CHAPTER 2

Usury

SYNOPSIS

§ 2.01 Overview of Usury[1]

Any mortgage loan closing begins with a loan, an obligation of a borrower to pay money to a lender. Before the parties begin to think about how to secure that loan and how to minimize mortgage recording tax, lender's counsel should analyze the transaction to confirm that the loan itself does not raise usury issues.

New York's usury law consists of a scrambled collection of statutes, most of which appear in the New York General Obligations Law.[2] Combined with federal preemption

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[1] The following discussion is based in substantial part on the author's previous article on New York usury law. *See* Joshua Stein, *Confusury Unraveled: New York Lenders Face Usury Risks In Atypical or Small Transactions,* N.Y. St. B. Ass'n J., July/August 2001, at 25; earlier version published in N.Y. St. B. Ass'n Real Prop. L. Sec. Newsl., Fall 1993, at 17.

[2] This Chapter cites the relevant sections of the General Obligations Law and other New York statutes throughout. For more on New York usury law, *see* 1 Bruce J. Bergman, Bergman on New York Mortgage Foreclosures 6-4 (LexisNexis Matthew Bender); Shimon A. Berger, *Note: Adding Insult to Injury: How* In re Venture Mortgage Fund *Exposes the Inequitable Results of New York's Usury Remedies,* 29

in certain areas described below, these statutes exempt most substantial commercial lending transactions from any usury restrictions.[3]

"Usury" remains a potential trap only for the unwary loan shark (who probably does not care, because the judicial system is not highly relevant to a loan shark's activities anyway) and participants in a few other atypical or small lending transactions. In the occasional weird case where usury restrictions do apply, a violation can invalidate the entire loan and constitute a felony.[4] A practitioner must consider this risk in any loan transaction that is small or involves a borrower other than a corporation or limited liability company.[5]

As in any other area, the practitioner should always refer to the most current version of the applicable statutes and other law before rendering any advice on New York usury law.

The following discussion of New York usury law does not cover any loan restrictions beyond usury and compound interest, such as prepayment, attorneys' fees, discount points, prepaid interest, and late charges. Adjustable-rate residential mortgages are subject to their own interacting federal and state limitations and disclosure requirements, which are beyond the scope of this chapter.[6] Exemptions for broker-dealer loans are also not addressed.[7] For ordinary mortgage loan transactions, the most common escape hatches from usury include those discussed below.

§ 2.02 Maximum Rate

In the rare factual circumstance where New York's usury ceiling actually applies and federal law does not preempt it, a lender usually cannot charge interest higher than

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Fordham Urb. L.J. 2193 (2002). The Berger article provides an extensive discussion of the theory and practice of New York usury law, as well as the historical and even biblical basis for usury laws. Berger describes New York's usury law as "among the most severe in the country" and says it produces "inequitable results," *Id.* at 2198, as demonstrated in *In re* Venture Mortgage Fund, L.P., 245 B.R. 460 (S.D.N.Y. 2000), *aff'd,* 282 F.3d 185 (2d Cir. 2002). In that case, a con man who "borrowed" (ultimately stole) money was able to avoid repaying his innocent and trusting victims by calling them usurers. Although Berger believes usury laws make sense, he favors a more discretionary approach, so that "the real 'loan sharks' are brought to justice and pay the full price for their actions, while allowing the relatively harmless offenders to escape the harsh penalties that do not fit their crimes." *Id.* at 2232.

[3] Although this book generally disregards residential transactions, they must be taken into account to provide a reasonable summary of New York usury law.

[4] *See* N.Y. Penal Law §§ 190.40, 190.42. For a criminal usury conviction, see People v. Valentzas, 70 N.Y.2d 446, 522 N.Y.S.2d 483, 517 N.E.2d 198 (N.Y. 1987).

[5] Thus, New York, which prides itself on being more practical and business-like than California, ends up with a usury law functionally the same as California's. One writer said California usury law "does not seriously inconvenience most lenders and offers very little protection to most borrowers. The law in this area has a loud bark but rarely bites. However, its rare bite can be painful indeed. This may be good politics, but it makes for complex law." E. Rabin & R. Brownlie, *Usury Law in California: A Guide Through the Maze,* 20 U.C. Davis L. Rev. 397, 440 (1987). The same comment could apply to New York's usury law.

[6] *See* 12 U.S.C. § 3803(c) (1998); 12 C.F.R. § 226.19 (1999); N.Y. Banking Law §§ 6-f, 6-g.

[7] *See* N.Y. Gen. Oblig. Law ("GOL") § 5-525.

16 percent per annum.[1] The Banking Law contains similar provisions.[2] In addition to the civil usury ceiling, a lender that charges more than 25 percent per annum may face criminal usury charges.[3] "Interest" includes certain other charges payable to the lender on account of the loan. The usury ceiling rises by 150 basis points to 17.5 percent per annum for loans secured by cooperative apartments.[4]

Floating-rate loans and loans that contemplate future advances create a few special complications of their own, which are beyond the scope of this chapter.[5]

§ 2.03 Computation of Interest

At the time of this writing in 2008, New York's usury ceiling is 16 percent per annum.[1] Therefore, a loan that bears interest at exactly 16 percent per annum, and does not require the borrower to pay any lender fees or charges, would not be usurious.[2] But lenders often require their borrowers to pay various fees or charges at closing or otherwise. Because the courts will deem at least some of those payments to constitute consideration for use of the lender's money,[3] the courts may characterize them as additional interest. To that extent, the loan could become usurious.[4]

For residential loans (those secured by one- or two-family residences), state

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[1] *See* GOL § 5-501(1) (maximum usury rate six percent per annum unless otherwise provided in N.Y. Banking Law § 14-a); N.Y. Banking Law § 14-a(1) (16 percent per annum maximum usury rate for purposes of GOL § 5-501). GOL § 5-501(3)(b) sets special rules for most residential loans where the annual interest rate exceeds six percent. In these cases, the borrower has the statutory right to prepay at any time. The lender cannot collect a prepayment fee unless the prepayment occurs in the first year and the documents expressly provide for such a fee. *See* GOL § 5-501(3)(b). This statute expressly provides for federal preemption.

