To Be Argued By:
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CTQ-2020-00005

Court of Appeals

STATE OF NEW YORK

GENESYS-ID, INC.,

Defendant-Appellant,

against

ADAR BAYS, LLC,

Plaintiff-Respondent.

On Questions Certified by the United States Court of Appeals for the Second Circuit (USCOA Docket No. 18-3023-cv) and for the Southern District of New York (USDCSDNY Docket No. 1:17-cv-01175-ALC)

BRIEF FOR *AMICUS CURIAE* POWER UP LENDING GROUP, LTD. IN SUPPORT OF PLAINTIFF-RESPONDENT

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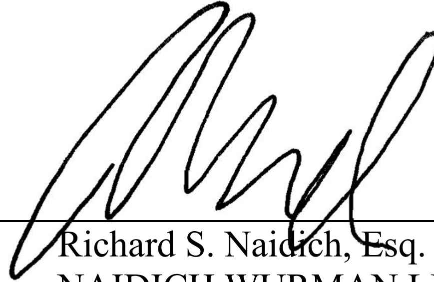
CORPORATE DISCLOSURE STATEMENT

Richard S. Naidich, Counsel for proposed Amicus Curiae, Power Up Lending Group, Ltd. certifies that Power Up Lending Group, Ltd. has no parent corporation, subsidiaries and/or affiliates.

Dated: Great Neck, New York
December 10, 2020



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COURT OF APPEALS
STATE OF NEW YORK
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GENESYS-ID, INC., CTQ 2020-00005

Defendant-Appellant,

v.

ADAR BAYS, LLC,

Plaintiff-Respondent.
--X

BRIEF OF POWER UP LENDING GROUP, LTD. AS AMICUS CURIAE

PRELIMINARY STATEMENT

Power Up Lending Group, Ltd. respectfully submits this Amicus Curiae Brief to assist the Court in determining two questions as certified by the United States Court of Appeals for the Second Circuit at 962 F. 3d 86 (2d Cir. 2020).

THE QUESTIONS PRESENTED

I. Whether a stock conversion option that permits a lender, in 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 N.Y. Penal Law §190.40, the criminal usury law.

We respectfully submit that this question should be answered in the negative.

II. If the interest charged on a loan is determined to be criminally usurious under N.Y. Penal Law §190.40, whether the contract is void *ab initio* pursuant to N.Y. General Obligations Law 5-511.

We respectfully submit that this question should be answered in the negative.

The Second Circuit also invited this Court "to reformulate these questions as it sees fit or expand them to address any other issues of New York law that would assist this Court in determining whether discounted conversion rates are interest pursuant to N.Y. Penal Law §190.40 and whether N.Y. Gen. Oblig. Law §5-511 can be read to void criminally usurious loans". We respectfully submit that other issues are presented herein that will assist this Court in determining such expanded questions and that will be of further aid to the Second Circuit.

STATEMENT OF INTEREST

Power Up Lending Group, Ltd. ("Power Up or "the Amicus") has a direct and substantial interest in the determination of these questions because it is engaged in the same business as the respondent, Adar Bays, LLC ("the Respondent" or "Adar Bays").

The Amicus, like Adar Bays is engaged in the business of making loans to small-cap public companies. The form of these loans typically involves a convertible promissory note ("the Note") executed by the borrower together with a securities purchase agreement ("SPA") and other companion loan documents.

Pursuant to this business model, the Amicus is enabled to provide small-cap public entities with much needed capital unavailable to them from more conventional sources. While the pertinent documents permit the borrower to prepay the Amicus within the first 180 days from funding, that right is critical, since the exercise of the right of pre-payment would prevent conversion. This simple fact refutes Appellant's usury claims. Stated otherwise, the right of conversion is not contingent on an event beyond the borrower's control and thus, any discount relied upon by Appellant cannot constitute interest within the meaning of the usury statutes.

In order to sell free trading stock, a publicly traded company like GeneSys ID, Inc. ("GeneSys" or "the Appellant") must register the stock, which is an expensive, time consuming and intricate process. Initial Public Offerings involve the sale of registered stock, which are unrestricted and free trading. Absent the stock being registered, the recipient of stock must find an exemption to registration, in order to convert the restricted stock into free trading stock. Rule 144 of the Securities Act of 1933 ("Rule 144") is such an exemption, to be utilized to effectuate the conversion. The exemption, however, belongs to the investor in the stock, in this case Adar Bays. If Adar Bays acquires a security in the issuing company, such as a convertible promissory note, and holds the Note for the required holding period of six months, (the "tacking period") and obtains stock in partial or full satisfaction of the Note, provided that an attorney issue an opinion letter which qualifies the stock for Rule

144 treatment, thus making it free trading. It is only after the issuance of that opinion letter that the stock becomes unrestricted and free trading and can be sold on an exchange.

