



Written Testimony of

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Committee on Small Business

“Crushed by Confessions of Judgment: The Small Business Story”

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WITNESS BACKGROUND STATEMENT

Shane R. Heskin, is a partner in the Philadelphia office of White and Williams LLP, a full-service regional law firm with over 240 lawyers in ten offices. Mr. Heskin practices in the firm's commercial litigation department and has nearly 20 years of experience litigating complex insurance coverage and general commercial matters. He is admitted to practice law before state and federal Courts in New York, Pennsylvania and Massachusetts, as well as before the United States Courts of Appeals for the First, Second, Third and Sixth Circuits.

Before joining White and Williams LLP, Mr. Heskin was Counsel in the New York office of O'Melveny & Myers LLP and an associate in the New York office of Milbank Tweed Hadley & McCoy LLP.

Mr. Heskin holds a J.D. from Albany Law School and a B.A. from Mayville State University. He graduated *summa cum laude* from both schools.

Since 2016, Mr. Heskin has represented more than fifty small businesses and individuals in connection with high-interest lending products located all over the country. These clients include small businesses located in Alabama, Arizona, California, Colorado, Connecticut, Georgia, Florida, Illinois, Kansas, New York, Maryland, Massachusetts, Michigan, Mississippi, New Jersey, New York, Oregon, Pennsylvania, Tennessee, Texas, Utah and Virginia.

Neither Mr. Heskin nor White and Williams LLP has received any federal grants or any compensation in connection with Mr. Heskin's testimony, and he is not testifying on behalf of any organization or individual. The views expressed in his testimony are solely his own.

A copy of Mr. Heskin's *curriculum vitae* and an overall of the firm's practices are attached to this written testimony as Exhibits 1 and 2.

Chairwoman Nydia M. Velázquez and distinguished Members of the Small Business Committee:

Thank you for inviting me to testify at this hearing. My name is Shane Heskin and I am a commercial litigation partner with the law firm of White and Williams LLP. I am admitted to practice law in New York, Pennsylvania and Massachusetts, and I have nearly twenty years of commercial litigation experience before state and federal courts in these and other jurisdictions.

Three years ago, I began representing small businesses and their owners in disputes with merchant cash advance (“MCA”) companies when my father-in-law’s bank accounts were frozen by an MCA company that had obtained a confessed judgment in New York against his third generation, family-owned tire business in Massachusetts. Since then, I have represented more than fifty small businesses in and out of court and consulted with dozens of other merchants, attorneys, consultants, as well as state and federal agencies with respect MCA-related matters. Although MCA disputes are mostly litigated in New York, my clients are from all over the country and have included the following trades:

- a boat mechanic and from Alabama;
- a speech therapist from Arizona;
- a wine distributor from California;
- a nursing home provider from Connecticut;
- an e-commerce retailer from Colorado;
- a restaurant from Florida;
- a landscaper from Georgia;
- a handyman from Kansas;
- a motorcycle repairman from Illinois;
- a trucker from Maryland;
- an auto mechanic from Massachusetts;
- a home renovator from Michigan;
- an iron worker from Mississippi;
- a staffing specialist from New Jersey;
- a daycare provider from New York;
- a leather manufacturer from Oregon;
- a decorator from Pennsylvania;
- a pharmacist from Tennessee;
- a construction worker from Texas;
- a solar installer from Utah; and
- a plumber from Virginia.

Most recently, I argued on behalf of small businesses in two seminal appeals regarding the validity of certain confessed judgments and the enforceability of certain MCA agreements that are pending before the Appellate Division, Supreme Court of the State of New York, Second Department. I am also lead counsel for three other pending state court appeals challenging other aspects of New York's confession of judgment statute.¹

I am here today to testify about confessions of judgment solely in my capacity as an attorney with specialized knowledge of matters germane to this hearing and I am not appearing on behalf of any entity, individual or organization.

Generally speaking, a confession of judgment is a contact provision or written statement signed by a debtor whereby the debtor waives their constitutional rights to due process and consents to the entry of judgment against them in a specific amount without notice or a hearing. Many states deem confessions to be so repugnant to public policy that they have banned their use² and even the highest courts in the jurisdictions that do enforce them have equated their powerful effect to "a warrior of old entering a combat by discarding his shield and breaking his sword." *Atlas Credit Corp. v. Ezrine*, 250 N.E.2d 474, 482 (N.Y. 1969) (citing *Cutler Corp. v. Latshaw*, 374 Pa. 1, 4 (1953)).

New York is one of the states that enforces confessions and, in recent years, many MCA companies have required small businesses and their owners to execute confessions of judgment before advancing any funds. If the small business defaults in its obligations, the MCA companies quickly file the confessions, obtain judgments and immediately begin to enforce the judgments before the small businesses are even aware that a judgment has been filed against them. Since MCA companies began using confessions of judgment in 2012, more than 32,000 confessions have been filed in New York, representing more than \$1.5 billion in judgments.³ Notwithstanding that these confessions were filed in New York, the use of confessions is not solely a New York problem, as even a cursory review of New York's electronic filing system reveals that the vast majority of these judgments are against merchants located outside of New York.⁴

I. THE MCA PROBLEM.

Small businesses and their individual owners are often experts at their trade or profession. But that does not mean they are sophisticated business persons who understand the legal ramifications of a confession of judgment or the distinctions between a factoring agreement and a loan. More often than not, my clients are hard-working middle class workers who are induced into an MCA agreement by some random third-party who claimed that taking out an MCA advance would help them grow their business. Instead of growing, the small business typically ends up

¹ *Merchant Funding Services, LLC v. Volunteer Pharmacy Inc. d/b/a Volunteer Pharmacy, Toby C. Frost and Camillia Frost*, Supreme Court of the State of New York, Second Department, Case Nos. 2017---121 and 2017-00483 and *Merchant Funding Services, LLC v. Micromanos Corporation d/b/a Micromanos and Atsumasa Tockhisako*, Supreme Court of the State of New York, Second Department, Case No. 2017-06548.

² See, e.g., Massachusetts General Law Ch. 231, § 13A and Florida Statute Ch. 55, § 55.05.

³ Zachary Mider and Zeke Faux, *Predatory Lenders Have Co-opted New York's Court System to put the Screws to Borrowers Nationwide* (Nov. 29, 2018) (www.Boomberg.com) and Zachary Mider and Zeke Faux, *N.Y. Moves to Ban Confessions of Judgment for Out-of-State Loans* (June 21, 2019) (www.Bloomber.com) attached as Ex. 3 and Ex. 4.

⁴ Ex. 6 (compiling representative list of small business confessions by just a single MCA company).

entering into a never-ending cycle of debt similar to Payday Lending. Although it usually starts with a small starter loan, it often spirals out of control to the point where the merchant takes out new MCAs just to pay off the prior ones:⁵

Advance Amount: **\$176,000.00**

Liner Tire Inc. ("the Merchant"), a Massachusetts Corporation, located at 144 Boylston Street, Brookline, MA Massachusetts 02445 hereby requests and authorizes Capacity Funding LLC ("Capacity") located at 7 Renaissance Square, 5th Floor, White Plains, NY 10601, to allocate the proceeds of this funding, upon the closing of this transaction on this date, as follows:

- Payoff in the amount of \$66,164.00 to Yellowstone Capital for existing obligations pursuant to the payoff letter received.

