18-3023-cv

United States Court of Appeals

for the

Second Circuit

ADAR BAYS, LLC,

Plaintiff-Appellee,

– v. –

GENESYS ID, INC., FKA RX Sales, Inc.,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF AND SPECIAL APPENDIX
FOR DEFENDANT-APPELLANT

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CORPORATE DISCLOSURE STATEMENT PURSUANT TO R. 26.1

The undersigned, counsel for Defendant-Appellant GeneSYS ID, Inc. certifies that GeneSYS ID, Inc. is a Nevada Corporation with no public corporate parent or subsidiary.

Dated: January 25, 2019

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JURISDICTIONAL STATEMENT

The United States District Court for the Southern District of New York ("the District Court") had subject matter jurisdiction under 28 U.S.C. § 1331 in this suit concerning the enforcement of a Convertible Redeemable Note. The District Court entered summary judgment for the Plaintiff-Appellee on September 20, 2018. The Defendant-Appellant filed a timely Notice of Appeal to this Court on October 12, 2018. This appeal is from a final judgment of the District Court that disposes of all of the parties' claims, and this Court has jurisdiction on appeal under 28 U.S.C. § 1291.

ISSUES PRESENTED FOR REVIEW

1. Did the District Court err in refusing to read N.Y. Penal Law § 190.40 together with N.Y. Gen. Oblig. Law §§5-511 and 5-501 and thereby err in denying Defendant-Appellant GeneSYS ID, Inc.'s ("GeneSYS") FRCP 12(c) motion to dismiss the case on the pleadings, where the Note payable to the Plaintiff-Appellee Adar Bays, LLC was criminally usurious under N.Y. Penal Law § 190.40 and, therefore, void under N.Y. Gen. Oblig. Law §5-511?

2. Did the District Court err in denying GeneSYS' FRCP 12(c) motion to dismiss the case on the pleadings, where the District Court failed to include the values of the attorney fees payable, the fixed conversion discounts, the irrevocable reservation of shares, or the default rates and penalties in determining whether the

Note payable to the Plaintiff-Appellee Adar Bays, LLC ("Adar Bays") was criminally usurious under N.Y. Penal Law § 190.40 and, therefore, void under N.Y. Gen. Oblig. Law § 5-511?

STATEMENT OF THE CASE

1. Nature of the Case and Procedural History

Adar Bays filed its Complaint against GeneSYS on February 16, 2017 and filed its First Amended Complaint on April 19, 2017 (A1, A3, A8-66), alleging the breach of a Securities Purchase Agreement and seeking to enforce two Convertible Redeemable Notes, requesting damages in excess of $150,000 (A18).

On January 16, 2018 GeneSYS filed a motion under FRCP 12(c) to dismiss the First Amended Complaint based on the pleadings, asserting that the Note was criminally usurious and void under New York law. On January 16, 2018 Adar Bays filed a motion for summary judgment under FRCP 56.

On September 20, 2018 the Honorable Andrew L. Carter, Jr. of the District Court held that the liquidated penalties clause and the daily penalties clause in the Note were invalid. The District Court, though, otherwise granted Adar Bays' motion for summary judgment and denied GeneSYS' motion to dismiss. The District Court held that (1) N.Y. Gen. Oblig. Law §5-511(1) does not apply to a loan which is allegedly criminally usurious under N.Y. Penal Law § 190.40, and (2) the attorney fees payable, the fixed conversion discounts, the irrevocable

reservation of shares, or the default rates and penalties under the Note did not constitute "hidden" interest above the stated 8% interest rate (SPA 1-25). *See Adar Bays, LLC v. GeneSYS ID, Inc.*, 341 F.Supp.3d 339 (S.D. N.Y. 2018).

2. Statement of the Facts

On May 24, 2016, GeneSYS (then known as "RX Safes, Inc."), a New York corporation whose stock shares are traded publicly over the counter (OTC), issued a $35,000 Convertible Redeemable Note (the "Note") at a stated 8% rate of interest to Adar Bays in order to secure a loan in that amount to GeneSYS, repayable by May 24, 2016 (A284 - A 292).

CEO Lorraine Yarde of GeneSYS executed the Note on behalf of the company on May 24, 2016 in order to borrow the money because the company was experiencing certain cash-flow issues concerning the payment of payroll, engineering, and professional fees necessary to maintain its OTC listing (A226). The transaction was not part of any capital raise for GeneSYS' general business purposes but, rather was a one-off, short-term loan between the company and Adar Bays, which specializes in this type of financing with cash-flow-restricted OTC companies (A227).

GeneSYS' repayment obligation under the terms of the Note is absolute, meaning that the company is obligated to repay this loan in the form of cash

or by Adar Bay's unilateral request at 180 days to issue to it stock at a 35% discount (*Id.*). Repayment upon Adar Bay's unilateral election to convert the principal balance to GeneSYS stock provides Adar Bays with a repayment of 135% of its principal and interest accrued under the Note at the time Adar Bays submits a conversion repayment request (*Id.*).

Simultaneously with the execution of the Note, GeneSYS was required to and did issue an irrevocable transfer agent letter that reserved 278,000 shares of its publicly traded common stock for the sole purpose of repayment on the loan (*Id.*).

On May 24, 2016 GeneSYS' public common stock price was $0.52 a share. (*Id.*). The value of the reservation of 278,000 shares on the date the GeneSYS made the reservation and the loan as consummated was $144,560.00 (A228). The reservation of shares under the Note amounts to over 400% of the face amount of the Note (*Id.*).

As to the specific terms of the Note, ¶ 4(a) allowed Adar Bays, LLC unilaterally to elect to convert the principal due on the Note into GeneSYS common stock at a discount price:

> The Holder of this Note is entitled, at its option, after 180 days and after full cash payment for the shares convertible hereunder, to convert all or any amount of the principal face amount of this Note then outstanding into shares of the Company's common stock (the 'Common Stock') at a price ('Conversion Price') for each share of Common Stock equal to 65% of the lowest trading price of the Common Stock as reported on the National Quotations Bureau OTCQB exchange which the Company's shares are traded or any

> exchange upon which the Common Stock may be traded in the future ('Exchange'), for the twenty prior trading days including the day upon which a Notice of Conversion is received by the Company . . .

(A285) (emphasis added).

Under ¶ 4(c) GeneSYS faced steep prepayment penalties if it paid the balance on the Note prior to the maturity date:

> The Notes may be prepaid with the following penalties: (i) if the note is prepaid within 60 days of the issuance date, then at 115% of the face amount plus any accrued interest; (ii) if the note is prepaid after 60 days after the issuance date but less than 121 days after the issuance date, then at 125% of the face amount plus any accrued interest and (iii) if the note is prepaid after 120 days after the issuance date but less than 180 days after the issuance date, then at 135% of the face amount plus any accrued interest. This Note may not be prepaid after the 180th day. Such redemption must be closed and funded within 3 days of giving notice of redemption of the right to redeem shall be null and void.

Under ¶ 5 of the Note, the transaction was cast as a permanent loan, never to be considered an investment in equity:

> No provision of this Note shall alter or impair the obligation of the Company, which is absolute and unconditional, to pay the principal of, and interest on, this Note at the time, place, and rate, and in the form, herein prescribed.

(A35).

Paragraph 12 of the Note provided that GeneSYS agreed to reserve 278,000 shares of its stock and up to three times that amount with the transfer agent to facilitate any unilateral election to convert shares which Adar Bays, LLC made after 180 days:

> The Company shall issue irrevocable transfer agent instructions reserving 278,000 shares of its Common Stock for conversions under this Note (the "Share Reserve"). Upon full conversion of this Note, any shares remaining in the Share Reserve shall be cancelled. The Company shall pay all costs associated with issuing and delivering the shares. If such amounts are to be paid by the Holder, it may deduct such amounts from the Conversion Price. Conversion Notices may be sent to the Company or its transfer agent via electric mail. The company should at all times reserve a minimum of three times the amount of shares required if the note would be fully converted. The Holder may reasonably request increases from time to time to reserve such amounts.

(A289) (emphasis added).

Paragraph 8(n) of the Note sets forth penalty provisions against GeneSYS in the event of default, including:

> Upon an Event of Default, interest shall accrue at a default interest rate of 24% per annum or, if such rate is usurious or not permitted by current law, then at the highest rate of interest permitted by law. In the event of a breach of Section 8(k) the penalty shall be $250 per day the shares are not issued beginning on the 4th day after the conversion notice was delivered to the Company. This penalty shall increase to $500 per day beginning on the 10th day. The penalty for a breach of Section 8(n) shall be an increase of the outstanding principal amounts by 20%. In case of a breach of Section 8(i), the outstanding principal due under this Note shall increase by 50%.

(A288) (emphasis added).

Paragraph 8(a) of the Note further provides for a "make-whole" remedy in the event that GeneSYS does deliver the required shares upon Adar Bays, LLC's election to convert the principal due into shares in the company:

> Make-Whole for Failure to Deliver Loss. At the Holder's election, if the Company fails for any reason to deliver to the Holder the

> conversion shares by the by the 3rd business day following the delivery of a Notice of Conversion to the Company and if the Holder incurs a Failure to Deliver Loss, then at any time the Holder may provide the Company written notice indicating the amounts payable to the Holder in respect of the Failure to Deliver Loss and the Company must make the Holder whole as follows:
>
> > Failure to Deliver Loss = [(High trade price at any time on or after the day of exercise) x (Number of conversion shares)].

(A289) (emphasis added).

The principal amount of the loan as stated in the Note was $35,000, with only $33,000 of that amount paid to GeneSYS and the remaining $2,000 paid to New Venture Attorneys, P.C., Adar Bays' attorneys (A401, A467).

GeneSYS terminated the transfer agent on September 6, 2016 and sought a settlement with Adar Bays on the payment of the balance and to avoid an election for conversion to stock (A343, 406-12).

On November 28, 2016 Adar Bays submitted a Notice of Conversion to GeneSYS electing to convert $5,000.00 of the principal amount of the Note into 439,560 shares of GeneSYS common stock at a conversion price of $0.011375 per share (A42). On November 29, 2016 CEO Yarde acknowledged GeneSYS' receipt of the Notice of Conversion but stated that the company would not be honoring it, and GeneSYS did not transfer the 439,560 shares in accordance with Adar Bays' unilateral election to give a Notice of Conversion for the shares (A470).

