IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF FLORIDA

REVENUE BASED FINANCE COALITION, *Plaintiff*, v. CONSUMER FINANCIAL PROTECTION BUREAU; and ROHIT CHOPRA, in his official capacity as Director of the Consumer Financial Protection Bureau, *Defendants*.	Civil Action No. 1:23-cv-24882-DSL

BRIEF OF RESPONSIBLE BUSINESS LENDING COALITION, COMMUNITY REINVESTMENT ALLIANCE OF FLORIDA, AND CENTER FOR RESPONSIBLE LENDING AS *AMICI CURIAE* IN SUPPORT OF DEFENDANTS' CROSS-MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

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The Responsible Business Lending Coalition ("RBLC") is a network of nonprofit and for-profit lenders, Community Development Financial Institutions, investors, and small business advocates who share a commitment to innovation in small business lending as well as concerns about the rise of irresponsible small business lending practices. RBLC is an unincorporated entity that does not issue stock. The mission of RBLC is to drive responsible practices in the small business lending sector. Members of RBLC include Accion Opportunity Fund, Bluevine, Camino Financial, Community Investment Management, National Community Reinvestment Coalition, National Association for Latino Community Asset Builders, Opportunity Finance Network, Small Business Majority, and the Aspen Institute. RBLC's members include "covered financial institutions" as defined by the Small Business Lending Rule, meaning financial institutions that originated at least 100 covered credit transactions for small businesses in each of the two preceding calendar years.

The Community Reinvestment Alliance of Florida ("CRAF") is a coalition of organizations and businesses in the state fighting for increased access to credit in underserved communities. CRAF advocates for policies that require banks to reinvest in low-income neighborhoods and support low-income families. CRAF also advocates for transparent, responsible lending practices to individuals and businesses. CRAF's membership includes small businesses, some of which have used merchant cash advance products.

The Center for Responsible Lending ("CRL") is a non-partisan, nonprofit research and policy advocacy organization working to promote financial fairness and economic opportunity for

[1] No counsel for a party authored this brief in whole or in part, and no entity or person other than *Amici*, their members, and their counsel made a monetary contribution intended to fund the preparation or submission of this brief.

all, end predatory lending, and close the racial wealth gap. CRL has extensive experience in consumer protection legal issues, including supporting strong state and federal consumer protections. CRL has researched and published on the topic of fintech cash advances.

INTRODUCTION

On March 30, 2023, the Consumer Financial Protection Bureau issued a final rule amending Regulation B, 12 C.F.R. § 1002, to implement Section 1071 of the Dodd-Frank Act. *See Small Business Lending Under the Equal Credit Opportunity Act (Regulation B)*, 88 Fed. Reg. 35,150 (May 31, 2023) (codified at 12 C.F.R. pt. 1002) ("Small Business Lending Rule"). Section 1071, which amends the Equal Credit Opportunity Act ("ECOA"), 15 U.S.C. §§ 1691–1691f, directs the CFPB to require covered financial institutions to collect and report information related to applications for credit for "women-owned, minority-owned, or small businesses." *Id.* §§ 1691c-2(b), (e)–(g). Collecting and reporting information should "facilitate enforcement of fair lending laws and enable communities, governmental entities, and creditors to identify business and community development needs and opportunities of women-owned, minority-owned, and small businesses." *Id.* § 1691c-2(a). Responding to this direction, the Small Business Lending Rule requires covered financial institutions to collect and report the required information related to applications for a variety of business financing products, including merchant cash advance ("MCA") products. Plaintiff seeks to carve out MCA products from the scope of the Rule.

Amici explain herein why the collection and reporting of information related to applications for MCAs is essential to the statutory purpose, namely identifying gaps in funding options for small, women-owned, and minority-owned businesses and informing whether enforcement action under ECOA may be appropriate. While MCAs can provide essential lifelines, and products like these can potentially be offered responsibly, they are commonly risky financing options for small businesses; they may have obfuscated terms, impossibly steep repayment rates, and draconian

penalties. As more and more small businesses—including those owned by people of color, which is a central topic of the rule in question—turn to MCAs for financing needs, data about who applies for and receives this type of funding is increasingly important to track. Retaining the Small Business Lending Rule's coverage of MCAs is necessary to fulfill Congress's vision of creating a "*comprehensive* database regarding lending to small businesses." Small Business Lending Rule, 88 Fed. Reg. at 35150 (emphasis added). *Amici* urge this Court to uphold the Small Business Lending Rule and the CFPB's authority to issue it.