- Payoff in the amount of \$47,450.00 to Capacity Deal #2 - Liner Tire for existing obligations pursuant to the payoff letter received.

- Payoff in the amount of \$56,575.00 to Capacity Deal #3 - Liner Tire for existing obligations pursuant to the payoff letter received.

After upfront origination and processing fees of \$5,811.00 to Capacity, Merchant will net \$0.00 which will be wired to Merchant's bank account as provided to Capacity.

In addition, MCA companies will knowingly induce small businesses to take out MCA agreements with other companies to ensure that their MCA agreements get paid off first.⁶ This, of course, is a default under an MCA agreement because they all prohibit a merchant from taking out other loans or entering into an MCA agreement with another company. The term in the industry is called "stacking."⁷

In addition to destroying the small business and the jobs of their employees, the MCA industry is destroying the lives of their individual owners and their families. It causes depression and anxiety, and sometimes leads to divorces.

The below e-mail is an example of what my clients endure:⁸

I need you to call me now . Not your staff You . Its Friday My kids and wife think we are loosing everything I told them you would have us restructured by today . My wife cried all day yesterday and ask me every 5 min have I herd from you or any body else . All I can tell her is no . But that you said you would help us . Its Friday What are you going to do

I firmly believe that the predatory lending of the MCA industry has become a national epidemic, and that action needs to be taken to fix the growing problem.

⁵ See Ex. 7, ¶ 6.

⁶ See Ex. 8.

⁷ See Ex. 9.

⁸ See Ex. 10.

II. AN OVERVIEW OF THE MCA INDUSTRY.

To understand confessions of judgment and their impact on small businesses, I believe it is necessary to provide the Committee with a brief overview of the MCA industry.

Generally speaking, a merchant cash advance is a form of non-traditional financing by which an MCA company purports on paper to purchase a merchant's future receipts at a discounted price. The merchant then repays the MCA company through predetermined daily payments until the full face value of the purchased receipts has been repaid. Although documented as the purchase of future receipts, make no mistake, it has been my experience that many MCA companies treat their cash advances just like loans that are absolutely repayable at effective annual interest rates that exceed 400% simple interest and 2,000% APR.

Merchant cash advances have been around in one form or another since the early 2000s, but they became a popular form of alternative financing for small businesses when banks and other traditional financial institutions tightened credit standards following the recession of 2008. Unable to readily obtain credit from banks, small businesses desperate for cash became easy prey for MCA companies and the independent sales officers ("ISO") who brokered their deals.

Because MCA agreements, on paper, involve the purchase of future receipts and not the lending of money, the MCA industry is virtually unregulated and has been described by more than one commentator as the "wild, wild west" of financing.⁹

A. Distinguishing an MCA agreement from a legitimate factoring agreement.

Traditional factoring has been around for centuries and its distinguishing factor is the transfer of risk. *See Endico Potatoes v. CIT Group/Factoring*, 67 F.3d 1063, 1069 (2d Cir. 1995) ("The root of all of these factors is the transfer of risk.").

In contrast, the *sine qua non* of a loan is that the money advanced is absolutely repayable. *See TIFD III-E, Inc. v. United States*, 459 F.3d 220 (2d Cir. 2006) (citing *Estate of Mixon v. United States*, 464 F.2d 394, 405 (5th Cir. 1972) ("If there is a definite obligation to repay the advance, the transaction [will] take on some indicia of a loan."); *Rosenberg v. Commissioner*, T.C. Memo 2000-108, 79 T.C.M. (CCH) 1769 (2000) ("A taxpayer's right to enforce repayment of an advance suggests that the advance is a loan.")).

In distinguishing a sale from a loan, the conduct and intent of the parties is instructive:

A sale is the transfer of the property in a thing for a price in money. The transfer of the property in the thing sold for a price is the essence of the transaction. The transfer is that of the general or absolute interest in property as distinguished from a special property interest. A loan, on the other hand, is the delivery of a sum of money to another under a contract to return at some future time an equivalent

⁹ See, e.g. McCarthy, Brayden, *Small Business Deserves the Same Protections as Consumers When Seeking a Loan* (March 20, 2017) located at <https://www.fundera.com/blog/small-businesses-deserve-the-same-legal-protections-as-consumers-when-seeking-a-loan> and Ex. 5.

amount with or without an additional sum agreed upon for its use; and if such be the intent of the parties the transaction will be deemed a loan regardless of its form. Emphasizing the necessity of appraising the transaction as disclosed by the evidence as a whole rather than by what the transaction appears or is represented by the parties to be, we observed that “All of the negotiations, circumstances and conduct of the parties surrounding and connected with their contracts may be material in determining whether the form thereof covered an intent to violate the usury law”

West Pico Furniture Co. v. Pacific Fin. Loans, 469 P.2d 665, 671-72 (Cal. 1970); *see also Endico Potatoes*, 67 F.3d at 1068 (“Resolution of whether the ‘contemporaneous transfer,’ as CIT describes Merberg’s assignment of accounts receivable to CIT and CIT’s loan advances to Merberg, constitutes a purchase for value or whether the exchange provides CIT with no more than a security interest, depends on the substance of the relationship between CIT and Merberg, and not simply the label attached to the transaction.”); *Trinity Holdings, Inc. v. Firestone Bank*, 1994 WL 449258, at *3 (W.D. Pa. May 4, 1994), *aff’d*, 66 F.3d 313 (3d Cir. 1995) (“The parties’ practices, objectives, activities and relationships are relevant in determining whether the transactions are absolute assignments or secured loans. Despite Firestone’s objection, we are guided by the factors delineated in *In re Joseph Kanner Hat Co., Inc.*, 482 F.2d 937 (2d Cir. 1973)”); *Bouffard v. Befese, LLC*, 111 A.D.3d 866, 869 (2d Dep’t 2013) (“In determining whether a transaction is usurious, the law looks not to its form, but its substance, or real character” and being a “hard money lender” to those “unable to obtain conventional financing” is nothing more than “plainly usurious” lending).

In order to avoid state usury laws, an MCA agreement purports to be a sale of a merchant’s future receivables. This device is not novel. As early as the time of Lord Mansfield, it was recognized that “the most usual form of usury was a pretended sale of goods.” *Quackenbos v. Sayer*, 62 N.Y. 344, 346 (1875); *see also Aardwoolf Corp. v. Nelson Capital Corp.*, 861 F.2d 46, 47 (2d Cir. 1988) (“At the outset, we lay to rest any question there may be as to the nature of the so-called ‘discount.’ It was, as the parties concede, the taking of interest in advance, a practice as old as the proverbial hills.”) (citing *Evans v. National Bank*, 251 U.S. 108, 113 (1919)).

Accordingly, as explained by Chief Justice John Marshall nearly 200 years ago, courts must look beyond the form to ascertain its true nature:

The ingenuity of lenders has devised many contrivances, by which under forms sanctioned by law, the statute may be evaded. . . Yet, it is apparent, that if giving this form to the contract will afford a cover which conceals it from judicial investigation, the statute would become a dead letter. Courts, therefore, perceived the necessity of disregarding the form, and examining into the real nature of the transaction.

