

LITIGATION INFORMATION MEMO

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New York State Court of Appeals Holds that Criminally Usurious Loans are Void Ab Initio

In a recent case, the New York Court of Appeals answered a novel question posed to it by the United States Court of Appeals for the Second Circuit concerning the intersection of the New York General Obligations Law and the New York Penal Law. That question was: where the interest charged on a loan is determined to be criminally usurious under N.Y. Penal Law § 190.40, is the underlying contract void in its entirety pursuant to N.Y. Gen. Oblig. Law § 5-511? The Court answered this question in the affirmative in a decision that has important implications for corporations and lenders in New York.

In *Adar Bays, LLC v. GeneSYS ID, Inc.*, 37 N.Y.3d 320 (2021), plaintiff Adar Bays, LLC issued defendant GeneSYS ID, Inc. a loan for \$35,000, with an 8% interest rate that would mature in one year. The loan agreement contained an option for Adar Bays to convert some or all of the debt into shares of GeneSYS stock at a discount of 35% from the lowest trading price for GeneSYS stock over the 20 days prior to the date on which Adar Bays requested a conversion.

Approximately six months after the loan was issued, Adar Bays exercised its option to request conversion of part of the debt. GeneSYS refused, instead seeking to renegotiate the terms of the loan. Adar Bays sued GeneSYS for breach of contract. GeneSYS moved to dismiss the lawsuit, claiming that the contract was void because the rate of interest, including the conversion option, exceeded the criminal usury rate of 25%.

In reaching its conclusion, the Court of Appeals reviewed provisions of the General Obligations Law, the Banking Law and the Penal Law, which combined, comprise New York's usury law. The Court noted that under these combined provisions, loans of less than \$250,000 issued to individuals cannot exceed a 16% annual interest rate (the civil usury rate) and loans of between \$250,000 and \$2.5 million cannot exceed 25% (the criminal usury rate). The Court further held that loans of a value of \$2.5 million or more are not subject to the usury laws.

The Court also held that while the defense of civil usury contained within New York's General Obligations Law is not available to corporations, a corporate borrower can still raise the defense of criminal usury in a civil action. More specifically, although Section 5-521(1) of the General Obligations Law "disallows" corporations from raising the defense of usury with respect to a loan charging less than 25% interest, this restriction is inapplicable where an interest rate is greater than 25%, bringing the loan within the realm of Penal Law § 190.40.

Referring to the legislative history of the enactment of the criminal usury law, the Court came to its final conclusion that loans that charge an interest rate exceeding 25% are to be voided in their entirety because it would negate the purpose of the usury law to allow a lender to recover payments for a loan for which it could be prosecuted for criminal usury. The Court held that it only makes sense that loans that violate the criminal usury statute are subject to the same consequence as any other usurious loan – complete invalidity of the instrument.

Another significant question that was posed to the Court in this case was whether a stock conversion option that permits a lender, at its sole discretion, to convert any outstanding balance to shares of stock at a fixed discount should be treated as interest for the purpose of determining whether the transaction violates the criminal usury law. The Court also answered this question in the affirmative.

The *Adar Bays* decision should be understood as a caution for lenders to carefully review the terms and conditions of its lending instruments. The potential consequences of including interest rate terms that violate the principles explained by the Court of Appeals are significant.

For any questions about this issue, please feel free to contact [Travis Talerico](#), any attorney in Bond's [Litigation practice](#) or the attorney at the firm with whom you are regularly in contact.