ARGUMENT

I. SMALL BUSINESSES ARE INCREASINGLY TURNING TO MERCHANT CASH ADVANCES TO MEET URGENT FINANCING NEEDS.

A merchant cash advance is a form of financing transaction whereby a lender purports to purchase future receivables of a business.[2] The lender provides a lump sum to a merchant today in exchange for a larger repayment in the future, paid in installments designated as a percentage of the business's receivables, or sales. "For example, $50,000 in capital is provided in exchange for $65,000 in future receipts, repaid with automatic draws of 10 percent of daily credit card sales."[3]

[2] Kara J. Bruce, *The Murky Process of Characterizing Merchant Cash Advance Agreements*, Bankr. L. Letter (Thomson Reuters), Apr. 2022, at 3, https://works.bepress.com/kara-bruce/15/download/ ("[A] Merchant Cash Advance transaction is structured as the sale of a percentage of future receivables."); Scott J. Bogucki, *MCA Transactions: True Sale or Disguised Loan?*, 41 Am. Bankr. Inst. J. 26, 26 (Dec. 2022) ("MCA companies structure their transactions as 'purchases' of future receivables as a way to protect their interests in the event that the business seeks bankruptcy protection."); *see also, e.g.*, Westwood Funding Purchase Agreement at 1, *In re Heart Heating & Cooling LLC*, No. 23-bk-13019 (Bankr. D. Col. Jan. 8, 2024), ECF No. 227-3 [hereinafter Westwood MCA]; FundKite Revenue Purchase Agreement at 5-6, *AKF, Inc. v. W. Foot & Ankle Ctr.*, 632 F. Supp. 3d 66 (E.D.N.Y. Mar. 31, 2021), ECF No. 46-5 [hereinafter FundKite MCA].

[3] Barbara J. Lipman & Ann Marie Wiersch, Bd. of Governors of the Fed. Rsrv. Sys., *Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites*, at 3 (Dec. 2019), https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf [hereinafter Lipman & Weirsch, *Uncertain Terms Study*].

MCA transactions typically include both a floor and a cap on repayment amounts, either in dollar amounts or percentages of receivables.[4]

In practice, MCAs are often not repaid by determining the agreed upon percentage of receivables each day. The MCA lender often withdraws a fixed amount of money from the business's bank account each day or weekday until the agreed upon repayment amount is fully collected.[5] Even if the payments are variable, however, they can still be projected, and in fact must be in order for the MCA lender to determine the financing terms it will set or establish the rate of return it expects to earn. Using either this fixed payment amount or a projection of the business's sales, the date that repayment will be complete can easily be calculated.[6]

An MCA can seem like a lifeline to a business struggling to meet operating costs.[7] MCAs provide an option for a very quick cash infusion to a struggling small business; funds can often be

[4] Matt Levine, *Cash Advance Looks a Lot Like a Loan*, Bloomberg (Mar. 11, 2024, 1:44 PM), https://www.bloomberg.com/opinion/articles/2024-03-11/cash-advance-looks-a-lot-like-a-loan.

[5] *See* Bruce, *supra* note 2, at 3 ("Daily payments are a hallmark of these transactions."); Angus Loten, *The Lure of Cash Advances*, Wall Street Journal (Aug. 18, 2011), https://www.wsj.com/articles/SB10001424053111903596904576514500766040470 ("A company's remittances are drawn from customers' debit-and credit-card purchases on a daily basis until the advance is repaid. Most providers form partnerships with card-payment processors and take payments directly from a business owner's card-swipe terminal."); *see also, e.g.*, Levine, *supra* note 4 (noting that cash advance lender Yellowstone "generally required daily payments"); Westwood MCA, *supra* note 2, at 1 (requiring $2,618.19 daily deduction from business's bank account); *AKF, Inc. v. W. Foot & Ankle Ctr.*, 632 F. Supp. 3d 66, 71 (E.D.N.Y. 2022) ("In lieu of calculating and timely transferring 14% of its Receipts on a daily basis, Western-1 chose to deposit a daily, pre-set sum of $888.06 to a Union Bank account that AKF agreed to debit (in its entirety) on 'each business day Monday to Friday.'" (internal citation omitted)).

[6] *See, e.g.*, *AFK, Inc.*, 632 F. Supp. 3d at 78 ("[W]hile the [FundKite MCA] states no explicit or definite term, the Court discerns it from the [MCA's] payment structure. Barring any reconciliation, the [MCA] mandated that Defendants deposit $888.06, Monday through Friday, until they paid [FundKite] $130,545.00. . . . The term of the [MCA] was, therefore, roughly 205 days.").

[7] Loten, *supra* note 5 ("Facing weak sales and tight credit, some store and restaurant owners are turning to high-cost merchant cash advances for working capital . . . .").

obtained within "days or even hours" of applying.[8] A cash advance can be obtained so quickly because the approval process is speedy in turn. MCA lenders typically do not require physical collateral or good credit histories.[9] Industry experts believe that MCAs have gained popularity in part because of their fast and easy online application process and their higher approval rates relative to more traditional forms of financing.[10]

Small businesses have therefore increasingly turned to MCAs as a credit option. The MCA industry has exploded over the past twenty years. In 2011, there were more than 40 companies issuing MCAs, up from "just a handful of providers" a decade prior.[11] By 2019, there were about 100 companies issuing MCAs.[12] The total dollar amount of MCAs issued has also skyrocketed. MCA lenders provided $8.6 billion of funding in 2014 and an estimated $19 billion of funding in 2019.[13] As an indicator of MCAs' entrenchment in the small business credit system, the Federal Reserve's annual "Small Business Credit Survey" describes the market as "Loans, Lines of Credit,

[8] Lipman & Weirsch, *Uncertain Terms Study*, *supra* note 3, at 1.