Scott v. Lloyd, 34 U.S. 418, 9 L.Ed. 178 (1835).

By definition, a “sale” is a “contract between two parties . . . by which the seller, in consideration of the payment or promise of payment of a certain price in money, to the buyer the title and possession of the property.” *Crisswell v. European Crossroads Shopping Centr. Ltd.*, 792 S.W.2d 945, 949 (Tex. 1990) (quoting BLACK’S LAW DICTIONARY 1200 (5th ed. 1979)).

In a true sale, the seller retains no benefits of ownership with respect to the subject assets transferred, the risk of loss with the subject assets is wholly transferred to the buyer, and the seller maintains no control over the assets. See *NetBank, FSB v. Kipperman (In Re Commer. Money Ctr. Inc.)*, 350 B.R. 465 (9th Cir. 2006) (finding transaction to be a loan rather than a sale where seller/assignor retained right to surplus proceeds); *In re Evergreen Valley Resort*, 23 B.R. 659, 661 (D. Me. 1982) (recognizing that a loan “is indicated if the assignee must account to the assignor for any surplus received from the assignment over the amount of the debt” rather than retaining such surplus as the benefits of ownership); *In re Hurricane Elkhorn Coal Corp. II*, 19 B.R. 609, 614 (W.D. Ky. 1982) (finding transaction was a loan because debtor retained right to use proceeds in excess of amount advanced).

In other words, in a true sale, “the benefits and burdens of ownership” pass from the seller to the buyer. See *JMW Auto Sales, Ltd. v. FT Dev. Inc. (In re Moye)*, 2010 Bankr. LEXIS 4378 (S.D. Tex. 2010) (holding agreement “did not evidence a consummated transfer of the benefits and burdens of ownership” so as to constitute a true sale); *Callow v. Comm’r*, 135 T.C. 26, 33-34 (U.S. Tax Ct. 2010) (“[T]he key to deciding whether the transaction was a sale or other disposition is to determine whether the benefits and burdens of ownership have passed” from seller to buyer.).

Generally recognized principles of accounting similarly focus on the transfer of ownership in determining whether a transaction must be accounted for as a sale or a loan. In order to be accounted as a sale, three requirements must be met: “First, the transferred financial assets must have been put beyond the reach of the transferor and its creditors. Second, the transferee must have the right to pledge or exchange the asset free of conditions. Third, the transferor must not maintain effective control over the asset.” *MF Global Holdings, Ltd. v. PricewaterhouseCoopers LLP*, 199 F. Supp. 3d 818, 824 (S.D.N.Y. 2016). None of these factors is met in an MCA agreement.

Although an MCA agreement purports to purchase a small business’s future receipts, the business retains responsibility for collecting the very receipts that were purportedly sold, and maintain “effective control” over their receipts. This type of transaction is not a sale under accepted accounting rules; it is a secured borrowing. *Id.* As explained by the Second Circuit:

Such transactions are somewhat ambiguous and admit of definition as loans or sales on slight differences. If a merchant discounts his customer’s note at a bank, endorsing it, but getting immediate credit for its discount value, it would be a most unnatural thing to consider it a loan from the bank. He remains liable if the customer defaults, but the collection is in the bank’s hands, and the transaction is closed in the absence of a default. If, on the other hand, a merchant pledges his accounts to a ‘finance’ company and collects them himself, paying the loan out of his collections, it is clearly a loan, and has always been so considered.

Elmer v. Commissioner, 65 F.2d 568 (2d Cir. 1933); see also *In re Gotham Can Co.*, 48 F.2d 540 (2d Cir. 1931); *Home Bond Co. v. McChesney*, 239 U.S. 568 (1916).

B. The mechanics of an MCA agreement.

On their face, most of the MCA agreements purport to be legitimate factoring agreements—but not all of them.

1. The Factor Rate.

The factor rate is the amount the MCA company charges for the time value of the money being lent. In an MCA agreement, it is the difference between the Purchase Price and the Purchased Amount. The factor rates are typically between .3 and .49. Thus, if a small business is getting an advance of \$100,000, and the factor rate is .49, the Purchase Price would be \$100,000 and the Purchased Amount would be \$149,000. Put another way, the MCA company is advancing the sum of \$100,000 and is being repaid \$149,000, meaning it is charging \$49,000 for the time value of the money advanced.

2. The Daily Payment Amount.

Under a legitimate MCA agreement, an MCA company would review a merchant's historical receivables, typically by reviewing the past three to four months of bank statements, and determine the small business's average monthly receivables in order to predict future revenue streams. A legitimate MCA company would then divide that average monthly revenue by twenty two to come up with a good-faith daily payment. The MCA company divides by twenty two because that is the average number of business days in a month. The MCA company would then multiply the percentage of receivables purchased, typically 10% to 25%, by the daily average to come up with the amount that will be debited each day.

Case Example: If the average monthly receivables equal \$100,000, then the merchant's average daily receivables is \$4,545 (\$100,000 divided by 22). If the MCA company was purchasing 10% of the merchant's receivables, then the good-faith estimated payment should be \$454 (\$4,545 x .10).

3. The Interest Rate.

The expected interest rate of an MCA can be determined based on the face of the agreement.

To determine the expected payback term, one simply has to divide the payback amount, i.e., the Purchased Amount, by the daily payment. Thus, in the two examples above, if the Purchased Amount is \$149,000 and the estimated daily payment is \$454, then the total number of daily payments is 328, which equates to approximately 65 weeks. When adding two days for each week to account for Saturdays and Sundays when no payments are withdrawn, the total expected term is 459 days.

To determine the interest rate, one then has to determine the annualized interest rate, which is determined by dividing the interest charged by the sum advanced. It is always the same as the

factor rate, and thus, in the example above, one would simply divide \$49,000 by \$100,000, which results in an annualized interest rate of 49%. To determine the actual interest rate for the particular transaction, one would multiply the factor rate by 365 days in year and then divide that number by the total days of the expected term. In the example above, the expected simple interest rate would be 39% ($.49 \times 365 = 178.85$ and 459 divided by $178.5 = .388$).

Notably, however, a simple interest rate of 39% is not typical of an MCA agreement. Thus, in order to increase the interest rate, an MCA company may artificially inflate the good-faith estimated daily payment or increase the percentage purchased. In my experience, the estimated daily payment has no relationship to the actual average monthly revenues.

But even where the MCA company increases the percentage of receivables purchased, the sham of the transaction becomes abundantly clear. For example, in one of my cases, the MCA company purchased 156% of the merchant's future receivables—a mathematical impossibility.

4. The Reconciliation Provision.

In order to give the appearance of risk, almost all MCA agreements contain a so-called “reconciliation” provision. The way it is supposed to work is, at the end of the month, a merchant has the right to provide a copy of its bank statements to the MCA company, and if the amount collected through the daily payments exceeds the percentage of receivables allegedly purchased, the MCA company is supposed to provide a refund of any excess amounts collected. To put this in simplest terms, if the business generated no receipts and the MCA company collected \$10,000 through the daily payments, the MCA company is required to refund the merchant the entire \$10,000 because 10% of zero is zero.

