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## **Criminal Usury and Its Impact on New York Business Transactions**

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## CRIMINAL USURY AND ITS IMPACT ON NEW YORK BUSINESS TRANSACTIONS

*Christopher Basile\**

### I. INTRODUCTION

Choice-of-law provisions have the devastating potential of bypassing state statutes implemented to protect the general public and undermining the legislative intent of a state. A choice-of-law clause is a provision in a contract where the parties choose a state's law to govern any conflicts or disputes that may arise between the parties.<sup>1</sup> Lenders may implement choice-of-law clauses in their contracts to avoid statutes or regulations of various states.<sup>2</sup> Many lenders use choice-of-law provisions to avoid New York laws and regulations intentionally. Additionally, inconsistencies and misinterpretations of New York law by the federal and state courts have led to forum shopping to exploit loopholes and bypass implications of violating New York law. Lenders attempt to avoid New York's criminal usury statutes through choice-of-law clauses. A lender commits usury when

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<sup>1</sup> Glen Banks, *New York Practice Series: New York Contract Law* § 8:3 (2019).

<sup>2</sup> William B. Emmal, comment, *Evading Prohibitions on Usury Through Choice of Law*, 9 TRANSLAW 6 (2009). Emmal stated, "[s]ome lenders might also use a choice-of-law clause to avoid the usury law of the state whose law would apply if no choice were made." *Id.*

the lender charges an illegal rate of interest on a financial instrument.<sup>3</sup> Thus, many lenders intentionally try to avoid New York's criminal usury statutes through the use of choice-of-law provisions or forum shopping.

When a transaction is executed in New York between two businesses, New York law should govern if the transaction is substantially related to New York.<sup>4</sup> Additionally, when two parties execute a transaction, one of the parties being in New York, and fundamental public policy would be violated by enforcing a choice-of-law provision.<sup>5</sup> New York law should govern the transaction.<sup>6</sup>

Part II will provide a brief history of usury in New York. Part III will analyze the various usury statutes of New York. This section will also discuss how businesses may invoke criminal usury as an affirmative defense, the required percentage threshold for a borrower to invoke criminal usury in New York, and the various financial instruments that the courts may deem as criminally usurious in New York. Part IV will discuss how the courts calculate interest on financial instruments in New York. Part V will delve into the intent of predatory businesses and explain why these businesses choose certain states to govern their contracts. Part VI will discuss New York's substantial relationship test and how it impacts choice-of-law provisions. Part VII will examine New York's fundamental public policy and how it may supersede choice-of-law provisions. Part VIII will examine the ramifications of criminally usurious transactions and how these transactions are void in New York. Part IX will shed light on the ambiguous nexus between criminally usurious transactions and waivers. Part X will delve into inconsistencies in rulings between the federal and state courts' interpretation of New York's usury laws, which ultimately leads to forum shopping. Finally, Part XI will conclude by discussing how the criminal usury laws should be interpreted by all of the courts in New York when there is a choice-of-law provision in dispute. The final section will reevaluate the usury statutes and clarify the statutory language of criminal and civil usury,

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<sup>3</sup> 75 Am. Jur. 3d. *Proof of Facts* § 103 (2019).

<sup>4</sup> 19A N.Y. Jur. 2d *Conflict of Laws* § 34 (2019). A choice-of-law provision will not be enforced or honored if the law chosen has no reasonable relationship or sufficient contacts with the transaction or subject matter of the contract in question. *Id.*

<sup>5</sup> 19A N.Y. Jur. 2d *Conflict of Laws* § 35 (2019). A choice-of-law provision will not be enforced or honored where to do so would violate a fundamental or public policy of the forum state.

<sup>6</sup> *Id.*

which will bring the federal and state decisions concerning criminal usury into harmony.

## II. A BRIEF HISTORY OF USURY IN NEW YORK

Since their founding, the courts in New York have taken a strong position against enforcing loans with a rate of interest above what is permitted by law.<sup>7</sup> Amidst establishing the foundation of interest limitations on financial instruments, “the ‘Statute of Anne’ (1713), which fixed a maximum rate of interest at five percent for all loans, was the model followed.”<sup>8</sup> In 1773, the Parliament of Great Britain passed the Statute of Anne to reduce the rate of interest on a loan without any prejudice to any Parliamentary Securities.<sup>9</sup> To combat the inherent issues that are faced when parties with disparate bargaining power enter into contractual agreements, the legislature of New York enacted its first usury statute in 1787.<sup>10</sup>

In New York State, the leading case regarding usurious transactions is *Curtiss v. Teller*,<sup>11</sup> in which the New York Court of Appeals held that usury statutes declare a usurious transaction void and provide for forfeitures and penalties against the usurer.<sup>12</sup> The decision and reasoning of the *Curtiss* Court were sustained nearly seventy years later in *Szerdahelyi v. Harris*.<sup>13</sup> The Court of Appeals in *Szerdahelyi* analyzed the history surrounding usury laws and noted that the interpretation of the usury statutes in *Curtiss* is consistent with New York’s legislative view on the matter.<sup>14</sup> In early judicial decisions, there was no legislation in effect to bifurcate usury into civil usury and criminal usury.

Further, the court held that a usurious transaction is *void ab initio*, and a financial instrument with a total interest charge exceeding the statutory limit results in the lender being unable to recoup the

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<sup>7</sup> Franklin W. Ryan, *Usury and Usury Laws: A Juristic-Economic Study of the Effects of State Statutory Maximums for Loan Charges upon Lending Operations in the United States*, Vol. 39, Boston: Houghton, Mifflin and Company, 1924, at 181.

<sup>8</sup> *Id.*

<sup>9</sup> Public Act, 13 Anne., c. 15 (Gr. Brit. 1773)

<sup>10</sup> *An Act for preventing Usury* (Feb. 8, 1787), Reprinted in *Laws of the State of New York*, Revised and Passed at the Thirty-Sixth Session of the Legislature, Volume 1.

<sup>11</sup> 112 N.E. 1056 (N.Y. 1916).

<sup>12</sup> *Id.*

<sup>13</sup> *Szerdahelyi v. Harris*, 490 N.E.2d 517 (N.Y. 1986).

<sup>14</sup> *Id.*

money that he or she has advanced.<sup>15</sup> Additionally, if a lender's total interest charge exceeds the statutory limit, the lender cannot collect the interest due on the transaction.<sup>16</sup> At the time *Szerdahelyi* was being heard, the New York State legislature made further revisions to the usury laws due to the evolving complexity of financial crimes such as loan-sharking.<sup>17</sup> The courts in New York have described loan-sharking as "one of the most heinous, virtually bloodsucking criminal activities of all times."<sup>18</sup> The Legislature in New York subsequently enacted comprehensive legislation to deal with this problem. The express intent of this legislation was to "amend the penal law and the general obligations law, concerning criminal usury and possession of records of a criminally usurious loan."<sup>19</sup> Usurious transactions are ultimately void under New York law, regardless of whether they violate the civil section of Statute 5-501 or the criminal section under the New York Penal Law Section 190.40.<sup>20</sup>

The current usury laws in New York are some of the strongest and most exceptional in the nation, reflecting the principles adopted by New York that go back to Lord Mansfield from the Kings High Court in England, in the mid-to-late 1700s.<sup>21</sup> The New York Court of Appeals was keenly aware of the issues arising from creative predatory lenders more than 144 years ago and stated:

The shifts and devices of usurers to evade the statutes against usury, have taken every shape and form that the wit of man could devise, but none have been allowed to prevail. Courts have been astute in getting at the true intent of the parties, and giving effect to the statute.<sup>22</sup>

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<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Hammelburger v. Foursome Inn Corp.*, 437 N.Y.S.2d 356, 360 (N.Y. App. Div. 2d Dep't 1980).

