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Business Track

Characterization & Treatment of Merchant Cash Advances in Subchapter V

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Characterization & Treatment of Merchant Cash Advances in Sub V Bankruptcies

Moderator:

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Speakers:

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What is a Merchant Cash Advance?

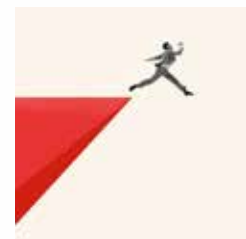
Structure of MCAs

- Purchase of future receipts in exchange for an advance of cash from the purchaser
 - The “seller” (debtor) is the cash recipient, which continues to collect A/R
 - Repayment occurs via regular direct debits from “Seller’s” bank account or separate account created per the MCA agreement.
 - Daily/weekly at an amount: generally predetermined
- Expedited application process
 - Generally little or no credit check
 - Generally little or no due diligence
 - But, “seller” representations are key and often recorded
- Look like a loan: Cash up front & regular payments



Typical MCA Terms

- Advance of future (unidentified) accounts receivable
- No stated interest rate (often interest/loan status is disclaimed)
 - “Factor rate” typically between 1.1 and 1.5
 - How to calculate effective interest rate?
- High fees
- “Indefinite” repayment term
- Reconciliation provision: adjusting repayment based on actual revenue
- Recourse against “Seller” or guarantor (may be personal guarantee)
- Broad grant of security interest





How are MCAs different from traditional factoring?

Factoring

- No up-front funding received
- Purchase or assignment of **specific** future receivables at percentage of face value
- Merchant elects whether to pursue A/R or to sell to factor company and transfer all collection risk and obligation
- Governed by UCC Article 9

Merchant Cash Advance

- MCA provides up-front funding
- Merchant then owes (larger) future amount from **all** sources
- Repayment obligation regardless of future income
- Not clearly governed by UCC
 - This does not stop “purchasers”



Pros & Cons of MCAs

- | | |
|---|--|
| <ul style="list-style-type: none">✓ Expedited process<ul style="list-style-type: none">✓ Minimal documentation required✓ Same-day pre-approval✓ Funding in 1-3 days✓ Not credit score-dependent✓ Not reported to credit bureaus✓ No collateral required✓ Convenient automatic repayment | <ul style="list-style-type: none">✗ Opaque & confusing fee structure✗ Automatic repayment can jeopardize cash flow✗ May require confession of judgment and/or waiver of defenses✗ May require personal guarantees✗ Availability of UCC liens✗ Ability to stack multiple MCAs can lead to over-extension |
|---|--|



True Sale or Disguised Loan?

Key Factors:

- True reconciliation provision
- Funder's recourse in the event of bankruptcy
- Definite term
- Parties' language and conduct

Who bears the risk of non-payment?

Consequences:

- State usury statutes
 - n.b. RICO- collection of unlawful debt
- Unfair trade practices
- Bankruptcy causes of action and estate issues, including preference exposure



In re Shoot the Moon, LLC (2021)

The Court established that certain MCAs were legally considered disguised secured loans, not true sales of receivables.

Factors Evaluated:

1. Whether the buyer has a right of recourse against the seller
2. Whether the seller continues to service the accounts and commingles receipts with its operating funds
3. Whether there was an independent investigation by the buyer of the account debtor
4. Whether the seller has a right to excess collections
5. Whether the seller retains an option to repurchase accounts
6. Whether the buyer can unilaterally alter the pricing terms
7. Whether the seller has the absolute power to alter or compromise the terms of the underlying asset
8. The language of the agreement and the conduct of the parties

CapCall, LLC v. Foster (In re Shoot the Moon, LLC), Adv. Pro. 17-00028-WLH, 2021 Bankr. LEXIS 2482, 2021 WL 4144933 (Bankr. D. Mont. Sept. 10, 2021).



The Courts have begun to take a “flexible, totality-of-the-circumstances approach.”

In a series of decisions applying various states’ substantive law *In re Crosby Marine* to numerous MCA agreements, the Court determined that under the analysis of Connecticut, Florida, and New York law, various MCA agreements were disguised loans.

The relevant question is: Who is exposed to the direct risk of non-payment of the receivables?