The superficial effect of this reconciliation provision allows the MCA company to claim that it is assuming risk. It also allows it to assert that the repayment term is indefinite so there can be no violation of the usury laws.

There are numerous problems with this so-called reconciliation provision. First, throughout all of my cases, I have never seen a merchant actually get money back under a reconciliation provision. Second, the vast majority of my clients do not even know they have a right to ask for a refund because the provision is buried in fine print and is almost never explained to them. Third, the vast majority of MCA agreements contain an addendum declaring a default if the business misses two or more daily payments. Fourth, the MCA companies often stack upon each other so the small business ends up with so many MCA agreements that the percentage of receivables allegedly sold far exceeds its margins and operating expenses.

Case Example: *McNider Marine (Alabama) v. Complete Business Solutions Group.* From just August until November 2016, the MCA companies contracted to take over 89% of McNider’s daily receivables, a small Alabama marina:¹⁰

Defendant	Loan Date	Daily %	Daily Payment
New Era	8/11/2016	15%	\$1,711
Ram Capital	9/19/2016	10%	\$1,999
CP	9/30/2016	9%	\$1,208
IBIS	10/6/2016	10%	\$1,165
Yellowstone	10/19/2016	15%	\$3,398
TVT	10/17/2016	15%	\$1,499
ML Factors	10/27/2016	10%	\$2,476
Funding Metrics	11/4/2016	2%	\$530
CP	11/14/2016	3%	\$362
Total Daily		89%	\$14,348

5. The Fees.

The fees charged vary depending upon the number of parties involved and are often misleading. Specifically, if a broker is involved, a merchant may get charged two sets of fees. A sample fee schedule is as follows:

APPENDIX A – FEE STRUCTURE

A. Origination Fee: \$19,995.00 (to cover underwriting and related expenses).

B. ACH Program Fee: \$3,495.00 (the ACH program is labor intensive and is not an automated process, requiring us to charge this fee to cover related costs).

C. Bank Fee: Minimum bank fee of \$195.00 or up to 10% of the funded amount.

D. NSF Fee: \$35.00 each occurrence (up to TWO occurrences before a default is declared).

E. Rejected ACH: \$100.00 (if a merchant directs the bank to reject our debit ACH).

F. Bank Change Fee: \$50.00 (If a merchant requires a change of account to be debited requiring us to adjust our system).

G. Unauthorized Account Fee: \$5,000.00 (if a merchant blocks QF’s ACH debit of the Account, bounces more than 2 debits of the Account, or simultaneously uses multiple bank accounts or credit-card processors to process its receipts).

H. Default Fee: \$2,500.00 or up to 10% of the funded amount. (if a merchant changes bank accounts or switches to another credit-card processor without QF’s consent, or commits another default pursuant to the Agreement) or bounces more than 2 debits of the Account.

I. Stacking Fee: If the Merchant takes any further financing from any other finance/factoring company a fee of 10% of the purchased amount will be added to the Merchants current balance.

J. Risk Assessment Fee: \$249.00

K. UCC Fee: \$195.00

¹⁰ See Ex. 11, ¶ 49.

The fee schedule above is for a \$250,000 advance to a non-profit community health care clinic located in California. At first glance, it appears that the merchant is being charged a Bank Fee of \$195. Not so. The merchant is actually being charged \$25,000 because it says \$195 or up to 10% of the funded amount. Thus, this particular merchant was charged nearly \$50,000 in fees for an advance of \$250,000. But it gets worse. The merchant was also charged a separate \$12,500 fee from his broker.¹¹

Note also the NSF Fee. After just two missed payments, it is an event of default, which triggers the enforcement devices described in the next section below.

6. The Personal Guarantee and Confession of Judgment.

In a legitimate factoring agreement, a purchaser does not have recourse against the seller in the event that the account debtor does not pay. Rather, that is a risk assumed by the purchaser. In other words, if a factoring company purchases a receivable owed by ABC company to the seller, and ABC company goes bankrupt or otherwise fails to pay, the factoring company does not get paid and has no recourse against the seller of those receivables.

That is not the case with a typical MCA agreement. In every MCA agreement that I have seen, it contains a personal guarantee, wherein the individual owner guarantees certain performance of the small business under the MCA agreement. Notably, unlike in a legitimate factoring agreement, the personal guarantee is typically invoked “at the time the Merchant admits its inability to pay its debts, or makes a general assignment for the benefit of creditors, or any proceeding shall be instituted by or against Merchant seeking to adjudicate it bankrupts or insolvent, or seeking reorganization, arrangement, adjustment, or composition of it or its debts.”¹²

In addition, the vast majority of MCA agreements require a merchant to execute a confession of judgment, permitting the MCA company to obtain a judgment against both the small business and its individual owner in the event of a default. And upon default, the confession of judgment almost always includes liquidated attorney’s fees between 25% and 33% of the outstanding balance.

C. The ISOs and Brokers.

In a story that I have heard time and time again from clients, prospective clients, consultants and other attorneys, it almost always starts with a cold call from a broker. The broker professes to know the needs of small businesses and promises to be able obtain financing within 48 hours in concise terms such as “50k, 60 day term, \$833 per day.”

¹¹ See Ex. 12, at pg. 8.

¹² See *id.* at pg. 5.

Case Example: *Liner Tire (MA). v. Cap Call, LLC et al.*¹³

Bary,

here are the new loan documents for the \$75,000 facility I obtained for you this morning from Everest Business Funding.

Please sign and initial in all places I have flagged and complete the bank log in information on the second to last page. Then fax or email the papers back to me. No notarization or overnight delivery of the original documents is necessary.

Here are the particulars of this loan:

Advance Amount:	\$75,000
Total Payback:	\$108,000
# of Payments:	90
Daily Payment:	\$1,200
Origination Fee:	\$395
Payment Processing Fee:	\$250
Funding Wire Fee:	\$35
Net Amount Funded:	\$74,320

Often, all the small business owner needs to obtain the financing is complete a one-page application, provide the broker with its past three month bank statements, sign various documents, and, of course, pay the broker a commission that is generally equal to 10% of the advance but which I have seen as high as 20%.

Case Example: *AMCO Mechanical Contractors (Texas) v. Ram Capital Funding, LLC*:¹⁴

On Wed, Apr 26, 2017 at 12:23 PM, Anthony Collin <anthony@smartbusinessfunder.com> wrote:
Approved!

High risk:

1 of 2 different options:

1) \$40,000.00 at \$1199.00 a day, 1.499 rate

2) \$30,000.00 at \$899.00 a day, 1.499 rate

Both deals pay 10% of the funded amount.

¹³ See Ex. 7, ¶ 14.

¹⁴ Ex. 13, ¶ 55.

Case Example: *Saturn Funding, LLC v. North River Outfitters:*¹⁵

From: Evan Chase <Evan@sidepaper.com>
Date: Thu, Sep 24, 2015 at 12:41 PM
Subject: Funding Application
To: "nroboston@gmail.com" <nroboston@gmail.com>

Hi Jason,

Thank you for contacting Side Paper for a business loan today. I attached our 1 page application for you to fill out. All we need is the 1 page application and the last 4 months of the business's bank statements to get you approved.