<sup>19</sup> *Szerdahelyi*, 490 N.E.2d 517 (N.Y. 1986).

<sup>20</sup> *See generally* *Bakhash v. Winston*, 19 N.Y.S.3d 887 (N.Y. App. Div. 1st Dep't 2015); *Fareri v. Rain's Int'l, Ltd.*, 589 N.Y.S.2d 579 (N.Y. App. Div. 2d Dep't 1992); *Abir v. Malky, Inc.*, 873 N.Y.S.2d 350 (N.Y. App. Div. 2d Dep't 2009); *Russkaya Reklama, Inc. v. Milman*, 9 N.Y.S.3d 759 (N.Y. Sup. Ct. App. Term 2015) (holding in all these cases that the usurious transactions are void as a matter of law).

<sup>21</sup> *Quackenbos v. Sayer* 62 N.Y. 344, 346 (N.Y. 1875) ("The most usual form of usury was a pretended sale of goods."). *Id.*

<sup>22</sup> *Id.*

The courts have acknowledged that the intent of lenders may be latently sinister, and that usury may not be immediately apparent on the face of a transaction.

Today, however, nearly 144 years later, private lenders continue to prevail in using complex financial instruments that disguise hidden fees, penalties, and rates on financial instruments to bypass the court and extract a rate of interest that is more than New York's criminal usury statute. While complicated loan structures and ambiguous language are apparent in today's business transactions, at the end of the day, a simple basic analysis premised on legal principles that have existed for centuries will result in a finding of a usurious transaction from which there is no recovery at all available to the creditor.<sup>23</sup>

### III. NEW YORK USURY STATUTES

New York bifurcated usury, and now a claim of usury may be either civil usury or criminal usury.<sup>24</sup> General Obligation Law and Penal Law contain usury statutes.<sup>25</sup> New York has enacted multiple statutes reflecting a view of the heinous nature of usury.<sup>26</sup> According to the New York Penal Law:

A person is guilty of criminal usury in the second degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty-five per centum per annum or the equivalent rate for a longer or shorter period.<sup>27</sup>

Further, "criminal usury in the second degree is a class E felony."<sup>28</sup> In the event of a criminally usurious interest rate, the statute estops the usurer from receiving interest on a loan.<sup>29</sup>

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<sup>23</sup> N.Y. GEN. OBLIG. LAW § 5-511 (McKinney 2019).

<sup>24</sup> N.Y. GEN. OBLIG. LAW § 5-501 (McKinney 2019).

<sup>25</sup> See N.Y. GEN. OBLIG. LAW § 5-501; N.Y. PENAL LAW § 190.40 (McKinney 2019).

<sup>26</sup> *Id.*

<sup>27</sup> N.Y. PENAL LAW § 190.40.

<sup>28</sup> *Id.*

<sup>29</sup> N.Y. GEN. OBLIG. LAW § 5-501(4). "Interest shall not be charged, taken, or received on any loan or forbearance at a rate exceeding such rate of interest as may be authorized by law at the time the loan or forbearance is made." *Id.*

New York prohibits corporations from interposing the defense of civil usury to a contract.<sup>30</sup> Only individuals may use civil usury as an affirmative defense to a contract or in a plenary action.<sup>31</sup> Civil usury in New York exists when the total interest on a financial instrument exceeds a rate of sixteen percent per annum.<sup>32</sup> In New York, only individuals may use civil usury as an affirmative defense to a contract.<sup>33</sup> At first blush, it appears New York bars corporate borrowers from claiming criminal usury as an affirmative defense in New York. Nonetheless, while corporations cannot plead civil usury as a defense to a contract, corporations may plead criminal usury as an affirmative defense to a contract.<sup>34</sup> There is no legislative difference between what is called “civil” usury and “criminal” usury when it comes to New York’s General Obligation Law Statute 5-511, effective 2006.<sup>35</sup> However, usury is usury, and the Legislature saw fit to make two “levels” of usury in response to growing loan-sharking in the state, one that exceeds sixteen percent (civil), and the other that exceeds twenty-five percent (criminal).<sup>36</sup>

When a New York court finds that a financial instrument is criminally usurious, the borrower may recover all interest payments or deliveries that were above the twenty-five percent threshold.<sup>37</sup> The Southern District of New York reinforced this remedy in *Carlone v. Lion & The Bull Films, Inc.*,<sup>38</sup> where the court stated that the borrower

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<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> N.Y. GEN. OBLIG. LAW § 5-521(3) (McKinney 2019). “(3) The provisions of subdivision one of this section shall not apply to any action in which a corporation interposes a defense of criminal usury as described in section 190.40 of the penal law.” *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> N.Y. GEN. OBLIG. LAW § 5-511.

<sup>36</sup> N.Y. GEN. OBLIG. LAW § 5-501. On a note, the civil usury threshold is an interest rate in the excess of sixteen percent, whereas the criminal usury threshold on a note is an interest rate in the excess of twenty-five percent. *Id.*

<sup>37</sup> N.Y. GEN. OBLIG. LAW § 5-513.

Every person who, for any such loan or forbearance, shall pay or deliver any greater sum or value than is allowed to be received pursuant to section 5-501, and his personal representatives, may recover in an action against the person who shall have taken or received the same, and his personal representatives, the amount of the money so paid or value delivered, above the rate aforesaid.

*Id.*

<sup>38</sup> 861 F. Supp. 2d 312 (S.D.N.Y. 2012).

could recover any interest payments made in excess of the legal rate of twenty-five percent.<sup>39</sup>

New York's General Obligation Law Statute 5-501, effective 2011, caps the maximum amount upon which to assert a claim under Section 190.40 at \$2,500,000.00.<sup>40</sup> The plain language of Section 190.40, as read with Statute 5-501, states that anything below \$2,500,000.00 is subject to criminal usury, and once found, voids the transaction.<sup>41</sup> Capping the maximum amount to \$2,500,000.00 to make a financial instrument subject to the criminal usury statutes was intended to solve the usury problem in New York regarding substantial commercial loans.<sup>42</sup> However, the cap is now a significant reason why multistate loan transactions are designated to be governed by New York law.<sup>43</sup> The \$2,500,000.00 limitation on the statute was upheld in 2009 by the New York Appellate Division.<sup>44</sup> Ultimately, the financial instruments subject to the criminal usury statutes of New York include bonds, bills, notes (both demand and promissory), assurances, and conveyances.<sup>45</sup>

Hence, in New York, a financial instrument is deemed void, and therefore, a contract between corporations is considered invalid as a matter of law when the lender charges a total interest on a financial instrument that exceeds the statutory limits.<sup>46</sup>

All bonds, bills, notes, assurances, conveyances, all other contracts or securities whatsoever . . . whereupon or whereby there shall be reserved or taken, or secured or agreed to be reserved or taken, any greater sum, or greater value, for the loan or forbearance of any money, goods or other things in action, than is prescribed in section 5-501, shall be void . . . .<sup>47</sup>

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<sup>39</sup> *Id.* at 324.