[2] *See* N.Y. Banking Law § 14-a(1); *see also, e.g.,* N.Y. Banking Law §§ 108(1) (state bank or trust company), 173(1) (private bankers), 202(1) (foreign banks), 510-a (investment companies); N.Y. Comp. Codes R. & Regs. tit. 3, § 4.1.

[3] *See* Penal L. § 190.40; *see also, e.g.*, Cusick v. Ifshin, 70 Misc. 2d 564, 334 N.Y.S.2d 106 (1972), *aff'd*, 73 Misc. 2d 127, 341 N.Y.S.2d 280 (App. Term, 1st Dept. 1973). For discussion of criminal usury, see § 2.06 *below*.

[4] N.Y. Banking Law §§ 103(5), 235(8-a), 380(2-a).

[5] GOL § 5-501(4), (4-a); N.Y. Banking Law § 14-a(1)–(2); N.Y. Comp. Codes R. & Regs. tit. 3, §§ 4.1–4.2 (regulations adopted by Banking Board).

[1] *See* GOL § 5-501(1); N.Y. Banking Law § 14-a(1).

[2] *See, e.g.*, C & M Systems v. Custom Land Dev. Group II, 262 A.D.2d 440, 692 N.Y.2d 146 (2d Dept. 1999) (awarding foreclosing lender interest at 16 percent because mortgage allowed recovery of interest at highest rate allowed by statute).

[3] Because the courts define interest as compensation for use or forbearance of money, "interest" is not limited to the expressly stated "interest rate" in the note. It would, for example, include fees and charges the borrower pays to the lender before or upon receipt of loan proceeds. *See e.g.*, Katz v. Nichols, 48 N.Y.S.2d 640, 641 (Sup. Ct. 1944), citing Macdonald v. MacDonald, 71 Misc. 516, 516 (N.Y. Sup. Ct. 1911) (defining interest as "the compensation allowed by law, or fixed by the parties, for the use or forbearance of money . . .").

[4] *See* Bruce J. Bergman, Bergman on New York Mortgage Foreclosures § 6.02 (LexisNexis Matthew Bender) (comprehensive discussion of various charges and fees included in computation of interest).

regulations define which items, fees, and charges count as interest for usury purposes.[5] For other loans, interest "shall mean all amounts paid or payable, directly or indirectly, by any person, to or for the account of the lender which would be includible as interest under New York law as it existed prior to [1968]."[6] Thus, the state throws up its hands and tells the reader go look at the old cases.[7] But the ultimate answer to the question doesn't turn out to be all that different.[8]

In deciding which lender fees or charges constitute interest, the courts seem to try to determine whether a particular fee or charge constitutes consideration for the borrower's use of the lender's money — or, in the alternative, whether the fee or charge constitutes something else. Bruce J. Bergman, summarizing the case law on this point, notes that these lender fees and charges have been found to constitute components of interest:

- Closing expenses, include those denominated as brokers' commissions, lenders' fees, origination fees, and bonuses paid to the lender or an agent of the lender.
- Contingency fees, or fees for items or services that are collateral to the mortgage agreement, if a lender derives a benefit, with no equivalent benefit to the borrower, so that the lender's benefit amounts to additional compensation for making the loan.

Bergman says the courts have found these items not to constitute interest:

- Commitment, standby fees, or other charges a borrower pays a lender for the lender to hold a loan available.
- Pre-payment penalties or premiums.
- Late charges.
- Reimbursement of reasonable legal fees.
- Interest after a loan has matured.
- Adjournment fees.[9]

Traditionally, courts calculate usury without considering the effect of timing on the value of money. The Court of Appeals upheld this approach in *Band Realty Company*

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[5] *See* 3 N.Y.C.R.R. § 4.2 (interest for loans secured by one or two family residences shall include origination fees, points and other discounts paid or payable in consideration for making the loan or forbearance); 3 N.Y.C.R.R. § 4.3 (listing fees and charges not includable as interest for loans secured by one or two family residences, including reasonable fees for legal services, appraisals and title insurance).

[6] 3 N.Y.C.R.R. § 4.2(b).

[7] *See* Bruce J. Bergman, Bergman on New York Mortgage Foreclosures § 6.02[3][b] (LexisNexis Matthew Bender) ("unreasonable to conclude that case law definitions of interest promulgated since [1968] would be disregarded [in determining what items are components of interest]").

[8] *See* Bruce J. Bergman, Bergman on New York Mortgage Foreclosures § 6.02 (LexisNexis Matthew Bender).

[9] *See* Bruce J. Bergman, Bergman on New York Mortgage Foreclosures § 6.02 (LexisNexis Matthew Bender).

v. North Brewster, Inc., rejecting the "present value" method of computing interest, in favor of the "traditional method," which ignores the time value of money. The court reasoned that although the "present value" method would produce a more mathematically accurate interest rate, case law and legislative history have supported the traditional method. Because the legislature used the traditional method of computing interest when it set usury ceilings, for the court to recognize a new method of computation would be to set a new usury ceiling. Therefore, even though a lender can invest any fees or charges it receives from the borrower, the amount of interest the lender could have thereby earned over the life of the loan should not be treated as additional fees or charges the lender received.

Thus the Court upheld the following traditional method for measuring interest. First, add up all the prepaid fees and charges deemed interest (ignoring any interest on these fees and charges), plus the stated interest rate on the note. Second, divide that total by the term of the loan in years, to yield the annual interest on the loan. Third, see if each year's total annual interest exceeds the usury ceiling.

The traditional formula for computing interest as expressed by the Court of Appeals in *Band Realty* remains the law, and the Court of Appeals has implicitly reaffirmed it in later years.[10]

§ 2.04 Compound Interest

Independent of the usury restrictions, New York limits a lender's ability to collect compound interest. Even if a loan is not usurious, the lender may be barred from charging interest on the borrower's unpaid interest. In general, New York prohibits compound interest on any loan of $250,000 or less, except in the following cases:

- *Certain Business Loans.* Business loans of $100,000 or more secured under the Uniform Commercial Code (the "UCC") with a rate at or below prime plus eight percent per annum;[1]
- *Prejudgment Interest.* Prejudgment interest on interest, from the date the payments were due until the plaintiff establishes liability by obtaining a verdict or judgment.[2] and
- *Certain UCC Loans.* Demand loans of $5,000 or more secured by certain Uniform Commercial Code documents;[3] and
- *Other.* Statutory exceptions enacted for particular industries.[4]

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[10] *See* Hammelburger v. Foursome Inn Corp., 54 N.Y.2d 580 (N.Y. 1981).