Sometimes, the brokers go even further and induce the small business to enter into an MCA agreement with promises of ultimately securing a permanent line of credit at favorable rates once the small business establishes a pattern of timely payments to the MCA company. What the brokers do not tell the small business is that their commission is frequently subject to being “clawed back” by the MCA company if the small business fails to make any of the payments necessary to establish this so-called “pattern.” To complete the scam, once the small business makes the required payments, the broker suddenly claims he/she is unable to obtain the line of credit and instead offers to obtain a second MCA agreement for even more money which the small business can use to repay the first agreement while its business fortunes allegedly improve. As a result, the broker keeps its initial commission and may even earn a second commission, while the small business is caught in a “death spiral” of ever increasing MCA debt from which it can never recover.

Case Example: *Mikes Auto (Somerville, MA) and Premier Working Capital Inc.* On January 29, 2016, Stephen Quroiz, a purported “Senior Commercial Banker” with Premier Working Capital induced Mike’s Auto to enter into an MCA agreement with Ibis Capital Group, LLC. In doing so, Quroiz wrote in an email that same day: “As discussed, after 5 business days, we will convert the loan into a 3 year Business Line Of Credit with a monthly principal and interest payment, with a credit limit of 175k.”¹⁶ Immediately thereafter, the broker “ghosted” the merchant, leaving him with a debt he could not pay. He was later sued in New York by the MCA company.

For their part, MCA companies are more than willing to make advances to small businesses for several reasons. First, the annualized interest under many agreements often exceeds 75% and can be as high as 400%. Second, the small business’s performance under the agreements is often secured by the grant of a security interest in substantially all of the business’s assets and upon default, the MCA company can exercise its rights and remedies under the Uniform Commercial Code to collect all amounts due under the agreement. Third, MCA companies frequently require the owners of the business to personally guaranty performance under the agreement. Finally, and perhaps most importantly to the present discussion before the Committee, many MCA companies require that the small business and its owners execute a confession of judgment.

¹⁵ Ex. 14, ¶ 60.

¹⁶ Ex. 15.

Compounding the problem is the lack of regulation on both the MCA companies and the brokers. Literally anyone can become an MCA broker regardless of financial experience.

Case Example: *BBK Motorsport (Ill.) v. Snap Advance et al.* On August 4, 2017, Peak Source sent BBK Motorsport's owner the following e-mail:¹⁷

Your business has been pre-approved!

Loan amount \$390,500

Payback \$566,225

Term 18 months

Daily payment \$1,498

Factor rate 1.45

Loan amount \$468,700

Payback \$674,928

Term 15

Daily payment \$2,143

Factor rate 1.44

At his deposition, the broker admitted having no basis for making this representation, and had not even reviewed BBK's financials. In addition, to this day, Peak Source professes on its website that it is "a full service investment agency located in New York City" with expertise in obtaining financing for small businesses with the goal of providing them "with the finances necessary to reach the next level of growth," and that it has a "team of professionals working 24 hours a day, 7 days a week to streamline the funding process." www.peaksourceus.com. According to the owner, however, Peak Source is run by the individual owner and his assistant. Neither has any financial experience whatsoever. Instead, the business was started by paying a few hundred dollars to build a website.¹⁸

Similarly, in my experience, representatives of the MCA companies often have zero financial experience. For example, one of Yellowstone Capital's most profitable funders is dubbed "the Closer," and his prior job was as a customer service representative for Verizon.¹⁹

D. The MCAs are advertised as loans.

Through my pre-suit investigations, I have also discovered overwhelming publicly available evidence demonstrating that the MCA companies advertise their products as loans. Yellowstone Capital, for example, has used the following advertisement:

¹⁷ See Ex. 16.

¹⁸ See Ex. 17.

¹⁹ See Ex. 18.



In or around August 2013, Yellowstone also created promotional videos that were marketed to the public on YouTube. One of the Yellowstone employees portrayed a character by the name of Dr. Daniel Dershowitz, a.k.a., Dynamite Disco Danny. The video is titled “Bad Credit Business Loans TM | 855-445-9649.” The premise of the video is that Dr. Dershowitz went to Las Vegas after his divorce, whereupon he overindulged, maxed out his credit cards and started dipping into his business account. Dr. Dershowitz then makes the following statements about his experience with a traditional lender and his experience with Yellowstone:

When the funds got low, I was in over my head. The only way out was to get a business loan. So I went to the bank and when they ran my credit, the lady laughed at me. So I went online and found Yellowstone Capital. I applied for a loan on Monday based on my monthly sales and on Wednesday they gave me my money. It’s crazy because my heartrate is higher than my credit score. So if you need money you need to apply right now while their computers are still giving out money to basically any business owner with a pulse.

Below the video is the following link: “CLICK HERE TO APPLY!
[http://www.yellowstonecap.com/FundsToday.](http://www.yellowstonecap.com/FundsToday)”

As the video played, subtitles described Yellowstone’s MCA program:

Bad credit business loans are, and forever will be, extremely hard to obtain. Luckily, Yellowstone Capital makes it easy to obtain an unsecured bad credit business loan if you have been turned away by your bank in search of an unsecured bad credit business loan, or unsecured business funding.

We keep our application process super short, and super easy. Once you submit your application, your business funding offer can be approved in the same day. Many of your clients receive their bad credit business loans in as little as three days.

Been turned away for a small business credit card? Apply at Yellowstone Capital for a bad credit business loan, also known as a business cash advance, or a merchant cash advance.

Need money for remodeling, upgrades, or to buy a new location? Our small business loans are easy to obtain for these things.

Our business loans are unsecured. There are no set minimum monthly payments, which means there are never any late fees. So what are you waiting for? Click the link at the top of the description to get started with your bad credit business loan application today!

These videos all link to a loan application on Yellowstone's website.²⁰


Another MCA company also describes its MCA agreements as loans on its website:

A PowerUp Small Business Loan, or ACH loan (Automated Clearing House), is a great way to get a lot of capital for immediate investment. These rates are higher than a traditional loan, so should be used for projects with an immediate ROI. ACH loans pull repayments directly from your checking account, reducing the need to mail out payments. **These loans** are also a good way to **consolidate prior loans**, extend the term and get additional working capital.

A Merchant Cash Advance works a little differently. An MCA looks at your predictable income based on past credit card receipts. This works best for companies that see a lot of smaller transactions. Because repayment is contingent on credit card transactions, **this type of loan** is optimal for seasonal businesses, like ski shops or Italian Ice stores. When business slows down in the off-season, so too, does the expectation of repayment.

I have also seen numerous brokers refer to the MCA agreements as loans when soliciting and approving MCA funding:

From: **Jessica DeCara via DocuSign** <dse_na2@docusign.net>
Date: Wed, Mar 23, 2016 at 12:21 PM
Subject: Fast Capital 360 - Your Funding Contract
To: alice indelicato <nroboston@gmail.com>

Please review and sign your document 

Hi alice indelicato,

I have some exciting news for you. **Your loan has been approved** and your funds will be available for acceptance upon receipt of executed loan documents and completion of items listed below.

