation, Term, **Recourse**
    - *Fleetwood Servs. V. Ram Capital Funding, LLC*, Case No. 20-cv-5120 (S.D.N.Y. June 6, 2022)
    - *LG Funding, LLC v. United Senior Props. of Olathe, LLC*, 181 A.D. 3d 664 (N.Y. Mar. 11, 2020)
- Other Considerations
  - Parties’ Conduct
  - Segregation v. Commingling Proceeds
  - Retention of Servicing Rights
  - Terms and Language of Underlying Agreements

# Burke Brands, Cont'd

Case No. 22-  
19932-BKC-  
RAM

- Adversary Proceedings
  - Dec Action: *Debtor v. MCAs*, No. 23-01022
  - § 523(a): *MCA v. Debtor*, No. 23-01080
- *Debtor v. MCAs*, Adv. Pro. No. 23-01022-RAM
  - Declaratory Relief
    - MCAs = Usurious Loans
    - Extent/Validity/Priority of Liens
  - Avoidance & Equitable Subordination
  - Fraudulent Transfer / Unjust Enrichment / Disgorgement
  - Objection to Claim
  - Tortious Interference with Business Relationships
  - Violations of Automatic Stay
  - Injunctive Relief

# Burke Brands, Cont'd

Case No. 22-  
19932-BKC-  
RAM

- Adversary Proceedings, Cont'd
  - Dec Action: *Debtor v. MCAs*, No. 23-01022
  - § 523(a): *MCA v. Debtor*, No. 23-01080
- Circuit Split
  - *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging, LLC)*, 36 F. 4<sup>th</sup> 509 (4<sup>th</sup> Cir. 2022) (§ 523 APPLIES to corporate debtors in sub V)
  - *Lafferty v. Off-Spec Sols., LLC (In re Off-Spec Sols., LLC)*, 651 B.R. 862 (9<sup>th</sup> Cir. BAP 2023) (§ 523 does NOT apply to corporate debtors in sub V)
- Bankruptcy Courts Agree: § 523 does NOT apply to corporate debtors in sub V



## § 523 of Bankruptcy Code + Usury / RICO

- Nondischargeability, § 523
  - Guarantors and SubV Debtors
  - *Cantwell-Cleary Co. v. Cleary Packaging, LLC (In re Cleary Packaging, LLC)*, 36 F. 4<sup>th</sup> 509 (4th Cir. 2022)
- Usury + RICO
  - Collection of an unlawful debt, 18 U.S.C. § 1962
  - *Mehdipour v. Hi Bar Capital, LLC, et al. (In re Excell Auto Group, Inc.)*, Adv. Pro. No. 23-01132-EPK
  - *Fleetwood Servs. V. Ram Capital Funding, LLC*, Case No. 20-cv-5120 (S.D.N.Y. June 6, 2022)

QUESTIONS?