[1] GOL § 5-526. The prime rate means "the average prime rate on short term business loans which is published by the board of governors of the federal reserve system for the most recent week which was publicly available from the board of governors of the federal reserve system on the previous business day." GOL § 5-526(4).

[2] Spodek v. Park Prop. Dev. Assocs., 96 N.Y.2d 577 (N.Y. 2001) (interpreting N.Y. C.P.L.R. 5001(a) to allow such recovery of interest).

[3] GOL § 5-523.

[4] *See, e.g.,* N.Y. Ins. Law § 3203(a)(8)(G); Martin E. Gold, *New York Approves Law Legalizing*

However, New York prohibits compound interest on any loan, regardless of amount, secured by a "one or two family owner-occupied residence," including a cooperative apartment.[5]

If a lender illegally charges compound interest and the net effective interest rate after compounding is at or below the usury ceiling, he or she must refund the "compounded" part of the interest but not the other interest already paid. In that case, the lender faces no other forfeiture risk. If the effective interest rate, after compounding, exceeds the usury ceiling, then the severe penalties for regular "usury" will apply.[6]

Until 1989, New York courts had, in a number of cases spanning almost two centuries, invalidated compound interest under the questionable assumption that interest payable on unpaid dollars of "interest" is something completely different from interest payable on unpaid dollars of "principal." Although in the Eighties, New York courts sometimes struggled to find exceptions to the general New York rules against compound interest, New York has retained its common law rule against compound interest. The legislature solved the problem in 1989, primarily at the urging of Martin E. Gold, formerly Director of Corporate Law in the New York City Law Department and now with Sidley Austin Brown & Wood in Manhattan.[7] Although the 1989 legislation allows compound interest on nearly all commercial mortgage loans, occasional loans outside the scope of the 1989 legislation remain subject to the common law ban.

If a mortgage loan that provides for "compound" interest does not run afoul of New York's rules in this area, the lender must still consider the mortgage recording tax. If the loan documents provide, or the parties ever agree, that unpaid interest shall be added to principal (for example, as part of a workout), then the loan thereby incurs additional mortgage recording tax on the resulting new "principal indebtedness." Moreover, the Department of Taxation and Finance takes the view that as soon as interest starts to accrue on previously accrued interest, the previously accrued interest becomes principal and itself incurs mortgage recording tax.[8]

Compound Interest, 62 N.Y. St. B. Ass'n J., Oct. 1990, at 26, 27–28 (citing other industry-specific statutory exceptions).

[5] *See* GOL § 5-527(2). The statute defines "residence" to "include" a cooperative apartment, but says nothing about condominiums. Although diligent research could not locate any reported cases on point, a court would probably say "residence" also includes a condominium apartment.

[6] Giventer v. Arnow, 37 N.Y.2d 305, 372 N.Y.S.2d 63, 333 N.E.2d 366 (1975).

[7] The history of compound interest in New York and the 1989 legislation are described in two articles by Mr. Gold: Martin E. Gold, *Compound Interest: Legalization Wins Approval,* N.Y.L.J., June 15, 1989, at 1; and Martin E. Gold, *New York Approves Law Legalizing Compound Interest,* N.Y. St. B. Ass'n J., Oct. 1990, at 26.

[8] *See* Op. N.Y. State Dep't of Taxation & Fin., Ticor Title Guar. Co., N.Y. St. Tax Rptr. (CCH) ¶ 401-177, at 46,171 (June 25, 1993) (mortgage recording tax imposed on capitalized interest "as if the interest had been actually paid to the mortgagee and the mortgagee then loaned the same amount back to the mortgagor"). Goldberg asks whether the parties might avoid this result by recharacterizing the "compound interest" as simple interest calculated using a different formula. "If interest has become due, and the lender then agrees to defer payment of that interest in return for the borrower's agreement to pay

§ 2.05 Penalties for Usury

If a loan is usurious, it becomes wholly void.[1] The lender forfeits all principal and interest (the loan, in effect, becomes a gift), and the borrower can also recover the usurious part of the interest previously paid.[2]

If the lender is "a savings bank, a savings and loan association or a federal savings and loan association" or within certain other categories of institutional lender, the statute provides a different penalty: the lender forfeits all interest (not just the usurious part of the interest), but not principal, and may also be required to repay the borrower twice the interest actually paid.[3]

Any action to recover a payment of usurious interest must be brought within one year after the borrower made the payment.[4]

§ 2.06 Criminal Usury and "Predatory Lending"

New York has a separate criminal usury ceiling of 25 percent per annum on nonexempt loans. Any lender that knowingly collects criminally usurious interest commits a felony.[1] The criminal usury ceiling applies to some loans that are not subject to civil usury restrictions at all: loans of $250,000 or more; and certain secured loans of $5,000 or more payable on demand.[2] In these cases, however, New York law does not appear to give the victim of usury any express civil remedy against the lender.[3] In contrast, for loans under $250,000, the statute expressly provides for

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interest on the deferred interest, or if the borrower exercises an option to capitalize interest, then it would seem that the deferred interest has become principal. However, if the initial loan agreement provided that interest would be compounded, then it would seem, although this is not the present state of the law, that the compounding is merely the means of calculating the cost of borrowing the original principal." David M. Goldberg, Transfer and Mortgage Recording Taxes in New York Title Closings § 6-13(a) (2001). In Cosmopolitan Broadcasting Corp. v. State Tax Comm'n, 78 A.D.2d 475, 435 N.Y.S.2d 804 (App. Div. 1981), the court required payment of mortgage recording tax on the total amount of principal indebtedness when the documents failed to distinguish between principal and interest. If unpaid interest is added to principal, the logical extension of this case would require payment of mortgage recording tax on the additional principal indebtedness.

[1] GOL § 5-511(1) (unless lender is savings bank, savings and loan association, or federal savings and loan association). *See also* Seidel v. 18 East 17th Street Owners, Inc., 79 N.Y.2d 735, 741, 586 N.Y.S.2d 240, 243, 598 N.E.2d 7, 10 (1992); Eikenberry v. Adirondack Spring Water Co., 65 N.Y.2d 125, 126, 490 N.Y.S.2d 484, 480 N.E.2d 70 (1985).

