Hi Bar Capital LLC v Parkway Dental Servs., LLC
2022 NY Slip Op 32934(U)
August 25, 2022
Supreme Court, Kings County
Docket Number: Index No. 533245/2021
Judge: Leon Ruchelsman
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF KINGS : CIVIL TERM: COMMERCIAL 8

HI BAR CAPITAL LLC D/B/A KINGDOM KAPITAL,
Plaintiff, Decision and order

- against - Index No. 533245/2021

PARKWAY DENTAL SERVICES, LLC,
and CHRISTOPHER COOLEY,
Defendants, August 25, 2022

PRESENT: HON. LEON RUCHELSMAN

The defendants have moved seeking to reargue a decision and order dated March 25, 2022. The plaintiff opposes the motion. Papers were submitted by the parties and arguments held. After reviewing all the arguments this court now makes the following determination.

As recorded in a prior order, on October 20, 2021 the plaintiff a merchant cash advance funding provider entered into a contract with defendants located in Florida. Pursuant to the agreement the plaintiff purchased $472,500 of defendant's future receivable for $350,000. The parties further agreed that the plaintiff would be able to obtain a daily amount of $4,725 until the amount of $472,500 was fully paid. Moreover, the defendants executed a guaranty and a security agreement. The defendants stopped remittances in December 2021 and still owed $292,950. An action was commenced on December 29, 2021 which the defendants did not answer. The plaintiff then obtained a default judgement, which was entered on February 4, 2022. The court denied the

defendants motion seeking to vacate the default on the grounds there was no service of process and on the grounds the agreement was really a usurious loan. The defendants now move seeking to reargue that determination.

Conclusions of Law

A motion to reargue must be based upon the fact the court overlooked or misapprehended fact or law or for some other reason mistakenly arrived at in its earlier decision (Deutsche Bank National Trust Co., v. Russo, 170 AD3d 952, 96 NYS2d 617 [2d Dept., 2019]).

As recorded in the prior order and recently reiterated in Principis Capital LLC v. I Do, Inc., 201 AD3d 752, 160 NYS3d 325 [2d Dept., 2022] "the court must examine whether the plaintiff is absolutely entitled to repayment under all circumstances. Unless a principal sum advanced is repayable absolutely, the transaction is not a loan. Usually, courts weigh three factors when determining whether repayment is absolute or contingent: (1) whether there is a reconciliation provision in the agreement; (2) whether the agreement has a finite term; and (3) whether there is any recourse should the merchant declare bankruptcy" (id).

Preliminarily, the recent Court of Appeals decision in Adar Bays, LLC v. Genesys ID Inc., 37 NY3d 320, 157 NYS3d 800 [2021] did not fundamentally alter the analysis whether usurious loans

exist in the merchant cash advance context. In that case the plaintiff Adar Bays loaned money to Genesys and had the option of seeking Genesys stock instead of a return of the amount loaned plus interest. The court considered whether "a conversion option that permits a lender to convert outstanding balance to shares of stock at a fixed discount should be treated as interest for purposes of a usury determination" and concluded that "in assessing whether the interest on a given loan has exceeded the statutory usury cap, the value of the floating-price convertible options should be included in the determination of interest" (id). The court explained that usury only applied to loans and that equity purchases and joint ventures are not loans and hence not subject to usury. The court emphasized a number of factors to discern whether a particular transaction is a loan. For example, the court noted that "parties who are not directly exposed to market risk in the value of the underlying assets are likely to be lenders, not investors. Moreover, the court stressed that "context, such as whether a party applied to the other for a loan or had outstanding, separate transactions, helps to distinguish between intent to borrow and intent to engage in a joint transaction or exchange money for some other reason" (id). Those observations, however, did not establish any new criteria when evaluating usury in the merchant cash advance context. Indeed, the court acknowledged that evading usury laws is nothing