<sup>40</sup> N.Y. GEN. OBLIG. LAW § 5-501.

<sup>41</sup> *Id.*

<sup>42</sup> Joshua Stein, *Confusury Unraveled: New York Lenders Face Usury Risks In Atypical Or Small Transactions*, N.Y. St. B.J. 25, at 28 (August 2001).

<sup>43</sup> *Id.*

<sup>44</sup> *Shasho v. Pruco Life Ins. Co. of N.J.*, 888 N.Y.S.2d 557 (N.Y. App. Div. 2d Dep't 2009) (holding that the statute providing the laws regulating the maximum rate of interest did not apply to loans or forbearances of \$2,500,000 or more).

<sup>45</sup> NY GEN. OBLIG. LAW § 5-501.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

Thus, if a court deems a contract involving one of these financial instruments to be criminally usurious in New York, the contract is deemed to be void as a matter of law.<sup>48</sup>

#### IV. CALCULATING THE TOTAL INTEREST CHARGE ON FINANCIAL INSTRUMENTS IN NEW YORK

New York's usury statutes are unambiguous on what is considered in calculating the interest on a financial instrument. The plain meaning of the statute and case law in New York dictate that interest charges include the amount on reserve to a creditor or a lender at the time of the execution of a financial instrument.<sup>49</sup> The analysis focuses only on the time a financial instrument is executed under the General Obligation Law Statute 5-501, and not on what the usurer ultimately collects.

Interest rates on a financial instrument are the leading figures in determining if a transaction is criminally usurious.<sup>50</sup> An interest rate is "the percentage that a borrower of money must pay to the lender in return for the use of money . . . expressed as a percentage of the principal payable . . ."<sup>51</sup> An illegal rate of interest is "an interest rate higher than the rate allowed by law."<sup>52</sup> The usury statutes of New York suggest that when determining if a transaction is criminally usurious, a proper analysis of hidden interest rates, including default rates, must be undertaken.<sup>53</sup> The New York Court of Appeals held that interest includes not only the interest rate charged in the note but also various other fees, including loan "origination fees" paid by the borrower or deducted from the loan proceeds.<sup>54</sup> The courts should consider additional fees and hidden interest on a financial instrument in determining if a transaction is criminally usurious.<sup>55</sup> These additional fees and hidden interest may include—but are not limited to—

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<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Interest Rate*, BLACK'S LAW DICTIONARY (11th ed. 2019).

<sup>52</sup> *Id.*

<sup>53</sup> N.Y. GEN. OBLIG. LAW § 5-501.

<sup>54</sup> *People v. Central Federal Savings & Loan Ass'n of Nassau County*, 385 N.E.2d 555 (N.Y. 1978).

<sup>55</sup> N.Y. GEN. OBLIG. LAW § 5-501.

prepayment penalties, stock options and exercising warrants, and default penalties.<sup>56</sup>

Prepayment penalty provisions surrounding a financial instrument may be considered interest in calculating the total interest charged to determine if a financial instrument is criminally usurious.<sup>57</sup> A prepayment penalty is the right of a lender to refuse any early tender towards an obligation by the borrower or to exact a fee or premium upon the borrower in the event of payment towards an obligation that is earlier than what the parties expressed and outlined within a contract.<sup>58</sup> The courts consider a prepayment penalty when the penalty brings the total interest computed on a financial instrument above the maximum lawful rate of twenty-five percent.<sup>59</sup> Conversely, if a prepayment penalty provision does not raise the total interest charged above the twenty-five percent threshold, then the prepayment provision does not, by itself, render the financial instrument criminally usurious.<sup>60</sup>

The courts must consider stock options and exercising warrants on a financial instrument in calculating the total interest to determine if a financial instrument is criminally usurious.<sup>61</sup> Convertible notes are hybrid financial instruments containing both unsecured debt and an option component with its discrete value.<sup>62</sup> The courts also consider the value of stock options in calculating the effective interest on a financial instrument.<sup>63</sup> Further, the value of a common stock given to a lender is critical in calculating the total interest charged on a financial instrument.<sup>64</sup> The underlying reasoning for these decisions is that a

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<sup>56</sup> *Id.*

<sup>57</sup> Alan J. Jacobs, J.D., Rachel M. Kane, M.A., and Kimberly C. Simmons, J.D., 72 N.Y. Jur. 2d *Interest and Usury* § 101 (August 2019).

<sup>58</sup> Robert K. Baldwin, *Prepayment Penalties: A Survey and Suggestion*, 40 VAND. L. REV. 409, 411 (1987).

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Hillair Capital Invs., L.P. v. Integrated Freight Corp.*, 963 F. Supp. 2d 336, 341 (S.D.N.Y. 2013).

<sup>62</sup> *In re Bridge Info. Sys.*, 311 B.R. 781, 793 (Bankr. E.D. Mo. 2004) (holding that the unsecured debt component and option in convertible notes have discrete values, and therefore, should be valued separately).

<sup>63</sup> *Hillair Capital Invs., L.P. v. Integrated Freight Corp.*, 963 F. Supp. 2d at 341 (holding that the value of a stock option is critical in calculating and evaluating the true amount of a financial instrument and the effective interest rate being charged).

<sup>64</sup> *Sabella v. Scantek Med., Inc.*, No. 08 Civ. 453 (CM)(HBP), 2009 WL 3233703, at \*1, \*21-22 (S.D.N.Y. Sep. 21, 2009) (ruling that the value of common stock given to a lender should be taken into account when calculating interest rates).

borrower issuing stock is agreeing to give something up for value to the lender.<sup>65</sup> In New York, a financial instrument is usurious when a creditor is entitled to the principal balance along with a legal rate of interest plus additional payments that are contingent on an event that is out of the borrower's control.<sup>66</sup> Warrants on a financial instrument are equivalent to options, and the courts should treat the valuation of warrants as an original issue discount (OID).<sup>67</sup> Thus, the courts should consider warrants in calculating the total interest on a financial instrument.<sup>68</sup>

In New York, the courts must consider a default penalty and a default interest on a financial instrument in calculating the total interest to determine if a financial instrument is criminally usurious. Generally, financial instruments contain default provisions, which act as a penalty to deter a breach of contract.<sup>69</sup> The default interest is usually a higher interest rate than the effective interest appearing on the face of a financial instrument.<sup>70</sup> Historically in New York, a default penalty and default interest were not considered an interest in the calculation on total interest charged relating to criminal usury.<sup>71</sup> However, as of 2017, New York began considering default provisions on a financial instrument in the calculation of the total interest charged on an instrument.<sup>72</sup> If a default provision within a financial instrument brings the total interest charged over the twenty-five percent threshold of New York, then the default provision is considered to determine if the financial instrument is criminally usurious.<sup>73</sup>

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<sup>65</sup> *In re Bridge Info. Sys.*, 311 B.R. at 791 (noting that possible proceeds from the sale of a stock option to a third party are an "opportunity cost").