[9] Becky Yerak, *An Easy Financing Source Pushes Some Small Business Into Bankruptcy*, Wall Street Journal (Feb. 19, 2024), https://www.wsj.com/articles/an-easy-financing-source-pushes-some-small-businesses-into-bankruptcy-c2b2ad1b.

[10] Yerak, *supra* note 9; *see also* Jessica Battisto et al., Fed. Rsrv. Banks of Atlanta et al., *Small Business Credit Survey: 2019 Report on Employer Firms* 18 (2019), https://www.fedsmallbusiness.org/-/media/project/smallbizcredittenant/fedsmallbusinesssite/fedsmallbusiness/files/2019/sbcs-employer-firms-report.pdf (finding that the approval rate for merchant cash advances was 85%, higher than any other form of financing).

[11] Loten, *supra* note 5.

[12] Yerak, *supra* note 9.

[13] Paul Sweeney, *Gold Rush: Merchant Cash Advances Are Still Hot*, DeBanked (Aug. 18, 2019), https://debanked.com/2019/08/gold-rush-merchant-cash-advances-are-still-hot/.

and Cash Advances."[14]

When small businesses need financing, they generally consider MCAs alongside loans and other forms of credit. Although Plaintiff spills much ink attempting to technically distinguish MCAs from loans and "debt," Pl.'s Mot. Summ. J. 12–17, such distinctions are usually irrelevant to small business owners in need of credit, who are just looking for the best financing option available to them.[15] Federal Reserve researchers studying the small business credit market observed that, "in contrast to industry analysts and researchers, potential borrowers do not appear to distinguish between cash advances and loans, nor do they appear to make distinctions among the various types of online lenders providing them."[16] The Federal Reserve researchers describe MCAs specifically as "potentially higher-cost and less-transparent credit products."[17]

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[14] Cornelius Johnson et al., Fed. Rsrv. Banks of Atlanta et al., *2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey* (Mar. 2024), https://www.fedsmallbusiness.org/-/media/project/clevelandfedtenant/fsbsite/reports/2024/2024-report-on-employer-firms.pdf. The term "Cash Advances" appears 48 times in the most recent Small Business Credit Survey report.

[15] *Amici* agree with the CFPB that merchant cash advances constitute a form of "credit" under ECOA because they grant merchants the right to defer payment and involve "debts" owed by the merchant to the lender. *See* Defs.' Cross-Mot. Summ. J. 10–17. That some courts have concluded that specific merchant cash advances did not constitute "loans" under unrelated state law is irrelevant to the question whether merchant cash advances constitute "credit" under ECOA. *See id.* at 18–20; *see also In re Hill*, 589 B.R. 614, 622 (Bankr. N.D. Ill. 2018) ("The fact that the [merchant cash agreement] transactions in this matter do not constitute loans, however, does not mean that Network Salon did not owe a debt to LG Funding."). In any case, as the CFPB points out, several courts have concluded that specific merchant cash advances *are* loans under state law. Defs.' Cross-Mot. Summ. J. 19–20; *see also In re Shoot The Moon, LLC*, 635 B.R. 797, 814 (Bankr. D. Mont. 2021) (concluding merchant cash advance agreements were loans).

[16] Barbara J. Lipman & Ann Marie Wiersch, Fed. Rsrv. Bank of Cleveland, *Alternative Lending Through the Eyes of "Mom & Pop" Small Business Owners: Findings from Online Focus Groups* 19 (Aug. 25, 2015), https://www.clevelandfed.org/publications/cd-reports/2015/sr-20150825-alternative-lending-through-the-eyes-of-mom-and-pop-small-business-owners [hereinafter Lipman & Weirsch, *Mom & Pop Study*].

[17] Mels de Zeeuw, Fed. Rsrv. Bank of Atlanta, *Small Business Credit Survey: 2019 Report on Minority-Owned Firms*, at IV (2019), https://www.fedsmallbusiness.org/-/media/project/smallbizcredittenant/fedsmallbusinesssite/fedsmallbusiness/files/2019/20191211-ced-minority-owned-firms-report.pdf?sc_lang=en.