In order to comply with Rule 144, the investor must hold the security (the "Note") six months from the funding to be in a position to obtain unrestricted shares, which places the investor at substantial risk since during the tacking period the debtor may (i) be delinquent in its filings with the United States Securities and Exchange Commission ("SEC"), the timely filing of which is a predicate to the lender's conversion rights; or (ii) the company's shares may be illiquid and trading volume insufficient to accommodate the lenders conversion; (iii) trading of the company's stock may be halted by the SEC or appropriate exchange, or (iv) the issuing company ceases to operate or (v) files a petition in bankruptcy. Should any one or more of the aforementioned situations occur it would render the conversion right unenforceable.

The Notes issued by Adar Bays provide for a stated annual interest rate of 8% and also provide entitlement after 6 months to convert all or any portion of the Note into shares of common stock at a conversion price set at 65% of the lowest trading price of the stock as reported on the over the counter market for the prior twenty trading days. Upon such conversion, payment of principal and interest in the amount of the conversion by the issuing company (here, GeneSys) is credited. Of particular

importance, the Note permits the borrower to repay at maturity the principal amount of the Note together with annual interest of 8%, provided that the borrower fails to avail itself of the right of prepayment and Adar Bays does not exercise its conversion rights.

STATEMENT OF FACTS

The facts of this case are amply presented by the parties, and the opinions of the United States District Court for the Southern District of New York and the United States Court of Appeals for the Second Circuit.

The positions of the parties are clear. GeneSys contends that the 35% discount that applies if Adar Bays elects to convert any outstanding debt into stock violates Penal Law §190.40 because that discount is the Note's "real" interest rate. The Appellant further contends that since that "real" rate exceeds 25% this Court should read Penal Law §190.40 *in para materia* with General Obligations Law ("GOL") §5-511 and hold the Note void as per the latter statute. Adar Bays contends that the 35% is not interest because at the time of contracting, the point at which the usury determination must be made, it is speculative whether the conversion option will be exercised. Adar Bays further contends that upon conversion the transaction becomes an equity investment which is not subject to the usury laws. Adar Bays also takes the position that the above referenced statutes should not be read together and that the voiding provisions of GOL§ 5-511 do not apply to corporations.

We agree with and support the contentions of Adar Bays. However, we also believe that there are additional arguments and authorities that must be considered in order for this Court to make a complete analysis and correct determination of the questions presented. We now present those arguments and authorities.

ARGUMENT

POINT I

THE ALLEGED DISCOUNT IS NOT INTEREST AS THE DEBTOR RETAINS THE AMOUNT RECEIVED

The Definition of Interest

The Appellant's Brief contains, among other things, a glossary of relevant terms. However, the most important term of all, i.e., the definition of what constitutes "interest" does not appear. "Interest" is "the compensation allowed by law or fixed by the parties for the use or forbearance of borrowed money". Black's Law Dictionary (Sixth Ed. 1991). The applicable case authority is to the same effect, i.e., that interest is "simply the cost of having the use of another person's money for a specified period". Spodek v. Park Property Development Associates, 279 A.D 2d 647 (2d Dep't, 2001); McPartland v. Young, 2011 N.Y. Slip. Op. 51024 (Suffolk Co. Dist. Ct., 2011) ("interest is the compensation allowed by law or fixed by the parties for the use or forbearance of money").

In the case at bar, the profits or prospective profits that might be realized through the conversion process and that the Appellant finds so objectionable

cannot be classified as interest for the simple reason that the Appellant does not simply have the *use* of Adar Bay's money, *but it gets to keep the money as part of the conversion process.* Thus, by definition, the profits on the conversion and sale of the stock at issue are not simply for the use of the proceeds that are advanced, but for the retention of those proceeds and cannot constitute interest by definition. If the conversion rights are not exercised, and the Note is not prepaid then GeneSys' obligation is to repay the principal together with 8% annual simple interest. Thus, usury does not apply in either event.

Indeed, in its Order of Certification, the Second Circuit appears to recognize the fact that the Appellant does not pay any interest in connection with the conversion process. Specifically, the Court noted that it is the Appellant's contention that "for each $1.00 of principal that Adar Bays requests be converted into shares, GeneSys is required to deliver stock worth $1.35", and that the "interest" on a "converted stock payment" being 35%, the transaction is criminally usurious because it provides for interest in excess of 25% per annum. 962 F. 3d at 90. In footnote 3 (p. 94), the Court seems to view that accounting skeptically as follows:

> One question which might be fairly asked about this accounting is what value GeneSYS is actually transferring to Adar Bays. The issuance of further stock, which GeneSYS may do essentially by corporate fiat, does not cost GeneSYS anything, even though those shares may be worth something if sold. Of course, by issuing and then transferring the requisite stock to satisfy the debt, GeneSYS may have