Paragraph 8(k) of the Note provides that an Event of Default shall occur if "[t]he Company shall not deliver to the Holder the Common Stock pursuant to paragraph 4 herein without restrictive legend within 3 business days of its receipt of a Notice of Conversion" (A37).

Adar Bays gave notice that this failure constituted an Event of Default under ¶ 8(k) of the Note and that GeneSYS must either transfer the 439,560 shares immediately or face default interest at a rate of 24% per annum and liquidated damages in the amount of $250 per day ,which began to accrue on December 1, 2016 and which escalated to $500 per day on December 7, 2016 (A413-414).

SUMMARY OF ARGUMENT

The District Court entered an opinion and order which simply mimicked what other district courts in this Circuit have decided on these issues and without engaging in a robust analysis of the documents involved in the loan documents or the relevant usury statutes.

A corporation may not interpose the defense of usury under the civil usury statutes. *See* N.Y. Gen. Oblig. Law §§5-521. However, a corporation may raise the defense that a loan is criminally usurious under N.Y. Penal Law § 190.40.

The District Court refused to read N.Y. Gen. Oblig. Law §§5-511 and 5-501 and N.Y. Penal Law § 190.40 together to determine if a criminally usurious loan to a corporation should be considered void. However, the civil usury statutes and the

criminal usury statutes are similar and should be read *in para materia* so that if a loan is criminally usurious under N.Y. Penal Law § 190.40, then it is void under N.Y. Gen. Oblig. Law § 5-511.

The District Court relied upon dictum in a case from this Court, *see In re Venture Mortgage Fund, L.P.*, 282 F.3d 185, 190, at n.4 (2d Cir. 2002), in holding that a criminally usurious loan should not be considered void under N.Y. Gen. Oblig. Law §5-511. More recently, the New York Appellate Division, Second Department expressly held that a corporation or an LLC may successfully defend the enforcement of a note based on the criminal usury statute which would also render the note void pursuant to N.Y. Gen. Oblig. Law §5-511(1). *See Fred Schutzman Co. v. Park Slope Advanced Medical, PLLC*, 128 A.D.3d 1007, 9 N.Y.S.3d 682 (2d Dep't 2015).

With respect to the "hidden" interest represented in the attorney fees payable, the fixed conversion discounts, the irrevocable reservation of shares, or the default rates and penalties under the Note, this Court has not directly addressed these issues, and the District Court relied upon only other district court cases in granting Adar Bays' motion for summary judgment.

Adar Bays presented no evidence of the services their attorneys allegedly provided with regard to the parties' execution of the Note or of the reasonableness of the attorney's fees charged, and the Trial Court erred in holding that the $2,000

disbursed in attorney's fees should not be considered 6% "interest" on the Note. Given Adar Bay's unilateral conversion right vesting at only 180 days, the stated 8% interest rate and the 6% attorney's fees equaled a per annum rate of 28% and was criminally usurious under N.Y. Penal Law § 190.40, making the Note void under N.Y. Gen. Oblig. Law §5-511(1).

Adar Bays had a unilateral right to elect at 180 days to convert the principal due, and on the date the Note was executed the 35% discount per share was criminally usurious under N.Y. Penal Law § 190.40 and void under N.Y. Gen. Oblig. Law §5-511(1). The terms of the Note are to be considered for the purposes of usury analysis at the time of the execution of the Note, and the possible stock price upon the 180-day conversion election date is irrelevant.

Also, GeneSYS faced stiff penalties under the terms of the Note if it prepaid prior to the maturity date, at rates which would be criminally usurious as part of the same bargain. Adar Bays' unilateral right to convert the principal into shares at the 180-day conversion date was beyond GeneSYS' control due to the prepayment penalty clause effectively precluding GeneSYS from satisfying the Note until the maturity date.

Furthermore, the 35% discount when coupled with the rate of 24% upon GeneSYS' default constitutes criminal usury, as recent courts which have discussed the issue have held that the criminal usury statute also applies to default

rates. There is at the least a conflict between the various district court opinions on that point, and this Court on appeal should definitively resolve the issue.

The irrevocable reservation of 278,000 shares of GeneSYS at the time of the execution of the Note, with the number of shares up to five times the principal due subject to reservation, completely restricted and precluded GeneSYS from the use of those shares and represents a per annum interest rate of 400%, and was criminally usurious under N.Y. Penal Law § 190.40, making the Note void under N.Y. Gen. Oblig. Law § 5-511(1).

ARGUMENT

1. Standard of Review

The Court reviews *de novo* a grant of summary judgment. *Golden Pacific Bancorp v. F.D.I.C.*, 273 F.3d 509, 514 (2d Cir. 2001). The Court reviews a district court's conclusions of law *de novo*. *Arch Insurance Co. v. Precision Stone, Inc.*, 584 F.3d 33, 38-39 (2d Cir. 2009).

Under New York law, construction of an unambiguous written contract is a question of law for the court. *JA Apparel Corp. v. Abboud*, 568 F.3d 390, 397 (2d Cir. 2009).

The Court reviews *de novo* constructions of statutes and rules and the conclusions of law upon which district court based its decision. *Chemoil Adani Pvt. Ltd. v. M/V Maritime King*, 894 F.3d 506, 508 (2d Cir. 2018).

In the present case, this Court will review the District Court's grant of summary judgment to Adar Bays and its denial of GeneSYS' motion to dismiss *de novo* concerning the District Court's legal conclusions about the proper construction of the Note and of the applicable usury statutes.

2. N.Y. Penal Law § 190.40 Should be Read *in Para Materia* with the Civil Usury Laws, N.Y. Gen. Oblig. Law § 5-501, et seq., and a Corporation's Note Which is Criminally Usurious under N.Y. Penal Law § 190.40 is Void Pursuant to N.Y. Gen. Oblig. Law § 5-511.

Two statutory provisions dealing with the same subject matter should be construed *in pari materia*. *See, e.g., Thielebeule v. M/S Nordsee Pilot*, 452 F.2d 1230, 1232 (2d Cir. 1972); *A.P.W. Paper Co. v. Federal Trade Commission*, 149 F.2d 424, 427 (2d Cir. 1945).

"To successfully raise the defense of usury, a debtor must allege and prove by clear and convincing evidence that a loan or forbearance of money, requiring interest in violation of a usury statute, was charged by the holder or payee with the intent to take interest in excess of the legal rate. 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." *Blue Wolf Capital Fund II, L.P. v. American Stevedoring Inc.*, 105 A.D.3d 178, 183, 961 N.Y.S.2d 86, 89 (1st Dep't 2013).

"In order for a transaction to constitute a loan, there must be a borrower and a lender; and it must appear that the real purpose of the transaction was, on the one

side, to lend money at usurious interest reserved in some form by the contract and, on the other side, to borrow upon the usurious terms dictated by the lender." *Donatelli v. Siskind*, 170 A.D.2d 433, 434, 565 N.Y.S.2d 224, 226 (2d Dep't 1991).

The underlying purpose of the transaction here was for GeneSYS to borrow money from the lender Adar Bays in order for GeneSYS to be able to meet its obligations necessary to maintain its OTC listing, thereby unmistakably making the Note a loan. Paragraph 5 of the Note also made it clear that the transaction was a loan throughout its life and never an investment or equity, stating that "[n]o provision of this Note shall alter or impair the obligation of the Company, which is absolute and unconditional, to pay the principal of, and interest on, this Note at the time, place, and rate, and in the form, herein prescribed."

The District Court, though, failed to conduct a robust analysis of the provisions of the Note with regard to the discussion in *In re Grand Union Co*., 219 F. 353(2d Cir.1914), to determine first whether the transaction between the parties was a "loan" or an "investment." The District Court simply cited other district court cases and essentially treated a convertible note as not being subject to usury analysis "as a matter of law" (SPA 21-22). Had the District Court conducted the necessary analysis with a proper application of the usury statutes, then it would have been clear to it that the Note is (1) absolutely repayable = no risk = a "loan,"

and (2) the charges as a percentage of the money GeneSYS received under the loan were in excess of 25%."

The District Court did assume *arguendo* that the Note constituted a "loan" for the purposes of the usury statutes (SPA 16).

New York law contains two usury provisions, one civil and one criminal. The civil usury statute prohibits loans at rates exceeding 16% per annum. NY. Gen. Oblig. Law § 5-501. An usurious loan over 16% is void as a civil matter:

> 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 . . .

N.Y. Gen. Oblig. Law § 5-511(1).

Under N.Y. Gen. Oblig. Law § 5-521(1), a corporation may not interpose the defense of usury under the civil usury statute: "No corporation shall hereafter interpose the defense of usury in any action. The term corporation, as used in this section, shall be construed to include all associations, and joint-stock companies having any of the powers and privileges of corporations not possessed by individuals or partnerships." *See generally Hillair Capital Investatement, L.P. v. Integrated Freight Corp.*, 963 F.Supp.2d 336, 339 (S.D.N.Y. 2013).

A corporation may, however, raise the defense of criminal usury under N.Y. Penal Law § 190.40, which bars loans bearing interest of 25% or more as usurious.

N.Y. Gen. Oblig. Law § 5-521(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"); *Hillair, supra*, 963 F.Supp.2d at 339.

The District Court cited this Court's dictum in *Venture Mortgage Fund, supra*, 282 F.3d at 190, at n.4, that there is "no specific statutory authority for voiding a loan that violates the criminal usury statute," to hold that GeneSYS could not defend against enforcement of the Note based on the civil usury statute. Other district courts have cited *Venture Mortgage Fund* on this point, and the District Court in this case merely parroted those opinions without looking further. A reasonable analysis shows that the Venture Mortgage Fund dictum is not a correct statement of the law in New York.

While a corporation may not invoke the civil usury limit of 16%, it can rely upon the criminal usury rate of 25% to have a loan voided under N.Y. Gen. Oblig. § 5-511(1). The New York Appellate Division, Second Department, has expressly held that a corporation or an LLC may successfully defend the enforcement of a note based on the criminal usury statute which would also render the note void pursuant to N.Y. Gen. Oblig. Law §5-511(1). *See Fred Schutzman Co.*, *supra*.