Please sign and fax the contract back to jd@fastcapital360.us or scan and attach the signed contract to this email.

²⁰ See Ex. 19 (thumb drive of videos).

E. The estimated daily payment is often a sham.

In addition to advertising MCAs as loans, in my experience, the estimated daily payment has no relationship to the merchant’s actual estimated receivables as purported on the face of the agreements. Instead, the purported estimated daily payment is tied to the size of the loan and the time period in which the MCA company wants to be repaid.

Case Example: *Antelope Valley Community Clinic (California) v. ML Factors*. As demonstrated by the below chart, the estimated daily payments increase with the size of the loan:²¹

Date	MCA Company	Loan Amount	Amount Received	Loan Payback	Daily %	Daily Payment
6/23/17	ML Factors	\$75,000	\$67,500	\$111,750	10%	\$1,863
9/15/17	ML Factors	\$75,000	\$42,948	\$111,750	10%	\$1,597
9/15/17	Queen	\$150,000	\$135,000	\$224,850	13%	\$2,999
10/17/17	Queen	\$215,000	\$65,131	\$322,285	13%	\$5,899
10/18/17	ML Factors	\$100,000	\$33,893	\$149,000	10%	\$2,484
11/13/17	GTR Source	\$50,000	\$40,000	\$74,950	None	\$1,999
11/27/17	GTR Source	\$75,000	\$60,000	\$112,425	None	\$2,249
11/27/17	ML Factors	\$140,000	\$40,869	\$208,600	10%	\$3,161
11/27/17	Queen	\$300,000	\$40,010	\$449,700	13%	\$8,990
12/27/17	Yellowstone	\$250,000	\$222,500	\$374,750	15%	\$3,999
1/17/18	ML Factors	\$200,000	\$73,391	\$298,000	10%	\$2,980
1/17/18	Ocean Fund	\$550,000	\$142,331	\$824,450	13%	\$5,999
1/19/18	Yellowstone	\$450,000	\$76,745	\$674,550	15%	\$5,499
1/19/18	Queen	\$250,000	\$185,000	\$374,750	13%	\$4,499
Totals		\$2,880,000	\$1,225,318	\$4,311,810		

III. OTHER HIGH-INTEREST LENDERS ARE HARMING SMALL BUSINESSES.

The MCA companies are not the only companies that have provided high-cost financing to my small business clients. Attached is a loan with an APR of 94% that was purportedly made by Celtic Bank but then assigned to Kabbage Inc.²² *But see Madden v. Midland Funding, LLC*, 786 F.3d 246, 251-53 (2d Cir. 2015) (holding assignee not entitled to federal preemption).

On Deck Capital, Inc. has likewise provided high interest rate loans to my clients. On its website, On Deck claims the “weighted average rate for term loans is 25.3% simple interest and 48.7% AIR.” <https://www.ondeck.com>. I have seen On Deck interest rates in excess of 84% APR.

Both Kabbage and On Deck have partnered with Celtic Bank to issue these high interest loans. Before it partnered with Celtic Bank, Kabbage provided high-cost funding through MCA agreements.²³ Unlike Kabbage, On Deck appears to issue loans directly when the interest rates do

²¹ See Ex. 20, ¶ 62.

²² See Ex. 21.

²³ See Ex. 22.

not exceed state usury laws, but in states where the interest rates would exceed state usury laws, the loans are issued by Celtic Bank.²⁴

Kabbage has also admitted in numerous publicly available forums that it is a direct lender, and that it assumes the risk of loss.²⁵ To wit, during a joint webinar presented in partnership with the National Federation of Independent Business, Kabbage's Chief Operating Officer admitted the following in response to the question "are you a direct lender?":

The answer is yes. We are not a marketplace lender. We do securitize the receivables that are generated, the loans that are generated, meaning we have investors in those loans that we make, but Kabbage actually takes the risk of loss. All of our loans are made in partnership with Celtic Bank, which is a Utah bank regulated by the FDIC. We work together with Celtic to manage customer relationships from the time they're originated all the way through the repayment of the loan.²⁶

Unsurprisingly, numerous state attorneys general oppose rent-a-bank schemes designed to evade their usury laws. See Letter from Massachusetts Attorney General Maura Healy, dated January 22, 2019 (citing *Pennsylvania v. Think Finance, Inc.*, 2016 WL 183289, at *1, *13 (E.D. Pa. Jan. 14, 2016); *CashCall, Inc. v. Morrissey*, 2014 WL 2404300 (W. Va. May 30, 2014); *Meade v. Marlette Funding LLC*, 2018 Colo. Dist. LEXIS 3856 (D. Col. Aug. 13, 2018).²⁷

Many of my clients have claimed that the high interest loans from Kabbage and On Deck have led to business failure and/or the need to take out additional financing from MCA companies at even worse interest rates. In other words, my clients view these high-interest loans as a gateway addiction to even harsher financing products.

IV. CONFESSIONS OF JUDGMENT AND ENFORCEMENT UNDER NEW YORK LAW.

New York has become a preferred venue for the filing of confessions of judgment because its confession statute is simple to use and its judgment enforcement practices are powerful.

A. New York's confession of judgment statute.

Under New York's confession of judgment statute, a debtor signs a document called an "Affidavit of Confession," wherein the small business and individual owner consent to a judgment being entered against them for a specific amount upon the happening of a breach in the future. See New York Civil Law and Procedure ("CPLR"), § 3218. Without further notice to the debtor, the creditor may file the Affidavit of Confession with a county clerk and the judgment may be entered against the debtor without a hearing or review by a judge.

²⁴ Compare Ex. 23 (lender identified as On Deck) with Ex. 24 (lender identified as Celtic Bank).

²⁵ See Ex. 25.

²⁶ See Ex. 26.

²⁷ Ex. 27.

In the cash advance context, MCA companies frequently require that merchants and their owners execute an affidavit confessing to the entry of a judgment against them upon default in an amount equal to the face value of the allegedly purchased receipts, less any amounts paid under the agreement, plus costs and attorney's fees calculated as percentage of the balance due under the agreement, which generally ranges from 25% to 33%. Thus, an MCA agreement with a balance of \$100,000 can result in a judgment of more than \$133,000 when costs, statutory interest and fees are included.

Upon an event they deem to be a default, an MCA company can file the affidavit together with their own affidavit stating that a default has occurred and a proposed form of judgment that the clerk signs and files without notice to the small business merchant, a hearing or consideration by a judge. The MCA company can thereafter immediately begin to exercise its enforcement rights under New York law.

The entire confession process is seamless and swift. Within hours, MCA companies can file confessions, obtain judgments and, as will be explained below, freeze bank accounts without any prior notice to the small business or its owners. Indeed, in my experience, often the first time a merchant learns that a judgment has been entered against it is when its bank accounts are frozen and it cannot make payroll or pay critical operating expenses such as rent, employee benefits or even taxes. As a result, the MCA company gains incredible leverage over the merchant such that the merchant is forced to capitulate to the MCA company's demands, close its doors or file for bankruptcy just to stave off the aggressive collection tactics employed by certain MCA companies.

