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## COURT HOLDS PURCHASE OF RECEIPTS IS A USURIOUS LOAN UNDER NEW YORK LAW

A court recently held that a purchase of receipts was a loan that provided for a usurious rate of interest under New York law. *Pearl Capital Ravis Ventures, LLC v. RDN Construction, Inc.*, No. 70590/15, 2016 WL 6245103 (N.Y. Sup. Ct. Oct. 25, 2016). Pearl Capital Ravis Ventures, LLC (Pearl) had purchased a specified amount of future receipts from RDN Construction, Inc. (RDN) at a discount pursuant to a Merchant Agreement between the parties. The Merchant Agreement authorized Pearl to debit RDN's bank account each day for either a fixed amount or a percentage of RDN's deposits until the entire amount of purchased receipts were collected. RDN's owner personally guaranteed RDN's performance under the Merchant Agreement. When Pearl's debit requests to RDN's bank account began to bounce, Pearl charged RDN bounced debit fees and a default fee in accordance with the Merchant Agreement. Pearl subsequently sued RDN for unjust enrichment and breach of contract and the individual guarantor on the guarantee. The trial court granted Pearl a default judgment as to the issue of liability when the defendants failed to appear.

During an inquest hearing to determine the amount of Pearl's damages, Pearl's Chief Risk Officer testified that Pearl loaned RDN a specified amount of money with an agreed-upon total payback amount, but that RDN repaid only part of the amount loaned. Because of this testimony and the court's concern that Pearl might be seeking a criminally usurious award, the court questioned the Chief Risk Officer about the daily interest rate on the transaction. When the Chief Risk Officer was unable to provide such a rate, the court performed its own calculations and determined that the transaction provided for an interest rate of approximately 180% per year.

The court held that the interest rate of 180% per year violated New York's 25% criminal usury cap. The court stated that in order for their to be criminal usury under New York law, there must be proof that the lender knowingly charged, took or received annual interest exceeding 25% on a loan or forbearance. The court explained that under New York common law, there can be no loan unless the principal sum is absolutely repayable and a guaranty can be evidence that the transaction is a loan and not a purchase and

sale. The court found that the transaction under consideration was absolutely repayable and thus a loan because the Merchant Agreement between the parties did not contain a non-recourse provision in which Pearl assumed the risk that it might not be able to collect payments from RDN's receivables. The court also found it particularly problematic that the Merchant Agreement was illegible and set forth in excessively small print. The Chief Risk Officer testified that Pearl was able to escape an element of risk by deeming the borrower's failure to pay to be willful or otherwise unjustified, thus entitling Pearl to seek payment in full under the personal guarantee. For these reasons, the court concluded that the real purpose of the Merchant Agreement was for Pearl to lend money to RDN at a usurious interest rate and ordered that Pearl was not entitled to recover any principal, interest, fees or costs arising out of the transaction.

The *Pearl Capital* court did not hold that purchases of receipts are always subject to New York's usury limitations, which is consistent with other recent cases from New York. See our ALERT dated Sept. 19, 2016 for discussions of the *Merchant Cash & Capital* and *Platinum Rapid Funding Group* cases. However, the *Pearl Capital* case is an important reminder of the recharacterization risks that are present if a purchase agreement (i) does not clearly document the risks to the purchaser in terms of the merchant going out of business or bankrupt without otherwise violating the agreement or (ii) otherwise attempts to insulate the purchaser from such risk through overbroad personal guarantees. Moreover, the *Pearl Capital* case illustrates the problems that may arise if a purchaser's representatives inadvertently make statements during servicing or collections that give a merchant or a court the impression that the transaction is an absolutely repayable "loan." □

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