<sup>66</sup> *Phlo Corp. v. Stevens*, No. 00 Civ. 3619(DC), 2001 WL 1313387, at \*1, \*5 (S.D.N.Y. Oct. 25, 2001) (noting that a contingent right to a bonus is something of value, and that this value must be added to the maximum interest charged in excess of the legal rate).

<sup>67</sup> *Custom Chrome, Inc. v. Commissioner*, 217 F.3d 1117, 1122 (9th Cir. 2000) (noting that the original issue discount is the difference between the redemption price at maturity and issue price, and therefore, a type of interest).

<sup>68</sup> *Id.*

<sup>69</sup> American Law Reports, *Validity and effect of anticipatory provision in contract in relation to rate of interest in the event of default*, 12 A.L.R. 367 (1921).

<sup>70</sup> *Id.*

<sup>71</sup> *Kraus v. Mendelsohn*, 948 N.Y.S.2d 119, 121 (ruling that the defense of usury did not apply where a promissory note at issue imposed a rate in excess of the statutory maximum only after the note's default or maturity).

<sup>72</sup> *Madden v. Midland Funding, LLC.*, 237 F.Supp.3d 130, 145 (S.D.N.Y. 2017) (holding that the criminal usury cap setting the maximum interest rate of twenty-five percent does apply to default obligations).

<sup>73</sup> *Id.*

## V. THE INTENT OF PREDATORY BUSINESSES

The four corners of a financial instrument can display a lender's usurious intent.<sup>74</sup> Furthermore, as a matter of law, a court can find a lender's usurious intent.<sup>75</sup> Intent is a critical element in a usury analysis.<sup>76</sup> When a lender of a financial instrument charges an interest rate above twenty-five percent, the statutory rate, it is immaterial whether the lender had explicit intent.<sup>77</sup> In a situation such as this, a court finds the lender's intent implied even though a lender had no actual intent to violate the usury laws.<sup>78</sup> New York courts have consistently ruled that when usury is determined to exist, the intent is implied.<sup>79</sup>

The court in *In re Rosner* noted that when usurious intent is not found on the face of the financial instrument, usury becomes a disputed question of material fact.<sup>80</sup> Nonetheless, the conversion discount option and the default remedies expressly stated in the contract of the financial instrument set the total interest charge of the financial instrument above twenty-five percent.<sup>81</sup> Therefore, in *In re Rosner*, the plaintiff established the defendant's intent to charge a usurious rate of interest.<sup>82</sup>

A person who comes to court with unclean hands is not afforded any equitable remedies.<sup>83</sup> When it comes to criminal usury, intent to charge a criminally usurious rate is implied based on the face

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<sup>74</sup> *Blue Wolf Capital Fund II, L.P. v. Am. Stevedoring Inc.*, 961 N.Y.S.2d 86 (N.Y. App. Div. 1st Dep't 2013) (holding that if usury can be gleaned from the face of an instrument, intent will be implied, and usury will be found as a matter of law).

<sup>75</sup> *Id.*

<sup>76</sup> N.Y. BANKING LAW § 380-E (McKinney 2019).

<sup>77</sup> *Fareri v. Rain's Int'l, Ltd.*, 589 N.Y.S.2d 579 (N.Y. App. Div. 2d Dep't 1992) (holding that a transaction and supporting documents were void as a matter of law because as stipulated by the parties, the agreement was usurious on its face, and therefore, usurious intent can be inferred).

<sup>78</sup> *Id.*

<sup>79</sup> *See generally Venables v. Sagona*, 925 N.Y.S.2d 578 (N.Y. App. Div. 2d Dep't 2011); *Abir v. Malky, Inc.*, 873 N.Y.S.2d 350 (N.Y. App. Div. 2d Dep't 2009) (noting that all usurious agreements will be void and unenforceable as a matter of law).

<sup>80</sup> 48 B.R. 538, 548. (Bankr. E.D.N.Y. 1985).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Blue Wolf Capital Fund II, L.P. v. Am. Stevedoring Inc.*, 961 N.Y.S.2d 86 (N.Y. App. Div. 1st Dep't 2013). (holding that lenders found to be charging criminally usurious rates of interest on a financial instrument are not entitled to equitable relief).

of a financial instrument, indicating wrongdoing.<sup>84</sup> Regarding financial recovery for creditors or lenders surrounding a financial instrument, the courts apply “the equitable maxim that he who comes into equity must come with clean hands.”<sup>85</sup>

The consequences to the lender of a usurious transaction can be harsh: the borrower is relieved of all further payment—not only interest but also outstanding principal, and any mortgages securing payment are [cancelled]. In effect, the borrower can simply keep the borrowed funds and walk away from the agreement. Moreover, the borrower can recover any interest payments made in excess of the legal rate (General Obligations Law § 5-513). New York usury laws historically have been severe in comparison to the majority of states . . . reflecting the view of our Legislature that the prescribed consequences are necessary to deter the evils of usury.<sup>86</sup>

Thus, a New York court will deny equitable relief to a lender when a lender attempting to recover demonstrates egregious conduct, such as fraud, unconscionability, or bad faith.<sup>87</sup>

To evade New York laws, lenders use choice-of-law provisions in a contract to avoid a state’s criminal usury statutes.<sup>88</sup> However, a court can find a contract between parties invalid if the lender (or party) used the contract as a cloak for usury.<sup>89</sup> If a contracting party uses a choice-of-law provision to select a state that has no substantial connection with the contract—to avoid an involving state’s criminal usury statutes—then a court can invalidate the contract.<sup>90</sup>

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<sup>84</sup> *Id.*

<sup>85</sup> *Lia v. Saporito*, 909 F. Supp. 2d 149, 173 (E.D.N.Y. 2012) (holding that a party seeking equitable relief must not have unclean hands).

<sup>86</sup> *Seidel v. 18 E. 17<sup>th</sup> St. Owners, Inc.*, 598 N.E.2d 7 (N.Y. 1992).

<sup>87</sup> *Balaber-Strauss v. Murphy*, 331 B.R. 107, 135 (Bankr. S.D.N.Y. 2005) (holding that equitable relief may be denied where a party applying for such relief is guilty of conduct involving fraud, unconscionability, or bad faith related to the matter at issue).

<sup>88</sup> William B. Emmal, *Evading Prohibitions on Usury Through Choice of Law* (August 2009).

<sup>89</sup> Cecily Fuhr, J.D., CJS INTEREST § 188 (2019). “The parties’ choice of law will be held to constitute a sham or subterfuge when the contacts between the transaction and the chosen state are not reasonably related or when the contracts themselves are contrived in order to substantiate the parties’ choice of law.”