Case Example: *Queen Funding, LLC v. Construction Masonry Inc. and Jose Soliz, N.Y. Index No. 17/811445.* On August 3, 2017, Construction Masonry entered into an MCA agreement with Queen Funding. Under the agreement, Queen was supposed to provide \$30,000 in funding, and Construction Masonry was supposed to pay back \$44,970 through fixed daily payments of \$999. Soliz personally guaranteed performance. The agreement was funded on August 9, 2017, but Construction Masonry only received \$25,800.²⁸ On August 14, 2017, after the broker refused to explain the shortfall, Construction Masonry stopped payment. Two days later, Queen filed a judgment by confession. By August 18, 2017, the judgment was entered, and the very same day Queen issued a restraining notice on the merchant's Wells Fargo account opened and maintained in Texas. It then sent in Marshal Barbarovich to levy the account. On August 24, 2017, Wells Fargo issued a check to Vadim Barbarovich for \$56,763.83.²⁹

In short, Queen funded \$25,800 on August 9, 2017, and was repaid \$56,763.83 just fifteen days later. That results in a staggering simple interest rate of 2,920%.

²⁸ See Ex. 28.

²⁹ See Ex. 29.

B. The far reach of New York's judgment enforcement procedures.

Upon obtaining a judgment, an MCA company's collection attorney can immediately issue and serve a restraining notice upon a merchant's bank or any other party believed to be in possession of a merchant's assets. The restraining notices have the force and effect of an injunction issued by a New York court and require the bank or other recipient to immediately restrain the judgment debtors' accounts or risk being held in contempt of court and subject to fines, penalties or even imprisonment. In my experience, through their attorneys, MCA companies readily serve restraining notices upon banks located outside of New York in order to freeze accounts opened and maintained at branches in other states.

New York law does not require that the small business be provided with advance notice of the restraints. Under New York law, the MCA companies can wait up to four days after service to provide the small business debtor with a copy of the restraining notice. *See* CPLR § 5222(d). Thus, by the time a small business receives notices of the restraints, its accounts are typically already frozen.

Perhaps more alarming, upon receipt of a restraining notice, banks not only freeze the business's accounts, but also any account on which the guarantor judgment debtors are signatories and in amounts equal to *twice the amount of the judgment* in order to take advantage of New York's safe harbor provisions in responding to the restraining notice. *See* CPLR § 5222(b). Thus, by merely signing and faxing a restraining notice to a bank's legal department in connection with a \$30,000 confessed judgment, an MCA company's collection attorney can immediately freeze \$60,000 in an account opened and maintained at a Michigan branch of a Texas-based bank with no banking operations in New York.

This practice raises serious due process considerations because, in my opinion, it is a trespass on funds that are not subject to the judgment. *See Siegel v. Northern Boulevard & 80th Street Corp.*, 31 A.D.2d 182, 187, 295 N.Y.S.2d 804, 810-11 (1st Dep't 1968) ("Where the process or attachment is irregular, unauthorized or void, a levy made by the officer renders the party suing out the attachment a trespasser. And where an attachment is for any reason void, the attachment plaintiff will be a trespasser ab initio and liable to the attachment defendant for any damages proximately resulting therefrom.") (citing *Hyde v. Southern Grocery Stores*, 197 S. C. 263 (1941) and C. J. S. Attachment, § 504, p. 661)).

In addition, these restraining notices are often served on out-of-state citizens and businesses that are not subject to the personal jurisdiction of a New York court. *See Bristol-Myers Squibb Co. v. Superior Court*, 137 S. Ct. 1773, 1781, 198 L. Ed. 2d 395, 404 (2017) (noting "specific jurisdiction is lacking regardless of the extent of a defendant's unconnected activities in the State.") (citing *Daimler-Chrysler AG v. Bauman*, 571 U.S. 117, 134 S.Ct. 746 (2014) ("[E]ven regularly occurring sales of a product in a State do not justify the exercise of jurisdiction over a claim unrelated to those sales"))).

While we believe these restraints also violate New York law, most banks insulate themselves from liability by including provisions in their deposit account agreements permitting the bank to honor any restraining notices or other enforcement devices without regard to whether they are validly issued or properly served. In other words, regardless of whether the restraining

notice is properly issued under New York law, it will be honored by many banks and the onus is placed upon the already financially strapped business to go into New York and challenge the restraints before the money is turned over to the MCA company in satisfaction of the judgment.

Meanwhile, the MCA companies do not even have to go to court to compel a bank to actually turn over the restrained funds. Under New York law, an MCA company's attorneys can issue a property execution or garnishment to a sheriff or New York City marshal. Thereafter, acting as officers of the court, the sheriff or marshal can issue a levy upon the bank. The levy essentially demands that the bank cut a check to the sheriff or marshal in the amount of the judgment plus an additional 5% fee under threat of contempt and the imposition of fines, penalties and even imprisonment if the bank fails to comply. Faced with these threats, it is not surprising that banks comply with these levies without any court intervention.

While New York statutory law imposes territorial limitations and other requirements upon the authority of sheriffs and marshals to levy upon banks, I believe that some MCA companies, collection attorneys and marshals exceed that authority by levying upon banks that have limited or no connection to New York and/or are located beyond the territorial boundaries of the marshal's authority. As a result, without any court intervention, MCA companies are able to initially freeze and then seize bank accounts opened and maintained at bank branches located outside of New York and/or at banks that do not maintain any banking operations in New York and over which the courts of New York have no personal jurisdiction under controlling United States Supreme Court precedent.

In short, in a matter of hours, MCA companies can obtain a confessed judgment against a small business and freeze its bank accounts without any prior notice to the small business or its owner and they can thereafter seize the restrained funds without any court involvement.

Case Example: *Richmond Capital Group, LLC v. The New Y-Capp, Inc.*, N.Y. Index No. 151761/2016. The New Y-Capp provides social services to its local community in Richmond, Virginia. On December 14, 2016, it entered into an MCA agreement with Richmond Capital Group, LLC.³⁰ A confession of judgment was entered just six days after the agreement was signed. Y-Capp's bank accounts were immediately wiped out.³¹

V. CONFESSIONS OF JUDGMENT PROCEDURES IN OTHER STATES.

A. Pennsylvania.

Pennsylvania and certain other states take a slightly different approach to confessed judgements. Instead of requiring the debtor to sign an affidavit confessing to the entry of a judgment, Pennsylvania permits a creditor to do it for the debtor. Under Pennsylvania law, commercial contracts may contain a clause that permits the creditor, or its attorney, to apply to the court for judgment against a debtor in default without requiring or permitting the debtor to respond to contest the judgment at that point in time. The Pennsylvania statute previously worked just like the New York statute, meaning that a judgment creditor could immediately begin enforcement

³⁰ <https://www.bloomberg.com/graphics/2018-confessions-of-judgment-marijuana-smuggler-turns-business-loan-kingpin/>

³¹ See Ex. 30.

action upon entry of the judgment. The Third Circuit, however, held that this prior practice violated the Due Process Clause. *See Jordan v. Fox, Rothschild, O'Brien & Frankel*, 20 F.3d 1250, 1253 (3d Cir. 1994). The statute was subsequently amended to address this holding.