In *Fred Schutzman Co.*, the defendant professional limited liability company (PLLC) borrowed the principal sum of $52,900 from the plaintiff and executed a

promissory note to secure the loan, which the individual defendants personally guaranteed. The promissory note charged an interest rate of 60%. The PLLC and the individual defendants moved for summary judgment as a matter of law because the promissory note imposed an annual interest rate in excess of 25% and was criminally usurious on its face per N.Y. Penal Law § 190.40.

The Second Department upheld the grant of summary judgment to the PLLC, et al. because while the PLLC could not raise the defense of civil usury, per N.Y. Gen. Oblig. § 5-521(3) and N.Y. Limited Liability Company Law § 1104(a), the violation of the criminal usury statute rendered the note void under N.Y. Gen. Oblig. § 5-511(1):

> Although a corporation or professional limited liability company [or] an individual guarantor of such an entity's debt, may not assert the defense of civil usury (*see* General Obligations Law § 5–521(1); Limited Liability Company Law § 1104(a)[,] a corporation or PLLC, or a guarantor of such an entity's debt, may assert the defense of criminal usury (*see* General Obligations Law § 5–521(3); Limited Liability Company Law § 1104(c); Penal Law § 190.40. Contrary to the plaintiff's contention, <u>even though the defendants in this case would have been precluded from interposing the defense of usury if the note had not been criminally usurious, the note imposed an annual interest rate in excess of 16%, and since that rate was more than the rate prescribed in General Obligations Law § 5–501 (see Banking Law § 14–a(1)), the note was void, pursuant to General Obligations Law § 5–511</u>.

Fred Schutzman Co., supra, 128 A.D.3d at 1008, 9 N.Y.S.3d at 683 (emphasis added).

Also, the Second Department in *Fred Schutzman Co.* made it clear that a purported usury "savings" clause like the one included in the Note here does not defeat the defense: "Contrary to the plaintiff's further contention, a clause in the subject promissory note <u>purporting to reduce the rate of interest to a non-usurious rate if the rate originally imposed was found to be usurious could not save the note from being usurious</u>," *Id*. (emphasis added); *see Simsbury Fund v. New St. Louis Assoc*., 204 A.D.2d 182, 611 N.Y.S.2d 557, 558 (1st Dep't 1994).

Accordingly, if the Note in the present case is criminally usurious under N.Y. Penal Law § 190.40, then it is void under N.Y. Gen. Oblig. Law § 5-511(1).

3. The 6% of the Loan Payable Upfront to Adar Bays' Attorneys Should be Considered "Hidden" Interest and When Paired with the Stated Interest Rate of 8% Payable Within 180 Days Lest Adar Bays Unilaterally Exercise its Conversion Rights at a 35% Discount, the Rate of Interest Under the Note was Criminally Usurious under N.Y. Penal Law § 190.40 and is Void Pursuant to N.Y. Gen. Oblig. Law § 5-511.

"To determine whether a transaction is usurious, courts look not to its form but to its substance or real character. If an instrument provides that the creditor will receive additional payment in the event of a contingency beyond the borrower's control, the contingent payment constitutes interest within the meaning of the usury statutes." *Blue Wolf, supra*, 105 A.D.3d at 183, 961 N.Y.S.2d at 89; *see also Feld v. Apple Bank for Savings*, 116 A.D.3d 549, 553, 984 N.Y.S.2d 319, 323 (1st Dep't 2014).

The Note provides that "[GeneSYS] agrees to pay all costs and expenses, including reasonable attorneys' fees and expenses, which may be incurred by the Holder in collecting any amount due under this Note" (A36). The SPA stated that disbursement would be "$35,000.00 less $2,000.00 in legal fees" (A30).

GeneSYS claimed that the $2,000 in legal fees taken off the top constituted "hidden" interest on the loan, per *Blue Wolf, supra*, and when joined with the 8% interest payable after 180 days equaled an effective annual interest rate of 28%, which is a criminally usurious rate under N.Y. Penal Law § 190.40. The District Court relied on the holding in *Hillair, supra*, 963 F. Supp. 2d at 339 that "[a] borrower may pay reasonable expenses attendant on a loan without rendering the loan usurious. Reasonable expenses can include payments for attorneys' fees associated with the loan" (SPA 19).

However, with regard to the motion for summary judgment the District Court stated that "[GeneSYS] adduces no evidence that the $2,000 fee did not legitimately reimburse [Adar Bays'] attorney's fees" (SPA 19). The District Court further dismissed GeneSYS' argument that a repayment within 180 days to forestall a stock conversion would combine with the 6% paid in attorney's fees to create an effective and usurious interest rate of 28%, by stating that "for the reasons discussed above, the $2,000 attorney's fees do not constitute interest" (SPA 19).

Under New York law, "a party moving for summary judgment must affirmatively establish the merits of its cause of action or defense and does not meet its burden by noting gaps in its opponent's proof." *Great Lakes Motor Corp. v. Johnson*, 132 A.D.3d 1390, 1391, 18 N.Y.S.3d 256, 257 (4th Dept. 2015). Adar Bays did not present any evidence showing that the $2,000 payable to its attorneys was legitimate and reasonable.

"An award of an attorney's fee pursuant to a contractual provision may only be enforced to the extent that the amount is reasonable and warranted for the services actually rendered." *Greenpoint Mortgage Corp. v. Lamberti*, 155 A.D.3d 100, 106, 466 N.Y.S.3d 32, 34 (2d Dep't 2017). "In determining reasonable compensation for an attorney, the court must consider such factors as the time, effort, and skill required; the difficulty of the questions presented; counsel's experience, ability, and reputation; the fee customarily charged in the locality; and the contingency or certainty of compensation." *Id.*

It was incumbent on Adar Bays to adduce evidence that the $2,000 payable up front to its attorneys were for reasonable fees legitimately incurred in the transaction, not GeneSYS. The District Court was wrong in placing that burden of proof upon GeneSYS, and this error is symptomatic of the District Court's failure to address the issues based on the facts presented in this case, rather than relying on precedent based on the evidence adduced in other cases.

Without an affirmative showing that the attorney's fees were reasonable, Adar Bays cannot rely on the rule in *Hillair, supra*, that "[a] borrower may pay reasonable expenses attendant on a loan without rendering the loan usurious." 963 F. Supp. 2d at 339. The 6% paid for attorney's fees should be treated as "hidden" interest in conjunction with the 180-conversion date, making the effective interest rate on the Note 28% and criminally usurious. *Cf. Blue Wolf, supra*, 105 A.D.3d at 183-84, 961 N.Y.S.2d at 90.[1]

4. The Discount of 35% Upon Adar Bays' Unilateral Exercise of its Right to Convert the Principal Due into Shares of GeneSYS Common Stock was Criminally Usurious under N.Y. Penal Law § 190.40 and is Void Pursuant to N.Y. Gen. Oblig. Law § 5-511.

Adar Bays had a unilateral right to elect at 180 days to convert the principal due to shares of GeneSYS stock and on the date of the Note was entitled to a 35% discount per share upon conversion. GeneSYS claimed that the District Court should take into consideration the stock conversion discount rate in ascertaining the interest payable on the Note. *See Hillair, supra*, 963 F.Supp.2d at 340 ("Defendants are correct that the stock payment should be taken into consideration in determining the interest rate"); *Sabella v. Scantek Medical, Inc.*, No. 08-cv-453,

[1] The District Court did not address GeneSYS' argument that the 8% interest rate payable within 180 days (to avoid a conversion) was, in effect, a 16% interest rate.

2009 WL 3233703 at *16-17 (S.D.N.Y. Sept. 25, 2009) (value of stock relevant to interest rate calculation for usury defense).

"[The] contingent right to a bonus is something of value, and this value added to the maximum interest [may] resul[t] in total interest in excess of the legal rate. Whenever the lender stipulates even for a chance of an advantage beyond the legal interest the contract is usurious, if he is entitled by the contract to have the money lent with the interest thereon repaid to him at all events." *Cusick v. Ifshin*, 70 Misc.2d 564, 567, 334 N.Y.S.2d 106, 109-110 (Civ. Ct. 1972) (and cases cited)

The District Court uncritically relied upon *Union Capital LLC v. Vape Holdings, Inc.*, No. 16-cv-1343, 2017 WL 1406278 (S.D.N.Y. Mar. 31, 2017), and *Beaufort Capital Partners, LLC v. Oxysure Systems, Inc.*, No. 16-cv-5176, 2017 WL 913791 (S.D.N.Y. Mar. 7, 2017), in holding that conversion to equity the loan "likely" has the character of an equity investment and that "[t]he conversion right was simply too uncertain at the time of contracting. [A] myriad of circumstances could decrease the price of the stock, including that Defendant could become delinquent in its filings, become delisted, experience sudden decreases in its stock price, experience no demand for its stock, or simply cancel the reserve or refuse a conversion." (SPA 21-22).

However, the time to judge whether a loan or note is usurious is at the time the loan is made. *See Matter of Dane's Estate*, 55 A.D.2d 224, 226, 390 N.Y.S.2d

249, 250 (3d Dep't 1976). "There is no requirement of a specific intent to violate the usury statute. A general intent to charge more than the legal rate as evidenced by the note, is all that is needed. If the lender intends to take and receive a rate in excess of the legal percentage at the time the note is made, the statute condemns the act and mandates its cancellation." *Id*. (emphasis added).

Mere supposition that the conversion right could become worthless later is irrelevant to the usurious nature of the loan subject to the conversion rights on the date of execution. The District Court's reliance on the opinions of other district courts in this manner without addressing the actual legal and financial effect of Adar Bays' conversion right at the time of the execution of the Note is, at best, unenlightening.

Also, Adar Bays' unilateral right at 180 days to elect a conversion of the principal due into share of stock was completely beyond GeneSys' control. If the lender "will receive additional payment in the event of a contingency beyond the borrower's control, the contingent payment constitutes interest within the meaning of the usury statutes." *Blue Wolf, supra*, 105 A.D.3d at 183, 961 N.Y.S.2d at 89. GeneSYS' right to pay the balance prior to 180 days and preclude Adar Bays' election to convert shares is illusory. Remember that ¶ 4(c) of the Note imposed large prepayment penalties on GeneSys, thereby effectively precluding it from paying the Note before the maturity date.