<sup>90</sup> *Id.*

# **VI. NEW YORK'S SUBSTANTIAL RELATIONSHIP APPROACH AND THE APPLICABILITY OF CHOICE-OF-LAW PROVISIONS**

Commonly, a choice-of-law provision in a contract between parties is effective and lawful if: “(1) the law of the selected jurisdiction has a reasonable relationship to an agreement; and (2) the chosen law does not violate a fundamental public policy of New York.”<sup>91</sup> If a court deems a contract between two parties as usurious under the general usury statutes of all states to which it has a substantial relationship, then the forum will “apply the usury statute of that state that imposes the lightest penalty.”<sup>92</sup> Under New York’s current choice-of-law rule, known as the center of gravity approach, a court will apply the law of the state that has the most significant contacts with the matter in dispute.<sup>93</sup>

The Supreme Court of the United States has ruled that to ensure that the choice-of-law is neither arbitrary nor fundamentally unfair, the choice-of-law must be from a state that has significant contacts with the parties and the occurrence or transaction in question.<sup>94</sup> Although New York recognizes that “the choice of law principle that parties to a contract have a right to choose the law to be applied in their contract, this freedom of choice on the part of the parties is not absolute.”<sup>95</sup> To determine the appropriateness of the parties’ choice-of-law, New York follows the “substantial relationship” approach, as stated in Restatement (Second) of Conflicts of Law Section 187:(2):

The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either . . . the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties’ choice, or . . . application of the law of the

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<sup>91</sup> Glen Banks, *New York Practice Series: New York Contract Law* § 8:5 (2019).

<sup>92</sup> 72 N.Y. Jur. 2d *Interest and Usury* § 57 (2019).

<sup>93</sup> *Id.*

<sup>94</sup> *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 308-09 (1981) (holding that applying a choice of law from a state with a mere slight and casual relationship to the parties and transaction would be fundamentally unfair to a state with a greater relationship to the parties or the transaction in question).

<sup>95</sup> *S. Leo Harmony, Inc. v. Binks Mfg. Co.*, 597 F. Supp. 1014, 1025 (S.D.N.Y. 1984).

chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.<sup>96</sup>

Under this approach, the law of the state chosen by the parties to govern their contractual rights would be contrary to a fundamental policy of a state that has a materially greater interest than the state chosen between the parties in a contract.<sup>97</sup>

A court considers many factors when determining if a state has a substantial relationship to a transaction. In applying the substantial relationship approach, New York follows the Restatement (Second) of Conflicts of Law's significant relationship test.<sup>98</sup> In New York, the factors considered in determining which state has a substantial relationship to a transaction are: (1) the place of contracting, (2) the place of negotiation of the contract, (3) the place of performance, (4) the location of the subject matter of the contract, and (5) the domicile, residence, nationality, place of incorporation, and place of business of the parties.<sup>99</sup> The courts are to evaluate the contacts according to their relative importance concerning the issue in question.<sup>100</sup>

New York courts generally enforce choice-of-law clauses.<sup>101</sup> The New York Court of Appeals addressed the substantial relationship approach and held that "while the parties' choice of law is to be given heavy weight, the law of the state with the 'most significant contacts' is to be applied."<sup>102</sup> In a contract between parties, New York law should apply, even if there is a choice-of-law provision electing

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<sup>96</sup> Restatement (Second) of Conflict of Laws § 187 (1971).

<sup>97</sup> *AM. Equities Grp., Inc. v. Ahava Dairy Prods. Corp.*, No. 01 Civ.5207 (RWS), 2004 WL 870260, at \*1, \*8 (S.D.N.Y. Apr. 2004)

<sup>98</sup> 47 C.J.S. Interest & Usury § 182.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> Glen Banks, *New York Practices Series: New York Contract Law* § 8:3 (2009). In the absence of fraud or violation of a fundamental state policy, New York courts generally defer to the choice-of-law made by the parties in their contract. Choice-of-law provisions are usually honored because the parties are free to reach an agreement on whatever terms they prefer. *Id.*

<sup>102</sup> *Cargill, Inc. v. Charles Kowsky Resources, Inc.*, 949 F.2d 51, 55 (2d Cir. 1991) (ruling that New York law permits a court to disregard the parties' choice-of-law provision in a contract when the most significant contacts surrounding the dispute in question are in another state).

another state to govern if significant contacts were in New York.<sup>103</sup> Moreover, when a state does not have a reasonable relationship to a contract between parties, and New York does have a reasonable relationship, then New York law should apply to the contract in question.<sup>104</sup> A court may establish a reasonable relationship with New York if the parties negotiate and execute a financial instrument in New York, the parties to a contract performed under the agreement in New York, or the principal place of business for either party is in New York.<sup>105</sup> In addition to the substantial relationship approach, New York “has a strong public policy against interest rates which exceed twenty-five percent.”<sup>106</sup>

## VII. NEW YORK’S FUNDAMENTAL PUBLIC POLICY AND ITS EFFECT ON CONTRACT PROVISIONS

States have different views on whether the protections against usury represent fundamental policy.<sup>107</sup> Some states, like New York, disregard choice-of-law provisions of another state’s laws that permit higher interest rates or have no restriction on usury.<sup>108</sup> The policy underlying New York’s usury laws is fundamental.<sup>109</sup> Therefore, to permit loan contracts executed in New York State to be governed by laws of other states, which have chosen to not outlaw usury, would ultimately violate time-honored public policy.<sup>110</sup> Contracts that are void due to public policy cannot become enforceable by estoppel.<sup>111</sup>

In New York, for a policy to be fundamental, the policy must, in any event, be a substantial one.<sup>112</sup> When it comes down to the

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<sup>103</sup> *AM. Equities Grp.*, No. 01 Civ.5207 (RWS), 2004 WL 870260, at \*1, \*9 (holding that because significant contacts were in New York, that New York law should apply, despite the agreement that New Jersey law would govern).

<sup>104</sup> *Power Up Lending Grp., Ltd. v. Cardinal Energy Grp., Inc.*, 2:16-cv-1545 (DRH)(GRB), 2019 WL 1473090, at \*1, \*4 (E.D.N.Y. Apr. 3, 2019).

<sup>105</sup> *Id.*

<sup>106</sup> *In re McCorhill Pub., Inc.*, 86 B.R. 783, 793 (Bankr. S.D.N.Y. 1988).

<sup>107</sup> William B. Emmal, comment, *Evading Prohibitions on Usury Through Choice of Law*, 9 TRANSLAW 6 (2009).

<sup>108</sup> *Id.*

<sup>109</sup> American Law Reports, *Conflict of laws as to usury*, 125 A.L.R. 482 (1940).

<sup>110</sup> *Id.*

<sup>111</sup> Harvard Law Review, *EFFECT OF ESTOPPEL UPON A CONTRACT VOID FOR USURY*, 19 HARV. L. REV. 454 (1906).

<sup>112</sup> Restatement (Second) of Conflict of Laws § 187 (1971).

fulfillment and satisfaction of a contract, the parties' expectations and considerations are not the only value of contract law.

The chosen law should not be applied without regard for the interests of the state which would be the state of the applicable law with respect to the particular issue involved in the absence of an effective choice by the parties. The forum will not refrain from applying the chosen law merely because this would lead to a different result than would be obtained under the local law of the state of the otherwise applicable law. Application of the chosen law will be refused only (1) to protect a fundamental policy of the state which, under the rule of § 188, would be the state of the otherwise applicable law, provided (2) that this state has a materially greater interest than the state of the chosen law in the determination of the particular issue.<sup>113</sup>

In New York, the courts will not enforce a choice-of-law clause when a state has a fundamental public policy that is impacted by the contract and has a greater material interest than the designated state that is addressed in the choice-of-law provision of the contract.