E.g., In re Crosby Marine Transportation, Docket Nos. 26-10678, 26-1018, 2026 LX 331663 (Bankr. E.D. La. June 18, 2026)



Familiar/Unfamiliar Terms In Response

Personal Guarantee v. Guarantee of Performance

G1. Guarantee of Performance. This is a guaranty of performance, dated [REDACTED], of the [REDACTED] Merchant Cash Advance Agreement, dated [REDACTED] (“Agreement”), inclusive of all addenda, if any, executed simultaneously therewith, by and between [REDACTED] and [REDACTED] (“Merchant”). Each undersigned Guarantor hereby guarantees each Merchant’s performance of all of the representations, warranties, and covenants made by each Merchant to [REDACTED] in the Agreement, inclusive of all addenda, if any, executed simultaneously herewith, as the Agreement may be renewed, amended, extended, or otherwise modified (the “Guaranteed Obligations”). Each Guarantor’s obligations are due*at the time of any breach by any Merchant of any representation, warranty, or covenant made by any Merchant in the Agreement.

Common Provision Often Breached – No Other MCAs

27. Stacking. Each Merchant represents, warrants, and covenants that it will not enter into with any party other than [REDACTED] any arrangement, agreement, or commitment that relates to or involves the Receivables, whether in the form of a purchase of, a loan against, collateral against, or the sale or purchase of credits against Receivables without the prior written consent of [REDACTED]



MCAs in Bankruptcy



General Considerations

- Representations made in application versus reality (solvency; other liens)
- Subchapter V eligibility
- Key strategic issues:
 - Treatment of MCAs in chapter 11 plans
 - Liens and/or UCC filings
 - Necessity of an adversary proceeding?
 - Choice of law issues
- Experience: MCA companies do not generally take aggressive stances on cash collateral issues



True Sale or Disguised Loan: Consequences in Bankruptcy

True Sale:

- Account no longer property of the estate
- Excluded from Subchapter V debt eligibility calculation (11 U.S.C. § 1182)
- Cash collateral issues
- Debtor cannot use without consent
- No automatic stay

Disguised Financing:

- MCA as secured/unsecured lender
- Included in Subchapter V debt eligibility calculation (11 U.S.C. § 1182)
- Perfection issues
- Modification of effective interest rate
- Modification of secured claim
- Avoidance actions



Cash Collateral 11 U.S.C. § 541

- Are subsequent accounts receivable property of the bankruptcy estate?
- Are MCAs entitled to adequate protection?
- Are there competing MCAs?
- Are there competing traditional loans secured by accounts receivable?



Avoidance Actions: Preference Claims 11 U.S.C. § 547(b)

- Source of payments: property of the estate?
- Was the Debtor insolvent?
- Defenses:
 - 11 U.S.C. § 547(c)(4) Subsequent new value
 - 11 U.S.C. § 547(c)(2) Ordinary course of business
- Case example: *J.P.R. Mechanical*

J.P.R. Mech. Inc. v. Radium2 Cap., LLC (In re J.P.R. Mech. Inc.), Adv. Pro. 21-07079 (DSJ) and 21-07082 (DSJ), 2025 Bankr. LEXIS 1319, 2025 WL 1550541 (Bankr. S.D.N.Y. May 30, 2025).



Avoidance Actions: Fraudulent Conveyance Claims 11 U.S.C. § 548 & state law

- Lookback period: up to 4 years
 - 11 U.S.C. § 548(a) provides 2 years
- Reasonably equivalent value issues: *Martinez Quality Painting & Drywall*
 - 11 U.S.C. 548(a)(1)(B) constructive fraudulent transfer claim
 - Court found agreements void under N.Y. Gen. Oblig. Law § 5-511 for civil usury
→ no reasonably equivalent value
- Solvency determinations

Martinez Quality Painting & Drywall, Inc. v. Newco Capital Grp. VI, LLC, (In re Martinez Quality Painting & Drywall, Inc.), Adv. Pro. 24-03039, 2025 Bankr. LEXIS 613, 2025 WL 828882 (Bankr. W.D.N.C. Mar. 14, 2025)



Nondischargeability Actions 11 U.S.C. § 523

§ 523(a)(2)(A)

- Nondischargeable because of violations of restrictions on use of funding
Strategic Funding Source, Inc. v. Donghee Choi (In re Donghee Choi), Adv. Pro. 18-50001, 2019 WL 11031716 (Bankr. N.D.N.Y. Dec. 20, 2019).
- Nondischargeable because of fraudulent inducement
Strategic Funding Source, Inc. v. Dockum (In re Dockum), Adv. Pro. 23-01007, 2024 WL 3633220 (Bankr. D. Vt. Aug. 1, 2024).



