450750/2024 03/05/2024	Partial Participation Recorded *Active*	PEOPLE OF THE STATE OF NEW YORK, by LETITIA JAMES, Attorney General of the State of New York v. YELLOWSTONE CAPITAL LLC et al	New Yo County Court *Special Proceed* *Other*

People v Yellowstone *et al*., Supreme Court, Albany County, Index No. 450750/2024

Petition

124. In truth, as detailed herein, Respondents' agreements are designed and enforced to virtually guarantee their continued collection of the fixed Daily Amount from merchants. The value of the fixed Daily Amount is disconnected from any fluctuations in the merchant's revenue, and—just like loan remittances—the payment amounts are altered only through the merchant's default or through Respondents' lowering the payment amount through an "adjustment"—a discretionary exercise of beneficence that sets a new payment amount prospectively, but without any consideration of or reference to the percentage of revenue Respondents purportedly purchased. *See infra* Part I.B and ¶¶ 305-316.

125. Respondents also make it virtually impossible for merchants to adjust their payments retroactively by obtaining a refund of excess payments following a drop in revenue—a process called "Reconciliation." *See infra* ¶¶ 193-304. Until at least 2018, Yellowstone failed to affirmatively notify merchants of their right to Reconcile, had no procedure in place if a merchant requested a Reconciliation, and used contract language that made Reconciliation needlessly difficult and ultimately discretionary. *See infra* ¶¶ 193-202. Following increased scrutiny of the MCA industry and Yellowstone specifically, Yellowstone changed its agreements and implemented a process that made it easier for merchants to *request* a Reconciliation—but structured its agreements so that the *result* of the Reconciliation would almost never be a refund to the merchant. *See infra* ¶¶ 203-

Reconciliation—but structured its agreements so that the *result* of the

248. Indeed, Yellowstone did not issue a single Reconciliation refund throughout its entire existence until 2020, and only very rarely after that. *See infra* ¶¶ 186-191. Yellowstone accomplished this chiefly by manipulating the Specified Percentages stated in its agreements with merchants—a practice that Delta Bridge continued. *See infra* ¶¶ 203-248.

126. For nearly all of Yellowstone's and Delta Bridge's existence, the "Specified Percentage" has been mostly an afterthought—Funders described it as "irrelevant," just "a number on the contract," and something that was included in the agreements for ambiguous "legal purposes" but was almost never discussed internally or negotiated with merchants. *See infra* ¶¶ 317-378. Although Yellowstone's and Delta Bridge's agreements state that the Daily Amount is intended to approximate the Specified Percentage of the merchant's daily revenue, the reality is the Funders negotiated and set the Daily Amount based on how quickly they wanted to be repaid and did not use the Specified Percentage at all. *See infra* ¶¶ 134-151. Yellowstone and Delta Bridge provided Funders with no guidance on how to set the Specified Percentage in their MCA agreements and took no interest in examining how the Specified Percentages were in fact being set. *See infra* ¶¶ 318-321. Both companies routinely entered into multiple concurrent MCA agreements with individual merchants, with a combined Specified Percentage that could reach as high as—or higher than—100%. *See infra* ¶¶ 342-357. As a result, the Specified Percentage could not, in fact, be the percentage of revenue that Yellowstone and Delta Bridge purchased from merchants.

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182. And Respondents made it all but impossible for merchants to adjust their payments retroactively through Reconciliation, the process of obtaining a refund of excess payments following a drop in revenue. Respondents protected themselves from having to issue refunds through a number of strategies, including by incorporating contractual language that rendered Reconciliation illusory, and then by manipulating the Specified Percentages stated in the contracts which had the same effect. Respondents' manipulation of the Reconciliation process through such tactics is a key factor showing usury. *See Davis*, 194 A.D.3d at 517 (usury indicated by "discretionary nature of the reconciliation provisions" and "allegations that defendants refused to permit reconciliation"); *Fleetwood*, 2022 WL 1997207, at *13 ("nominal[] . . . reconciliation provision," that is "largely illusory").