[2] GOL §§ 5-511, 5-513. *But see* GOL § 5-519 (granting partial relief if lender repays excess interest).

[3] GOL §§ 5-511(1), 5-513; *see also, e.g.,* N.Y. Banking Law §§ 108(6), 202(7), 235-b, 380-e, 510-(a)(1).

[4] N.Y. CPLR § 215(6).

[1] N.Y. Penal Law §§ 190.40, 190.42.

[2] *See* §§ 2.09, 211 *below*.

[3] *See* American Express Co. v. Brown, 392 F. Supp. 235, 238 (S.D.N.Y. 1975) (discussing the inability of the victim "to personally enforce the criminal usury law of the state") (*dictum*). *But see* N.Y. LLC Law § 1104(c) and N.Y. GOL § 5-521(3) (suggesting that corporations and limited liability companies may interpose criminal usury as a defense). *See also* Feinberg v. Old Vestal Rd. Assoc., Inc., 157 A.D.2d 1002, 1003 (N.Y. App. Div. 3d Dep't 1990) (corporations may interpose defense of criminal usury); Cusick v.

invalidation, as described in § 2.04. In a 2001 decision, a federal court applying New York law ruled that a criminally usurious loan above $250,000 can be invalidated on general grounds of public policy.[4] Conversely, in *American Equities Group, Inc. v. Ahava Dairy Prods. Corp.*,[5] the court adopted Second Circuit dictum concluding that there is no statutory support to void a criminally usurious loan.[6] Instead, the court suggested alternative remedies such as canceling the interest obligation but not the obligation to pay principal or revising the obligation to require the borrower to pay only a non-usurious interest rate.[7]

A few cases say that banking institutions are exempt from criminal liability for usury.[8] The only penalty available against them would thus appear to be forfeiture.

Beyond considering New York's web of civil and criminal usury statutes, any lender that plans to lend $300,000[9] or less, secured by a mortgage on residential real estate,[10] should consider New York's "predatory lending" statute, which the Legislature enacted in 2002, effective April 1, 2003. This statute imposes a number of burdensome requirements and restrictions on any "high-cost home loan."

Ifshin, 70 Misc. 2d 564, 334 N.Y.S.2d 106 (1972), *aff'd*, 73 Misc. 2d 127, 341 N.Y.S.2d 280 (App. Term, 1st Dept. 1973).

[4] Hufnagel v. George, 135 F. Supp. 2d 406 (S.D.N.Y. 2001). Not all courts have accepted this view. *See* Am. Equities Group, Inc. v. Ahava Dairy Prods. Corp., 2004 U.S. Dist. LEXIS 6970 (S.D.N.Y., 2004). *See also* Kenneth M. Block & Jeffrey B. Steiner, *Usury: Voiding Criminally Usurious Loans Under the Civil Usury Law,* N.Y.L.J., July 17, 2002, at 5. *See also In re* Venture Mortgage Fund, L.P., 282 F.3d 185, 190-91 (2d Cir. 2002) (noting that "it is an open question under New York law whether a criminally usurious loan is void" and disagreeing with *Hufnagel*); Funding Group, Inc. v. Water Chef, Inc., 2008 NY Slip Op 28069, 6, 852 N.Y.S.2d 736, 743, (N.Y. Sup. Ct. 2008) (citing *In re Venture* and holding that criminal usury is strictly an affirmative defense to an action seeking repayment of loan and not a means of effecting recovery by the borrower).

[5] No. 5207, 2004 U.S. Dist. LEXIS 6970, at *47-49 (S.D.N.Y. Apr. 23, 2004).

[6] Specifically, the court noted that the voiding provision only voids loans that violate the civil usury statute and further pointed out that no provision in the criminal usury statute provides for voiding. *American Equities*, 2004 U.S. Dist. LEXIS 6970, at *48 (quoting *Venture Mortgage Fund*, 282 F.3d at 190-91).

[7] *American Equities*, 2004 U.S. Dist. LEXIS at *49 (quoting *Venture Mortgage Fund*, 282 F.3d at 189 n.3) (pointing out that the Legislature contemplated some remedy for the victim of criminal usury, otherwise, the exception in § 5-521(3), permitting corporations to interpose a criminal usury defense, would be meaningless).

[8] *See* Flushing Nat'l Bank v. Pinetop Bldg. Corp., 54 A.D.2d 555, 387 N.Y.S.2d 8 (2d Dep't 1976) (citing Franklin Nat'l Bank v. DeGiacomo, 20 A.D.2d 797, 248 N.Y.S.2d 586 (App. Div. 1964); Reisman v. William Hartmann & Sons, 51 Misc. 2d 393, 273 N.Y.S.2d 295 (1966)). *See also* Tides Edge Corp. v. Central Fed. Sav., F.S.B., 151 A.D.2d 741, 542 N.Y.S.2d 763 (App. Div. 1989).

[9] The statutory ceiling is actually $300,000 or the "conforming loan size limit for a comparable dwelling as established from time to time by the federal national mortgage association," if that is lower. *See* N.Y. Banking Law § 6-l(1)(e)(i).

[10] The statute applies to any loan secured by a mortgage or deed of trust on property that has or will have one- to four-family residences, and that will be the borrower's principal residence. *See* N.Y. Banking Law § 6-l(1)(e)(iv).

The statute provides a lengthy and detailed definition of a "high-cost home loan,"[11] which Weinstock and Agrippina have summarized as being "a first lien mortgage loan that bears interest at least eight percentage points over U.S. treasury securities having comparable periods of maturity, or one in which points and fees exceed 5 percent of the total loan amount."[12] In the current market at the time of writing in 2008, this means a 30-year residential mortgage loan, securing a principal amount below the cap, at a rate of around 13 percent per annum, will be a "high-cost home loan" and hence subject to the "predatory lending" statute. The predatory lending statute allows only one exemption: for federal thrifts. Federal law pre-empts the statute for certain categories of federally regulated lenders.[13] Subject to those exceptions, loans and lenders that might qualify for exemption from New York usury restrictions have no such luck under the predatory lending statute.