Indeed, MCA lenders contribute to the conflation of merchant cash advances and other forms of credit products. MCA lenders themselves often use loan or lender terminology when describing MCAs. Llama Loan (a member of Plaintiff), for example, repeatedly referred to the provider of an MCA as a "lender" on its website.[18] Redline Capital—another member of Plaintiff—similarly refers to MCA providers as "lenders."[19] Indeed, due to MCA agreements commonly placing the real risk of the transaction on the merchant, *see* Part II below, courts often acknowledge that many of them function as loans.[20] The United States District Court for the Eastern District of New York recently concluded that an MCA agreement issued by FundKite—another member of plaintiff—is in fact a usurious loan.[21] It is no small wonder that any distinction between loans and MCAs "may be unclear" to small businesses in urgent need of funding.[22]

The CFPB therefore correctly determined not to exclude MCA transactions from the Small Business Lending Rule. Indeed, excluding MCAs from the Small Business Lending Rule would result in a glaring gap in the data set on small business lending that Congress intended for the

[18] *See* Llama Loan, *Merchant Cash Advance: Revenue Based Financing* (Sept. 25, 2023), https://web.archive.org/web/20230925151738/https://www.llamaloan.com/small-business-loans/merchant-cash-advance. Llama Loan has since replaced the word "lender" with "provider." *Compare id.* ("The *lender* will then set up automatic withdrawals via your business's credit card processor. . . . (emphasis added)), *with* Llama Loan, *Merchant Cash Advance: Revenue Based Financing*, https://www.llamaloan.com/small-business-loans/merchant-cash-advance (last visited Apr. 24, 2024) ("The *provider* will then set up automatic withdrawals via your business's bank account processor. . . ." (emphasis added)). *See also* Revenue Based Fin. Coal., *Members*, https://rbfc.net/members/ (last visited Apr. 24, 2024) (listing Llama Loan as a member of the coalition).

[19] Redline Capital, *Revenue-Based Financing*, https://redlinecapitalinc.com/revenue-based-financing/ (last visited Apr. 24, 2024); *see also* Revenue Based Fin. Coal., *Members*, *supra* note 18 (listing Redline Capital as a member of the coalition).

[20] *See supra* note 15.

[21] *AKF, Inc.*, 632 F. Supp. 3d at 79.

[22] Lipman & Weirsch, *Mom & Pop Study*, *supra* note 16, at 4.

CFPB to compile.[23] The database would have no information with respect to a significant and increasing source of financing for small businesses—data which would be useful for identifying gaps in credit access not only to the CFPB but also to the small business credit industry as a whole.[24]

II. MERCHANT CASH ADVANCES MERIT PARTICULAR ATTENTION UNDER SECTION 1071 BECAUSE OF THEIR RISKS TO SMALL BUSINESSES.

If an MCA may seem too good to be true to a small business owner, that is because it may be. An immediate bundle of cash, understandably, comes at a cost. But problems arise when businesses do not understand the true extent of the cost or the ways in which the agreement leaves them unprotected.

The discrepancy between the appearance and reality of MCA agreements has proven problematic for businesses that enter into them. The Board of Governors of the Federal Reserve has noted "a growing trend among small business owners getting into trouble with expensive online small business loans, such as merchant cash advances . . . . Oftentimes, the pricing and structure of these loans is deliberately obscured, and small business owners take on debt burdens and fees that they are not able to sustain."[25] The Federal Trade Commission has observed that "businesses desperate for funding often seek out MCAs in the short term because they are quick

[23] *See* Small Business Lending Rule, 88 Fed. Reg. at 35,150; *see also* Johnson et al., *2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey*, *supra* note 14, at 10 (finding that 8% of small businesses large enough to have employees had applied for an MCA within the previous 12 months).

[24] *See* Darryl E. Getter et al., CRS Report R7788, *Section 1071: Small Business Lending Data Collection and Reporting*, Cong. Rsch. Serv., at 23 (Oct. 18, 2023), https://crsreports.congress.gov/product/pdf/R/R47788/2 ("Without reliable data, the ability to evaluate the performance of various small business lending markets—specifically whether (1) a small business credit shortage exists, (2) pricing for loans to small businesses is significantly above the lending risks and funding costs, or (3) fair lending risks are present—is extremely challenging.").

[25] Cmty. Advisory Council & Bd. of Governors, *Record of Meeting*, Fed. Rsrv., at 7 (Oct. 5, 2018), https://www.federalreserve.gov/aboutthefed/files/cac-20181005.pdf.

and easy to obtain, but then suffer negative long-term consequences," including obtaining additional MCAs just to repay existing ones in a process known as stacking.[26] "[F]ar from being the infusion of cash to right a sinking ship, these high-cost financing transactions often exacerbate an already perilous financial position."[27]

The reasons that MCAs can be a risky prospect for a struggling business are manifold. First, MCAs are expensive. "When annualized, the rate of return [of merchant cash advances] . . . is often extremely high and would ordinarily exceed the applicable usury ceiling."[28] A study by the Federal Reserve Board of Governors found that equivalent annual percentage rates "may exceed 80 percent or even rise to triple digits."[29] MCA agreements issued by members of the Plaintiff coalition provide examples of sky-high effective annual percentage rates. In one agreement, Westwood Funding issued an MCA of $190,000.[30] The "Total Dollar Cost of Financing" was $288,000, to be paid through deductions of $2,618.19 each business day.[31] Assuming five business days per week, the business would repay this advance over approximately 154 days. The effective annual percentage rate for this merchant cash advance is approximately

[26] FTC Bureau of Consumer Prot., *"Strictly Business" Forum: Staff Perspective*, at 6 (Feb. 2020), https://www.ftc.gov/system/files/documents/reports/staff-perspective-paper-ftcs-strictly-business-forum/strictly_business_forum_staff_perspective.pdf.