> rational concerns about subsequent sales by Adar Bays flooding the market in its securities and thus perhaps reducing GeneSYS's stock price. But that decline in stock price, if it is a "transfer of value" at all, comes at the expense of GeneSYS's existing shareholders (including Adar Bays if it is unable or unwilling to sell some or all of its newly transferred shares), who are now left holding a less valuable security. GeneSYS thus may be rightly concerned with the perceptions of equity investors as to its appeal as an investment and the impact of those perceptions on its ability to seek capital from equity markets in the future. However, the value of those concerns to GeneSYS is only uncertainly related to the "$1.35 in value for every $1 of principal" accounting which GeneSYS posits. Perhaps the value to GeneSYS is irrelevant in the usury analysis, but, if that is true, the possibility that the shares transferred could become worthless due to bankruptcy or other events remains as an obstacle to the neat calculus which GeneSYS puts forth. (Emphasis supplied).

Thus, the Second Circuit itself appears to recognize and acknowledge that issuers such as the Appellant actually do not make any payment to the Noteholder such as Adar Bays and that the transaction costs the issuer nothing except a treasury stock certificate that was sitting in its stock book that had no value as it could not be traded. In this light, the Appellant's contentions must fall.

The Second Circuit also seems to recognize that "other events" may render the value of the stock problematic making any "accounting" or calculation of supposed interest impossible, thus presenting "obstacles" to the Appellant's position. We respectfully submit that this very Court has already recognized these "obstacles" and the fact that the price at which a person takes an option in a highly speculative transaction such as this, is no reasonable criterion of value, thus contradicting the position of the Appellant. Halsey v. Winant, 258 N.Y. 512

(1932). In that case, Harriman loaned $2,600,000 to Winant who pledged 450,000 shares of stock in the Falcon Oil Corporation as collateral for the loan. The loan provided payment of interest at six percent per year together with an option agreement permitting Harriman to buy the stock at a specified figure and take forty percent of the possible profits from a proposed deal between Winant and the Venezuelan government. Payment was due to Harriman on December 1, 1928 but was extended for one month. When Winant defaulted, Harriman gave notice that he would sell the shares at public auction on February 6, 1929.

In the meantime, Halsey commenced an action against Winant on January 25, 1929 for a separate $300,000 loan under which Winant was also in default. On February 1, 1929, Winant consented to a judgment in favor of Halsey. On February 6, 1929, Harriman accepted the stock in full satisfaction of the $2,600,000 indebtedness owed to him.

Halsey began an action against both Winant and Harriman contending that the transfer of the stock to Harriman was not for fair consideration and also that the transaction between Winant and Harriman was usurious in the first instance because the option given to Harriman made the interest rate in excess of the statutory cap. The Supreme Court, New York County dismissed the action. The Appellate Division, First Department rejected Halsey's usury claim stating among other things, that the difference between the option price and the price at

which the stock might be marketed by Harriman represented his profit and compensation for his services, much like the profit made by Adar Bays as compensation, in effect, for converting regulated stock into unregulated stock. However, the Appellate Division held that the transfer of the stock to Winant was not for fair consideration because the option price had been as low as $7.50 per share and other stock had been sold for $9.14 per share. Thus, the Appellate Division reversed the Supreme Court and entered judgment in favor of Halsey for the amount of $306,021.86. The opinion of the Appellate Division at 233 App. Div. 103 (1st Dep't, 1931), is cited on page 26 of the Brief for Defendant-Appellant as standing for the proposition that when a creditor takes property in satisfaction of an antecedent debt, the property must be no more than "a fair equivalent".

However, the Appellant fails to mention that the Appellate Division was reversed by this very Court at 258 N.Y. 512. This Court agreed with the Appellate Division that the transactions in question were not usurious, thus supporting the position of Adar Bays. This Court also noted the difference between the $7.50 option price and the $9.00 actual sales price. However, this Court stated that "obviously the price at which a person takes an option, especially under circumstances where he is in involved in a highly speculative transaction, is no reliable criterion of value". The same words should apply with equal vigor to the

case at bar as the transactions under consideration are also highly speculative, and any purported option premium cannot be deemed a reliable criterion of value nor may they be used as a basis for computing interest and holding the transaction void under the criminal usury laws. In words equally applicable here, this Court also observed that the party asserting the usury claim was "seeking equity without an offer to do equity". Such is the case here, and these words ring true with respect to the Appellant who seeks to create a loophole to extract an undeserved windfall.