183. As a result, Respondents virtually never issued any refunds to merchants as the result of a Reconciliation. Respondents issued Reconciliation refunds on just 2.4% of their more recent Delta Bridge MCA deals since August 2022, 0.37% of their earlier Delta Bridge deals, and 0.06% of their MCA deals at Yellowstone—including zero prior to 2020. *See infra* ¶¶ 186-189.

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210. By Reconciling merchants' payments against a made-up, inflated Specified Percentage number that bore no relation to the Daily Amount actually negotiated by the parties, Yellowstone, Delta Bridge, and their Funders made it virtually impossible for merchants to qualify for any Reconciliation refund. As one merchant explained, "I cannot imagine that [my business] would have taken advantage of this reconciliation process, since reconciling [my business's] payments based on this 15% 'Specified Percentage' likely would have caused its payment amount not to decrease but to increase." Ostrowski Aff. ¶¶ 30-31; *see also id.* ¶ 16.

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281. In addition, because Yellowstone and Delta Bridge's Reconciliation procedures looked at merchants' payments over the entire term of the MCA, *see* Maczuga Tr. at 239:19-240:4, Reconciliation refunds continued to be unavailable in the case of a sudden drop in revenue. Merchants did not qualify for a Reconciliation refund until their cumulative payments to Yellowstone or Delta Bridge exceeded the inflated percentage of their actual revenue over the entire term of the MCA. *See* Kern Tr. at 134:7-17 (Reconciliation entailed evaluating merchant's "total revenue for that month").

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298. When merchants proactively reported a drop in revenue, Funders almost never raised the possibility of performing a Reconciliation to retroactively adjust the merchant's payments to match the Specified Percentage of their actual revenue. *E.g.*, McNeil Tr. at 156:8-13; Alabudi Aff. ¶¶ 27, 39.

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308. Yellowstone's contracts also disallowed Adjustments unless a Reconciliation had occurred and resulted in a refund of at least 15% of the total amount collected. *See id.* at 4 § 12(b). As a result, Adjustments were unavailable to virtually all merchants under the terms of Yellowstone's agreements, since Reconciliation was an explicit precondition, and Respondents made it virtually impossible to obtain any Reconciliation as discussed above. *See supra* ¶¶ 179-304. Yellowstone's contracts also provided that any adjusted Daily Amount would automatically revert to the original amount after 30 days. *See* Yellowstone 2020 Exemplar at 4 § 12(a, b).

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346. But as one former Yellowstone and Delta Bridge Funder acknowledged, even *25%* was not a realistic share of revenue for merchants to sell, "because then he has other expenses, payroll, rent, he has to take money for himself." McNeil Tr. at 119:2-19; *see also* Saffer Tr. at 238:9-17 ("49 percent [is] not a realistic percentage"). "[I]n general you're not going anywhere near that 25 percent threshold because you're going to kill the merchant if you do." McNeil Tr. at 122:22-24.

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383. Respondents' claim to such recourse is facilitated by their requirement that each transaction is personally guaranteed in the event of default—usually by the business's owner. *E.g.*, Delta Bridge Exemplar at 12-15; Yellowstone 2020 Exemplar at 10 § 27(i), 14-16; Yellowstone 2018 Exemplar at 6-7; *see also* Rubin Aff. ¶ 18. Respondents' Agreements provide explicitly that they can be enforced against the guarantor in the event of default. *E.g.*, Delta Bridge Exemplar at 9 § 26(c) ("If any Event of Default occurs . . . [Delta Bridge] may enforce the provisions of any

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Guaranty against each Guarantor."); Yellowstone 2020 Exemplar at 10 § 30(b) ("Upon [merchant's] default, [Yellowstone] may immediately . . . [e]nforce[e] the provisions of the Personal Guarantee of Performance against the Guarantor(s) without first seeking recourse from [merchant]."); Delta Bridge Exemplar at 12-13 § 2 ("[I]f default or breach shall at any time be made by [merchant] in the Guaranteed Obligations, Guarantor shall well and truly perform (or cause to be performed) the Guaranteed Obligations and pay all damages and other amounts stipulated in the Agreement with respect to the non-performance of the Guaranteed Obligations, or any of them."); Yellowstone 2020 Exemplar at 14 § 2 (same).

