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New York Appellate Decision Provides Clear and Well-Reasoned Resource for the RBF Industry

May 29, 2026 | Robert F. Gage

I frequently write about court decisions involving revenue-based financing ("RBF" also commonly referred to as "sales-based finance" or "merchant cash advance") because these decisions are the primary basis on which we determine how revenue-based financing transactions must be structured and how RBF contracts should be written. A recent decision from a New York Appellate Court caught my eye. It's called ***Spin Capital, LLC v Bridgelink Engineering, LLC*** and it provides a clear and well-reasoned resource for the RBF industry. I will explain why.

As we all know, a properly structured and documented RBF transaction should not be subject to state usury laws. To ensure proper structure and documentation, we largely rely on court decisions that effectively establish "tests" for determining when an RBF transaction will be recharacterized as a disguised loan (making it subject to potential usury limits).

The principal test is commonly referred to as the "***LG Funding*** Test" (so-called because the test was well-articulated in a case called ***LG Funding, LLC v. United Senior Props. of Olathe, LLC)*** . Under the ***LG Funding*** Test, courts will conclude that an RBF transaction is a loan if the funder is absolutely entitled to repayment under all circumstances. But if the repayment is a contingent obligation (i.e., not absolute) then the transaction is not a loan not subject to usury. When deciding whether an RBF transaction imposes a contingent payment obligation, the courts are guided by the following three factors:

> (1) Whether the agreement of the parties includes the right to obtain a "reconciliation" that adjusts the payment obligation to a specified percentage of the revenue;
>
> (2) Whether the agreement has a finite term; and
>
> (3) Whether there is any recourse should the business declare bankruptcy.

On its face, this seems like a simple test. But there are layers of complexity. Let's start with the first factor (reconciliation). There has always been some uncertainty as to what, exactly, the courts think "reconciliation" really means. I like to think of reconciliation as process that leads to at least one of the following outcomes:

- Adjustment. This is an adjustment to the merchant's payment so that post-reconciliation payments more closely reflect a specified percentage of the merchant's periodic revenue. The idea here is that the merchant's right to adjust payments based on changes in revenue shows

that the payment obligation is contingent instead of absolute.

- Refund. The other outcome is some kind of refund payment (sometimes referred to as a "true up"). If payments made by a merchant during the period of time covered by the reconciliation have exceeded the specified percentage of the merchant's periodic revenue, then the funder would refund the excess. The refund is another way to show that the payment obligation is contingent instead of absolute.

All things being equal, funders would generally prefer to provide adjustments and not refunds. But for some time, there have been debates within the industry about whether the *LG Funding* test requires a reconciliation to include refunds, or whether adjustments alone are sufficient. So far, the courts have provided little, if any, explicit guidance on whether the *LG Funding* Test requires reconciliation refunds.

The *Spin Capital* decision is significant for the way it handled the first factor in the *LG Funding* test. The New York Supreme Court, Appellate Division, Second Department noted that: "the merchant agreement contained a clause that provided for the adjustment of the defendants' remittances in response to fluctuations in the defendants' receipts" and the reconciliation adjustments "rendered the term of the agreement indefinite". That statement strongly suggests that a reconciliation process that results in adjustments alone is sufficient to meet the first element of the *LG Funding* test. And doing so effectively satisfies the second factor (indefinite term) at the same time. This should give a boost of confidence to funders who provide adjustments only, while taking away nothing from more conservative funders whose contracts provide for both adjustments and refunds.

The third element of the *LG Funding* test has also been the source of a lot of debate and uncertainty. The question is what, exactly, does "recourse should the business declare bankruptcy" really mean? Some courts have suggested that a funder who takes collateral as security for the merchant's obligations will have "recourse in bankruptcy" because the collateral assignment can give the funder rights as a secured creditor in bankruptcy. That has never made much sense. Bankruptcy address different types of claims that are clearly not loans. If the "no recourse in bankruptcy" factor of the *LG Funding* test is triggered merely because a funder has rights to make a claim in a merchant's bankruptcy, then a provider of revenue-based financing would have to disclaim all rights in bankruptcy.

The better view is that the "recourse in bankruptcy" element refers to contractual rights triggered by a merchant's bankruptcy and not rights afforded under bankruptcy law. For example, in loan agreements bankruptcy is usually an event of default that allows the lender to accelerate the obligation and declare the entire balance of the loan immediately due and payable. In properly drafted RBF contracts, a merchant's bankruptcy does not trigger acceleration. RBF contracts that make bankruptcy an event of default could be recharacterized as loans. However, partly due to some poorly reasoned federal court opinions, uncertainty remains with regard to the "recourse in bankruptcy" factor

Happily, the *Spin Capital* court has provided some clarity. In its discussion of the "recourse in bankruptcy" factor, the court noted that the Spin Capital agreement contained "no contractual provision . . . establishing that a declaration of bankruptcy would constitute an event of default". In other words, what mattered to the court was not that the funder may have had some rights in a bankruptcy proceeding, but whether a merchant's bankruptcy triggered an event of default.

The rationale for this position is not obvious, but it begins with the principle that the merchant's payment obligation is contingent because the merchant has the right to reduce payments in proportion

to reductions in revenue. If the funder has the ability to accelerate the balance at precisely the moment the merchant files for bankruptcy (which sometimes is triggered by a drop in revenue) then there is a subversion of the principle that the payment obligation is contingent upon the merchant's revenue. Whether "recourse in bankruptcy" should be one of the factors in the recharacterization test could be the subject of a different debate. But to the extent it remains a factor, the *Spin Capital* court clearly understood that that this factor should only take into account whether bankruptcy filing gives the funder the right to accelerate the balance and not whether the funder has the ability to pursue claims in a bankruptcy proceeding.

This was a nice win for Spin Capital. If more courts follow this approach to the *LG Funding* test, it will provide much greater certainty for those who want to structure RBF to be as robust as possible to the threat of recharacterization.

Spin Capital, LLC v Bridgelink Engineering, LLC, N.Y. Slip Op. 02296, 2026 WL 1017492 (N.Y.A.D. 2 Dept., Apr. 15, 2026)

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