Now, once a judgment is entered, a judgment creditor is required to give a debtor thirty-days notice before it can enforce the judgment. This provides the creditor with the immediate benefit of a judgment lien against real property while affording the debtor an opportunity to contest the judgment prior to execution against a debtor's bank accounts and other personal assets.

However, there are exceptions to this notice rule and even under Pennsylvania law, a judgment creditor can take steps to immediately enforce a judgment without any notice of its entry to the judgment debtor. Thus, even today, a judgment debtor's bank accounts can still be levied prior to the debtor having any notice that a judgment has been entered against it.

Case Example: *Complete Business Solutions Group, Inc. v. HMC, Inc.*, Pa. Comm. Pls., Case ID 190501349. A judgment by confession was entered on May 14, 2019. A writ of execution was issued on May 17, 2019, and served on HMC's bank accounts at Wells Fargo and Bank of America through a Pennsylvania sheriff. Both accounts were frozen before HMC even knew a judgment had been entered against it, even though its bank accounts were opened and maintained in Maryland.³²

B. California.

California takes yet a different approach to confessions. Under California law, a merchant may sign a written statement, verified under oath, confessing to the entry of judgment in a certain amount. To be enforceable, however, it must be accompanied by an independent attorney's declaration stating that the attorney has examined the proposed judgment and has advised the debtor with respect to the waiver of rights and defenses under the confession of judgment procedure and has advised the defendant to utilize the confession of judgment procedure. Upon default, the creditor may file the confession, the declaration and a proposed judgment without notice the debtor. A judge then signs the proposed judgment and a creditor can then immediately begin to exercise its default rights and remedies. The intent of the statute is to protect a debtor's constitutional due process rights under *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174 (1972).

VI. CIRCUMVENTING THE LAW OF MASSACHUSETTS AND OTHER STATES THAT BAN CONFESSIONS.

Massachusetts and many other states ban the use of confessions of judgment and void any contractual provisions that permit the entry of confessed judgments. But that does not prevent MCA companies from requiring that Massachusetts businesses and individual owners sign confessions of judgment in order to obtain financing and it does not necessarily prevent MCA companies from enforcing confessed judgments in Massachusetts.

Under the Full Faith and Credit Clause of the United States Constitution, with certain limited exceptions, states must honor money judgments entered in sister states. Thus, an MCA company can attempt to take a confessed judgment, domesticate it in Massachusetts, and enforce

³² See Ex. 31.

it under Massachusetts law even though the strong public policy of Massachusetts would prevent the MCA company from directly obtaining a confessed judgment against the same merchant in Massachusetts.

VII. ABUSES OF CONFESSIONS OF JUDGMENT BY THE MCA INDUSTRY.

The abuses of the confession of judgment statutes are too numerous to discuss in detail. Below are just some of the examples that I have either personally observed or have discovered through my own independent investigation:

- Robo-signing: Filing same generic form of affidavit accusing business and individual owner of being in default because they supposedly “blocked the account” and “stopped remitting payments” despite still being “in receipt accounts-receivable.”³³
- Forging the county in which judgment is authorized by altering the document.³⁴
- Filing a confession of judgment against merchant evacuated due to Hurricane Mathew.³⁵
- Levying out-of-state bank account in Michigan, which had no New York branches and resulted in missing payroll and appointment of receivership.³⁶
- Domesticating a New York confession of judgment to Texas against a California merchant and resident with no ties to Texas whatsoever.³⁷
- Filing confessions of judgment against merchants where confessions of judgment are illegal in their own home state.³⁸
- Filing a confession of judgment against merchant who was on a cruise and was defaulted because one of her customers had bounced a check. The MCA company then levied their account, which contained deposits from customers and was later sued by those customers.³⁹
- Filing confession of judgment against same merchant in two different counties.⁴⁰
- Filing confession of judgment because bank put seven day hold on deposits due to stolen checks.⁴¹

³³ See Ex. 32.

³⁴ Compare Ex. 33 (Kings County listed) with Ex. 34 (Kings County not listed); compare Ex. 36 (Westchester County) with Ex. 37 (Richmond County).

³⁵ See Ex. 35.

³⁶ See Exs. 38-40.

³⁷ See Ex. 41.

³⁸ See Ex. 42.

³⁹ See Ex. 43.

⁴⁰ See Exs. 44 and 45.

⁴¹ See Ex. 13, ¶ 88.

VIII. STATE REFORM OF CONFESSIONS OF JUDGMENT.

On June 20, 2019, the New York Assembly approved a bill that would effectively prohibit the future use of confessions of judgment against businesses and individuals located outside of New York. The bill now awaits Governor Cuomo's signature. While the bill will not impact the more than 32,000 confessed judgments that have already been obtained, it will likely prohibit that number from growing substantially in the near future. However, this does not mean the concern over the use of confessions should be diminished. Other states, such as Pennsylvania, continue to honor them and their use in these states will continue to provide MCA companies with an alternative venue to obtain a judgment against small businesses and begin enforcement.

Further, New York's reform of its confession of judgment statute will do nothing to address other concerns about the MCA industry. This Committee should not lose sight of the need for reform and regulation within the industry. I strongly encourage the Committee to continue to investigate the industry before it overwhelms and destroys small business throughout the United States.

IX. THE NEXT WEAPON OF THE MCA INDUSTRY.

The death of the confession of judgment in New York will not stop the MCA industry from using their next best weapon against small businesses: The Uniform Commercial Code.

In virtually every MCA agreement, a small business has to provide the MCA company with a UCC lien over all of its receivables. As a result, upon any alleged default by the small business owner, the MCA company has a wide range of ways to cripple a business and thereby extort a settlement under duress. Credit card processors and PayPal accounts are usually the first to get hit.⁴² If that does not work, the MCA company can use the merchant's bank statements to identify their customers.⁴³ That, of course, can have a domino effect because not only does it freeze-up desperately needed funds, but more importantly, it also threatens the relationship with the customer.

But perhaps the most egregious example I have seen is where an MCA company sent out UCC notices to the customers of an insurance agent. In doing so, the MCA company represented that it now owned the insurance carrier, and that if the customer did not pay the MCA company directly, their "account will be dropped":⁴⁴

NOTICE OF PURCHASED OF ACCOUNTS RECEIVABLE

***** We now own Your insurance carrier and If you choose to not pay your account will be dropped *****

⁴² See Ex. 46-47.

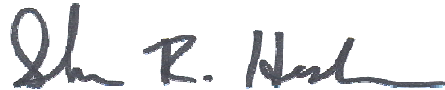
⁴³ See Ex. 48.

⁴⁴ See Ex. 49.

X. CONCLUDING REMARKS.

I would like to once again thank Chairwoman Nydia M. Velázquez and the distinguished Members of the Small Business Committee for the opportunity to appear here today. I hope my testimony has helped shed light on the dangers of confessions of judgment and, more globally, on the need for reform of the MCA industry and other high-interest lenders. As the Committee continues its inquiry, I welcome the opportunity to speak again.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Shane R. Heskin". The signature is fluid and cursive, with a long horizontal stroke at the end.

Shane R. Heskin