New York has a fundamental public policy against interest rates from creditors that exceed twenty-five percent.<sup>114</sup> Moreover, New York enforces its heavy stance on its public policy against excessive interest rates.<sup>115</sup> This essential public policy is further bolstered by a ruling of the New York Supreme Court, where the court held that the choice of Illinois law would not be given effect in part because New York's usury prohibition is a fundamental public policy, and therefore, trumps the choice-of-law provision.<sup>116</sup> The court's ruling in *Clever Ideas, Inc.* conforms with the New York Court of Appeals, which stated that it would not enforce a choice-of-law clause in a contract "when New York's nexus with the case is substantial enough to threaten our public policy."<sup>117</sup>

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<sup>113</sup> *Id.*

<sup>114</sup> *AM. Equities Grp.*, No. 01 Civ.5207(RWS), 2004 WL 870260, at \*1, \*8.

<sup>115</sup> *American Exp. Travel Related Serv.'s Co., Inc. v. Assih*, 893 N.Y.S.2d 438 (N.Y. Civ. Ct. 2009).

<sup>116</sup> *Clever Ideas, Inc. v. 999 Rest. Corp.*, No. 0602302/06, 2007 N.Y. Misc. LEXIS 9248, at \*1, \*2-4 (Sup. Ct. N.Y. Cty. Oct. 12, 2007).

<sup>117</sup> *Cooney v. Osgood Machinery, Inc.*, 612 N.E.2d 277, 285 (N.Y. 1993).

Additionally, New York's decision to criminalize interest rates exceeding twenty-five percent is further evidence that usury prohibition is a fundamental public policy.<sup>118</sup> The courts in the Second Circuit have recognized that New York's criminal usury laws represent an important and fundamental public policy that overrides a choice-of-law provision.<sup>119</sup> Even if the substantial relationship test with another state is satisfied, New York's vital public policy reflected in its usury laws overrides the substantial relationship test, and New York law must apply.<sup>120</sup> Generally, New York courts will enforce a contract that it does not deem criminally usurious under the laws of the contracting state or country or where the parties were to perform.<sup>121</sup> Nonetheless, if there is a violation of a fundamental public policy that New York recognizes, then the loan will not be enforced and be deemed as void.<sup>122</sup>

Therefore, a court will enforce the substantive law of New York when a borrower brings a claim of criminal usury surrounding a financial instrument against a lender, even if there is a choice-of-law provision that provides that another state's law will govern the transaction between the parties.

#### VIII. THE EFFECTS OF CRIMINALLY USURIOUS FINANCIAL INSTRUMENTS IN NEW YORK

The New York usury laws apply to financial instruments, such as loans and forbearances.<sup>123</sup> For a transaction to constitute a usurious loan, there must be two parties contracting (a debtor/borrower and a creditor/lender).<sup>124</sup> Additionally, it must appear that the real purpose of the transaction was, on the one side, to lend or provide money or a

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<sup>118</sup> *Electric & Magneto Serv. Co. v. AMBAC Int'l Corp.*, 941 F.2d 660, 663 (8th Cir. 1991) (holding that the existence of a criminal provision is significant because the legislature would not allow a criminal law to be bypassed by the mere existence of a choice-of-law provision contained in a contract).

<sup>119</sup> *Madden v. Midland Funding, LLC.*, 237 F. Supp. 3d 130, 145 (S.D.N.Y. 2017) (holding that New York's interest in preventing criminal usury prevails over the choice-of-law provisions set forth by parties in a contract).

<sup>120</sup> *Id.*

<sup>121</sup> 72 N.Y. Jur. 2d § 57 (2019).

<sup>122</sup> *Id.*

<sup>123</sup> *See generally* *Orvis v. Curtiss*, 52 N.E. 690 (N.Y. 1899); *Bristol Inv. Fund, Inc. v. Carnegie Intern. Corp.*, 310 F. Supp. 2d 556, 562 (S.D.N.Y. 2003) (holding that the defense of usury must be found upon a loan or forbearance of money).

<sup>124</sup> *Donatelli v. Siskind*, 565 N.Y.S.2d 224 (N.Y. App. Div. 2d Dep't 1991).

form of money at a usurious interest reserved in some form by the contract and, on the other side, to borrow upon the usurious terms dictated by the creditor/lender.<sup>125</sup>

There are two situations where criminal usury may be utilized: prosecution and as an affirmative defense. While prosecution of this crime is rare, courts have held that criminal usury is constitutional. In *People v. Fernandez*,<sup>126</sup> the court reasoned that:

The statute is sufficiently definite so as to give a reasonable man of ordinary intelligence fair, unequivocal warning of what conduct is prohibited and what is required of him. Persons who engage in the business of making loans have sufficient intelligence in mathematics to know when the “rates” exceed the statutory limit and to therefore seek legal advice. No fundamental “sense of justice” will be denied defendants by subjecting them to prosecution under the statute.<sup>127</sup>

The *Fernandez* court’s recognition of the criminal usury statute as constitutional is promising. However, avoidance of a criminally usurious loan is not a question of constitutionality, but about lenders being held accountable for their intentional actions and freeing borrowers from the shackles of usurious loans. Courts should explicitly void criminally usurious loans.

For prosecution purposes, a lender charging usurious interest on a loan is elevated to criminal usury in the first degree, a class C felony, when “either the actor had previously been convicted of the crime of criminal usury or of the attempt to commit such crime, or the actor’s conduct was part of a scheme or business of making or collecting usurious loans.”<sup>128</sup> The New York Court of Appeals held that a “scheme” is “a design or plan formed to accomplish some purpose, and that ‘business’ means commercial activity engaged in for a gain.”<sup>129</sup> The prosecution may offer evidence of usurious transactions not specifically alleged in an indictment for criminal usury in the first degree when an allegation states that the loan in question

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<sup>125</sup> *Id.*

<sup>126</sup> 402 N.Y.S.2d 940 (N.Y. Sup. Ct. 1979).

<sup>127</sup> *Id.*

<sup>128</sup> N.Y. PENAL LAW § 190.42 (McKinney 2019).

<sup>129</sup> 6 N.Y. Prac., Criminal Law § 19:15 (2019).

was part of a scheme or business.<sup>130</sup> The Court of Appeals has held that when the plaintiff charges the defendant with criminal usury, that the defendant is “entitled to particulars as to the scheme or business allegation in order to know what he [will] be called upon to defend against.”<sup>131</sup>

In transactions involving criminally usurious financial instruments, “the effect of the exaction of an illegal rate of interest differs under the various provisions of the consolidated laws which deal with interest and usury.”<sup>132</sup> A criminally usurious financial instrument is null and void, and a court grants no equitable relief to the creditor executing the usurious financial instrument under the sovereignty of New York.<sup>133</sup> A criminally usurious instrument is treated as a pretense in New York and is ineffectual as a source of obligation or right as a matter of law.<sup>134</sup>

Further, in New York, not only is a criminally usurious transaction void, but a court also has the statutory power to declare any obligation or security taken by the lender in violation of the statute void as well, as a matter of law.<sup>135</sup> In 2017, the Supreme Court of New York, Appellate Division, Second Department, recognized the applicability of General Obligation Law Statute 5-511 as an affirmative defense to a criminally usurious transaction, voiding the underlying transaction.<sup>136</sup>

Further, any other transaction arising or stemming from a criminally usurious transaction is purged and treated as being null and void.<sup>137</sup> The usurious nature of a contract or obligation is “to be determined as of the time it is entered into, and an obligation void at its inception for usury continues to be void forever, whatever its subsequent history may be, unless it is purged of usury.”<sup>138</sup> In other words, when a party executes a contract, and the total interest exceeds the criminal usury threshold, the transaction is void at the moment that

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<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> 72 N.Y. Jur. 2d Interest and Usury § 143 (2019).