Any lender that makes a "high-cost home loan" must comply with numerous special procedures and documentation requirements. For example, the lender must demonstrate "due regard" for a borrower's ability to repay, whatever that may mean. The lender must also advise the borrower to obtain pre-closing counseling about the loan, and must report the borrower's payment history to a consumer credit bureau at least annually. The lender must also give the borrower a series of "*Miranda*"-type warnings, using specific language found in the text of the statute.[14]

Lenders in the sub-prime market (to the extent that such a market continues to exist) should pay close attention to the extensive and byzantine restrictions that apply to a "high-cost home loan." If a lender violates one of these restrictions, it can face harsh penalties and foreclosure defenses as described below. Weinstock and Agrippina have summarized a number of these "high-cost home loan" restrictions as follows:[15]

- A lender may not accelerate the indebtedness in its sole discretion, except in the case of good faith acceleration due to a borrower's failure to abide by the material terms of the loan;
- The loan may not have a scheduled balloon payment that is more than twice as large as the average of earlier scheduled payments, unless such payment becomes due and payable at least 15 years after origination of the loan;[16]
- The loan may not have negative amortization under a payment schedule that causes the principal to increase rather than decrease;
- A lender may not increase an interest rate after default;

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[11] *See* N.Y. Banking Law § 6-l(1)(d).

[12] Benjamin Weinstock & Joanne S. Agrippina, *Outside Counsel: New Restrictions on Predatory Lending in High-Cost Home Loans,* N.Y.L.J., Nov. 6, 2002, at 4. For subordinate mortgages, the spread over treasuries is 1 percent higher (9 percent per annum). *See* N.Y. Banking Law § 6-1(1)(g)(i).

[13] *See* OTS Op. Chief Counsel (January 30, 2003) (preemption of New York predatory lending law).

[14] *See* N.Y. Banking Law § 6-l(2)-(2-a).

[15] For a complete list of "[l]imitations and prohibited practices," *see* N.Y. Banking Law § 6-l(2).

[16] In the typical case, this restriction means a lender cannot make a "high-cost home loan" for a term of less than 15 years.

- A lender may not require more than two periodic installments to be paid in advance;
- A lender may not charge a borrower any fees to modify, renew, extend, or amend a high-cost home loan if thereafter the loan is still a high-cost home loan, or if the annual percentage rate has not been reduced by at least two percentage points;[17]
- A loan may not compel arbitration that is oppressive or substantially in derogation of the rights of consumers; and
- A loan may not be used to finance any credit life, credit disability, credit unemployment, credit property insurance, or any other life or health insurance premiums, or any payments for any debt cancellation or suspension agreement, except within certain narrow guidelines.

Furthermore, no lender or mortgage broker making or arranging a high-cost home loan may:

- Engage in the unfair act or practice of "loan flipping," which is making a home loan to a borrower that refinances an existing home loan when the new loan does not have a tangible net benefit to the borrower;
- Refinance an existing home loan that is originated, subsidized, or guaranteed by or through a state, tribal, or local government, or nonprofit organization, which either bears a below-market interest rate at the time of origination, or has non-standard payment terms beneficial to the borrower that the borrower will lose as a result of the refinancing, unless HUD certified loan counseling is provided to the borrower and properly documented; . . .
- Directly or indirectly, finance any points and fees in excess of three percent of the loan;
- Pay a contractor under a home improvement contract from the proceeds of a high-cost home loan other than by an instrument payable to the borrower or jointly to the borrower and the contractor;
- Recommend or encourage default on an existing loan or other debt;
- Accept or give any fee or payment other than for goods or services actually rendered; or
- Charge a borrower points and fees in connection with the high-cost home loan if the proceeds of the loan are used to refinance an existing high-cost home loan held by the lender or its affiliate.[18]

Some of the rules that govern "high-cost home loans" are incomprehensible. For

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[17] This restriction would appear to prevent lenders from engaging in many typical "workout" transactions for troubled loans, thus denying borrowers the benefits they might otherwise obtain from those transactions.

[18] *See* Benjamin Weinstock & Joanne S. Agrippina, *Outside Counsel: New Restrictions on Predatory Lending in High-Cost Home Loans,* N.Y.L.J., Nov. 6, 2002, at 4.

example, when is arbitration "oppressive"? Other rules are totally inconsistent with routine lending practices. For example, the rules prohibit any increase in the interest rate when the loan goes into default. Although this statute represents something of a jumbled mess, it nevertheless demands close attention because it exposes "high-cost home loan" lenders to extremely comprehensive and severe penalties.

If a lender ever tries to foreclose a mortgage securing a "high-cost home loan," the "predatory lending" statute lets the borrower assert a range of defenses. A borrower can assert any violation of the predatory lending statute as a defense to foreclosure.[19] If the court finds any such violation, the borrower may rescind the loan. These remedies are available against both the original lender and its assignees, apparently with no time limit. In foreclosure, the lender must affirmatively plead compliance with the predatory lending statute.[20] Weinstock and Agrippina have summarized as follows a borrower's remedies under the "predatory lending" statute:

> Where predatory practices are found, the attorney general, the superintendent of banks, or any party to a high-cost home loan, may bring an action to void the loan agreement, thereby causing the lender to forfeit all rights to the principal, interest and other loan charges.
>
> Even more damning than the usury law, the lender will not only forfeit all future payments of principal and interest, but will also be required to disgorge payments previously made by the borrower. . . .
>
> [A]nyone found to have intentionally violated the law will also be liable for actual damages [including consequential and incidental damages] and in certain cases, statutory damages including a penalty equal to the greater of $5,000 or twice the points charged for the loan. . . .
>
> Finally, Section 6-1 of the Banking [Law] adds to the borrower's arsenal of remedies, injunctive, declaratory or other equitable relief, and an award of reasonable attorneys fees if a court so orders.[21]

The "predatory lending" statute does not expressly outlaw "high-cost home loans." It does, however, impose on them tremendous burdens, uncertainties, and potential enforcement problems. The legislature might just as well have banned them completely and saved almost 4,000 words of statutory verbiage as well as tremendous amounts of paper and Internet downloading bandwidth. In all likelihood, borrowers will be "protected" from "high-cost home loans" by not being able to obtain them at all.

If there is in fact a stratum of the mortgage finance market for which 10 points over treasuries is the "right" risk-adjusted pricing for a loan and in which legitimate lenders would otherwise provide mortgage credit, then New York's predatory lending statute may ultimately reduce the mortgage credit available to this market. The same "public

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[19] *See* N.Y. RPAPL § 1302(2) (2002).