[27] Bruce, *supra* note 2, at 2.

[28] Jason M. Medley, *Legal Eagle Spotlight – Banks: Beware the Merchant Cash Advance*, The Show-Me Banker (Dec. 12, 2023), https://the-show-me-banker.thenewslinkgroup.org/legal-eagle-spotlight-banks-beware-the-merchant-cash-advance/; *see also* Lipman & Weirsch, *Mom & Pop Study*, *supra* note 16, at 4 ("In practice, [merchant cash advances] . . . often carry effective interest rates that exceed those of traditional bank products.").

[29] Lipman & Weirsch, *Uncertain Terms Study*, *supra* note 3, at 3.

[30] Westwood MCA, *supra* note 2, at 1 (noting $190,000 was the "net deposit total" for purported $200,000 advance "after fees are assessed"); *see also* Revenue Based Fin. Coal., *Members*, *supra* note 18 (listing Westwood Funding as a member).

[31] Westwood MCA, *supra* note 2, at 1.

212 percent.[32] Likewise, a FundKite agreement indicates that it issued an MCA of $93,614.[33] The "Purchased Amount" was $130,545, to be paid through deductions of $888.06 each business day.[34] Assuming five business days per week, the business would repay this advance over approximately 206 days. The effective annual percentage rate is approximately 125 percent.[35]

The relatively rapid repayment periods—generally, between 3 and 18 months[36]—can obscure the excessive costs of MCAs. Unlike a loan from a bank with transparent terms, the effective rate of return for repayment of an MCA is not readily identifiable to a small business owner, unless they are located in states where disclosure of the estimated APR for these products is required by law. Indeed, small business owner participants in a focus group who were asked to calculate an interest rate of a hypothetical MCA transaction could not do so with consistent accuracy, "respond[ing] with a wide range of estimates, from 10 percent to over 50 percent."[37]

The effective annual percentage rate is not the only thing that merchants find unclear about MCA agreement terms. Despite MCAs' purported structure as a purchase of future receivables—which Plaintiff argues is a reason their products are not credit, *see* Pl.'s Mot. Summ. J. 12–13, 25—MCA agreements may also be "supported by security interests in a large pool of the merchant's collateral—not just the assigned receivables."[38] For example, the Plaintiff member

[32] Effective APR calculated using *Merchant Cash Advance APR Calculator: Find the True Cost of an MCA*, Nerdwallet, https://www.nerdwallet.com/article/small-business/merchant-cash-advance-mca-calculator (last updated Feb. 28, 2024).

[33] FundKite MCA, *supra* note 2, at 4 (noting $93,614 was the "Disbursement Amount" after deducting "Underwriting and Initial Fees"); *see also* Revenue Based Fin. Coal., *Members*, *supra* note 18 (listing FundKite as a member).

[34] FundKite MCA, *supra* note 2, at 4.

[35] Effective APR calculated using *Merchant Cash Advance APR Calculator*, *supra* note 32.

[36] Lipman & Weirsch, *Uncertain Terms Study*, *supra* note 3, at 3.

[37] *Id.* at 19.

[38] Bruce, *supra* note 2, at 3.

FundKite MCA agreement discussed above states that it "shall be deemed an assignment of Merchant's lease of Merchant's business premises to [Fundkite]."[39]

Whether a merchant will be liable for the full repayment amount—even where they do not have adequate funds to cover it—may also be ambiguous. Plaintiff claims that businesses who receive MCAs have no obligation to repay them, and that the risk of the transaction is on the MCA provider. Pl.'s Mot. Summ. J. 13. Although MCA agreements may provide on their face that the lender bears the risk, sometimes "[i]n reality, the purported 'risk of nonpayment' does not exist."[40] Many MCA agreements, for example, provide that in the event of a default, the full remaining repayment amount is immediately due.[41]

Many MCA agreements purport to permit the business to request a lower daily repayment amount through a process known as reconciliation. Yet the agreements frequently impose parameters that make reconciliation practically unobtainable. For example, MCA lender Yellowstone Capital structured its agreements to permit reconciliation only where the merchant "experienced a drop in revenue so precipitous that Yellowstone's total collections actually amounted to half of [its] revenue during the term of the" agreement, making it "virtually impossible for merchants to qualify" for reconciliation.[42] Reconciliation might also be permitted only where no default has occurred. For these reasons, some courts have found reconciliation provisions to be illusory, or "remote and highly improbable."[43]

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[39] FundKite MCA, *supra* note 2, at 10.