The Operation of Rule 144

In Stuckey v. Online Resources Corp., 909 F. Supp. 2d 912 (S.D. Ohio 2012), the Court presented a lucid explanation of how these "other events" might occur and an explanation of how Rule 144 operates in connection with convertible promissory notes, as well a recognition of the fundamental distinction between registered stock and unregistered stock, and their respective rights and restrictions.

The Court discussed the fact that under Rule 144, adequate current information must be available to the public through the requiring of all required reports such as Forms 10-Ks, 10-Qs and 8-Ks, and if they are not, stock cannot be sold. Thus, what the Appellant in the case at bar fails to take into account is the fundamental distinction between the unregistered stock that it places with the transfer agent and the registered free trading stock that is created six months later

through the actions of the Amicus and its legal counsel. The failure to take this difference into account renders the Appellant's contentions utterly without merit.

The Substance of These Transactions

It is well settled that in determining whether a transaction is usurious, the law looks not to its form, but its substance, or real character. Bouffard v. Befese, LLC., 111 A.D. 3d 866 (2d Dep't, 2013); O'Donovan v. Galinski, 62 A.D. 3d 679 (2d Dep't, 2009). Here, the substance of the subject transactions is that the issuing company, i.e. the Appellant, is enabled to sell unregistered stock, having a questionable value, for about 65% of what its free trading value would be. These transactions should be viewed as hybrid transactions with characteristics of both debt and equity, beyond the scope of the usury statutes.

Prepayments are Not Subject to Usury Challenge

To the extent that the Appellant relies upon the prepayment provisions of the Notes to support their claim of usury, such an effort would be unavailing. It is established law that prepayment provisions are not subject to challenge based upon the usury laws. Feldman v. Kings Highway Savings Bank, 303 N.Y. 677, 102 N.E. 2d 836 (1951); Lyons v. National Savings Bank of Albany, 280 App. Div. 339 (3d Dep't, 1952); Poughkeepsie Galleria Company v. Aetna Life Insurance Company, 178 Misc. 2d 646 (Sup. Ct., Dutchess Co., 1998); Achee Holdings, LLC v. Silver Hill Financial LLC, 2009 WL 347751 (S.D. Texas 2009).

Moreover, the contractual right of GeneSys to prepay the Note at its sole option totally defeats its usury contention. This is because "the contingent payment" i.e., the conversion right to acquire stock at an alleged discount, can be obviated and avoided by prepayment, an event that is not beyond the borrower's control, but instead is within its control. Feld v. Apple Bank for Savings, 116 A.D. 3d 549 (1st Dep't, 2014).

In LG Capital Funding, LLC v. PositiveID Corp., 2019 WL 3437973 (E.D.N.Y. 2019), Report and Recommendation adopted, 2019 WL 4564882 (E.D.N.Y. 2019), that Court considered virtually identical convertible promissory notes as those at issue here. The case was litigated by the same attorneys as those here. That Court refuted the Appellant's usury argument by, among other things, focusing on the right of prepayment. The Court found that under the debtor's own formulation, the prepayment penalty is not considered interest because whether the debtor chooses to prepay the loan, is an event completely within its control. The same result should obtain here.

Default Payments Are Also Not Subject to Usury Challenge

Likewise, it is well settled that an interest rate imposed upon default is not subject to a claim of usury. Bloom v. Trepmal Construction Corp., 29 A.D. 2d 951 (2d Dep't, 1968) *aff'd*, 29 N.Y. 2d 730, 244 N.E. 2d 62 (1968); H.D.S. Trading Co. v. Redisch, 19 Misc. 2d 716 (Sup. Ct., Queens Co., 1959); Heelan v. Security

National Bank, 73 Misc. 2d 1004 (Dist. Ct., Suffolk Co., 1973). Thus, any contentions that the usury laws apply here based upon either a default rate of interest or a prepayment provision would be without merit and contrary to all authority. Hicki v. Choice Capital Corp., 264 A.D. 2d 710 (2d Dep't, 1999); Kraus v. Mendelsohn, 97 A.D. 3d 641 (2d Dep't, 2012) ("the defense of usury does not apply where the terms of the mortgage and note impose a rate of interest in excess of the statutory maximum only after default or maturity"); Miller Planning Corp. v. Wells, 253 A.D. 2d 859 (2d Dep't, 1998) ("same"); Shorehaven Associates Inc. v. King, 184 A.D. 2d 764 (2d Dep't, 1992) ("the appellants purported use of usury based upon a provision increasing the interest to a higher rate upon a default is meritless"); Klapper v. Integrated Agriculture Management Company, Inc., 149 A.D. 2d 765 (3d Dep't, 1989) ("promissory note with 18% annual rate of interest on default not subject to usury defense"); Atul Bhatari v. Futterman, 122 A.D. 3d 509 (1st Dep't, 2014) (transfer of valuable membership interests that did not occur until after default did not constitute interest). Appellant's contention falls of its own weight.