[20] *See* N.Y. RPAPL § 1302(1) (2002).

[21] Benjamin Weinstock & Joanne S. Agrippina, *Outside Counsel: New Restrictions on Predatory Lending in High-Cost Home Loans,* N.Y.L.J., Nov. 6, 2002, at 4.

interest" and "consumer" groups that spearheaded the new "predatory lending" statute (acting no doubt with the best of intentions in an effort to improve the world) will then complain that mortgage lenders are not meeting the needs of low-income and high-risk mortgage borrowers in New York.

New York's "predatory lending" statute seems to conform to a bit of a national trend.[22] It may, however, impose fewer burdens on fewer lenders than "predatory lending" statutes enacted in some other jurisdictions. Given the number of these statutes, it should soon be possible to determine whether they have the dire effects predicted above, or whether either: (1) high-cost lenders can learn to live with them (just as the lending world learned to live with "truth in lending") and do business successfully in the riskiest niches of the residential mortgage market;[23] or (2) legitimate lenders do not really want to do business in those risky niches anyway, so the "predatory lending" statutes have no practical effect.

In the meantime, any lender that considers making a "high-cost home loan" should probably think twice (or more times) before doing so.

As a practical matter, the meltdown of the "subprime" mortgage market in late 2007 and early 2008 should do more to discourage this type of lending than all the legislative efforts in all the 50 states.

A 2008 New York supreme court decision, *LaSalle Bank v. Shearon*,[24] is believed to be the first reported decision enforcing New York's "predatory lending" statute.[25] In *LaSalle Bank*, the court found that the lender had violated the "predatory lending" statute when it, among other things, failed to ask about the borrower's ability to pay before financing a "high-cost home loan," and also failed to give the borrower a list of credit counselors, as the statute requires.[26] Points exceeded 3 percent of the amount financed, which violated the statute.[27] Declaring these "egregious violations" of the predatory lending law, the court denied the foreclosing mortgagee's motion for

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[22] New York is the third state, after North Carolina and Georgia, to enact a "predatory lending" law. *See* Benjamin Weinstock & Joanne S. Agrippina, *Outside Counsel: New Restrictions on Predatory Lending in High-Cost Home Loans,* N.Y.L.J., Nov. 6, 2002, at 4. The District of Columbia briefly adopted a "predatory lending" law, but suspended it when it caused residential mortgage lenders to stop doing business in the District. Many more states have passed such laws. An updated list appears at <http://www.acorn.org/index.php>. *See also* http://www.mbaa.org/resources/predlend/. "Predatory lending" has been the subject of extensive seminars, publications, and commentary—as well as various attempts at federal preemption—generally beyond the scope of this work.

[23] *See* Benjamin Weinstock & Joanne S. Agrippina, *Outside Counsel: New Restrictions on Predatory Lending in High-Cost Home Loans,* N.Y.L.J., Nov. 6, 2002, at 4 ("The investment firm of Morgan Stanley surveyed 280 branch managers in the sub-prime lending industry nationwide and found no evidence to support the position that regulatory pressure, the threat of legal action, or changes to lending practices have dampened growth—even in North Carolina and Georgia, which have tough lending regulations.").

[24] LaSalle Bank v. Shearon, 19 Misc. 3d 433, 850 N.Y.S.2d 871 (N.Y. Sup. Ct. 2008).

[25] *See* Vesselin Mitev, Judge Finds Homeowner Liable for Loan, N.Y.L.J., April 22, 2008, at 1.

[26] LaSalle Bank v. Shearon, 19 Misc. 3d 433, 441, 850 N.Y.S.2d 871 (N.Y. Sup. Ct. 2008).

[27] LaSalle Bank v. Shearon, 19 Misc. 3d 433, 442, 850 N.Y.S.2d 871 (N.Y. Sup. Ct. 2008). The fees and points consumed nearly 5.4 percent of the principal amount of the High Cost Loan.

summary judgment and scheduled a hearing to determine the borrower's damages. The court indicated that relief could include voiding the loan and giving the borrower a judgment for all mortgage payments it ever made.[28] Other courts have hesitated to use the "predatory lending" statute as a way for mortgagors to "escape their legal obligations simply because they borrowed too much."[29]

§ 2.07 Federal Preemption for Residential First-Mortgage Loans

Federal law preempts all state interest-rate restrictions, presumably both "usury" and "compound interest" restrictions, for residential first-mortgage loans (including first-lien co-op loans) made to any borrower by any federally insured institution, federally regulated lender, federal government agency, lender approved by the Federal Home Loan Mortgage Corporation (Freddie Mac), any other lender that regularly makes residential mortgage loans totaling more than $1,000,000 a year, or a number of other lenders regulated by or connected with the federal government.[1]

Although Congress allowed the states to override the federal usury preemption for residential first-mortgage loans, New York did not. To the contrary, New York affirmed the federal override.[2] As a result, virtually all residential first mortgages[3] are exempt

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[28] LaSalle Bank v. Shearon, 19 Misc. 3d 433, 442, 850 N.Y.S.2d 871 (N.Y. Sup. Ct. 2008).

[29] Alliance Mtge. Banking Corp. v. Dobkin, 19 Misc. 3d 1121A, 862 N.Y.S.2d 812 (N.Y. Sup. Ct. 2008). The court, noting its sympathy for this and all other foreclosure defendants, found that even though the defendant should not have accepted the financing and the lender should not have offered it, the defendant failed to show she qualified for the protection of the "predatory lending" statute, because the total amount of the two loans in question exceeded $300,000.

[1] *See* 12 U.S.C. §§ 1735f-5(b), 1735f-7a(a)(1); *see also* 12 C.F.R. § 590.2(b) (implementing regulations). The statute also indicates, but the regulations do not confirm, that the federal exemption even applies to any individual owner-occupant of a residence who sells and takes back a note. The latter issue is moot in New York, as purchase-money notes are exempt from usury restrictions, as described in § 2.12, *below.*

[2] N.Y. Banking Law § 14-a(7).