Additionally, as a matter of law this Court should determine if these exorbitant prepayment penalties set an usurious 180-day interest rate on the Note. While there is authority that prepayment of a loan does not constitute interest, those cases dealt with a new, supplemental agreement for prepayment or where the prepayment did not exceed the total interest payable at the maturity date. *See, e.g., Lyons v. National Savings Bank of City of Albany*, 280 A.D. 339, 113 N.Y.S.2d 695 (3d Dep't 1952); *Feldman v. Kings Highway Savings Bank*, 278 App. Div. 589–590, 102 N.Y.S.2d 306, 307 (2d Dep't), *aff'd*, 303 N.Y. 675, 102 N.E.2d 835 (1951). The penalty here for, e.g., prepayment prior to 180 days, is 35% and was part of the original transaction. Such a penalty would be greater than the stated amount of interest due by maturity and at 35% is criminally usurious.

Even if were proper for the District Court to consider the possibility of default or the future worthlessness of Adar Bays' conversion right in determining whether the conversion discount should be considered usurious at the time of execution, the default rate of interest of 24% combined with the 35% discount upon conversion certainly constitutes a criminally usurious rate of interest greater than the 25% allowed under N.Y. Penal Law 190.40. Adar Bay is actually asserting that it is due the default rate of interest while also claiming the discount conversion rate. "To determine whether a transaction is usurious, courts look not

to its form but to its substance or real character." *Blue Wolf, supra*, 105 A.D.3d at 183, 961 N.Y.S.2d at 89.

Finally, this Court has not addressed whether under New York law the criminal usury statute should apply to default rates of interest. There is a conflict among the district courts of this Circuit, and this Court should consider resolving this disputed question (SPA 23-24). *See generally Madden v. Midland Funding, LLC*, 237 F.Supp.3d 130 (S.D.N.Y. 2017); *Blue Citi, LLC v. 5Barz International Inc*., 338 F.Supp.3d 326 (S.D.N.Y.2018); *Adar Bays, supra*, 341 F.Supp.3d 339 (each recognizing disagreement and collecting cases).

5. The Mandated Reservation of 278,000 Shares of GeneSYS Common Stock With Up to Five Times The Principal Due Subject to Reservation, was Criminally Usurious under N.Y. Penal Law § 190.40 and is Void Pursuant to N.Y. Gen. Oblig. Law § 5-511.

Under the share reservation required under the terms of the Note, the value of the 278,000 shares on the date the reservation was given and the loan was consummated was $144,560, or 400% of the value of the loan. Again, the District Court simply relied on the notion that a corporation cannot invoke the civil usury statute as a defense, which is irrelevant to this analysis as discussed above, and then the District Court quoted another district court opinion concerning a similar provision in another Adar Bays' note, without any independent analysis of the legal and economic impact of the share reservation on GeneSYS (SPA 22-23).

The irrevocable transfer agent letter effectively sequestered and reserved that stock, on behalf of Adar Bays, to make it available on account for GeneSYS to effectuate future conversions of the loan into equity for purposes of repayment.

N.Y. Gen. Oblig. Law § 5-511(1) states that a note or loan is void if "there shall <u>be reserved</u> or taken, <u>or secured</u> or <u>agreed to be reserved</u> or taken, any greater sum, or greater value, for the loan or forbearance of any money, goods or other things in action" than the usury rate of interest. (Emphasis added). The quantity of stock under the reservation agreement is five times the amount of stock that Adar Bays could convert, at its fixed 35% discount to market. By this mechanism, Adar Bays "reserved" a "greater sum" than 25% on the loan to GeneSYS.

This Court should recognize that the mandated reservation of shares in ¶ 12 of the Note constitutes interest and thus must be computed together with all other interest charges in determining the loan is usurious. *See generally Hufnagel v. George,* 135 F.Supp.2d 406 (S.D.N.Y. 2001) (reservation of an amount payable to the lender equaling a rate higher than the usury rate); *Funding Group, Inc. v. Water Chef, Inc.*, 19 Misc. 3d 483, 852 N.Y.S.2d 736 (Sup. Ct. 2008) (same).

CONCLUSION

The Note is criminally usurious under N.Y. Penal Law § 140.90 and is void under N.Y. Gen. Oblig. § 5-511(1). This Court should reverse the District Court 's grant of summary judgment in favor of Adar Bays and enter judgment in favor of GeneSYS in accordance with its FRCP 12(c) motion to dismiss.

Dated: January 25, 2019

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CERTIFICATE OF COMPLIANCE

This Opening Brief of Appellant has been prepared in accordance with Fed. R. App. 32(a)(7)(B) using: Microsoft Word, Times New Roman, 14 Point Type Space, with a total word count of 6,381 exclusive of the Corporate Disclosure Statement, Table of Contents, Table of Authorities, Request for Oral Argument, Certificate of Compliance, and the Certificate of Filing and Service.

Dated: January 25, 2019

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SPECIAL APPENDIX

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FILED
DOC#: ______________
DATE FILED: 9-20-18

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

ADAR BAYS, LLC, **Plaintiff,** **-against-** **GENESYS ID, INC.,** **Defendant.**	**17-cv-01175 (ALC)** **OPINION AND ORDER**

ANDREW L. CARTER, JR., United States District Judge:

Plaintiff Adar Bays, LLC ("AB") brings this action alleging breach of a Securities Purchase Agreement ("SPA") providing for the purchase and issuance of two Convertible Redeemable Notes ("Notes"). Plaintiff seeks summary judgment on its claims. Defendant GeneSYS ID, Inc. ("GNID") contends that the Notes are void as usurious, and accordingly moves to dismiss the complaint on usury grounds. For the following reasons, Plaintiff's motion for summary judgment is GRANTED and Defendant's motion to dismiss is DENIED.

BACKGROUND

I. Factual Background

The following facts are drawn from the parties' Rule 56.1 statements. Facts are agreed upon unless otherwise noted.

AB is a limited liability company based in Florida. Rule 56.1 Statement of Material Facts ¶ 1 (ECF No. 52) ("SMF"). GNID is a corporation based in Nevada whose shares are publicly traded on the Over-The-Counter ("OTC") Market. *Id.* ¶¶ 2-3.[1]

[1] GNID was previously known as RX Safes, Inc. *Id.* ¶ 4. For purposes of clarity, it is referred to as GNID throughout this opinion.

On May 24, 2016, AB and GNID entered into an SPA. *Id.* ¶ 5; *see* Declaration of Aryeh Goldstein ("Goldstein Decl") Ex. A (ECF No. 53-1) ("SPA"). AB contends that the SPA provided for, *inter alia*, the purchase and issuance of a $35,000 8% Convertible Redeemable Note. *Id.* ¶ 7. GNID disputes this characterization, and contends that GNID borrowed $35,000 and executed a promissory Note reflecting the same. Response to SMF ¶ 7 (ECF No. 58) ("RSMF").

A. Terms of the SPA and Note

The Note stated that GNID promised to pay AB the aggregate principal amount of $35,000 on the Maturity Date, May 24, 2017, and to pay interest on the principal outstanding at the rate of 8% per annum, commencing on May 24, 2016. *Id.* ¶¶ 11-12; Goldstein Decl Ex. B (ECF No. 53-2) ("Note"). As detailed below, GNID contends that the effective interest rate on the Note was actually significantly higher than 8%, and accordingly the Note is usurious. *See generally* RSMF.

The Note provides that AB is entitled, at any time after 180 days from Note issuance, to convert any or all of the outstanding balance of the Note into shares of GNID's common stock ("Common Stock") at a price ("Conversion Price"). *Id.* ¶¶ 22-23; *see* Note § 4(a). The Conversion Price would be 65% of the lowest trading price of the Common Stock on the OTC Market for the twenty prior trading days. *Id.* ¶ 24; *see* Note § 4(a). AB was required to submit a Notice of Conversion prior to exercising this right. *Id.* ¶ 25; *see* Note § 4(a). Then, GNID was required to effectuate the conversion by delivering the shares of Common Stock within three business days of receipt of the Notice of Conversion. *Id.* ¶ 27; *see* Note § 4(a). AB contends that the conversion right is a material term of the Note. *Id.* ¶ 29.

The SPA states that GNID would authorize and reserve shares for the purposes of conversion. *Id.* ¶ 31; *see* SPA § 3(c). Under the Note, GNID would initially issue irrevocable transfer agent instructions reserving 278,000 shares of Common Stock for the purposes of conversion ("Share Reserve"). *Id.* ¶ 32; *see* Note § 12. The Note further required GNID to "reserve a minimum of three times the amount of shares required if the note would be fully converted." *Id.* ¶ 34; *see* Note § 12. It also allowed AB to "reasonably request increases from time to time to reserve such amounts." *Id.* ¶ 35; *see* Note § 12.

The Note provides for several "Events of Default." *Id.* ¶ 47; *See* Note § 8. Under § 8(k), failure to deliver converted stock within three business days triggers default. *Id.* ¶ 48; *see* Note § 8(k). Section 8(b) states that default will occur if any "representations or warranties made by [GNID]" in connection with the Note or SPA "shall be false or misleading in any respect." *Id.* ¶ 52; *see* Note § 8(b). Further, § 8(c) provides for default if GNID fails to perform or observe "any covenant, term, provision, condition, agreement, or obligation" under the Note. *Id.* ¶ 56; *see* Note § 8(c). The Note states that upon default, interest would accrue at 24% per annum, or – if usurious or otherwise not permitted by law – at the highest rate permitted by law. *Id.* ¶ 74; Note § 8.

The Note provides for two alternative remedies if GNID breaches by failing to deliver shares. *Id.* ¶ 64; *see* Note § 8. First, liquidated damages would accrue in the amount of $250 per day beginning on the fourth day after the Notice of Conversion was delivered, and increase to $500 per day beginning on the tenth day. *Id.* ¶ 65; *see* Note § 8. Second, the "Make-Whole for Failure to Deliver Loss" provision allows AB to provide GNID with written notice of the amounts payable, and requires GNID to make it whole as follows: Failure to Deliver Loss = [(High trade price at any time on or after the day of exercise) x (Number of conversion shares)].

