

ANDERSON KILL COMMERCIAL LITIGATION ADVISOR



Understanding New York Criminal Usury

By Christopher L. Ayers and Christopher Paolino

Charging too much interest can be a crime. Usury is the general practice of making unethical financial loans that unilaterally benefit the lender. Typically, a loan is considered usurious if the interest rate is excessive or abusive. Under New York's criminal usury statute, the maximum per annum interest rate for a loan of money is 25 percent. Penal Law § 190.40,¹ § 190.42.² With some exceptions, individuals, corporations, and limited liability companies may assert criminal usury as a defense where the amount of the loan is more than \$250,000 and less than \$2,500,000. While a corporation or limited liability company may not interpose the defense of civil usury³, such prohibition does not extend to criminal usury.

Usury Penalties

A lender that knowingly collects criminally usurious interest commits a felony and could

face penalties ranging from probation to prison. These penalties are in addition to any other co-occurring crimes, such as bank fraud and money laundering. Healthy monetary fines are typically levied as well as the court's requirement for restitution. Significantly, while prior case law suggested that there was no civil remedy for criminal usury with respect to loans not subject to the civil usury statute (i.e., loans of \$250,000 or more), a recent appellate court held, in *Blue Wolf Capital Fund II, L.P. v. American Stevedoring Inc.*, 961 N.Y.S.2d 86 (1st Dep't 2013), that such loans are nevertheless void and some lenders may be subject to forfeiture of principal and interest — or, in the case of a savings bank, a savings and loan association or a federal savings and loan association, a borrower may be able to recover twice the interest paid.

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Substance Over Form

Attempts to disguise interest may put a loan in jeopardy. In order to determine whether a transaction is usurious, courts look not to its form but to its substance or real character. Warrants, success fees, consulting fees and other fees may be appropriate, but if used to disguise interest, lenders may be inviting trouble.

Usury Savings Clauses

Lenders will often include in their loan documents “usury savings clauses” stating that if the loan turns out to be usurious, then any payments by the borrower above the allowable rate shall be retroactively recharacterized as repayments of principal. In the few cases that have considered the validity of such clauses, the results were not encouraging for lenders.

There are, however, a number of exceptions and exemptions to the usury rule, only a few of which are discussed here.

Default Interest

New York usury laws do not apply to defaulted obligations. Any penalty interest rates or late fees assessed against a borrower do not constitute usury. This is because where interest has already fallen due, it becomes a debt that, like any other debt, may either be paid in cash or treated as a new loan to the debtor under an agreement that it shall bear interest.

Special Relationship

A borrower is estopped from interposing a usury defense when, through a special relationship with the lender, the borrower induces reliance on the legality of the transaction. Otherwise, a borrower could void the transaction, keep the principal, and achieve a total windfall, at the expense of an innocent person, through his own subterfuge and inequitable deception. Based on a finding of a special relationship, the lender will be entitled to the unpaid principal together with the legal rate of interest. Special relationships that may preclude assertion of a usury defense include attorney-client, fiduciary, or trustee, or a longstanding friendship or its equivalent. Moreover, a special relationship is usually characterized by superior knowledge,

experience, or sophistication, which enables a borrower to induce the lender to make the loan at a usurious rate.

UCC Article 9

Loans secured in accordance with Article 9 of the Universal Commercial Code, including discretionary or mandatory advances in the amount of \$100,000 or more, are not subject to usury limitations, if on the date when the interest is charged or accrued, such interest is not greater than eight percentage points over the prime rate.

There are a number of other escape hatches from usury laws, including waiver, burdens of proof, standing, application of another state’s law, estoppel and other equitable defenses. It is also possible to cure usurious loans via modification and amendment. Given how easy it is to steer clear of usury problems in New York commercial transactions, it is critical to obtain good legal counsel at the outset. ▲

ENDNOTES

¹ Penal Law § 190.40 provides: “A person is guilty of criminal usury in the second degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty-five per centum per annum or the equivalent rate for a longer or shorter period.”

² Penal Law § 190.42 provides: “A person is guilty of criminal usury in the first degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty-five per centum per annum or the equivalent rate for a longer or shorter period and either the actor had previously been convicted of the crime of criminal usury or of the attempt to commit such crime, or the actor’s conduct was part of a scheme or business of making or collecting usurious loans.

³ New York civil usury laws, imposing a 16% interest rate per annum ceiling on loans and forbearances, do not apply to a loan of \$250,000.00 or more, unless such loan is secured primarily by a mortgage on a one or two family residence.

About Anderson Kill

Anderson Kill practices law in the areas of Insurance Recovery, Commercial Litigation, Environmental Law, Estates, Trusts and Tax Services, Corporate and Securities, Antitrust, Banking and Lending, Bankruptcy and Restructuring, Real Estate and Construction, Foreign Investment Recovery, Public Law, Government Affairs, Employment and Labor Law, Captive Insurance, Intellectual Property, Corporate Tax, Hospitality, and Health Reform. Recognized nationwide by Chambers USA for Client Service and Commercial Awareness, and best-known for its work in insurance recovery, the firm represents policyholders only in insurance coverage disputes — with no ties to insurance companies and has no conflicts of interest. Clients include Fortune 1000 companies, small and medium-sized businesses, governmental entities, and nonprofits as well as personal estates. Based in New York City, the firm also has offices in Ventura, CA, Philadelphia, PA, Stamford, CT, Washington, DC, and Newark, NJ.

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