[40] *In re GMI Grp., Inc.*, 606 B.R. 467, 486 (Bankr. N.D. Ga. 2019).

[41] *See, e.g.*, Westwood MCA, *supra* note 2, at 4; FundKite MCA, *supra* note 2, at 10.

[42] Levine, *supra* note 4.

[43] *AKF, Inc.*, 632 F. Supp. 3d at 77 (referring to FundKite MCA); *see also Lateral Recovery LLC v. Funderz.net, LLC*, No. 22-CV-02170, 2024 WL 216533, at *10 (S.D.N.Y. Jan. 19, 2024) (business plausibly pleaded reconciliation provisions in merchant cash advance agreements were "illusory").

To ensure they can collect the full repayment amount, many MCA lenders require businesses to sign a document at the time of the transaction—separate from the MCA agreement—called a "confession of judgment."[44] By signing a confession of judgment, the business owner agrees—in advance of any default—that the business has defaulted on the MCA agreement and the business is therefore liable for the full remaining repayment amount, plus interest and attorney's fees.[45] MCA lenders who use confessions of judgment typically require the business owner to preemptively confess liability both personally and on behalf of the business.[46]

The confession of judgment enables an MCA lender to obtain a default judgment against a business in state courts that permit their use, without any advance notice to the business.[47] Because New York law permits the use of confessions of judgment, many MCA agreements provide for the application of New York law, even where the business is located in a different state and does not do business in New York. Lenders typically file for default judgment in counties outside of

[44] *See* Zachary R. Mider & Zeke Faux, *Sign Here to Lose Everything Part 1: "I Hereby Confess to Judgement"*, Bloomberg (Nov. 20, 2018), https://www.bloomberg.com/graphics/2018-confessions-of-judgment/?srnd=confessions-of-judgment (describing how merchant cash advance lenders use confessions of judgment to freeze bank accounts of businesses) [hereinafter *Mider & Faux*, I Hereby Confess to Judgement]; Bogucki, *supra* note 2, at 26 ("[A]n MCA company will typically also require a personal guarantee from the business's principal and may insist on the signing of a confession of judgment or similar device by both the business and its principal.").

[45] For an example of a confession of judgment used by Everest Business Funding, listed as a board member of plaintiff on plaintiff's website, *see* Aff. of Confession of J. ¶ 5, *EBF Partners, LLC v. Hackenberg d/b/a Nu Wave Botanicals*, No. 802383/2017, (N.Y. Sup. Ct. Erie County Feb. 17, 2017), ECF No. 1 [hereinafter Everest Confession of J.] (business owner agreeing that business and owner individually are liable for remaining repayment amount for merchant cash advance, plus 9% interest and 25% attorney's fees, signed at time of merchant cash advance transaction); *see also* Revenue Based Fin. Coal., *Members*, *supra* note 18.

[46] *See, e.g.*, Everest Confession of J. ¶ 3, 5 (business and owner jointly and individually confessing judgment and signing both as individual and on behalf of business).

[47] Bruce, *supra* note 2, at 3 (MCA "transactions are commonly accompanied by confessions of judgment, which allow the financier to obtain judgment upon the counterparty's default without the formalities of bringing suit.").

New York City, where the case load volume is lower and default judgments can be obtained within a day of requesting them; Erie County has become a favorite of MCA lenders.[48] Tales of suddenly frozen bank accounts—due to either unscrupulous behavior or simply a mistake on the part of the lender or bank—abound.[49]

Finally, some—although certainly not all—MCA lenders have turned to unscrupulous and even dangerous means to ensure businesses pay the full contracted amount. A Bloomberg profile on Yellowstone Capital describes its mafia-like methods, including sending text messages and leaving voicemails threatening violence.[50] Another news article disclosed a text from an unnamed MCA lender to a business owner reading, "If you don't send money to me today you're done . . . . I will put you in the hospital and your family . . . ."[51] The Federal Trade Commission has charged MCA lenders with using deceptive and illegal means to seize assets from small businesses, resulting in settlements and redress payments.[52]

Unsurprisingly, MCAs can contribute to small businesses declaring bankruptcy. "More

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[48] Zachary R. Mider & Zeke Faux, *Sign Here to Lose Everything Part 3: Rubber-Stamp Justice*, Bloomberg (Nov. 29, 2018), https://www.bloomberg.com/graphics/2018-confessions-of-judgment-new-york-court-clerks/; *see also, e.g.*, Everest Confession of J. (confession of judgment signed by Houston, Texas-based business filed in Erie County, New York).