new and loans have been disguised as a "sale of choses in action" exempted from the law (id) and that legislative changes were made "in response to the 'vacuum' in the law that failed to deter the usurious exploitation of corporations by criminal syndicates" and "ended the practice by limiting the corporate exception" (id). The court concluded that "if misused, the floating-price convertible option may constitute another form of usury cloaked in novel form" (id). Noticeably absent from the litany of usury-evading activity is the merchant cash advance agreement. The court's omission of this prevalent and pervasive business model and its reliance instead upon centuries old practices addressed in Quackenbos v. Sayer, 62 NY 344, 17 Sickels 344 [1875] and Meaker v. Fiero, 145 NY 165, 100 Sickels 165 [1895] only confirms the status quo when analyzing merchant cash agreements. The omission is all the more curious since Adar Bays (supra) was authored by Judge Wilson who dissented in Plymouth Venture Partners II LP v. GTR Source LLC, 37 NY3d 591, 163 NYS3d 467 [2021] where he raised concerns that merchant cash advance agreements may be considered "high-interest loans that might trigger usury concerns" (id. at Footnote 2). Thus, this court will only examine the three criteria noted, as well as precedent in this regard, to determine whether the agreement was in fact a usurious loan.

The defendants argue that even though the agreement

contained a reconciliation provision such provision is a sham for four reasons. First, the provision does contain a definite term, second, that the daily payment is not a good faith estimate of receivables, third, that the provision in practically impossible to secure and lastly, that the agreement provides for recourse in bankruptcy. These arguments are also included within the proposed answer and counterclaims filed.

First, the agreement itself states that the merchant "is not borrowing money from KDK, therefore there is no interest rate or payment schedule and no time period during which the Purchased Amount must be collected by KDK" (see, Revenue Purchase Agreement, page 1 [NYSCEF Doc. #2] see, also, Pirs Capital LLC v. D & M Fire Truck, Tire & Trailer Repair Inc., 69 Misc3d 457, 129 NYS3d 734 [Supreme Court New York County 2020]). Further, the agreement also states that "merchant going bankrupt or going out of business, or experiencing a slowdown in business, or a delay in collecting its receivables, in and of itself, does not constitute a breach of this Agreement (id). The mere fact the guaranty states that if the plaintiff has to return any amount paid to the plaintiff because a guarantor has declared bankruptcy then the guarantor's obligations include that amount does not mean the plaintiff has recourse in the event of a bankruptcy.

There is only one case that held a merchant agreement was really a loan, based in part, on the fact the daily payment rate

did not represent a good faith estimate of receivables (see, Davis v. Richmond Capital Group LLC, 194 AD3d 516, 150 NYS3d 2 [1st Dept., 2021]). In Davis, the court explained a merchant agreement was really a loan for five distinct reasons. First, the reconciliation provision was discretionary, second, the funder refused to permit reconciliation, third, "the selection of daily payment rates that did not appear to represent a good faith estimate of receivables" (id), fourth, the agreement made rejection of automated debits on two or three occasions an improper event of default, and lastly, the agreement authorized collection on a personal guaranty in the event of bankruptcy. Thus, based upon that decision the defendants argue the reconciliation provision in this case is a sham because there is no good faith basis the daily amount taken each day is a good faith estimate of receivables. In truth, there is no way of knowing whether such daily amount represents a good faith estimate of receivables and for that very reason the merchant may reconcile if the amount taken is too high. To be sure, such estimate must be based upon the merchant's representations of daily revenue. Any changes in revenue can surely trigger the reconciliation as noted. Moreover, it is unlikely the court in Davis sought to create a new basis to challenge the reasonableness of a merchant cash agreement, standing alone, on the grounds the amount taken is not correlative to revenue. As

noted, that was one reason among five, rendering the agreement problematic in totality (see, Haymount Urgent Care P.C., v. GoFund Advance LLC, 2022 WL 2297768 [S.D.N.Y. 2022]). Thus, this contention, in isolation, is really another way of arguing the funder did not permit, or the agreement did not allow, reconciliation. In this case the agreement states that the daily remittence "is a good faith estimate of KDK's share of the future revenue stream" (see, Revenue Purchase Agreement, Page 1) and any reconciliations sought are delineated in Section 1.4. That section states that the "Merchant may give notice to KDK to request a decrease in the Remittance, should they experience a decrease in its Future Receipts" (id). Further, all such requests "must include copies of all of Merchant's bank account statements, credit card processing statements, and accounts receivable report outstanding from the date of this Agreement through and including the date the request is made" (id). Further, "the Remittance shall be modified to more closely reflect the Merchant's actual receipts by multiplying the Merchant's actual receipts by the Purchased Percentage divided by the number of business days in the previous (2) calendar weeks" (id). Thus, the funder has a contractual obligation to reconcile and adjust the daily remittence accordingly. This provision is not discretionary at all. Moreover, the plaintiff's alleged refusal to reconcile does not mean the reconciliation provision

