SDNY Holds that Revenue-Based Financing Contract is Not a Loan

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After a series of adverse decisions against revenue-based financing providers, the U.S. District Court for the Southern District of New York has given one provider a decisive victory and, in so doing, given the industry valuable guidance that should be required reading for those who craft revenue purchase agreements.

In this case, *Streamlined Consultants, Inc. v. EBF Holdings LLC*, the plaintiffs, Streamlined Consultants and one of its principals, had sold $199,500 of Streamlined Consultants' future revenue to EBF Holdings (also known as Everest Business Funding or "Everest") for a purchase price of $150,000. Just six weeks later, Streamlined Consultants sued Everest, alleging that the transaction was a usurious loan. The plaintiffs sought equitable relief in the form of rescission of the revenue purchase agreement and a declaration that the entire transaction was usurious and unenforceable. The court ruled in favor of Everest on its motion to dismiss.

The primary basis on which the court rejected the plaintiffs' claims was well-established precedent that a corporation is prohibited from bringing an affirmative claim or counterclaim alleging criminal usury. But the court's opinion nevertheless discusses particular provisions of the Everest contract in detail, giving valuable insight into how these provisions would be interpreted in a case in which a court would have to consider claims that a revenue-based financing transaction should be recharacterized as a usurious loan.

Particularly noteworthy sections of the court's analysis include the following:

- The court credited Everest for including a reconciliation provision in its agreement that clearly identified the funder's obligation to honor requests for reconciliation, emphasizing that the contract stated that, upon reasonable verification of the information necessary for reconciliation Everest "shall" reconcile Streamlined Consultants' actual receipts. This is in contrast to other decisions in which courts have found the contractual obligation to reconciliation was less prescriptive (*i.e.*, the funder "may" reconcile).

- Default provisions that are inconsistent with the principle that revenue-based financing requires the funder to take on contractual risk of nonpayment due to a decline in business revenue or total business failure have led to recharacterization of some transactions. In this case, the court specifically reviewed a default provision based on repeated failure of the merchant to make the agreed-upon daily payments and the merchant's non-cooperation with the funder's requests for information about the merchant's revenue. The court found that this default provision did *not* provide a basis for recharacterization. This decision may have been bolstered by other provisions in the contract in which Everest explicitly acknowledged its acceptance of risk that Streamlined Consultants' business might slow down or fail, or that Streamlined Consultants might seek bankruptcy protection.

As it comes on the heels of several decisions from the Southern District of New York that are adverse to revenue-based financing providers, the favorable decision in this case should have greater resonance than it might coming from another jurisdiction. It arguably demonstrates the importance of careful structuring of the terms of revenue-based financing transactions and, specifically, those provisions dealing with reconciliation and merchant defaults.

However, the court's observations about the well-crafted Everest contract must be viewed in light of the fact (mentioned above) that the court was able to dispose of the plaintiffs' complaint by relying solely on New York usury law. No recharacterization analysis was actually required, even though the court clearly engaged in such an analysis on some level.

In addition, the plaintiffs' behavior leading up to its complaint clearly hurt them. Having sought to rescind the contract just six weeks after receiving a sizable amount of money from Everest and making no effort to ask for reconciliation or other informal relief, the court speculated that the plaintiffs had no intention of ever honoring the promises they made to Everest. Having come to the court with unclean hands, it should not be too surprising that the court was unwilling to provide the plaintiffs with the equitable remedies they sought.

Streamlined Consultants, Inc. v. EBF Holdings LLC, 2022 U.S. Dist. LEXIS 171085 (SDNY September 20, 2022).

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