[49] Mider & Faux, *I Hereby Confess to Judgement*, *supra* note 44 ("In dozens of interviews and court pleadings, borrowers describe lenders who've forged documents, lied about how much they were owed, or fabricated defaults out of thin air.").

[50] *Id.* (describing communications from a Yellowstone Capital executive to business owners saying "I will make this my personal business to f--- you" and "I will watch you crash and burn.").

[51] Gretchen Morgenson, *FTC Official: Legal 'Loan Sharks' May Be Exploiting Coronavirus to Squeeze Small Businesses*, NBC News (Apr. 3, 2020), https://www.nbcnews.com/business/economy/ftc-official-legal-loan-sharks-may-be-exploiting-coronavirus-squeeze-n1173346.

[52] Fed. Trade Comm'n, *Merchant Cash Advance Providers Banned from Industry, Ordered to Redress Small Businesses* (Jan. 5, 2022), https://www.ftc.gov/news-events/news/press-releases/2022/01/merchant-cash-advance-providers-banned-industry-ordered-redress-small-businesses; Fed. Trade Comm'n, *Yellowstone Capital Refunds* (June 2022), https://www.ftc.gov/enforcement/refunds/yellowstone-capital-refunds.

than 100 businesses that filed for chapter 11 since the start of 2023 have attributed their bankruptcies at least partly to cash advances, up from at least 68 for 2022 and 16 for 2021, according to a Wall Street Journal review of court records."[53] According to a U.S. bankruptcy judge, MCAs "very often seem to be the . . . cause[] [of] the bankruptcy."[54]

Because businesses that take MCAs may not fully understand the conditions under which they receive and must repay the debt—and because businesses often turn to MCAs as a last resort—MCAs can be a risky prospect for small businesses. Congress passed Section 1071 to instruct the CFPB to understand how small businesses are served in the financing market. MCAs are a crucial part of the story. Omitting MCA products from the scope of the Small Business Lending Rule would result in an inaccurate picture of the small business credit system.

III. INFORMATION ON APPLICATIONS FOR MERCHANT CASH ADVANCES IS NECESSARY TO IDENTIFY FUNDING GAPS AND INFORM ENFORCEMENT OF FAIR LENDING LAWS.

As discussed above, small businesses are increasingly turning to MCAs for financing. From a small business's perspective, an MCA is just one credit option among many. Carving MCAs out of this Rule would artificially limit information about these credit options.

Compiling information with respect to applications for MCAs is doubly important because the existing data, while limited, indicates a racial and ethnic disparity in their use. A small business credit survey conducted by the Federal Reserve Bank of Atlanta in 2018 observed that "[m]inority-owned firms more frequently applied for potentially higher-cost and less-transparent credit products," including MCAs.[55] In particular, "Hispanic-owned firm applicants sought merchant cash advance products more frequently than did White-owned businesses: 15% compared with

[53] Yerak, *supra* note 9.

[54] *Id.*

[55] Mels de Zeeuw, *Small Business Credit Survey: 2019 Report on Minority-Owned Firms*, *supra* note 17, at IV.

8%."[56] Eleven percent of Black-owned businesses sought an MCA.[57] The survey further indicated that "[a]pproval rates for loans or lines of credit and cash advances sought by minority-owned firms at small banks or online lenders were lower than those for White-owned firms (not controlling for other firm characteristics)."[58]

These trends continued in subsequent surveys. A 2021 report found that only 24% of Black-owned firms and 32% of Hispanic-owned firms were fully approved for a loan, line of credit, or MCA, compared to 45% of Asian-owned firms and 55% of White-owned firms.[59] Yet Black-owned firms sought financing—including MCAs—more than did other firms.[60] Black-owned firms sought MCAs at twice the rate of White-owned firms.[61] Meanwhile, Black-owned, Asian-owned, and Hispanic-owned firms faced more financial stress in 2020—during the onset of the COVID-19 pandemic—than did White-owned firms.[62]

A 2022 report concluded that "[f]irms owned by people of color were less likely than white-owned firms to be approved for loans, lines of credit, and cash advances across banks and non-bank lenders."[63] Furthermore, "[a]mong successful applicants, firms owned by people of color

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[56] *Id.*

[57] *Id.* at 12.

[58] *Id.* at V.

[59] Jessica Battisto et al., Fed. Rsrv. Banks of Atlanta et al., *Small Business Credit Survey: 2021 Report on Firms Owned by People of Color*, at 32 (2021), https://www.fedsmallbusiness.org/-/media/project/smallbizcredittenant/fedsmallbusinesssite/fedsmallbusiness/files/2021/sbcs-report-on-firms-owned-by-people-of-color.pdf?sc_lang=en.

[60] *See id.* at 30.

[61] *Id.* (Of firms that sought financing, 14% of Black-owned firms sought an MCA versus 7% of White-owned firms).

[62] *Id.* at ii–iii.