Id. ¶¶ 69-70; *see* Note § 8. Additionally, the Note provides that GNID will pay reasonable attorneys' fees, costs, and expenses. *Id.* ¶¶ 80-81; *see* Note §§ 7, 8. Finally, the Note provides that if any section is held to be invalid or unenforceable, it "shall be adjusted rather than voided, if possible." *Id.* ¶ 82; *see* Note § 9.

Terms of the Note were reflected in GNID's Quarterly Statement for the period ending on September 30, 2016. *Id.* ¶ 13; *see also* Goldstein Decl Ex. C ("ECF No. 53-3") ("10-Q").

B. Performance

On May 24, 2016, GNID issued a Disbursement Memorandum that directed AB to disburse (1) $2,000 to New Venture Attorneys, P.C. and (2) $33,000 to GNID, in conjunction with the funding of the Note. *Id.* ¶¶ 15-17; *see* Goldstein Decl Ex. D (ECF No. 53-4) ("Disbursement Memo"). On May 26, 2016, AB wired the requisite funds per the instructions in the Disbursement Memo. *Id.* ¶ 20; *see* Goldstein Decl Ex. E (ECF No. 53-5).

AB thus contends that the Note was fully funded. GNID, however, maintains that only $33,000 was funded, since $2,000—6% of the loan amount—was disbursed to AB's attorneys. Counterstatement to Statement of Material Facts ¶¶ 1-2 (ECF No. 58) ("CSF").

C. Failure to Honor Notice of Conversion

On November 28, 2016, AB submitted a Notice of Conversion to GNID for $5,000 of the Note to be converted into 439,560 shares of GNID Common Stock at $.011375 per share. SMF ¶¶ 36-38; *see* Goldstein Decl Exs. F, G (ECF Nos. 53-6, 53-7). The following day Lorraine Yarde, GNID's Chief Executive Officer ("CEO"), acknowledged receipt of the Notice of Conversion but stated that GNID would not be honoring it. *Id.* ¶ 39; *see* Goldstein Decl. Ex. H (ECF No. 53-8). GNID did not deliver the shares. *Id.* ¶ 40.

GNID's 10-Q for the period ending September 30, 2016 stated that the company "terminated it transfer agent on September 6, 2016, preventing further toxic conversions and bringing all parties to the table to discuss a satisfactory settlement . . . ." *Id.* ¶ 41; *see* 10-Q at 36.

Around December 15, 2016, AB emailed a Default Notice to Yarde. *Id.* ¶ 42; *see* Goldstien Decl. Ex. I (ECF No. 53-9). The Notice reiterated the terms of the Note and SPA, stated that GNID breached the Note by failing to tender the requested shares, and demanded immediate delivery of the requested shares. *Id.* ¶¶ 42-45.

To date, GNID has not delivered the requested shares. *Id.* ¶ 46.

AB alleges that GNID has breached the following provisions of the Note: § 8(k), by failing to deliver the requested shares of Converted Stock; § 8(b), by breaching its representations that it would deliver the requested shares, maintain a share reserve, and repay the Note upon maturity; and § 12, by terminating its relationship with its transfer agent. *Id.* ¶¶ 48-49, 52-55, 59, 61. It further alleges that GNID breached Section 3(c) of the SPA by failing to deliver the requested shares and terminating the transfer agent. *Id.* ¶¶ 50-51, 59, 60.

AB contends that as a result of this breach, GNID is in default and owes payments at the default interest rate as well as damages as provided for in the Note. GNID contends that the Note is void *ab initio* as usurious.

II. Procedural Background

AB filed the complaint commencing this action on February 16, 2017. ECF No. 1. AB filed an amended complaint on April 19, 2017, bringing claims for breach of the SPA, breach of the Note, unjust enrichment, anticipatory breach of the Note and SPA, and costs, expenses, and attorneys' fees. ECF No. 18 ("FAC"). That is the operative complaint in this motion.

On January 16, 2018, GNID moved to dismiss this action pursuant to Fed. R. Civ. P. 12(c) on the grounds that the Note is void as usurious. ECF No. 48 (Def Mem). Also that day, AB moved for summary judgment under Fed. R. Civ. P. 56 on all counts. ECF No. 54 ("Pl Mem"). The parties filed their respective opposition motions on February 13 and 14, 2018. ECF No. 55 ("Pl Opp"); ECF No. 59 ("Def Opp"). On February 27, 2018, both parties filed their respective reply briefs. ECF No. 60 ("Def Reply"); ECF No. 61 ("Pl Reply"). Accordingly, the Court considers the motions fully submitted.

DISCUSSION

Motion for Summary Judgment

I. Legal Standard

Summary judgment is appropriate if there is "no genuine dispute as to any material fact." Fed. R. Civ. P. Rule 56(a); *see also Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247 (1986). The moving party "bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986) (internal quotation marks omitted).

Then, the burden shifts to the non-moving party to "set forth specific facts showing that there is a genuine issue for trial." *Anderson*, 477 U.S. at 250. The party opposing summary judgment "may not rely on mere speculation or conjecture" as "mere conclusory allegations or denials . . . cannot by themselves create a genuine issue of material fact where none would otherwise exist." *Hicks v. Baines*, 593 F.3d 159, 166 (2d Cir. 2010) (quoting *Fletcher v. Atex, Inc.*, 68 F.3d 1451, 1456 (2d Cir. 1995)).

Factual disputes that are "irrelevant" or "unnecessary" are insufficient; "[o]nly disputes over facts that might affect the outcome of the suit under the governing law" can defeat a motion for summary judgment. *Anderson*, 477 U.S. at 248.

In making this determination, the Court must draw all inferences in the light most favorable to the non-moving party. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

II. Application

A. Breach of Contract

To state a claim for breach of contract under New York law, a plaintiff must adduce "proof of (1) an agreement, (2) adequate performance by the plaintiff, (3) breach by the defendant, and (4) damages." *Fischer & Mandell, LLP v. Citibank, N.A.*, 632 F.3d 793, 799 (2d Cir. 2010) (citations omitted). Summary judgment on a breach of contract claim "is appropriate if the terms of the contract are unambiguous." *Id.* (citation omitted). In order to prevail at the summary judgment stage, "it must be clear at the outset that there are no genuine issues of material fact that either [the party] did not breach an agreement, or if it did, that its breach does not rise to the appropriate level of materiality to justify termination of the agreement." *Drapkin v. Mafco Consol. Group, Inc.*, 818 F. Supp. 2d 678, 685-86 (S.D.N.Y. 2011) (citation omitted).

i. Existence of an Agreement

GNID does not dispute the existence of the SPA and Note. However, it contends that material issues of fact as to the terms of these agreements remain. Essentially, GNID contends that the fact that the Note had an 8% interest rate is "disputed" because (1) the $2,000 payment to AB's attorney should be considered 6% "hidden interest"; (2) since the cash repayment option was only available for the first 180 days, the actual interest rate prior to conversion was 28%; (3)

the discounted stock created an interest rate of at least 35%; and (4) the stock reservation represented a 400% interest rate. Def Opp at 8.[2]

As AB argues, these disputes relate to legal conclusions, not actual facts. GNID does not deny, for instance, that $2,000 was applied to attorneys' fees—it merely seeks to characterize them as part of the interest rate for the purposes of its legal argument. This is insufficient to raise a material issue of fact on a summary judgment motion. *See Schwapp v. Town of Avon*, 118 F.3d 106, 111 (2d Cir. 1997) (to the extent affidavits "contain[ed] bald assertions and legal conclusions . . . the district court properly refused to rely on them"); *Ying Jing Gan v. City of N.Y.*, 996 F. 2d 522, 532 (2d Cir. 1993) (nonmoving party "may not rely simply on conclusory statements or on contentions that the affidavits supporting the motion are not credible").

ii. Adequate Performance

AB performed by wiring the aggregate $35,000 pursuant to the Note. *See* Goldstein Decl Exs. D, E. GNID denies that it accepted those funds because "the note is criminally usurious." RSMF ¶ 21. However, GNID does not offer any evidence for that assertion. Its argument that the Note is usurious has no bearing on whether AB performed under it. *See Ying Jing*, 996 F. 2d at 532. It is thus undisputed that AB performed under the agreement.

iii. Breach

AB contends that GNID breached the agreement by (1) failing to honor AB's Notice of Conversion and (2) terminating its transfer agent.

[2] Specifically, GNID raises twenty-two objections to AB's Rule 56.1 statement. *See* RSMF ¶ 7 (disputing that SPA provided for "purchase and issuance of a $35,000.00 8% Convertible Redeemable Note" because "Defendant borrowed $35,000.00 and executed a Promissory Note reflecting the same"); ¶ 9 (same); ¶ 11 (same and noting that "the amount funded was $33,000.00 as $2,000 was applied to plaintiff's alleged attorney's fees"); ¶ 30 (denying that failure to honor conversion feature of Note deprives AB of a benefit for which it negotiated and purchased the Note because conversion was a form of repayment of the Note only); ¶¶ 21. 53, 54, 60-63, 67-79 (denying various facts because the note is void *ab initio* as criminally usurious).

GNID does not dispute these facts. As discussed below, GNID merely contends that it did not need to comply with the agreement because the Note is usurious. This is a legal, not factual, dispute and thus does not preclude summary judgment. *See Schwapp*, 118 F.3d at 111. Moreover, for the reasons discussed below GNID's usury claim is without merit.

Accordingly, the Court concludes that GNID breached the agreement.

iv. Damages

AB contends that it incurred significant damages as a result of this breach. It argues that, had GNID honored the conversion, it would have been free to sell the shares on the open market at a profit, and to convert further portions of the Note if the market remained favorable.

GNID yet again does not contest this assertion, but argues that the Note's interest rate is usurious and thus damages are unwarranted. There thus is no factual dispute that AB was damaged. The question is the amount of those damages.

