New York Courts Appear Skeptical of Certain Fees in Sales-Based Financing Transactions

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On February 11, 2025, the Supreme Court of New York, Nassau County, ordered a hearing on whether a financing contract between Square Funding LLC and Walsh Roofing Services of Tampa Bay, LLC, was a "merchant cash advance" contract or a "predatory loan scheme." The order is an unusual move that may indicate a tendency in New York courts toward greater scrutiny of contractual fees in sales-based financing agreements.

Walsh Roofing sold $218,850 worth of future receivables to Square for $150,000. After deduction of a $7,500 fee for underwriting and an ACH debit program, Square provided Walsh Roofing $142,500 in funding. The contract specified a default fee of $2,500 and a returned ACH fee of $50. According to court documents, Walsh Roofing allegedly stopped making payments about seven weeks after the date of funding. Square sued Walsh Roofing for breach of contract. Square claimed that Walsh Roofing was liable for about $148,000 in unpaid future receivables, a $2,500 default fee, 15 returned ACH fees totaling $750, liquidated damages of about $37,000 (equal to 25% of the amount in default before fees, although the court did not state the 25% figure), and a $195 UCC-1 filing fee, for a total of about $188,000, not including attorney fees. Square's manager declared in an affidavit that Walsh Roofing had failed to notify Square of the lack of funds in its account before its bank started declining payments due to insufficient funds. Square moved for summary judgment. The court decided that before it ruled on the motion, it must determine whether the agreement was a predatory loan.

The court ordered Square to substantiate several specific fees that Walsh Roofing allegedly owed or had paid, including the origination fee, the default fee, the attorney fees, a 40% contingency fee, prejudgment interest at 24% per annum, and the liquidated damages. The court also questioned the overall payment amount, which it calculated at about $259,000—the $188,000 that Square sought plus the $71,000 that Walsh Roofing had already paid. The court sought "clarification" on how $259,000 could be due on $142,500 of financing in less than one year without the agreement being a predatory loan. The hearing is scheduled for April 11, 2025.

This case is not the first time a New York court has questioned contractual fees in a sales-based financing agreement. In June of 2024, the Supreme Court of New York, Monroe County, granted partial summary judgment to Capybara Capital, LLC, in its breach-of-contract lawsuit against Affordable Construction Company LLC but found some of the contractual fee provisions unenforceable. Specifically, the court ruled that the contract's default fee and stop payment fee were unenforceable penalties. A default fee of 25% of the outstanding balance or 10% of the funding amount, whichever was more, bore no relation to the amount of damages that Capybara would suffer due to a default, according to the court. The court also found that Capybara had failed

to prove damages related to Affordable's stop payment order. The court therefore awarded summary judgment to Affordable on the default fee and the stop payment fee.

These two cases, particularly the case involving Square Funding, suggest that sales-based financing providers may face increasing skepticism from New York courts regarding certain fees in their contracts. The courts in these cases focused on whether the plaintiffs (i.e., providers) could substantiate the amounts of the fees, and courts are likely to focus on the same question in future cases.