Nondischargeability Actions 11 U.S.C. § 523 (continued)

- **§ 523(a)(2)(B)** – nondischargeable because of misrepresentation of financial condition
Kapitus Servicing, Inc. v. Keith (In re Keith), Adv. Pro. 22-06003-MMP, 2024 WL 3350885 (Bankr. W.D. Tex. July 9, 2024)
- **§ 523(a)(4)**
 - Nondischargeable because of fiduciary defalcation
T Street LLC v. Jaques (In re Jaques), 615 B.R. 608 (Bankr. D. Idaho 2020).
 - Not nondischargeable; lacked necessary intent for embezzlement
Swift Financial Corp. v. Steele (In re Steele), Adv. Pro. 17-00081-5, 2019 WL 3756368 (Bankr. E.D.N.C. Aug. 8, 2019).



Nuclear Tools

- **§ 506 Default Judgment Strategy** — Answering a secured status challenge forces industry-threatening precedent; MCA funders routinely take the default and accept unsecured treatment
- **Executory Contract Rejection** — Future receivables don't exist at signing; the agreement may be rejectable under the plan, converting the MCA claim to a pre-petition unsecured obligation
- **Preference Exposure (§ 547)** — Once recharacterized as a loan, 90 days of daily ACH payments already collected become recoverable by the estate
- **Constructive Fraudulent Transfer** — The spread between advance received and purchased amount (often 40–60%+) supports a "reasonably equivalent value" attack under § 548
- **No Business = No Collections** — Under § 1191(b), the plan confirms over objection; in liquidation, the MCA collects nothing; the math favors settlement every time



Faculty

Hon. Mildred Cabán is Chief Bankruptcy Judge for the District of Puerto Rico in San Juan, initially sworn in on March 19, 2010, and appointed Chief Judge in 2018. She serves on the U.S. Supreme Court Conference on Judicial Security, the First Circuit Judicial Council as the Bankruptcy Observer and the First Circuit Judicial Council Judicial Security, and the District Examination Committee for the U.S. District Court for the District of Puerto Rico. Judge Cabán is a member of ABI and the American Bar Association, Commercial Law League of America, Hispanic National Bar Association, International Women's Insolvency & Restructuring Confederation, National Conference of Bankruptcy Judges (NCBJ), Phi Alpha Delta Law Fraternity and the Puerto Rico Bankruptcy Bar Association. For NCBJ, she is on the Public Outreach Committee and on the Security Committee, and she previously chaired various NCBJ committees such as the Public Outreach Committee, Diversity, Security, and the Liaison of the Hispanic National Bar Association. She also served as the First Circuit Governor. Judge Cabán was a board member of Federal Judicial Center and a member of Federal Judicial Center Education Committee. She clerked for Hon. Héctor M. Laffitte of the U.S. District Court for the District of Puerto Rico, after which she practiced bankruptcy law at Brown Newsom & Córdova and then as a partner at Goldman Antonetti & Córdova, P.S.C., where she focused on representing creditors in commercial and consumer bankruptcy cases. Judge Cabán has been a speaker for various organizations on bankruptcy and consumer law topics. She also is an advisory board member of CARE (Credit Abuse Resistance Education) and speaks on financial literacy matters to students of all age groups. She received ABI's 2014 CARE Volunteer of the Year Award. Judge Cabán received her B.A. from Barnard College in 1983 and her J.D. from New York University School of Law in 1986.

Joanna M. Kornafel is a partner with Green & Sklarz LLC in New Haven, Conn., where she represents individuals and clients with complex financial and litigation needs in a wide array of industries, including healthcare, construction, horticulture, retail and hospitality. Her practice focuses on commercial bankruptcy, civil litigation matters, unfair trade practices (CUTPA), business torts, breach of contracts, debtor/creditor litigation, workouts, bankruptcy litigation and other commercial litigation matters. Ms. Kornafel has experience handling all aspects of bankruptcies and workouts, representing secured and unsecured creditors, unsecured creditors' committees, debtors, chapter 7 bankruptcy trustees, and acquirers of businesses in chapter 11 bankruptcies. In addition, she has represented clients in state and federal courts and has prosecuted and defended evidentiary hearings related to applications for preliminary injunctions, applications for prejudgment remedy, and contested matters in bankruptcy court. Ms. Kornafel is actively involved in the Connecticut Bar Association (CBA) and has served as the co-chair of the annual Connecticut Bankruptcy Conference. She also served as vice chair of the Connecticut Network of the International Women's Insolvency & Restructuring Confederation (IWIRC), and she was selected as a Fellow of the American Bar Association for Business Law (2019-21). She has been a Fellow of the American Bar Foundation since 2017. In 2020, Ms. Kornafel received the CBA's Vanguard Award, and she was listed as a *Connecticut Super Lawyers* "Rising Star" from 2019-21 and a "Super Lawyer" from 2024 in the area of business bankruptcy. Prior to attending law school, she worked for several years for the global management consulting firm McKinsey & Company. Ms. Kornafel is admitted to practice in Connecticut, Massachusetts, the U.S. District Court for the District of Connecticut, the U.S. Tax Court and the U.S. Supreme Court. She received her B.A. with honors from McGill University in Montréal and her J.D. from Boston College