1. Liquidated Damages

AB seeks to enforce a liquidated damages clause providing for $250 per day beginning on the fourth day after the Notice of Conversion was delivered, and escalating to $500 per day following the tenth day. Here, AB contends, this results in $204,000 in damages as of the filing of its summary judgment motion. Goldstein Decl ¶¶ 45-46. In addition, AB contends that it is entitled to repayment of the remaining $30,000 of principal, as well as regular and default interest accrued thereupon. *Id.* ¶ 50. Combined with the 24% default interest rate, that sum would amount to $39,690.47. *Id.* ¶¶ 51-52.

GNID makes no argument that the liquidated damages clause here is an unenforceable penalty. Nevertheless, the Court addresses this issue. "[A] liquidated damage[s] provision is an estimate, made by the parties at the time they enter into their agreement, of the extent of the

injury that would be sustained as a result of a breach of the agreement." *Agerbrink v. Model Serv. LLC*, 196 F. Supp. 3d 412, 416 (S.D.N.Y. 2016) (citations and internal quotation marks omitted). Where a liquidated damages provision "does not serve the purpose of reasonably measuring the anticipated harm," and is instead "punitive in nature," it "will not be enforced." *Id.* at 417 (citation omitted). In determining whether a clause is a valid liquidated damages provision or an unenforceable penalty, courts "look to substance and not to form." *Id.* (citation and internal quotation marks omitted).

Accordingly, "courts will uphold and enforce liquidated damages provisions where (1) actual damages are difficult to determine and (2) the amount of damages awarded pursuant to the clause is not clearly disproportionate to the potential loss." *LG Capital Funding, LLC v. 5Barz Int'l, Inc.*, 307 F. Supp. 3d 84, 101 (E.D.N.Y. 2018) (citation and internal quotation marks omitted). If the provision "does not satisfy one or both of these factors, the liquidated damages provision will be deemed an unenforceable penalty." *Id.* "In other words, '[i]f such a clause is intended to operate as a means to compel performance, it will be deemed a penalty and will not be enforced.'" *Union Capital LLC v. Vape Holdings, Inc.*, No. 16-cv-1343, 2017 WL 1406278, at *7 (S.D.N.Y. Mar. 31, 2017) (quoting *Rattigan v. Commodore Int'l Ltd.*, 739 F. Supp. 167, 169 (S.D.N.Y. 1990)).

Here, the clause is an unenforceable penalty. Two courts recently considered and rejected nearly identical "liquidated damages" provisions. *See LG Capital*, 307 F. Supp. 3d at 102 (clause imposing $250 per day penalty beginning on the fourth day after Notice of Conversion and $500 per day beginning on the tenth day unenforceable because damages "are clearly disproportionate to the potential loss"); *Union Capital*, 2017 WL 1406278, at *7 (striking down same penalty arrangement as "the prototypical forbidden penalty"). As in *LG Capital* and

Union Capital, the Note here even "expressly uses the word 'penalty'" to describe these damages. *LG Capital*, 307 F. Supp. 3d at 102; *see* Note § 8 ("the penalty shall be $250 per day . . ."). And as in those cases, "Plaintiff offers no explanation as to how a daily fee of $250, escalating to $500 after the tenth day on which defendant has failed to convert shares could bear a proportional relation to plaintiff's probable loss arising from defendant's failure to deliver conversion shares." *LG Capital*, 307 F. Supp. 3d at 102. Moreover, as discussed below actual damages here are readily ascertainable.

2. Failure to Deliver Loss/Make-Whole Provision

Alternatively, AB contends that, had it elected to enforce the "Make-Whole" provision, it would be entitled to $56,043.90 in damages (a high trade price of $.1275 on August 3, 2017 x 439,560). Goldstein Decl ¶¶ 47-49 & n.1. Although GNID objects only on usury grounds, the Court again addresses whether this provision is otherwise invalid.

In *LG Capital* and *Union Capital*, the courts addressed essentially identical "Make-Whole" provisions to the one at issue here. Those courts determined that the formula was "'designed to provide [plaintiff] with a guaranteed higher cash payout than a true make-whole measure, which would focus only on [plaintiff's] loss as a result of [defendant's] failure to abide by the terms of the bargain.'" *LG Capital*, 307 F. Supp. 3d at 103 (quoting *Union Capital*, 2017 WL 1406278, at * 7). Such provisions were "inappropriate where, as here, plaintiff's actual damages are a function of readily determinable information." *Id.*

The Court agrees with this analysis, and concludes that the Make-Whole provision is not enforceable.

3. Expectation Damages

As AB notes in its brief, and as the *LG Capital* and *Union Capital* courts held under similar circumstances, expectation damages are readily available here. AB's damages are "ascertainable through expectation damages, calculated by subtracting the contract price—the price at which [AB] is entitled to convert shares under the Note—from the market price of the shares on the date of the breach." *Union Capital*, 2017 WL 1406278, at * 6; *accord LG Capital*, 307 F. Supp. 3d at 103 (applying same formula).

Applying this formula, Plaintiff's expectation damages from the November 28, 2016 conversion are $8,168.80. Pl Mem at 12 & n.4.[3] As Plaintiff argues, it is further entitled to repayment of $5,000, the cost of conversion that Plaintiff would have recouped upon sale of the converted shares. *See id.* at 12 n.5.

Plaintiff also urges this Court to calculate expectation damages for conversion of the remainder of the Note. *Id.* at 12 n.6. While Plaintiff does not expressly allege that Defendant refused to honor any future notices of conversion, Defendant effectively did so by terminating its transfer agent. As the *Union Capital* court held in similar circumstances, the Court would award damages by taking the date of the breach and determining the conversion price AB was entitled to on that date, the number of shares AB was authorized to convert, and the market price of those shares on the date of the breach. *See Union Capital*, 2017 WL 1406278, at * 6. Applying this formula, Plaintiff's expectation damages for the remainder of the Note are $49,120.87. Pl Mem at 12 & n.6.[4] As Plaintiff argues, it is further entitled to repayment of 30,000, the cost of

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[3] Plaintiff states that the price on date of breach was $.03, and the conversion price was $.011375, rendering expectation damages $.018625 per 439,560 shares. Pl Mem at 12 n.4.

[4] Plaintiff states that the number of shares to which Plaintiff would have been entitled to is 2,637,362, calculated by dividing balance of the Note ($30,000) by the conversion price ($.011375), rendering expectation damages $.018625 per 2,637,362 shares. Pl Mem at 12 n. 6.

conversion that Plaintiff would have been entitled to as the Note's outstanding balance. In total, Plaintiff is entitled to $92,307.67 in damages.

4. Fees and Costs

"Under New York law, a contract that provides for an award of reasonable attorneys' fees to the prevailing party in an action to enforce the contract is enforceable if the contractual language is sufficiently clear." *NetJets Aviation, Inc. v. LHC Commc'ns, LLC*, 537 F.3d 168, 175 (2d Cir. 2008) (collecting cases). The parties' intent to provide fees as damages for breach of contract must be "unmistakably clear from the language of the contract." *Oscar Gruss & Son, Inc. v. Hollander*, 337 F.3d 186, 199 (2d Cir. 2003) (citations and internal quotation marks omitted).

Here the parties unmistakably intended to provide attorneys' fees to the prevailing party. *See* Note § 7 ("The Company agrees to pay all costs and expenses, including reasonable attorneys' fees and expenses, which may be incurred by the Holder in collecting any amount due under this Note."). GNID does not dispute the existence of this provision. For the reasons discussed above, AB has prevailed on its breach of contract claim. Thus, it is entitled to reasonable attorneys' fees.

In conclusion, the Court determines that there are no issues of material fact. Further, AB has successfully alleged each element of its breach of contract claim. As discussed below, GNID's usury defense is without merit. Accordingly, summary judgment for AB on its claims for breach of the SPA and Note is appropriate.[5]

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[5] Plaintiff also brought claims for unjust enrichment and anticipatory breach. Neither party has subsequently addressed the anticipatory breach claim. Further, Plaintiff did not respond to Defendant's arguments that its unjust enrichment claim should be dismissed under the "unclean hands" doctrine. Def Mem at 29-32. "Whatever the merit of this argument, plaintiff has abandoned the[se] [] claim[s], as [its] motion papers fail to contest or otherwise respond to defendant['s] contention." *Moccio v. Cornell Univ.*, No. 09-cv-3601, 2009 WL 2176626, at *4 (S.D.N.Y. July 21, 2009); *accord Lipton v. Cnty. of Orange, N.Y.*, 315 F. Supp. 2d 434, 446 (S.D.N.Y. 2004) ("This Court may, and generally will, deem a claim abandoned when a plaintiff fails to respond to a defendant's arguments that

Motion to Dismiss

I. Legal Standard

"'Judgment on the pleadings is appropriate where material facts are undisputed and where a judgment on the merits is possible merely by considering the contents of the pleadings.'" *Vail v. City of N.Y.*, 68 F. Supp. 3d 412, 420 (S.D.N.Y. 2014) (quoting *Sellers v. M.C. Floor Crafters, Inc.*, 842 F.2d 639, 642 (2d Cir. 1988)). The standard for dismissal under 12(c) mirrors that for 12(b): the complaint "must allege sufficient facts which, taken as true, state a plausible claim for relief." *Id.* (internal citations and quotation marks omitted). The Court may consider the complaint as well as "any written instrument attached to it as an exhibit, materials incorporated in it by reference, and documents that, although not incorporated by reference, are 'integral' to the complaint." *Sira v. Morton*, 380 F.3d 57, 67 (2d Cir. 2004) (internal citations omitted).[6]

II. Application

GNID argues that the entire complaint should be dismissed because the loan at issue was usurious and therefore void.

Usury laws prohibit exorbitant interest rates on loans. To state a usury defense, the defendant must allege that "the lender (1) knowingly charged, took or received (2) annual interest exceeding [the usury rate] (3) on a loan or forbearance." *Prof'l Merchant Advance*

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the claim should be dismissed."). In any event, Plaintiff "may not ultimately recover under both the breach of contract and unjust enrichment claims." *Transcience Corp. v. Big Time Toys, LLC*, 50 F. Supp. 3d 441, 452 (S.D.N.Y. 2014) (collecting cases) (emphasis omitted).