POINT II

APPELLANT'S CONTENTIONS FAIL TO RECOGNIZE THE DIFFERENCE IN VALUE BETWEEN RESTRICTED AND UNRESTRICTED STOCK

The Economic Realities

A fundamental flaw in the Appellant's presentation is the incorrect assumption that unregistered stock which has questionable value since it represents ownership in a corporation with no assets nor income, should be valued at the full free market trading price for registered stock. This is the whole foundation for the Appellant's contentions and represents a totally false narrative. Stated differently, the Appellant contends that on the same day that Adar Bays lent $1.00 to GeneSys, Adar Bays received the right to receive stock worth $1.54 at a 35% discount. Thus, the Appellant opines that Adar Bays received interest on the date of the making of the loan of 54%, thereby violating the criminal usury statutes. Brief for Defendant-Appellant, p. 18. This is untrue for the reason that at funding Adar Bays receives no stock, only the ability to acquire the stock six months, hence, is speculative. There is no guaranty of a market price or a purchaser. Appellant's contention is unfounded.

The simple fact is that such unregistered stock cannot be equated with free trading stock. The value of restricted stock should be discounted at least 33% (thereby wiping out almost the entire discount relied upon by Appellant). In fact, GeneSys' stock should have a discount of 100% because the Appellant is insolvent

from an asset and income point of view. The Internal Revenue Service ("IRS") and the SEC have recognized the fundamental difference of registered and unregistered stock and give heavy emphasis to the lack of assets and income in the corporate issuer. The Appellant's arguments completely miss the mark and are devoid of economic reality.

The Position of the Internal Revenue Service

In Revenue Ruling 77-287, 1977-2 C.B. 319, 1977 WL 43794, the IRS considered the issue of the valuation of securities restricted from immediate resale pursuant to the Federal Securities Laws. After identifying such restricted securities as being those at issue here, the IRS addressed the question of how such shares or securities should be valued. In particular the IRS ruled that the market in which publicly held securities are traded reflected variances in the amount of discount that is applied to restricted securities purchases. It determined that discount rates were greatest on restricted stocks with unrestricted counterparts traded over the counter (OTC Markets) (as in the case at bar), followed by those with unrestricted counterparts on the American Stock Exchange, while the discount rates for those stocks with unrestricted counterparts listed on the New York Stock Exchange were the smallest.

The IRS also observed that different relevant facts and circumstances bear upon the worth of restricted stock, including earnings, net assets, and net sales which

should be given primary consideration. The IRS further stated that resale provisions must be scrutinized and weighed, and that the two elements of time and expense bear upon this discount. The longer the buyer of the shares must wait to liquidate them, the greater the discount. Also, the expense of registration must be taken into account. In summary, the IRS recognizes that the valuation of restricted shares versus unrestricted shares can be very different and is dependent upon a number of facts and circumstances. In particular, since the stock here would be traded on the OTC market, it should be entitled to the largest discount of any trading stock, based upon this analysis.

The Position of the SEC

The SEC agrees with the IRS, and disagrees with the Appellant, who contends that the value of restricted and unrestricted shares is one and the same. In Release No. 5847, Release No. IC-5847, 1969 WL 95335, the SEC also considered the question of valuation of restricted securities. It addressed the problems for the seller, which is that such restricted securities cannot be sold to the public without prior registration, which is expensive, difficult, and problematic. The SEC specifically noted that "the valuation of restricted securities at the market quotations of the same class would, except for the most unusual situations, be improper". Nevertheless, that is the position of the Appellant, to wit, that the restricted shares and the option to purchase them should be valued at the market quotations for unrestricted free

trading stock. In this light, the position of the Appellant is not just contrary to that of Adar Bays but to the IRS and the SEC, not to mention various courts that have considered the issue. The SEC noted that the valuation of restricted securities by reference to the market price of unrestricted securities would depend on a number of factors that may not exist when the market for the unrestricted securities is very thin, as here, like most OTC companies.

In sum, the SEC recognized that restricted securities are regularly purchased at a discount, frequently substantial, from the market price of outstanding unrestricted securities of the same class. This reflects the fact that securities which cannot be readily sold in the public market place are less valuable than securities that can be sold, and also the fact that, by the direct sale of restricted securities, sellers (such as the Appellant) avoid the expense, time and public disclosure which registration entails.