Law School. While in law school, she was selected for the London Study Abroad Program, where she interned in the General Counsel Division at the Financial Services Authority and attended classes at King's College London. She was also a student attorney in the Civil Litigation Clinic at the Boston College Litigation Assistance Bureau, where she represented clients with a variety of legal problems, including child guardianship issues, landlord/tenant disputes and Social Security disability appeals.

Ryan M. Long is a shareholder with Primmer Piper Eggleston & Cramer PC in Burlington, Vt., where his practice focuses on bankruptcy, restructuring, creditors' rights and commercial litigation. His practice includes representing creditors, lenders, debtors, and other stakeholders in bankruptcy and restructuring matters. Mr. Long has experience in chapter 7, chapter 11 and subchapter V cases, as well as bankruptcy litigation, contested matters, plan-confirmation disputes, stay-relief litigation, dischargeability actions and out-of-court workouts. He has advised creditors and debtors in disputes involving merchant cash advances and has litigated dischargeability and fraud-related claims arising from MCA transactions. Before joining Primmer, Mr. Long practiced at a national law firm in New York City, where he handled complex commercial litigation and business disputes for corporate clients. He brings that litigation background to insolvency matters involving fraud allegations, business torts, and other claims arising in distressed business situations. Mr. Long serves as co-chair of the Vermont Bar Association's Bankruptcy Section, where he works to support the development of new bankruptcy practitioners and strengthen Vermont's bankruptcy bar. He is a former member of ABI's Emerging Leaders Committee, a regular member of the U.S. Bankruptcy Court for the District of Vermont Task Force responsible for revising the Vermont Local Bankruptcy Rules, and a member of the Court Advisory Group for the U.S. District Court for the District of Vermont. He frequently presents on bankruptcy and restructuring topics, including subchapter V practice, bankruptcy litigation, emergency bankruptcy motions and trial preparation in bankruptcy court. Mr. Long received his B.A. in English magna cum laude from Michigan State University and his J.D. from New York University School of Law, where he was a Mortimer Bishop Scholar.

Kenneth R. Yager II, CTP, CRO is the founder and president of Newpoint Advisors Corporation in Brentwood, Tenn., and has more than 35 years of executive leadership and turnaround management experience to distressed and underperforming businesses nationwide. He and his team serve as trusted advocates for small and mid-sized companies facing financial and operational challenges. Mr. Yager founded Newpoint Advisors in 2013 after his own experience with a failed entrepreneurial venture. Since then, he has led more than 300 engagements across diverse industries, helping business owners stabilize operations and preserve value. Throughout his career, Mr. Yager has held direct responsibility for profit and loss and risk-management for cash-constrained companies in growth, leveraged buyout and turnaround situations. He is the innovator behind Newpoint's proprietary Turnaround Action Matrix Evaluation (TAME), a structured, data-driven methodology for diagnosing and addressing business distress. Mr. Yager sits on multiple Turnaround Management Association Global committees, such as The Education Oversight Committee, and he has served on the Nominations Committee. He has been a repeat guest editor for TMA's *Journal of Corporate Renewal*. He also sits on the SFNet Content Committee and serves as Education Director of ABI's Financial Advisors and Investment Banking Committee. In addition, he is a current member of the TMA FL board, as well as programming and membership, and the TMA Southeast Regional Conference. He also is a former member of the TMA Chicago/Midwest Chapter board and membership, awards and programming committees. Mr. Yager's insights have been published in leading industry journals, and he has been quoted by *The Wall Street Journal*, *Forbes* and *Crain's Chicago Business*. He received his B.S. in management and business from Tulane University, and his M.M. in strategy from Northwestern University Kellogg School of Management.