[3] The term "first mortgage" would probably not include a wraparound mortgage. *See* Mitchell v. Trustees of U.S. Mut. Real Estate Inv. Trust, 144 Mich. App. 302, 375 N.W.2d 424, 430 (Mich. Ct. App. 1985). This type of mortgage arises when the parties want to preserve an existing mortgage, probably with a below-market interest rate. The borrower signs a new mortgage, part of which is "new money" and part of which just replicates the principal indebtedness secured by the old underlying mortgage. The borrower makes payments only to the holder of the "wraparound," who is supposed to pay the "underlying" mortgage. Typically, the holder of the wraparound mortgage benefits from the difference between the low interest rate on the underlying mortgage and the higher rate on the entire wraparound mortgage. The holder of the wraparound mortgage ends up in an economic position much like that of the "B" note holder in a modern "A/B Note" transaction, in which a single mortgage loan is synthetically broken into two loans: a senior "A" note at a lower interest rate and a junior "B" note at a higher interest rate. Wraparound mortgage transactions are less common today than they once were, for several reasons. First, interest rates at the time of this writing are relatively low. Second, most existing mortgages categorically prohibit any further (subordinate) mortgages. Third, wraparound mortgages create substantial risks for all parties except the holder of the wraparound—risks that were not adequately identified, analyzed, and dealt with during the last wave of wraparound financing. The details are beyond the scope of this book. Finally, those risks created unique problems for cooperative apartment corporations, which in the early 1990s were often left as potential bag-holders when a sponsor took back a wraparound mortgage and assigned it to "Wrap,

from New York usury restrictions.[4] Federal law also supersedes state usury restrictions for certain other categories of loans, but these miscellaneous exemptions generally will have no practical effect given the other exemptions and preemptions available as well as today's rate environment.[5]

§ 2.08 Junior Mortgages; Other Institutional Lender Exemptions

A New York state-chartered bank or trust company or licensed mortgage banker may make junior mortgage loans to individual borrowers at whatever interest rate is "agreed to by the [lender] and the borrower."[1] By implication, these loans are exempt from the usury ceiling in the New York General Obligations Law.[2] Similar exemptions-by-implication would probably apply to certain "personal loans" made by a state bank or trust company, foreign bank, or other licensed lenders.[3] Other state banking-related statutes may permit other specific regulated lenders to charge interest above the usury ceiling.

§ 2.09 Loans of $2,500,000 or More

Any loan of $2,500,000 or more, including obligatory future advances,[1] is exempt

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Inc." (literally, in at least one case), then defaulted on maintenance payments for the unsold apartments, yet continued to collect payments on the wraparound mortgage. The "wraparound mortgage" structure is not highly favored today, but is still occasionally seen. It also creates mortgage recording tax issues, which are also outside the scope of this book.

[4] Common exceptions include mortgages involving unusual lenders and careless lenders taking a mortgage on a "residential manufactured home" that fail to comply with certain consumer protection requirements. *See* 12 U.S.C. § 1735f-7a(c), (d), (e)(4); Quiller v. Barclays American/Credit Inc., 764 F.2d 1400 (11th Cir. 1985) (construing the transaction as nevertheless complying with federal regulations, because language allowing borrower a right to cure implied that borrower would receive notice of default), *aff'd* 727 F.2d 1067, 1072 (11th Cir. 1984) (denying protection of federal preemption because a contract term allowed lender to commence foreclosure without notice upon default); 12 C.F.R. § 590.1-4 (1999) (implementing regulations for consumer protection).

[5] *See, e.g.,* 12 U.S.C. § 1735f-7a (loans insured under Titles I and II of National Housing Act); 38 U.S.C. § 3728 (1998) (Veterans Administration guaranteed loans); 12 U.S.C. § 85 (national banks not subject to states' discriminatory rate caps or caps below discount rate plus one percent); 12 U.S.C. § 1831d (preempting state usury ceilings below discount rate plus one percent); Depository Institutions Deregulation and Monetary Control Act of 1980, § 511(a), Pub. L. No. 96-221, 94 Stat. 132 (1980) (certain business and agricultural loans made between 1980 and 1983); GOL § 5-501(5) (loans insured by "federal housing commissioner" or pursuant to "Servicemen's Readjustment Act of 1944"). The foregoing does not purport to list all banking-related statutes that could preempt New York usury laws.

[1] *See* N.Y. Banking Law §§ 103(4-a) (state bank or trust company), 591-a(1) (licensed mortgage bankers, limiting security to residential real property on mortgage that is not a first lien).

[2] *See* Novelty Textile Mills, Inc. v. Hopkins, 145 Misc. 2d 583, 547 N.Y.S.2d 516, 517 (Sup. Ct. 1989).

[3] *See* N.Y. Banking Law §§ 108(4)(b), (5)(b), 202(4)(b), 352(a). These "exemptions-by-implication" might not avoid criminal usury problems.

[1] Multiple advances of the same funds under a revolving credit agreement will apparently not be added together to determine whether the loan satisfies the $2,500,000 test. *In re* Rosner, 48 B.R. 538, 561 (Bankr. E.D.N.Y. 1985). This is rather different from the treatment of revolving loans for mortgage recording tax purposes, as described in Chapter 8.

from all usury restrictions, including criminal usury.[2] This simple provision of New York law basically solves the usury problem for all substantial commercial loans and is a major part of the reason that multistate loan transactions are often governed by New York law.[3]

If, however, a loan is secured by a "one or two family owner-occupied residence," including a cooperative apartment,[4] the lender still cannot collect compound interest.[5] For most residential first mortgages, however, federal law would preempt even the restriction on compound interest.

§ 2.10 Limited Liability Company and Corporate Borrowers

A limited liability company ("LLC") or corporate borrower cannot "interpose the defense of usury in any action,"[1] nor can a guarantor of a corporation's debt.[2] The same logic would suggest that a guarantor of an LLC's obligations should also not be able to raise a usury defense. The courts do not seem to have addressed this issue in any reported case to date.

Some very old cases suggest that a corporation also cannot affirmatively commence an action to invalidate a usurious obligation.[3] No recent New York case has considered this question.[4] The courts' general attitude in this area would indicate, however, that a corporation (presumably also an LLC) probably could not assert usury even as an affirmative claim. A New York corporate or LLC borrower can still assert the invalidity of compound interest on loans of $250,000 or less.[5] The usury exemption for loans made to a corporate or LLC borrower does not apply to entities formed to own a one- or two-family dwelling.[6] If, however, the corporation was formed to immunize a

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[2] *See* GOL § 5-501(6)(b).