The Appellant's Form 10-Q

When we consider that the underlying assets and income and operations of the issuing company, here the Appellant, are of great significance to the valuation of such shares or securities, it is necessary to view the records of the Appellant as encompassed by its most recent Form 10-Q and/or Form 10-K. In the Form 10-Q filed by GeneSys for the quarter ending September 30, 2016 (A 43-63), GeneSys reports total assets of $282,476 and total liabilities of $9,628,670. It also reports that

for the prior three months it had a loss from operations of $344,423 and a total net loss of $8,270,344. It would seem to us that these calculations demonstrate the risks incurred and uncertainty in valuing the options because of the fact that GeneSys is insolvent by any definition. The Form 10-Q also lists eighteen similar convertible promissory notes with a face value of $816,310, executed by GeneSys in favor of six other companies engaged in a business similar if not identical to those of Adar Bays. Nowhere does GeneSys intimate that any of these notes are void or otherwise unenforceable. Should not GeneSys be estopped from asserting such a position? We think the answer is self-evident. However, as noted by the Second Circuit, the Form 10-Q also states that:

> "[T]he Company terminated its transfer agent on September 6, 2016, preventing further toxic conversions and bringing all parties to the table to discuss a satisfactory settlement which would provide the Company with a window to redeem the outstanding notes over an extended period of time and prevent any further conversions for several months."

Stated differently, the Appellant, in one fell swoop, violated its contractual obligations to a half a dozen companies that had extended credit in good faith based upon the Appellant's representations. However, that impact is on the shareholders of the debtor, not the debtor itself, and such reduction in price cannot obviously constitute interest for purposes of the usury laws.

POINT III

THE APPELLANT'S CONTENTIONS ARE UNAVAILING AND ITS AUTHORITIES DISTINGUISHABLE

The cases and authorities cited by and relied upon by the Appellant in its Brief do not answer the certified questions nor do they lend any support to its cause.

In Diehl v. Becker, 227 N.Y. 318 (1919), cited by Appellant, a loan of $5,000 was made in exchange for which the creditor was to receive, out of net proceeds from a mining business, interest of 6% per year plus an additional $1,250 all to be paid within six months. The creditor in the Diehl case was to receive not just repayment, but additional amounts as well, as opposed to the case at bar, where Adar Bays does not receive *both* items of recovery, but only one. Thus, the case is distinguishable.

In Cleveland v. Loder & Draper, 7 Paige Ch. 557 (1839), cited by Appellant, defendant loaned plaintiff $5,000 for six months at the legal rate of interest, and also received 400 shares of stock together with a note receivable of $4,000 which the borrower held against an unrelated third party. The lender had the option to retain 200 shares and return the remaining shares and note receivable to the borrower and the obligation would be satisfied. If the lender elected not to retain the stock, then the borrower was to pay the money loaned and the interest due thereon at the end of six months. The agreement also provided that the borrower would receive $1,500

of the loan in uncurrent eastern bills. The stock was not restricted, unlike the stock at issue here.

Any "sum" received by the creditor in the case at bar, is not the result of any increase or potential increase in the trading value of unrestricted shares trading in such a market, but rather as reflective of the transmuting of unregistered, essentially valueless stock, which cannot be traded or sold, into free trading stock, which is accomplished by the creditor's use of the legally sanctioned privilege of using Rule 144.

In Alpha Capital Anstalt v. Biometrics Inc., 2010 N.Y. Slip. Op. 30045 (Sup. Ct., Suffolk Co. 2010), relied upon by Appellant, the creditor moved for summary judgment in lieu of complaint based upon a promissory note in the amount of $400,000 paying interest at 8% per year until default and 15% per year after default. The note also provided an option for the noteholder to convert all or part of the note into common stock.

Moreover, and significantly, the creditor in the Alpha case, like so many other creditors referred to by the Appellant, was seeking to obtain full repayment of principal plus interest, and then additional amounts on top of that, whether in the form of stock, warrants, profits, or other property. Such is not the case here, as Adar Bays can only obtain *either* the return of principal plus interest at 8% a year *or* the stock subject to conversion rights. That is a fundamental difference that

distinguishes the case at bar from all of the cases and authorities recited by Appellant.

Blue Wolf Capital Fund II, LP v. American Stevedoring, Inc., 105 A.D. 3d 178 (1st Dep't, 2013), relied upon by Appellant, is distinguishable. In that case, a secured loan of $1,130,000 was made, with the borrower only receiving $805,000 and the lender retaining $325,000 as fees and deposits. Such is not the case here, as the Appellant received the entire amount of the advancement reflected in the Note. Thus, Blue Wolf does not apply here.

In Hillair Capital Investments, L.P, 963 F. Supp. 2d 336 (S.D.N.Y. 2013), cited by Appellant, a hedge fund made two separate loans to a freight and trucking company. As part of the transactions the trucking company agreed to issue shares of its common stock to the hedge fund. It did in fact issue 500,000 shares for one loan and 453,030 shares for the other loan. The hedge fund actually received the shares at the time that the loans were made, in contrast to the case at bar, where the shares are deposited with the transfer agent of GeneSys and remain in the name of GeneSys for at least six months until the conversion process can commence.