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> *Roopchand v. Mohammed*, 62 N.Y.S.3d 514 (N.Y. App. Div. 2d Dep’t 2017) (ruling that the defendants successfully met the burden of proving criminal usury and granted defendants’ cross motion for summary judgment, dismissing the action).

<sup>137</sup> 72 N.Y. Jur. 2d Interest and Usury § 148 (2019).

<sup>138</sup> *Id.*

the contract was executed, and will continue to remain void and unenforceable. Further, usury attaches to all consecutive obligations or securities that derive from the original usurious transaction, and all of those additional obligations are void.<sup>139</sup>

**IX. THE AMBIGUOUS AND UNRESOLVED RELATIONSHIP  
BETWEEN CRIMINALLY USURIOUS TRANSACTIONS AND  
WAIVER**

The issue of whether a party can waive its right to the affirmative defense of usury is a gray area that riddles the courts. A waiver is “[t]he voluntary relinquishment or abandonment – express or implied – of a legal right or advantage.”<sup>140</sup> An express waiver is a voluntary and intentional waiver of a legal right or advantage.<sup>141</sup> A waiver may be implied by a party’s unequivocal conduct and actions that are tantamount to reasonably inferring the intent to waive a legal right or advantage.<sup>142</sup>

The borrower may waive civil usurious transactions in a transaction under CPLR 3211.<sup>143</sup>

At any time before service of the responsive pleading is required, a party may move on one or more of the grounds set forth in subdivision (a), and no more than one such motion shall be permitted. Any objection or defense based upon a ground set forth in paragraphs one, three, four, five and six of subdivision (a) is waived unless raised either by such motion or in the responsive pleading. A motion based upon a ground specified in paragraph two, seven or ten of subdivision (a) may be made at any subsequent time or in a later pleading, if one is permitted; an objection that the summons and complaint, summons with notice, or notice of petition and petition was not properly served is waived if, having raised such an objection in a pleading, the objecting party does not move for judgment on that ground within sixty days after serving

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<sup>139</sup> *Id.*

<sup>140</sup> *Waiver*, BLACK’S LAW DICTIONARY (11th ed. 2019).

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> CPTL Rule 3211(e) (McKinney’s 2006).

the pleading, unless the court extends the time upon the ground of undue hardship.<sup>144</sup>

Thus, a party may explicitly or impliedly waive an affirmative defense through not pleading the affirmative defense or objecting to a claim on the basis of the affirmative defense.

However, criminally usurious transactions cannot be waived by a party as an affirmative defense because New York has a fundamental public policy against the enforcement of criminally usurious financial instruments.<sup>145</sup> While there is minimal law in New York to support this assertion, in *Hammelburger v. Foursome Inn Corp.*,<sup>146</sup> the New York Court of Appeals addressed the waiver of a criminally usurious transaction.<sup>147</sup>

In *Hammelburger*, the Supreme Court of New York, Appellate Division, Second Department addressed a situation where the defendant had first agreed in the contract to waive the usury defense expressly.<sup>148</sup> Then, when the lender subsequently brought an action to enforce the contract in question after the defendant defaulted, the defendant failed to assert a criminal usury defense in its initial pleadings, amounting to an implied waiver.<sup>149</sup> When the defendant moved to amend its answer to include the usury defense, the trial court denied the motion and granted summary judgment to the lender.<sup>150</sup> However, on appeal, the court vacated the trial court's decision and reversed in favor of the defendant.<sup>151</sup> The court held that "when a right has been created for the betterment or protection of society as a whole, an individual is incapable of waiving that right; it is not his to waive."<sup>152</sup> *Aquila v. Rubio*<sup>153</sup> reinforced this point. In *Aquilla*, the

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<sup>144</sup> *Id.*

<sup>145</sup> American Law Reports, *supra* note 109.

<sup>146</sup> 431 N.E.2d 278 (N.Y. 1981).

<sup>147</sup> *Id.*

<sup>148</sup> *Hammelburger v. Foursome Inn Corp.*, 437 N.Y.S.2d 356 (N.Y. App. Div. 2d Dep't 1980).

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* at 360.

<sup>153</sup> No. 33561-12, 2016 WL 17161968, at \*1 (N.Y. Sup. Ct., May 2016).

court held that a party could not waive its right to be safeguarded from criminally usurious loans.<sup>154</sup>

Ultimately, the Court of Appeals in *Hammelburger* ruled that the transaction was lawful, even though the court deemed the transaction to be criminally usurious.<sup>155</sup> Nonetheless, the New York Court of Appeals did not directly address the waiver issue presented in the case.<sup>156</sup> Unfortunately, this ruling (and perhaps the somewhat unique facts of *Hammelburger*) has resulted in the courts viewing the waiver issue as unresolved, with the resulting patchwork of inconsistent rulings on the question of waiver.<sup>157</sup> Nonetheless, Judge Cooke, who had ruled with the judges in *Hammelburger*, wrote a concurring opinion that discussed waiver and its impact on criminally usurious transactions.<sup>158</sup> Judge Cooke stated that “[a] lender who may be criminally prosecuted for a particular loan should not be permitted to avoid the civil consequences of this wrong through the simple expedient of obtaining a waiver from the borrower.”<sup>159</sup> He continued that as a matter of public policy, he would never hold that a criminal usury transaction was waivable outside a judicial proceeding.<sup>160</sup> This concurring opinion served as evidence that even though the judges in *Hammelburger* ruled in favor of the lender, it was not because of the waiver being applicable against a criminal usury defense.

While no case law directly addresses how a court should deal with criminally usurious transactions when there has been a waiver, the mere fact that New York has a fundamental public policy against criminally usurious transactions dictates that waiver cannot be used to estop a party from invoking criminal usury as an affirmative defense.

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<sup>154</sup> *Id.* at \*1, \*6 (holding that “[a] party cannot waive his right to be protected from criminally usurious loans . . . [t]he right is not personal to the borrower, so as to be waivable by him . . . [t]he right exists for the benefit of everyone.”).

<sup>155</sup> 431 N.E.2d 278 (N.Y. 1981) (ruling that grant of summary judgment for the defendant was improper).

<sup>156</sup> *Id.*

<sup>157</sup> See *Hammelburger v. Foursome Inn Corp.*, 437 N.Y.S.2d 356 (N.Y. App. Div. 2d Dep’t 1980); *American E Group LLC v. Livewire Ergogenics Inc.*, 1:18-cv-3969-GHW, 2020 WL 209903 (S.D.N.Y. Jan. 2020) (noting that while no final position was taken on the waiver provision in the engagement letter, the court noted skepticism as to the waiver provision in the engagement letter that stated “any conflicts shall be properly waived.”).

<sup>158</sup> *Hammelburger v. Foursome Inn Corp.*, 431 N.E.2d 278 (N.Y. 1981).