is illusory, rather, those allegations can raise claims for breach of contract (see, OriginClear Inc., v. GTR Source LLC, 2021 WL 5907878 [W.D.N.Y. 2021]). Nor is the reconciliation provision discretionary because the finder has the right to ask for the production of specific documentation. As noted, assuming all conditions precedent are satisfied the funder maintains a contractual obligation to reconcile.

Next, the defendants argue the reconciliation provision is functionally impossible to implement rendering it illusory. The defendants assert that the agreement provides the funder "five days after the end of the calendar month to review reconciliation requests, but only two missed ACH payments will constitute an event of default. Read in conjunction with the default provisions, reconciliation is functionally inaccessible under this contract by its language alone" (see, Memorandum in Support, Page 14 [NYSCEF Doc. #50]). In Reply, the defendants similarly argue that according to the agreement, "a reconciliation may only occur if there has been no breach. The reconciliation process takes at least two business days, and during that period, the merchant cannot place a stop payment on its bank accounts. Thus, if the merchant's receipts are insufficient to make the daily payment while seeking a reconciliation, a default will occur before the right to reconciliation occurs. To be sure, the agreement expressly provides: "NSF Fee Standard: $50.00

(each) up to TWO TIMES ONLY before a default is declared" (see, Memorandum in Reply, Page 6 [NYSCEF Doc. #121). First, the above arguments blame the funder for taking two days to review the reconciliation request where, perhaps, the merchant waited too long seeking the request in the first place. Thus, the merchant cannot make a reconciliation request and expect an immediate response. The inability to provide a response the same day does not mean the reconciliation provision is functionally inoperable. Rather, the merchant, like all merchants, must bear the responsibility for making a timely reconciliation request gauging the trajectory of its daily revenue. The fact the reconciliation cannot be approved immediately and the merchant must still permit daily remittances while the reconciliation request is being reviewed does not render the reconciliation provision illusory at all.

Thus, the specific provisions challenged do not by themselves raise any issues concerning the agreement. However, there are other arguments presented which raise significant defenses whether the agreement in this case is really a high-interest loan. Recently, Federal 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. Thus, in Haymount Urgent Care P.C., v. GoFund

Advance LLC, supra) the court explained that where an agreement contains a clause that a default exists if the bank withdrawing the funds rejects an automated debit without the merchant provided prior notice then such agreement is more akin to a high interest loan. Likewise, in Lateral Recovery LLC v. Queen Funding LLC, 2022 WL 2829913 [S.D.N.Y. 2022] the court noted that failing to notify the funder of an impending rejection or two rejected attempts to withdraw the daily amount really means there is no risk to the funder. Again, in Fleetwood Services LLC v. Ram Capital Funding LLC, 2022 WL 1997207 [S.D.N.Y. 2022], Fleetwood received money from Ram and Richmond Capital. The court explained the "real character" of the reconciliation provisions in that case demonstrated they were loans. The court observed that "the lender 'is absolutely entitled to repayment [by Fleetwood] under all circumstances,'...and it is the borrower—and not the lender—who bears the risk of the account debtor's nonpayment. On the most elementary level, the Agreement places the obligation on Fleetwood and not on any account debtor to repay Richmond and sets that sum not as a percentage of the receipts from account debtors but as an absolute figure of "the specific daily amount" of $1,399 "each business day," regardless of whether any accounts receivable are collectible or not...Thus, Fleetwood, not the account debtors, assumes responsibility 'for ensuring that the specified percentage to be debited ... remains