However, unlike GeneSys, the trucking company in that case did not keep the loan proceeds! This is a fundamental distinction from the facts in the case at bar. Significantly, the Court recognized that because the stock was restricted it could not be valued by simply looking at the share price on the stock market, as the Appellant

here contends. Instead, the Court noted that Revenue Ruling 77-287, as well as other authorities, must be taken into account as restricted values generally are issued at a discount. Intriguingly, that Court also stated that intent to enter into a usurious transaction must also be taken into account, and that even if the transactions were subject to a criminal usury defense, that the hedge fund might still be able to recover on a theory of unjust enrichment. Thus, the Hillair case actually supports our contentions that (i) certified question number 2 should be answered in the negative, as the debtor must establish both intent and that the relative culpability, bargaining power, and knowledge of the parties are balanced in its favor, and (ii) that certified question number 1 should be answered in the negative because restricted shares must be valued at a discount, and not at free trading values as postulated by the Appellant.

In its Reply Brief (p.16), the Appellant in discussing the Hillaire case makes a statement that is totally incorrect. Appellant contends that the recipient of restricted stock would not be insulated from price declines during the six months holding period of Rule 144 and that "this is the reason restricted stock is given a lower valuation". NOT SO!! The reason for the lower valuation is that the stock cannot be traded and therefore has no value to the purchase, since it cannot be resold.

In Browne v. Vredenburgh, 43 N.Y. 195 (1870), cited by Appellant this Court held that where the transaction provided for repayment of the principal sum with legal interest, and a benefit beyond the legal rate of interest, that the transaction

would be usurious. In the case at bar, the receipt of the stock upon conversion is the sole manner of repayment. However, the value of the right to obtain restricted stock six months from the date of the transaction is valueless and the value only becomes ascertainable in the future. Thus, this transaction cannot be determined as usurious and the borrower's burden cannot be met, since the determination is not discernible within the four corners of the document.

In Cusick v. Ifshin, 70 Misc. 2d 564 (Civ. Ct., N.Y. Co., 1972), *aff'd*, 73 Misc. 2d 127 (App. Tm., 1st Dep't, 1973), relied upon by Appellant, there was a loan of $10,000 in exchange for which the corporate borrower promised to pay principal in two years with interest at the rate of 20% per annum. In addition, the corporate borrower promised that if certain real estate was sold during that period, the loan would be immediately due, and the lender would receive an additional payment of $4,000. Here once again we are faced with a circumstance that a lender at inception is entitled to obtain a repayment of a note and to additionally receive *from the borrower* potentially a sum in excess of the original principal plus interest. In the case at bar, Adar Bays, receives either repayment or the stock, but not both. (Emphasis added).

In Franklin Realty Co. v. PAAMCO Founders Co. LLC., 2010 WL 11598029 (S.D.N.Y. 2010), relied upon by Appellant, there was a revolving credit line secured by a note under which the debtor would pay 10% per year of outstanding principal

or 40% of the debtor's adjusted net profits whichever was greater. The lender moved for summary judgment and the debtor contended that both forms of payment were criminally usurious. The Court found that usury may only exist if the principal sum advanced is repayable absolutely. It found that the principal in that case was not "repayable absolutely" but remains subject to loss as long as there was a principal balance outstanding. Specifically, the Court determined that the creditor's entitlement to interest beyond the 10% calculation was entirely dependent on the debtor's uncertain profits, just as Adar Bays entitlement to recovery upon conversion is dependent on GeneSys' continued survival and the trading status of its stock, which is subject to innumerable pit falls. Thus, that case actually supports our contentions.

POINT IV

THE CONTRACTS SHOULD NOT BE VOID EVEN ASSUMING APPLICATION OF THE CRIMINAL USURY LAW

The Second Circuit has also provided insight as to its thoughts on the second certified question, i.e., whether or not a loan to a corporation that charges more than 25% per year in interest should be void in all respects. In Footnote 9, 942 F. 3d 86 at 94, that Court states as follows:

> For our part, we have noted that "the consequences to a lender avoiding a usury loan transaction are harsh, and that New York courts thus "have been reluctant to extend them beyond cases that fall squarely under the statute".

We agree that the consequences are harsh, and that the Courts should be reluctant to extend those consequences to any scenario that does not clearly fall within the ambit of the usury statutes.

As the Commentator of 72 N.Y. Jur. 2d, Interest and Usury, §56 has observed:

> Usury is not a crime in itself or malum in se; it is merely malum prohibitum. Both as an offense against the laws and a defense in suits in court, it is dependent upon express statute, and in determining the rights and remedies of the parties to a usurious exaction of interest, reference must be made to the provisions of the statute involved. However, usury violations must be strictly construed within the plain meaning of the usury statute.