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

“Litigants may waive rules of law or statutory provisions made in their favor, where no considerations of public policy are involved.”<sup>161</sup>

Thus, if a lender raises waiver, either express or implied, to estop the borrower from asserting the affirmative defense of criminal usury, a New York court should allow the borrower to raise criminal usury as an affirmative defense because it concerns a fundamental public policy.

#### **X. INCONSISTENCIES AND LACK OF CONFORMITY BETWEEN FEDERAL AND STATE COURTS’ INTERPRETATIONS OF NEW YORK’S USURY LAWS**

Due to inconsistencies of statutory interpretation, the federal courts have inappropriately applied New York’s laws on criminal usury in dozens of cases.<sup>162</sup> These decisions resulted in a wide range of differing opinions and judgments that are not consistent with the longstanding history of usury in New York.<sup>163</sup> The only consistency found among both federal and state courts in New York is that they agree that the usury prohibition in New York reflects a longstanding and fundamental public policy of the state of New York.<sup>164</sup> Through these inconsistencies of statutory interpretation, parties who have executed criminally usurious financial instruments seek to forum shop<sup>165</sup> in order to evade the consequences of criminally usurious transactions in New York.<sup>166</sup>

In *In re Ventures Mtge. Fund, L.P.*,<sup>167</sup> the Second Circuit expressly flagged the question of whether a loan is void if it violates New York’s criminal usury statute without violating New York’s civil usury statute, as one that needed resolution by the New York state courts.<sup>168</sup> The court speculated that, under a close reading of the statutory scheme, the voidance mechanism of General Obligations

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<sup>161</sup> *Stone v. Oneida Motor Car Co.*, 275 N.Y.S. 426 (N.Y. Co. Ct. 1934).

<sup>162</sup> See *supra* note 109.

<sup>163</sup> *Id.*

<sup>164</sup> *United Mizrahi Bank Ltd. v. Sullivan*, No. 97-CV-9282, 1998 WL 575137, at 1, 8 (S.D.N.Y. Sept. 9, 1998) (holding that criminal usury is a fundamental public policy).

<sup>165</sup> “A litigant’s attempt to have his action tried in a particular court or jurisdiction where he feels he will receive the most favorable judgment or verdict.” Harvard Law Review, *FORUM SHOPPING RECONSIDERED*, 103 Harv. L. Rev. 1677 (1990).

<sup>166</sup> *United Mizrahi Bank Ltd.*, No. 97-CV-9282, 1998 WL 575137, at 8.

<sup>167</sup> 282 F.3d 185 (2d Cir. 2002).

<sup>168</sup> *Id.*

Law Statute 5-511(1) might not operate to void usurious loans that only violated NY Penal Law Section 190.40 (i.e., the loans of \$250,000 or more described in section 5-501(6)).<sup>169</sup> Notably, the court expressly acknowledged that it made no decision on the issue and that the question was framed “at some length in dictum because . . . this opinion might otherwise be misread to settle or foreclose the issue in the federal courts of this Circuit.”<sup>170</sup> Despite that caution, the federal courts of the Second Circuit seem to have done precisely that.<sup>171</sup> The courts seem to have even further restricted Section 5-511’s avoidance mechanism to be inoperable as against any loan found to be criminally usurious, even loans for less than \$250,000.<sup>172</sup>

Many courts have applied General Obligations Law Statute 5-511 to hold that all usurious contracts shall be void.<sup>173</sup> As mentioned earlier, the New York Court of Appeals has confirmed that courts must deem a transaction involving a financial instrument void if it is usurious.<sup>174</sup> However, many federal courts fail to void criminally usurious contracts relying on the reasoning that, unlike New York’s civil usury statute, Penal Law Section 190.40 does not explicitly serve to void instruments which violate it.<sup>175</sup> As a result of this oversight in the drafting of Penal Law Section 190.40, some federal courts have chosen to hold that General Obligations Law Statute 5-511 does not void criminally usurious instruments simply because the criminal usury statute does not expressly provide as such.<sup>176</sup> This significant discrepancy between the federal and state courts have caused various and different rulings on usurious transactions. These discrepancies

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<sup>169</sup> *Id.* at 190.

<sup>170</sup> *Id.* at 187.

<sup>171</sup> See generally *Adar Bays, LLC, v. GeneSYS ID, Inc.*, 341 F.Supp.3d 339, 354 (S.D.N.Y. 2018) (finding that *In re Venture* posited that there was, “no specific statutory authority for voiding a loan that violates the criminal usury statute.”); *LG Capital Funding, LLC, v. Vapor Group, Inc.*, 17-CV-1297-NGG-SJB, 2019 WL 3437973, at \*1, \*10 (E.D.N.Y. June 27, 2018) (finding that the *In re Venture*’s non-voiding analysis would apply to a criminally usurious loan of \$115,000).

<sup>172</sup> *Id.*

<sup>173</sup> See *Roopchand v. Mohammed*, 62 N.Y.S.3d 514 (N.Y. App. Div. 2d Dep’t 2017); *Donatelli v. Siskind*, 565 N.Y.S.2d 224 (N.Y. App. Div. 2d Dep’t 1991).

<sup>174</sup> *Szerdahelyi v. Harris*, 490 N.E.2d 517 (N.Y. 1986).

<sup>175</sup> N.Y. PENAL LAW § 190.40 (McKinney 2019).

<sup>176</sup> See *In re Venture Mortgage Fund, L.P.* 282 F. Supp. 3d 185 (2d Cir. 2002) (finding in dicta that nothing in Penal Law § 190.40 provides for voiding criminally usurious loans, and that it is uncertain whether the legislature intended such an effect based upon the language of the statute); *American Equities Group, Inc. v. Ahava Dairy Prods. Corp.*, No. 01 Civ.5207(RWS), 2004 WL 870260, at \*1 (S.D.N.Y. 2004).

have led issuers of criminally usurious financial instruments to forum shop for a favorable court that would not void a criminally usurious financial instrument. This judicial loophole of forum shopping ultimately leads lenders to evade the criminal usury laws enacted by New York and undermines New York's legislative intent.

## **XI. CONCLUSION**

All in all, when a transaction has been executed in New York between two businesses, the transaction should be governed by New York law if the transaction is substantially related to New York. Additionally, when parties execute a transaction in New York, and a court would violate New York's fundamental public policy by enforcing a choice-of-law provision, New York law should govern the transaction. If a borrower is unable to invoke criminal usury as an affirmative defense to an agreement due to a choice-of-law provision, the objective of protecting the public is frustrated and hindered. Further, a choice-of-law provision creates loopholes where a lender can side-step the substantive statutes and regulations of a state, setting a dangerous precedent for the future. As a matter of principle and protecting the general public from loan-sharking, courts should evaluate choice-of-law provisions on a case by case basis, and when a choice-of-law provision in a contract conflicts with the public policy of another state that has a reasonable relationship, that forum state should govern the transaction in question.

Finally, reconciling the statutory language concerning criminal and civil usury would be a big step to help clear confusion and ambiguity in contracts already in place and protect and avoid borrowers from paying a tremendous amount of interest that was once hidden usury on a financial instrument. By reconciling the statutory language of criminal and civil usury, the federal court's rulings on criminal usury cases will be consistent with New York State court's rulings, and ultimately, in unison with New York's legislative intent. Altogether, this will allow an approach to usury laws in New York that aligns with the history and legislative intent of usury.