384. Respondents' Agreements also require full, immediate payment of the entire Payback Amount in the event of default—discarding altogether the notion of payments tied to the merchants' revenue. Delta Bridge's acceleration clause, for example, states that in an "Event of Default," "The Specified Percentage shall equal 100%. The full undelivered Purchased Amount plus all fees and charges (including

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1. Respondents Claim Extensive Recourse in the Event of Merchant Bankruptcy

386. Although Respondents purport to be buying a percentage of each merchant's revenue, Respondents reserve rights to repayment even if the merchant's business fails altogether and files for bankruptcy. This is a key factor showing usury. *See Fleetwood*, 2023 WL 3882697, at *2 ("whether there is any recourse should the merchant declare bankruptcy"); *Davis*, 194 A.D.3d at 517 (usury shown by "provisions authorizing [MCA lender] to collect on the personal guaranty in the event of plaintiff business's . . . bankruptcy").

387. Respondents obtain security interests pursuant to Article 9 of the Uniform Commercial Code ("UCC") in a vast array of merchants' assets. Delta Bridge Exemplar at 8 § 21(ii); Yellowstone 2020 Exemplar at 9 § 22; Yellowstone 2018 Exemplar at 6 § I. These secured interests give Respondents priority status in the event of a merchant's bankruptcy, ensuring that they can still recover in full against the merchant's assets—even if the merchant has collected zero dollars in revenue, and even while unsecured and lower-priority claims against the merchant remain uncollectable. *See, e.g.*, 1 Collier on Bankruptcy P. 1.03 § 4 (explaining that

384. Respondents' Agreements also require full, immediate payment of the entire Payback Amount in the event of default—discarding altogether the notion of payments tied to the merchants' revenue. Delta Bridge's acceleration clause, for example, states that in an "Event of Default," "The Specified Percentage shall equal 100%. The full undelivered Purchased Amount plus all fees and charges (including legal fees) assessed under this Agreement will become due and payable in full immediately." Delta Bridge Exemplar at 9 § 26(a); *accord* Yellowstone 2020 Exemplar at 10 § 29.

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392. Yellowstone's Agreements during this period also provided that a merchant would default on its Agreement if "Merchant interrupts the operation of his business . . . without . . . the express written permission of [Yellowstone]." *Id.* at 3 § 1.10(d). Although the clause included exceptions for "adverse weather, natural disasters, or acts of God," there was no exception for business interruptions resulting from bankruptcy, even though the typical bankruptcy involves at least some length of business interruption, if not termination. *Id.*

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493. In these complaints, Respondents—as Yellowstone/Fundry and as Delta Bridge/Cloudfund—continued to make the same false representations to New York courts, stating that the merchants had agreed to pay the Specified Percentage of their revenue, and had then deprived Respondents of that percentage of revenue.

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Memo of Law

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To create the illusion that payment amounts and terms are variable, Respondents state in each agreement that merchants can request a "reconciliation" of past payment amounts to ensure that they do not exceed the Specified Percentage of revenue ("Reconciliation Clause"). *E.g.*, Yellowstone 2020 Exemplar at 3-4 § 10; Delta Bridge Exemplar at 4 § 10.
But these "nominal[] . . . reconciliation provision[s]" are "illusory." *See Fleetwood*, 2022 WL 1997207, at *13. Respondents neither set merchants' Daily Amounts based on Specified Percentages nor reconcile payments. Yellowstone did not issue a single reconciliation refund to a merchant from the formation of its business in 2009 until January 2020. Petition ¶ 186. Subsequently, from January 2020 until August 2022, Respondents issued a mere 109 reconciliation refunds across 23,000 transactions, for a refund rate of less than half of one percent. *Id.* ¶ 187.