[6] As Plaintiff notes, "[w]hen matters outside the pleadings are presented in support of, or in opposition to[,] a [Rule 12(c)] motion, a district court must either exclude the additional material and decide the motion on the [pleadings] alone [,] or convert the motion to one for summary judgment under [Rule 56] and afford all parties the opportunity to present supporting material." *Vail*, 68 F. Supp. 3d at 420 (citation and internal quotation marks omitted). The only additional materials considered in relation to Defendant's motion are the SPA and Note, which may be properly considered on a 12(c) motion as they were attached to the complaint as exhibits. *See* FAC.

Capital, LLC v. C Care Serv's, LLC, No. 13-cv-6562, 2015 WL 4392081, at *4 (S.D.N.Y. July 15, 2015) (citation and internal quotation marks omitted). "Usury is an affirmative defense and a heavy burden rests upon the party seeking to impeach a transaction for usury." *Adar Bays, LLC v. Aim Exploration, Inc.*, 285 F. Supp. 3d 698, 701 (S.D.N.Y. 2018) (citation and internal quotation marks omitted).

A. Civil and Criminal Usury Statutes

New York law contains two usury provisions, one civil and one criminal. The civil usury statute prohibits loans at rates exceeding 16% per annum. N.Y. Gen. Ob. Law § 5-501. Contracts proscribed by the civil usury statute are void. However, importantly, a corporation may not assert civil usury as a defense in litigation. N.Y. Gen. Ob. Law § 5-521(1); *accord Hillair Capital Inv., L.P. v. Integrated Freight Corp.*, 963 F. Supp. 2d 336, 339 (S.D.N.Y. 2013).

The criminal usury statute prohibits loans at interest rates exceeding 25% per annum. N.Y. Penal Law § 190.40. Unlike with civil usury, a corporation *can* assert criminal usury as a defense. N.Y. Gen. Ob. Law § 5-521(3); *accord Hillair*, 963 F. Supp. 2d at 339. However, in contrast yet again with the civil usury statute, there is "no specific statutory authority for voiding a loan that violates the criminal usury statute." *In re Venture Mortgage Fund, L.P.*, 282 F.3d 185, 190 n.4 (2d Cir. 2002); *accord Prof'l Merchant Advance Capital*, 2015 WL 4392081, at *5 n.4 (collecting cases).

GNID seeks to persuade this Court that the New York legislature "did not intend to create two different 'types' of usury" but instead "enacted the criminal provision to create two 'levels' of usury in a civil context." Def Reply at 6. Nevertheless, courts in this District routinely distinguish between the two types of usury when determining who may assert the defense and whether the resultant agreement should be voided. *See, e.g.*, *Coastal Inv. Partners, LLC v. DSG*

Global, Inc., No. 17-cv-4427, 2018 WL 2744719, at *5 (S.D.N.Y. June 6, 2018) ("[O]n its face, § 5–511 applies to civil, not criminal usury. Corporations, including Defendant in this action, cannot assert a civil usury defense."); *Ammirato v. Duraclean Intern., Inc.*, 687 F. Supp. 2d 210, 220-21 (E.D.N.Y. 2010) (differentiating between civil and criminal usury statutes); *Sabella v. Scantek Med., Inc.*, No. 08-cv-453, 2009 WL 3233703, at *16-17 (S.D.N.Y. Sept. 25, 2009) (same).

Accordingly, as a corporation GNID may not state a claim under the civil usury statue. This Court thus analyzes GNID's claim under the criminal usury provision.[7]

B. Whether the Note is a Loan Subject to Usury Laws

The Court first addresses whether the Note is a loan, triggering the application of usury laws.

"The rudimentary element of usury is the existence of a loan or forbearance of money." *Colonial Funding Network, Inc. for TVT Capital, LLC v. Epazz, Inc.*, 252 F. Supp. 3d 274, 280 (S.D.N.Y. 2017) (citation and internal quotation marks omitted). If there is no loan, "'there can be no usury, however unconscionable the contract may be.'" *Id.* (quoting *Seidel v. 18 E. 17th St. Owners, Inc.*, 79 N.Y.2d 735, 744 (N.Y. 1992)). "In order for a transaction to constitute a loan, there must be a borrower and a lender; and it must appear that the real purpose of the transaction was, on the one side, to lend money at usurious interest reserved in some form by the contract and, on the other side, to borrow upon the usurious terms dictated by the lender." *Id.* (citation and internal quotation marks omitted). In this analysis, the transaction "must be 'considered in its totality and judged by its real character, rather than by the name, color, or form which the

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[7] The Court notes that if it had analyzed the claim under the civil usury statute, GNID still would not have alleged a usury defense.

parties have seen fit to give it.'" *Id.* (quoting *Abir v. Malky, Inc.*, 59 A.D.3d 646, 649 (N.Y. 2d Dep't 2009)).

GNID argues that the transaction "is simply a loan with an exclusive option of the plaintiff to convert the loan into shares at some future time." Def Mem at 16. The Court assumes *arguendo* that the transaction constitutes a loan.

C. Whether AB Intended to Charge a Usurious Rate

Under New York law, "[a] loan is usurious if the lender intends to take and receive a rate of interest in excess of that allowed by law even though the lender has no specific intent to violate the usury laws." *In re Venture Mortgage Fund*, 282 F.3d at 188 (citation and internal quotation marks omitted). "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." *Blue Wolf Capital Fund II, L.P. v. Am. Stevedoring, Inc.*, 105 A.D.3d 178, 183 (N.Y. 1st Dep't 2013) (citation omitted). However, "[w]hen a note is not usurious on its face, a court will not presume usury; rather, the party asserting the defense must prove all the elements," including "the lender's usurious intent." *Union Capital*, 2017 WL 1406278, at *4. This "intent must be shown by clear, unequivocal and convincing proof." *Phlo Corp. v. Stevens*, No. 00-cv-3619, 2001 WL 1313387, at *4 (S.D.N.Y. Oct. 25, 2001) (citations omitted). "There is a strong presumption against the finding of usurious intent and a loan is not usurious merely because there is a possibility that the lender will receive more than the legal rate of interest." *Id.* (citation omitted).

GNID contends that the Note is usurious on its face because the conversion discount option (35%), share reserve requirement (400%), and default remedies provisions, which are expressly stated in the Note, set the interest rate well above 25%. Def Mem at 25. However, GNID's own line of argumentation makes clear that the face of the loan is not usurious. It

simultaneously contends that the Note is unmistakably usurious on its face and that AB "cleverly disguise[d] various additional charges" that resulted in in "hidden" rates of interests. Def Mem at 32. GNID essentially contends that so long as a Court determines that an interest rate is *effectively* usurious, intent is implied. Yet the cases GNID cites make clear that intent is only "conclusively presumed" if "the note . . . *shows* a rate of interest higher than the statutory lawful rate." *In re Rosner*, 48 B.R. 538, 547 (Bankr. E.D.N.Y. 1985) (citation and internal quotation marks omitted) (emphasis added); *see also Venables v. Sagona*, 85 A.D.3d 904, 905 (N.Y. 2d Dep't 2011) (Note usurious on its face where it "expressly called for repayment of the principal sum together 'with interest' at a rate far in excess of 25%").

Here, in contrast, the Note provides for an 8% interest rate per annum. That rate is patently not usurious. *See Phlo*, 2001 WL 1313387, at *4 (Note providing for 14% interest rate per annum not usurious on its face). Intent is thus not implied.[8]

D. Whether the Rate Was Usurious

The next issue is whether the Note's interest rate was usurious. "A loan is usurious where the lender is entitled to the return of the principal and the full legal rate of interest plus a bonus to be paid upon a contingency over which the borrower has no control." *Phlo*, 2001 WL 1313387, at *4. Courts have explained that "[t]his contingent right to a bonus is something of value and this value added to the maximum interest results in total interest in excess of the legal rate." *Id.* (citation omitted). Nevertheless, "[a]n agreement to pay an amount which may be more or less than the legal interest, depending upon a reasonable contingency, is not ipso facto

[8] In its opposition to Plaintiff's motion for summary judgment, GNID further argues that the Note is intentionally usurious. However, as AB points out, the Note contains two usury avoidance clauses. *See* Note §§ 8, 9. While a "'usury avoidance clause' does not, by itself, save an agreement from a charge of usury," courts have held that it "may be relevant to the issue of intent." *Hillair*, 963 F. Supp. 2d at 338 n.1 (internal citations omitted). Given the existence of two usury avoidance clauses, the fact that the Note is not usurious on its face, and the lack of evidence of intent, the Court concludes that, on summary judgment, GNID has not met its burden of proving intent.

usurious, because of the possibility that more than legal interest must be paid." *Id.* (citation omitted).

i. Attorneys' Fees

GNID contends that the $2,000 of loan proceeds applied to attorneys' fees represents a "hidden interest" of 6% of the loan amount. However, caselaw makes clear that a "borrower may pay reasonable expenses attendant on a loan without rendering the loan usurious," and that "[r]easonable expenses can include payments for attorneys' fees associated with the loan." *Hillair*, 963 F. Supp. 2d at 339 (citations and internal quotation marks omitted). To be sure, when "fee payments do not actually reimburse lenders for expenses associated with the loan, and instead are a disguised loan payment, then such fee expenses can be considered in determining the interest rate." *Id.* However, GNID adduces no evidence that the $2,000 fee did not legitimately reimburse plaintiff's attorneys' fees.

ii. Repayment Within 180 days

Next, GNID states that, under the Note, the principal plus interest actually had to be repaid within 180 days lest GNID be subject to AB's conversion option. Def Opp at 13-14. Accordingly, it argues that the 8% face interest plus "6% in hidden interest as legal fees" paid off in a six-month period creates a 29% interest rate. *Id.* at 14.