[63] Ann Marie Wiersch & Lucas Misera, Fed. Rsrv. Banks of Atlanta et al., *Small Business Credit Survey: 2022 Report on Firms Owned by People of Color*, at 18 (2022), https://www.fedsmallbusiness.org/-/media/project/smallbizcredittenant/fedsmallbusinesssite/fedsmallbusiness/files/2022/2022-sbcs-firms-owned-by-people-of-color.pdf?sc_lang=en.

were generally less satisfied with their experiences with their lenders than were white-owned firms."[64] Firms were least satisfied with online lenders,[65] where MCAs can so easily be obtained.[66] Another 2022 report concluded that "smaller, newer, Black-owned, and Hispanic-owned firms [were] more likely to apply to online lenders."[67] The report also found that "online lender applicants were less satisfied with their experiences than were bank applicants," and "online lender applicant firms often reported challenges with high interest rates and unfavorable repayment terms."[68]

The 2024 survey report confirms that racial and ethnic disparities in MCA applications, approval rates, and customer satisfaction persist.[69] First, the percentage of small businesses that regularly use financing has risen: 87% of firms regularly used financing in 2023 versus 80% in 2019.[70] Five percent of small businesses regularly used MCAs in 2023.[71] But racial and ethnic disparities persist, with Black-, Asian-, and Hispanic-owned small businesses using MCAs at about

[64] *Id.* at 19.

[65] *Id.*

[66] Becky Yerak, *Small-Business Bankruptcies Surge Ahead of Potential Law Change*, Wall Street Journal (Mar. 12, 2024), https://www.wsj.com/articles/small-business-bankruptcies-surge-ahead-of-potential-law-change-e0c81dbb.

[67] Ann Marie Wiersch et al., Fed. Rsrv. Bank of Cleveland et al., *Clicking for Credit: Experiences of Online Lender Applicants From the Small Business Credit Survey*, at 3 (Aug. 2022), https://www.fedsmallbusiness.org/-/media/project/smallbizcredittenant/fedsmallbusinesssite/fedsmallbusiness/files/2022/sbcs-report-online-lender-08162022.pdf?sc_lang=en. The report included MCAs in online lender products. *See id.* at 2.

[68] *Id.* at 3.

[69] Johnson et al., *2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey*, *supra* note 14.

[70] *Id.* at 8.

[71] *Id.*

twice the rate as White-owned businesses.[72] This is exactly the sort of data that Congress instructed the CFPB though Section 1071, to obtain greater detail and accuracy that the Federal Reserve's relatively small survey. The report concluded that "[o]lder, larger, and white-owned firms were more likely than their counterparts to be fully approved for a loan, line of credit, or merchant cash advance"; 56% of white-owned firms were fully approved for financing, whereas only 32% of Black-owned firms, 32% of Hispanic-owned firms, and 34% of Asian-owned firms were fully approved.[73] The report further found that "[a]pplicants at online lenders were more likely than applicants at other lenders to report some type of challenge," the most common of which was "high interest rates."[74]

While these data are indicative of a trend, they are insufficient on their own. The data collected in these reports are limited to voluntary responses to an online questionnaire.[75] For example, the self-reported data about MCAs may be inaccurate as many small business owners appear to consider MCAs they obtain to be loans, and so may be reporting them to the Federal Reserve as loans. More comprehensive and systematically collected data are needed to fully understand the racial and ethnic disparities in applications for and approvals of MCAs. The Small Business Lending Rule is the vehicle for that data collection and reporting. The results will better illuminate gaps in credit for small businesses, and particularly businesses owned by people of

[72] *See* FED Small Business, *2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey* (Mar. 7, 2024), https://www.fedsmallbusiness.org/reports/survey/2024/2024-report-on-employer-firms ("Download data" icon; raw data shows that 8% of Black-owned businesses, 7% of Asian-owned businesses, 7% of Hispanic-owned businesses, and 4% of White-owned businesses reported "regularly" using MCAs).

[73] Johnson et al., *2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey*, *supra* note 14, at 16.

[74] *Id.* at 20.

[75] *See id.* at 27.

color, and will help indicate whether enforcement action under ECOA is needed.

CONCLUSION

For the reasons stated above and in Defendants' brief, *Amici* respectfully urge this Court to deny Plaintiff's motion for summary judgment and grant Defendants' cross-motion.

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Respectfully Submitted,

s/ Rachel L. Fried
Rachel L. Fried (*pro hac vice* pending)
Robin F. Thurston (*pro hac vice* pending)
DEMOCRACY FORWARD FOUNDATION
P.O. Box 34553
Washington, DC 20043
(202) 448-9090 Ext. 1011
rfried@democracyforward.org

Diana L. Martin
Florida Bar No. 624489
COHEN MILSTEIN SELLERS & TOLL
11780 U.S. Highway One, Suite N500
Palm Beach Gardens, FL 33408
(561) 515-1400
DMartin@cohenmilstein.com

Counsel for Amici Curiae