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Respondents determine payment amounts for each transaction based not on such percentages but instead on the number of days in the term. *Supra* at 8-9. The term length, in turn, is based not on Specified Percentages but primarily on the risk of nonpayment, as reflected by such factors as merchants' credit ratings and payment histories. Petition ¶¶ 152-70. Furthermore, even beyond the payment amount, the Specified Percentage is treated as irrelevant to the entire so-called purchase of revenue. Petition ¶¶ 318-78.

b. Respondents Manipulate Their Specified Percentages to Prevent Merchants from Obtaining Reconciliation Refunds

For years, Respondents have set their Specified Percentages at values so high

that it has been virtually impossible for merchants to obtain refunds through payment reconciliation. As a result, Respondents' Reconciliation Clauses are illusory, further showing that their purported MCAs are loans. *See generally* Petition ¶¶ 203-48.

For example, Delta Bridge in 2022 issued an MCA to the merchant Cookies Restaurant Group ("Cookies") which set a Daily Amount of $208, Rubey Aff. Ex. 2B at 1, an amount equaling 13-18% of the merchant's historical daily revenue, Rubey Aff. ¶ 29. But Delta Bridge fraudulently stated 49% as Cookies' Specified Percentage and falsely stated that $208 was a "good faith approximation" of the 49% number. Rubey Aff. Ex. 2B at 1. By doing so, Delta Bridge raised the bar impossibly high for Cookies to obtain a reconciliation of its past payments. Thus, when Cookies experienced a 50% decline in its revenues, Delta Bridge refused the merchant's request for a reconciliation refund because the amount Delta Bridge had collected ($6,953) was still less than 49% (the Specified Percentage) of the merchant's $37,041 in revenues. Ex. 394 at 164 (row 26989); Rubey Aff. ¶ 33.

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In its earliest agreements, Yellowstone set its Specified Percentages at around 10% and 15%, then in 2017 and 2018 raised the percentages to 25%. Petition ¶¶ 216-23. From 2019 through 2021 Yellowstone issued MCAs with higher and higher percentages – most commonly 49% of merchants' revenue (as in the case of Cookies,

supra), a practice that Delta Bridge adopted when it continued Yellowstone's business in May 2021. Petition ¶¶ 226-48. Respondents set Specified Percentages far higher than the payment amounts merchants agree to, *see* Rubey Aff. ¶¶ 29, 54, and far higher than merchants can realistically repay, *e.g.*, Saffer Tr. at 238:9-17; McNeil Tr. at 119:14-17, 122:22-24. The purpose and effect of doing so is to put reconciliation out of reach for merchants, Petition ¶¶ 236, 241-48, ensuring that Respondents' Reconciliation Clauses are mere "window dressing." *Fleetwood,* 2022 WL 1997207, at *11.4

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Delta Bridge continues Yellowstone's practice of making such future payment adjustments arbitrarily, not based on Specified Percentages. Maczuga Tr. 244:25-245:8 ("[T]he specified percentage does not play a role in adjustments or modifications."

Respondents' agreements state that reconciliation is not available to a merchant that is "in default" of its Agreement. *E.g.*, Delta Bridge Exemplar at 4 § 10(a); Yellowstone 2020 Exemplar at 3 § 10(a). But Respondents ensure that merchants typically are "in default on Day 1," *Richmond Capital,* 80 Misc. 3d 1213, at *4, by requiring them to misrepresent that their receipts are free and clear of other encumbrances, when in fact Respondents know that merchants have often already pledged their receipts to other MCA companies.

