

Potential Pitfalls of Legal Factoring

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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.

^[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).

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