CARTER/LEDYARD

our resources

# Second Circuit Brings Federal RICO Caselaw in Line with New York State Merchant Cash Advance Decisions

**June 09, 2023**

On June 8, 2023, the United States Second Circuit Court of Appeals issued a summary order in *Fleetwood Services LLC v. Richmond Capital Group LLC*, 22-1885-cv, whichaffirmed a district court judgment in favor of a merchant cash advance (MCA) customer (merchant) against its funder. The order upheld the lower court's determination that the MCA agreement at issue was actually a usurious loan agreement and its award of damages on the merchant's civil Racketeer Influenced Corrupt Organizations Act (RICO) claim.

The order, the first from a federal appeals court in the MCA space, seems to bring clarity where lower federal courts have been in disarray as to the standards to be applied in the numerous RICO cases winding through the federal court system.

The Second Circuit, quoting the New York state court decision in *Principis Cap., LLC v. I Do, Inc.*, 160 N.Y.S.3d 325, 326-327 (2d Dept. 2022), has expressly adopted the three-part test repeatedly applied by New York state courts in assessing whether an MCA agreement constitutes a purchase of receivables, not subject to state usury regulations, or a regulated loan:

New York courts usually weigh three factors in making that determination: "(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."

The court found, based on the particular form of MCA agreement at issue, that the agreement did not satisfy the first and third factors. Specifically, the agreement provided that any adjustment to the daily amount was subject to the funder's "sole discretion," not a matter of right for the merchant whose receivables may have diminished, and the form of agreement expressly provided recourse against personal guarantors of the merchant in the event that the merchant declared bankruptcy.

Although the Second Circuit ruled on the merits against the funder, it brings clarity in a case—and in federal courts generally—where the district court decision created uncertainty. As noted in my March 10, 2023 New York Law Journal article, the underlying district court decision, *Fleetwood Services v. Ram Capital Funding LLC*, 2022 U.S. Dist. LEXIS 100837 (S.D.N.Y. June 6, 2022), began forging a new federal MCA doctrine in which the three *Principis* factors "provide only a guide to analysis," but neither dictate the conclusion nor need to all be present for an MCA transaction to be judicially recharacterized as a loan.

The district court found that a number of provisions of the agreement form in question, seemingly innocuous and even standard in some legacy MCA agreements, should be read holistically with the rest of the contract to support the finding that the transaction was a loan. In the district court's subjective assessment, there was insufficient transfer of risk to the funder where, for example, the contractual mechanism for collecting receivables was to debit funds directly from the merchant rather than from the merchant's customers. (As noted in my prior article, even the district court judge in a subsequent decision backed away from some of these positions in validating at least one form of MCA agreement as being a purchase of receivables rather than a loan. *See Lateral Recovery LLC v. Capital Merchant Services, LLC*, 2022 U.S. Dist. LEXIS 181044 (S.D.N.Y. Sep. 30, 2022)).

The Second Circuit's *Fleetwood* order affirmed the district court's judgment, but did so on other grounds than the legal reasons set forth in the lower court decision. Instead, it applied *just* the three-factor *Principis* test, without upholding the district court's extraneous and confusing rulings. By doing so, the Second Circuit brings federal cases in line with their New York state counterparts, and may bring more certainty in how federal district courts will review MCA agreements when faced with RICO challenges in the future.

The *Fleetwood* appellate order is a timely reminder to funders to have their forms reviewed by knowledgeable MCA counsel, and bring them in line with the substantial legal developments in MCA caselaw (and other regulatory changes) of the past few years. If an agreement contains provisions that do not meet the basic requirements of the *Principis* test, it will be found by both federal and state courts to be a usurious loan, and may result in hefty damages awards against funders who were not vigilant in their compliance.

* * *



## related professionals

Jacob H. Nemon / Partner
D 212-238-8728
nemon@clm.com