Potential Pitfalls of Legal Factoring

By Christian M. Lovelace

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With respect to determining whether a financial transaction is a factoring arrangement or a loan, New York courts have held that it is the *substance* of an arrangement, and not the name assigned to an arrangement, that determines whether a transaction should be considered a factor or a loan. Indeed, if accounts receivables are purchased in a manner where there is no reasonable means of non-payment—such as a purchase of receivables that requires a personal guarantee of payment from the Seller and/or pursuant to which the Purchaser is awarded a security interest in the Seller's property—the arrangement may be deemed a loan even if the parties believed they were entering into a factoring agreement.[1] As such, in order to avoid potential issues with usury laws, it is vital that any party wishing to enter the factoring business carefully draft its operative agreements to ensure its arrangements will not be considered loans.

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[1] *See*, *Ideas v. 999 restaurant Corp* ., 2007 WL 3234747 (Sup. Ct. NY Cnty.)(denying a plaintiff's motion for summary judgment regarding a defendant's non-payment pursuant to a factoring agreement because there was a question of fact as to whether the agreement was a loan as, to ensure the plaintiff received the amounts due under the factoring arrangement, the defendant executed a personal guaranty and the plaintiff obtained a security interest in certain property owned by the defendant).

Related Team

Christian M. Lovelace
Partner | Team Leader - Franchising & Licensing; Team Leader - Asset Receivable Management

Sean P. Balkin
Senior Associate

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LippesMathias LLP ATTORNEYS AT LAW

ALBANY | 54 State Street, Suite 1001 • Albany, NY 12207 • 518.462.0110

BUFFALO | 50 Fountain Plaza, Suite 1700 • Buffalo, NY 14202 • 716.853.5100

CHICAGO | 125 S Clark St., 17th Floor • Chicago, IL 60603 • 872.254.5500

GREATER TORONTO AREA (PRACTICE FOCUSED ON U.S. LAW) | 1100 Burloak Drive, Suite 300 • Burlington, ON L7L 6B2 • 905.319.8964

JACKSONVILLE | 10151 Deerwood Park Blvd. , Bldg. 300, Suite 300 • Jacksonville, FL 32256 • 904.660.0020

LONG ISLAND | 1979 Marcus Ave, Suite 210 • Lake Success, NY 11042 • 516-820-1500

NEW YORK CITY | 260 Madison Avenue, 17th Floor • New York City, NY 10016 • 332.345.4500

ROCHESTER | 400 Linden Oaks Dr., Suite 150 • Rochester, NY 14625 • 585.770.7590

SAN ANTONIO | 4499 Pond Hill Road, • San Antonio, TX 78231 • 210.436.6222

WASHINGTON, D.C. | 1900 K Street, NW, Suite 730 • Washington, DC 20006 • 202.888.7610