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Respondents further ensure that merchants will default by defining "Default" to include any instance when a merchant's bank rejects four (or fewer) debit attempts by Respondents. Delta Bridge Exemplar at 8-9 § 25(g); Yellowstone 2020 Exemplar at 10 § 27(h). By doing so, Respondents ensure that merchants with insufficient funds to cover Respondents' daily debits will be ineligible to receive reconciliation. Petition ¶¶ 394-401.

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Respondents draft their agreements to ensure that they retain "'recourse should the merchant declare bankruptcy,'" *Richmond Capital*, 80 Misc.3d 1213, at *10, and that they may "collect on the personal guaranty in the event of [a merchant's] inability to pay or bankruptcy," *Davis*, 194 A.D.3d at 517, further rendering each agreement usurious on its face. *See generally* Petition ¶¶ 382-412.

Respondents ensure such protection by, *inter alia*, requiring guarantors (who are usually merchants' owners, Petition ¶ 390) to guarantee "all of [merchant's] obligations" (or similar phrasing), Yellowstone 2020 Exemplar at 14 § 2, including merchants' obligation to convey their receipts of revenue without prior encumbrances and to make payments without exceeding a small number of bounced debits, *id.* at 8 § 21(o), 10 § 27(a, h). Guarantors, like merchants, are "immediately"

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liable for the full Payback Amount in any such "Event of Default," *see, e.g., id.* at 10 § 27(a), 10 § 30(b), 14 § 2; Delta Bridge Exemplar at 8-9 § 25, 9 § 26(a, c), 12-13 § 2, and are not relieved from such obligations in the event of merchant bankruptcy, Petition ¶¶ 389-91.

The agreements also vest Respondents with secured interests in a vast arra of merchants' assets pursuant to Uniform Commercial Code Article 9, such as merchants' "equipment, general intangibles, instruments, and inventory." *E.g.*, Delta Bridge Exemplar at 8 § 21. As a result, Respondents are priority creditors i the event of merchant bankruptcy, *see* 1 Collier on Bankruptcy P. 1.03 § 4, and car collect from bankrupt merchants' non-revenue assets. Respondents' recent agreements state that a merchant is not liable if it declares bankruptcy and as a result "ceases its operations," *e.g.*, Delta Bridge Exemplar at 5 § 14(b), but they provide no such protection to guarantors, nor do they provide such protection to merchants that have kept their doors open during Chapter 11 reorganization bankruptcies, Petition ¶ 389.

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Respondents have pursued their secured, guaranteed rights even while aware that merchant's business operations have ceased. Petition ¶¶ 402-12. When one merchant's proprietor told Respondents Matthew Melnikoff and Mark Sanders that his "business [had] not been operating," and that he had "accepted a part time job elsewhere," Melnikoff and Sanders demanded that the merchant continue making payments – even though it was clear the merchant had no receipts of revenue left to collect upon. Ex. 274 at 3-4. In another incident, Respondent Steve Davis told a

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In their affidavits and complaints, which are filed by Respondent Vadim Serebro and other attorneys for Respondents, Respondents have falsely averred that (1) they "conduct[ed] . . ACH debits of the Specified Percentage" of merchants' revenue, and (2) merchants defaulted when they "stopped remitting the Specified Percentage" to Respondents. *E.g.*, Ex. 379 at 7, § 11-12 (or similar wording); Petition ¶¶ 474-501. But Respondents' court papers are false. Respondents did not underwrite or collect merchants' payment amounts based on Specified Percentages, as set forth above.

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526-34. As Yellowstone, Respondents concealed from merchants the amounts of their fees by stating that they would charge fees in either express amounts, such $195, or "up to 10% of the funded amount" (or similar wording) – thereby allowing for fees far higher than the express amounts – and concealing from merchants the actual fee amounts until after they signed Respondents' agreements. Petition ¶¶ 534-38. Respondents also concealed the basis for the fees, presenting them as payment for certain services, when they were in fact just additional profit for Respondents. Petition ¶¶ 539-42; *see also Richmond Capital*, 80 Misc.3d 1213, at *5-6 (concluding that MCA providers engaged in fraud through similar practices).