in the Account'...The Designated Account is to be the 'only one depositing bank account'...And if Fleetwood fails in its obligation to ensure that the 'specified percentage to be debited remains in the account,' then Richmond is entitled to remedies against Fleetwood and not against the account debtors. Among other things, if the Designated Account does not have sufficient funds to cover the withdrawals of the daily amount more than four times, a default is declared...the full uncollected Purchased Amount becoming immediately due and payable, and Richmond has the right to pursue all remedies provided for in the Agreement against Fleetwood and the guarantors" (id). The court further noted that the purported agreement concerning accounts receivable was mere "window dressing" and did not have any of the "characteristics of the sale of receivables in terms of the transfer of risk and rewards. The Fleetwood Agreement provides that Fleetwood "sells, assigns and transfers" not just its accounts receivable but 'all of [its] future accounts, contract rights and other entitlements arising from or relating to the payment of monies from Merchants' customers and/or third party payors ...for the payments due to Merchant as a result of Merchant's sale of goods or services' until the total 'Purchased Amount' is repaid...That language is so broad as to be essentially vacuous. It captures not just future accounts from Fleetwood's customers but gives Richmond the right to all

Fleetwood revenues up to the full uncollected Purchased Amount. It covers all contract rights and other entitlements as long as those entitlements relate to the payment of monies from any third-party payors related to the sale of goods or services. Tellingly, Defendants do not identify any revenue that Fleetwood, or any operating business, could receive that would not somehow be captured by this broad language, and it is difficult to imagine what revenue would not fall within it" (id).

The agreement in this case states that an event of default will exist if "the Merchant fails to give KDK 24 hours advance notice that there will be insufficient funds in the account such that the ACH of the Remittance amount will not be honored by Merchant's bank" (see, Revenue Purchase Agreement, ¶ 3.1(d)). Further, the security agreement provides the funder with a security interest in "all of Merchant's assets of any kind whatsoever, and such assets shall then become Secured Assets. These security interests and liens will secure all of KDK's entitlements under this Agreement and any other agreements now existing or later entered into between Merchant, KDK or an affiliate of KDK is authorized to file any and all notices or filings it deems necessary or appropriate to enforce its entitlements hereunder" (see, Security Agreement and Guaranty of Performance, Page 1). Lastly, the agreement only permits the merchant two instances of insufficient funds before declaring a

full default (see, Appendix A-The Fee Structure, C). While that eventuality is not listed as a default among the Events of Default found in Section 3 of the Agreement, it is nevertheless found in the appendix and there is no reason to believe such provision would not enforced by the funder. "Thus, under the Agreement, there are virtually no circumstances where, if the accounts receivable would not be sufficient to pay the Purchased Amounts, Richmond would not be absolutely entitled to repayment of that amount by Fleetwood" (Fleetwood, supra).

In this case, there are surely questions raised whether the agreement comports with the requirements necessary to be considered a genuine cash advance agreement.

Lastly, Section 4.3 of the Agreement states that "all notices, requests, consents, demands and other communications hereunder shall be delivered by certified mail, return receipt requested, to the respective parties to this Agreement at the addresses set forth in this Agreement...Notices to Merchant shall become effective three days after mailing" (id). Section 4.5 states that "Merchant and Guarantor(s) hereby agree that the mailing of any Summons and Complaint in any proceeding commenced by KDK by certified or registered mail, return receipt requested to the Mailing Address listed on this Agreement, or via email to the Email Address listed on this Agreement, or any other process required by any such court will constitute valid and lawful

service of process against them without the necessity for service by any other means provided by statute or rule of court" (id).

The defendants argue that although the judgement was filed thirty days after three days of the mailing of the summons and complaint it was filed before the defendants actually received the summons and complaint rendering the judgement invalid. Therefore, there are surely questions raised whether the defendants were timely served with the summons and complaint.

Consequently, focusing upon the guidance of the above noted decisions, the motion seeking reargument is granted and upon reargument the motion seeking to vacate the default is granted.

So ordered.

ENTER:

DATED: August 25, 2022
Brooklyn N.Y.

Hon. Leon Ruchelsman
JSC