Without regard to the rest of GNID's argument, for the reasons discussed above, the $2,000 attorneys' fees do not constitute interest. Accordingly, this argument fails.

iii. Discount on Converted Stock

GNID argues that AB's 35% discount on the market price of GNID's stock must be considered interest. It relies on cases holding that convertible notes containing both an unsecured debt and an option to convert shares should be valued separately in determining the effective

interest rate. *See, e.g.*, *Hillair*, 963 F. Supp. 3d at 340 ("Defendants are correct that the stock payment should be taken into consideration in determining the interest rate.); *Sabella*, 2009 WL 3233703, at *17-18 (value of stock relevant to interest rate calculation for usury defense); Def Mem at 18-19. Thus, according to GNID the 35% discount has a separate value that must be counted because "for each $1.00 of principal and interest, defendant is required to pay back $1.35." Def Mem at 19. Moreover, GNID emphasizes that the conversion is entirely under AB's control as (1) AB has the sole conversion right and (2) the Note guarantees conversion at a "fixed rate on the lowest trading price from the 20 prior days upon the notice to convert," meaning that "there is no risk of loss to plaintiff upon conversion." *Id.* GNID then relies on *Blue Wolf* for the proposition that AB has "disguised" interest charges in an attempt to evade usury laws. *Id.* (citing *Blue Wolf*, 105 A.D.3d at 182).

As AB notes, however, cases relied on by GNID address Notes that required loan repayment *and* deliveries of shared stock, as opposed to delivery of stock *in lieu of* loan repayment. Under such circumstances, the stock value was plainly relevant to calculating the effective interest rate. Pl Opp at 16-17; *compare Hillair*, 963 F. Supp. 2d at 338 (contract provided for $165,000 loan to be repaid in the amount of $178,200 *plus* 500,000 shares of common stock) (emphasis added); *Sabella*, 2009 WL 3233703, at *18 ("in return for loaning money to Scantek, Sabella was entitled to receive shares of the company's common stock as *additional* consideration") (emphasis added) *with* Note § 4(a) (note-holder *may convert* amount of principal face of the Note into common stock) (emphasis added). Further, *Blue Wolf* addressed a fundamentally different Note, involving hundreds of thousands of dollars of deposits and fees that the court determined must be added to the interest rate calculation. *See Blue Wolf*, 105 A.D.3d at 183.

Much more to the point are cases cited by AB that considered Notes similar to the one at issue here and held that such discounts are not interest. For instance, *Union Capital* addressed a Note that, as here, had an 8% annual interest rate and allowed the lender "at any time to convert all or any amount of the principal face amount" of the Note into shares of the borrower's common stock. *Union Capital*, 2017 WL 1406278, at *1. There, the discount was 58% of the lowest trading price within thirteen days prior to receipt of notice. *Id.* Rejecting the borrower's argument that the discount should be calculated in considering the effective interest rate, the court held that the borrower:

> simply held an option to convert shares, and it could have elected to obtain repayment in cash, which would clearly not have been usurious. Moreover, even if Union chose to convert the loan principal into shares, any potential profit Union might realize would still be dependent on the market price at the time of conversion and so, therefore, would be too uncertain to incorporate into an interest rate calculation . . . Furthermore, even if the discount rate could be considered. [A] usury defense could no longer be applied against the loan once the Note principal was converted into equity.

Union Capital, 2017 WL 1406278, at *5 (collecting cases); *accord Beaufort Capital Partners, LLC v. Oxysure Sys., Inc.*, No. 16-cv-5176, 2017 WL 913791, at *3 (S.D.N.Y. Mar. 7, 2017) (option to redeem Notes for equity at discounted price should not be factored into interest analysis because "though the initial transaction took the form of a loan, upon conversion to equity, the loans likely have the character of an equity investment, and are thus no longer vulnerable to a usury defense"); *Adar Bays*, 285 F. Supp. 3d at 703 ("Adar Bays has at minimum stated a plausible claim that a right to convert loan principal into shares, even at a fixed percentage discount, is materially more uncertain than a right to receive cash and therefore should not be considered as interest in a usury calculation.").[9]

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[9] GNID stresses that the Court must analyze usury "specifically and only at the time the loan was made." Def Mem at 16 (collecting cases). It argues that AB is impermissibly discussing the time of the loan *at conversion*. Def Reply at 8-9. However, AB does not appear to dispute the contention that usury is determined at the time the loan was

The Court agrees with AB that the 35% discount should not be included in the interest calculation. The conversion right was simply too uncertain at the time of contracting. As courts have noted, a myriad of circumstances could decrease the price of the stock, including that "Defendant could become delinquent in its filings, become delisted, experience sudden decreases in its stock price, experience no demand for its stock, or simply cancel the reserve or refuse a conversion." *Adar Bays*, 285 F. Supp. 3d at 702-03; *accord Phlo*, 2001 WL 1313387, at *5 ("[I]t was not clear that any effective interest rate in excess of 25% would ever have to be paid, as the value of the warrants was uncertain."). Accordingly, GNID has not carried its burden of showing that the discounted stock price should be considered in the interest calculation.

iv. Share Reserve

GNID next contends that the share reserve that the Note required it to keep in order to effectuate conversions is part of the interest rate. Essentially, GNID argues that the initial reservation of 278,000 shares, and the requirement that it at all times reserve at least three times the amount of shares required if the Note were fully converted, is unlawful under § 5-511 as the reservation of a "greater sum" for the loan. *See* Def Mem at 20-21. Per GNID's calculations, the value of the reservation at the time the Note was executed was $144,560.00 based on the $35,000 principal, or *400%* of the value of the original loan. *Id.*

As AB states, GNID's argument does not hold. Chiefly, § 5-511 is the *civil* usury statute, which "cannot be asserted by a corporation" such as GNID. *Adar Bays*, 285 F. Supp. 3d at 704. In any event, GNID is not giving up the shares in reserve. They remain in control of GNID's agent while AB has the option to convert the shares, and are returned to GNID if AB does not exercise its option. As a court found when evaluating a similar Note, "the reservation of shares

made. It merely, and properly, makes the logical connection that money obtained after conversion into shares is not subject to usury laws.

was not an independent payment to Adar Bays, but merely a mechanism by which to effectuate the share conversion as envisioned by the Note and the SPA. Since the share conversion feature does not render the agreement usurious, neither does the reservation of shares provision." *Id.*

v. Default Rates

GNID additionally seeks to add the 24% per annum default interest rate to the interest rate calculation. The parties debate whether New York's usury laws apply to default interest rates. The bulk of authority supports AB's contention that "default payments are separate and distinct from the actual interest rate and therefore are not relevant in determining if the rate is usurious." *Hillair*, 963 F. Supp. 2d at 340 (collecting cases).

However, GNID relies on a 2017 decision that applied the criminal usury statute to a credit card company's 32.24% default interest rate on an individual. *Madden v. Midland Funding, LLC*, 237 F. Supp. 3d 130, 138 (S.D.N.Y. 2017). After reviewing state and federal cases, the court in *Madden* concluded that, while it is clear that "the civil usury cap does not apply to defaulted obligations," the New York Court of Appeals has yet to rule on whether the criminal usury cap so applies and, were it to reach this issue, it likely "would hold that the criminal usury cap limits interest charged on debts to 25% annually, even for defaulted debts." *Id.* at 140-44. One court has since applied *Madden* to hold that "the criminal usury cap *does* apply to default interest." *Union Capital*, 2017 WL 1406278, at *8. However, other courts have declined to follow *Madden*'s analysis, instead following the "overwhelming authority" to the contrary. *LG Capital Funding, LLC v. One World Holding, Inc.*, No. 15-cv-698, 2018 WL 3135848, at *12 (E.D.N.Y. June 27, 2018); *see also Beaufort*, 2017 WL 913791, at *3 (collecting cases); *Adar Bays*, 285 F. Supp. 3d at 705 (describing split of authority).

This Court need not resolve this dispute, however, since the default interest rate here is 24% per annum, which does not exceed the criminal usury cap.[10]

vi. Damages Provisions

GNID contends that the liquidated damages provisions of the Note bring the overall effective default interest rate above 25%. *See* Note § 8 (listing damages provisions). It relies on cases holding liquidated damages unlawful because they were grossly disproportionate to the possible loss and actual damages were not difficult to determine. *See Union Capital*, 2017 WL 1406278, at *7 (liquidated damages provision "unenforceable penalty"); *Bristol Inv. Fund, Inc. v. Carnegie Intern. Corp.*, 310 F. Supp. 2d 556, 568 (S.D.N.Y. 2003) (liquidated damages "unconscionable" penalty that is "not intended to compensate [Plaintiff] for [Defendant's] breach).

As AB argues, whether the liquidated damages provisions here are unenforceable is a wholly separate question from whether they constitute interest for the purposes of New York's usury laws. Indeed, as discussed above the Court strikes the liquidated damages provisions. Accordingly, they cannot be considered part of the effective interest rate.

E. Remedy

Finally, even if the Court had found that the Note was usurious, it would not necessarily be void. GNID contends that "[i]t is well settled law in New York that criminally usurious loans are *void ab initio*." Def Mem at 26 (collecting cases). Yet as numerous courts have recognized, "there is no specific statutory authority for voiding a loan that violates the criminal usury statute." *In re Venture Mortgage Fund*, 282 F.3d at 190 n.4. Since the Court determines that the Note is not usurious, it need not determine the appropriate remedy here.

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[10] Since, as discussed above, GNID cannot assert a civil usury defense given its status as a corporation, the fact that the default interest rate exceeds the civil usury statute is of no moment.

CONCLUSION

The Court has considered all of the parties' arguments. For the foregoing reasons, Plaintiff's motion for summary judgment on its breach of contract claim is GRANTED and Defendant's motion to dismiss is DENIED. Plaintiff's claims for unjust enrichment and anticipatory breach are deemed abandoned.

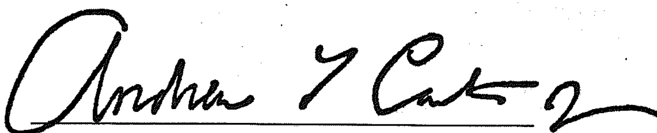
Plaintiff shall file its motion for attorneys' fees by October 22, 2018. Defendant shall file its response by November 26, 2018. Plaintiff's reply, if any, shall be due by December 10, 2018.

The Clerk of Court is respectfully requested to terminate the motions at ECF Nos. 47 and 51.

SO ORDERED.

Dated: September 20, 2018

New York, New York



HON. ANDREW L. CARTER, JR.
United States District Judge