Addressing Merchant Cash Advances In Subchapter V

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For small businesses, merchant cash advances provide a quick and easy-to-access source of financing, yet they also present significant risks. The burden of repaying MCAs can drive small businesses into financial distress, often necessitating them to file for Subchapter V bankruptcy.

MCAs have recently been brought into the spotlight within a Texas lawsuit, G-Core Construction LLC v. W Funding Group LLC, involving a San Antonio construction company that filed suit against an MCA provider, alleging violations of Texas' relatively new commercial financing disclosure law.

The case centers on approximately $2.5 million in financing that the company obtained through five MCA transactions with Virginia-based W Funding Group and repayment obligations that increased to $3.5 million or more. G-Core alleged failed disclosures from W Funding that are required by Chapter 398 of the Texas Finance Code, and also asked the court to evaluate if the MCA agreements were disguised loans rather than purchases of future receivables.

Filed May 12 in the Bexar County District Court in San Antonio, Texas, the case has raised issues familiar to bankruptcy practitioners, including whether MCAs should be treated as disguised loans or true receivable purchases. While the G-Core case does not involve bankruptcy, it focuses on the same issue of characterizing the MCA that legal professionals and fiduciaries must contend with when MCA debt is part of a bankruptcy case.

Understanding How MCAs Work

MCAs provide a form of small business financing in which a funder provides an up-front lump sum in exchange for a specified dollar amount of the business's future receipts or receivables.

While they are commonly positioned as purchases rather than loans, courts frequently characterize them as the latter. They are generally easy for distressed small businesses to obtain, requiring little more than a few bank statements. Once a business has one MCA, it often becomes a target for additional ones, a practice commonly known as stacking.

Some typical characteristics of MCAs include daily or weekly automated clearinghouse withdrawals from the business's bank account, personal guaranties from the business owner, Uniform Commercial Code financing statement filings claiming a lien on the borrower's property, reconciliation provisions that are illusory at best, confession of judgment clauses allowing the lender to obtain a court judgment against the borrower, and high interest rates that can be 50% or more annually.

The MCA industry is largely unregulated, with agreements that are complex and onerous. Furthermore, some MCAs are outright predatory. The burden of daily ACH withdrawals frequently drives small businesses into bankruptcy. Another common trigger for a bankruptcy filing occurs when an MCA funder sues the debtor after ACH payments are stopped.

Key Legal Issues Involving MCAs and Bankruptcy

As seen in the G-Core Construction case, the central question in most MCA disputes is whether the transaction is a genuine sale of future receivables or a disguised loan. Within bankruptcy, legal counsel and trustees must also give consideration to this question.

In determining the answer, courts often examine a multitude of factors, including whether repayment is absolute under all circumstances. This indicates whether the MCA is a loan or contingent on actual receipts — with the latter signaling that it represents a sale.

Other factors include whether the reconciliation provision is meaningful or illusory, whether there is full recourse against the debtor upon default, and whether the funder took a security interest in all the business assets, which would suggest the MCA is a loan.

While the G-Core Construction case remains undecided, courts have reached varying conclusions on whether an MCA is a sale or a loan. The courts found MCAs to be loans in decisions such as the U.S. Bankruptcy Court for the District of Montana's 2021 ruling in In re: Shoot the Moon LLC, the U.S. Bankruptcy Court for the Northern District of Georgia's 2019 ruling in GMI Group Inc. v. Unique Funding Solutions LLC, and the U.S. Bankruptcy Court for the Eastern District of North Carolina's 2025 ruling in In re: Williams Land Clearing, Grading and Timber Logging LLC.[1]

However, in the In re: R&J Pizza Corp. case, the U.S. Bankruptcy Court for the Eastern District of New York found the MCA to be a true sale in a 2014 decision.[2]

Another common legal issue that occurs in an MCA transaction is the application of local usury law. For example, if the MCA is recharacterized as a loan, MCAs governed by New York law may be void ab initio as criminally usurious. Courts may also apply local usury law even when the agreement specifies another state's law, based on public policy exceptions to the choice-of-law provisions.