Moreover, the usury statutes are entitled to a "liberal construction", that is, a construction favoring the validity and enforceability of corporate obligations which but for the statute would be subject to the defense of usury. *Id.*, §132. That is to say, usury must be proven by clear and convincing evidence, and a clear violation of the statutes. Goldstein v. CIBC World Markets Corp., 6 A.D. 3d 295 (1st Dep't, 2004).

This very Court has held that where contracts which violate statutory provisions are merely malum prohibitum, the general rule - - that illegal contracts are generally unenforceable - - does not always apply. John E. Rosasco Creameries, Inc. v. Cohen, 276 N.Y. 274 (1937). If the statute does not expressly provide that its violation will deprive the parties of their right to sue on the contract, and the denial of relief is wholly out of proportion to the requirements of public policy, the right to recovery will not be denied. *Id*. Stated differently, not every contract which

violates a statute is for that reason unenforceable. Holmes v. Nationwide Mutual Insurance Company, 40 Misc. 2d 894 (Sup. Ct., Broome Co., 1963), *aff'd,* 19 A.D. 2d 947 (3d Dep't, 1963); National Superlease, Inc. v. Reliance Insurance Company of New York, 126 Misc. 2d 988 (Sup. Ct. Queens Co., 1985); Hayes v. Magnus-Cutler, Inc., 41 Misc. 2d 420 (Sup. Ct. Nassau Co., 1963).

In light of the fact that GOL§5-521 (3) only gives a corporation the opportunity to interpose an affirmative defense based on criminal usury, and does not, in and of itself, state the effect of such an affirmative defense, we submit that it is the better rule of law that corporate obligations not be completely forgiven but instead be subject to reformation or other adjustment in order to prevent a forfeiture. As Appellant's counsel states, avarice is among us. This is because there are corporations like the Appellant that willfully, deliberately, and with malice and intent aforethought, accept the proceeds of the advancements and loans described while virtually lying to the lenders and creditors by making promises and obligations that they have no intention of honoring. We fail to perceive how the approval of such misconduct by this Court would constitute good law. It would not.

It is for this reason among others that the Courts of this state have found a better remedy than conferring an undeserved windfall on such party. Koenig v. Slazer Enterprises, Owner, LLC, 2010 N.Y. Slip. Op. 50688 (Sup. Ct., Rockland Co., 2010); Murlar Equities Partnership v. Jimanez, 2018 N.Y. Slip. Op. 31225 (Sup.

Ct., Bronx Co., 2018); Realty Holdings of America, LLC v. Stein, 2013 N.Y. Slip. Op. 32945 (Sup. Ct., N.Y. Co., 2013). As have many federal courts. Venture Mortgage Fund, L.P. v. Schmutz, 282 F. 3d 185 (2d Dep't, 2002); Carlone v. Lion & The Bull Films, Inc., 861 F. Supp. 2d 312 (S.D.N.Y. 2012).

Considering the harsh results of the position advocated by the Appellant, the lack of clear authority from the Legislature for adopting such a position, and the unjust forfeitures and corresponding undeserved windfalls that would result, we submit that the better rule of law is the one that we espouse. Thus, certified question number 2 should be answered in the negative.

Indeed, in Seidel v. 18 East 17th Street Owners, Inc., 79 N.Y. 2d 735 (1992), this very Court considered a case where the actual interest rate of a loan was determined to be 28.6% per annum. The lenders did not dispute that figure nor that the loan was usurious. This very Court held that a party asserting a usury defense may be estopped from doing so in order to avoid a result where a borrower could achieve a total windfall, at the expense of an innocent person, through his own subterfuge and inequitable deception - - words applicable here to GeneSys. This Court also stated that the creditor's recovery would be limited, at most, to recovery to the amount advanced, with legal interest - - which is our position assuming that any transaction at issue was in fact criminally usurious.

CONCLUSION

1. The first certified question should be answered in the negative.

2. The second certified question should be answered in the negative.

Dated: Great Neck, New York
December 10, 2020

Respectfully Submitted,

By: ______________________________

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CERTIFICATE OF COMPLIANCE

I hereby certify pursuant to 22 NYCRR § 500.13(c) that the foregoing brief was prepared on a computer.

A proportionally spaced typeface was used, as follows:

Name of typeface: Times New Roman

Point size: 14

Line spacing: Double

The total number of words in the brief, inclusive of point headings and footnotes and exclusive of the statement of the status of related litigation; the corporate disclosure statement; the table of contents, the table of cases and authorities and the statement of questions presented required by subsection (a) of this section; and any addendum containing material required by § 500.1(h) is 6,940.

Dated: Great Neck, New York
December 10, 2020

Respectfully Submitted,

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