UCC issues can also create legal challenges involving MCAs. An MCA funder that did not file a UCC-1 financing statement cannot claim priority in receivables. The debtor retains full rights to those accounts as property of the estate. A senior lender with a prior blanket UCC-1 filing generally has priority over a subsequent MCA funder, as seen in the U.S. Bankruptcy Court for the Central District of Illinois' 2020 decision in In re: Brooks.[3]

MCA funders' claims of true sale are undermined if they failed to properly perfect them under Article 9 of the UCC.

Preferences and fraudulent transfers also create legal considerations for MCAs during the bankruptcy process. If an MCA is characterized as a loan, prepetition payments may be recoverable as preferences under Section 547 of the U.S. Bankruptcy Code. Furthermore, a large disparity between the amount advanced to the borrower and the amount owed may support a fraudulent transfer claim.

Strategies for Addressing MCAs in Subchapter V Bankruptcy

While MCAs can present significant challenges during Subchapter V bankruptcy, legal counsel and trustees can more effectively manage them with key strategies and practices at various stages of the process.

Prior to filing for bankruptcy, attorneys and fiduciaries representing the debtor should research each MCA funder and obtain their proper service addresses. They can also run a UCC search to identify all financing statements and determine their priority. It's also advisable for the debtor and its professionals to terminate all ACH withdrawals to preserve cash in the estate, with the understanding that doing so will likely trigger a default.

During the bankruptcy case, professionals can schedule MCA claims as disputed, contingent or unliquidated, as many MCA funders will fail to file a proof of claim. They can also seek use of cash collateral with the court while reserving rights to contest the funder's lien validity. In order to have undercollateralized MCA claims treated as general unsecured debt, professionals can also file adversary proceedings to challenge secured status under Section 506 of the Bankruptcy Code.

Other tactics may include exploring whether the MCA agreement constitutes an executory contract subject to rejection under the plan and challenging MCA transactions as disguised loans, potentially rendering them void under usury laws. A claim under the Racketeer Influenced and Corrupt Organizations Act can also be pursued for cases that involve usurious interest rates.

In pursuing confirmation of a plan of reorganization, professionals can provide an alternate plan treatment depending on the outcome of the adversary proceedings. They should ensure that the plan explicitly addresses MCA funders that were scheduled as disputed but filed no proof of claim. The plan process can also be used as an opportunity to negotiate with MCA funders, which often prefer some recovery over none.

In some instances, MCA funders may aggressively pursue personal guarantors and seek nondischargeability under Bankruptcy Code Sections 523(a)(2), (a)(4), or (a)(6). Courts are generally skeptical of converting a breach-of-contract claim into a fraud claim, but may find nondischargeability where there is evidence of asset concealment, misdirected receivables or materially false financial statements.

From a regulatory standpoint, state attorneys general have started pursuing MCA funders to curb their potentially illicit tactics.

Notable actions have included New York attorney general proceedings against Richmond Capital Group in 2023 and Yellowstone Capital LLC in 2025, as well as the New Jersey attorney general's settlement with Yellowstone Capital in 2022. In each case, regulators found the MCAs to be disguised loans that were usurious, unconscionable or in violation of consumer protection statutes.

As regulatory enforcement continues and more small businesses turn to Subchapter V bankruptcy to manage MCA debt, legal professionals and trustees can take meaningful steps throughout the bankruptcy process to more successfully counteract the potentially nefarious actions of MCAs.

Practitioners who understand the mechanics of MCA agreements and the strategic tools available in bankruptcy will be best positioned to protect their clients as this area of law continues to develop.

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[1] CapCall LLC v. Foster (In re Shoot the Moon LLC), 635 B.R. 797, 817 (Bankr. D. Mont. 2021). GMI Group, Inc. v. Unique Funding Sols., LLC (In re GMI Grp., Inc.), 606 B.R. 467, 495 (Bankr. N.D. Ga. 2019). In re Williams Land Clearing, Grading, & Timber Logging, LLC, 2025 Bankr. LEXIS 1201 (Bankr. E.D.N.C. May 16, 2025).

[2] In re R&J Pizza Corp., 2014 Bankr. LEXIS 5461 (Bankr. E.D.N.Y. Oct. 14, 2014).

[3] Brooks v. Strategic Funding Source, Inc. (In re Brooks), 619 B.R. 669 (Bankr. C.D. Ill. 2020).