[3] For more on multistate financing transactions, *see* Chapter 17.

[4] The statute does not expressly refer to condominium apartments. One would expect a court to treat condominium apartments the same as cooperative apartments, as they would seem to be functionally equivalent at least for purposes of usury and consumer protection.

[5] *See* GOL § 5-527(2).

[1] GOL § 5-521(1); N.Y. Ltd. Liab. Co. Law § 1104.

[2] *See* First Nat'l Bank v. Mountain Food Enterprises, Inc., 159 A.D.2d 900, 553 N.Y.S.2d 233, 234 (1990). The documents in this case were vague about whether the corporation or the individual guarantor was the true borrower. The court decided that the availability of the usury defense hinged on "whether the loan was made to repay personal obligations or to further a profit-oriented enterprise." First Nat'l Bank v. Mountain Food Enterprises, Inc., 159 A.D.2d 900, 553 N.Y.S.2d 233, 235 (1990). If the latter, then neither borrower nor guarantor could raise a usury defense.

[3] *See, e.g.,* Atlantic Trust Co. v. Proceeds of the Vigilancia, 68 F. 781, 782 (S.D.N.Y. 1895) (stating that the usury statute is, in effect, repealed as to corporations, citing Merchants Exchange Nat'l Bank v. Commercial Warehouse Co., 49 N.Y. 635 (1872); Rosa v. Butterfield, 33 N.Y. 665 (1865); Curtis v. Leavitt, 15 N.Y. 9 (1857)).

[4] A search of the cases in 2006 confirmed that this statement remains correct.

[5] Although loans to a borrower of this type remain subject to "criminal usury" limits, that statute is a criminal one probably enforceable only by the state, as described in § 2.06, *above*.

[6] *See* GOL § 5-521(2).

business-related debt from usury problems, the court will honor the corporate form.[7] Finally, a corporate loan remains potentially subject to criminal usury restrictions, *but see* § 2.05, which discusses potential remedies for criminal usury.

A commentator on New York usury law recently described the remaining usury restrictions on corporate loans as being much like "the appendix in humans and wings on flightless birds," and as an economic matter "not only useless, but . . . unsound as well."[8] The author of this book agrees with these comments.

If any lender intends to rely on the usury exemptions described in this Section 2.09, counsel should confirm that the borrower is in fact a corporation or limited liability company. In one recent set of facts brought to the author's attention, the borrower was an entity that could have been a corporation or limited liability company, but its status was not entirely clear from its name. Simple corporate due diligence—checking the name online, obtaining a copy of the organizational documents—would have spared the lender a great deal of grief.

§ 2.11 Loans of $250,000 or More

Any loan of $250,000 or more not "secured primarily by an interest in real property improved by a one or two family residence" is treated the same as any loan of $2,500,000 or more (*see* § 2.08 *above*), except that criminal usury restrictions still apply.[1]

Various additional statutory exemptions sometimes also come into play.[2]

§ 2.12 Usury Savings Clauses

Lenders will often include in their documents "usury savings clauses," language saying 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 and effectiveness of such clauses, the results were not encouraging for lenders.

The decision in *Federal Home Loan Mortgage Corp. v. 333 Neptune Avenue Limited Partnership* offers an interesting, though typically unilluminating, example.[1] In that

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[7] *See* FDIC v. Julius Richman, Inc., 666 F.2d 780 (2d Cir. 1981); *In re* Seisay, 49 B.R. 354 (S.D.N.Y. 1985); Millerton Properties Assoc. v. Brescia Enters. Inc., 184 A.D.2d 845, 584 N.Y.S.2d 660, 662 (3d Dep't 1992).

[8] Paul Golden, *Evolution of Corporate Usury Laws Has Left Vestigial Statutes That Hinder Business Transactions,* N.Y. St. B. Ass'n J., May 2001, at 20.

[1] *See* GOL § 5-501(6)(a).

[2] These include the following: Any loan of $5,000 or more, payable on demand, secured by a pledge of documents of title or negotiable instruments under Article 3, 7, or 8 of the UCC, is exempt from all restrictions on interest rates and interest compounding, except criminal usury. *See* GOL § 5-523. The Banking Law contains similar provisions. *See, e.g.,* N.Y. Banking Law § 510-a(2) (loans by investment companies). In general, no usury restrictions apply, not even criminal usury, when a corporation borrows $100,000 or more (not including future discretionary advances) for business purposes, at a rate of up to prime plus eight percent per annum, granting a UCC security interest as security. *See* GOL § 5-526.

[1] The usury savings clause at issue stated in relevant part:

case, a bankruptcy court applying New York law initially found that the loan, although usurious, was saved by the "usury savings" clause. The District Court for the Eastern District of New York rejected that reasoning, concluding instead that the " 'usury-avoidance' provision does not save the otherwise usurious loan. Since the loan is usurious, it is void."[2] The court followed by analogy an old and well-established line of New York cases holding that a lender cannot cure an otherwise usurious loan by simply returning to the borrower (or alternatively, allowing credit for) interest payments above the usury cap.[3]

On appeal of this case, the Second Circuit explicitly refused to adjudicate the issue, saying that the "usury savings" provision raises "knotty and undecided questions of New York state law that are best avoided by federal courts."[4] The appellate court vacated and remanded the decision of the District Court. No subsequent published opinion has been found.

A few years earlier, the Appellate Division, in a memorandum decision, ignored a "usury savings" provision. Although the loan documents in that case said that if the interest rate were found to be usurious it would drop to the legal rate, the court decided this was not enough to make the loan nonusurious.[5]

The court cited its own 1965 decision, *Durst v. Abrash,* in which it had concluded that even if the parties agree to arbitrate any disputes over the interest rate, the courts can still examine whether a loan is usurious and impose appropriate remedies.[6] Over a dissent that implied the usury statutes may be second- or third-class citizens in the statute books,[7] the *Durst* majority concluded that usury statutes are to be taken seriously and the parties should not be able to sidestep them.[8] By citing the *Durst* case

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> Under no circumstances shall Mortgagor be charged under the note or this Mortgage, more than the highest rate of interest which lawfully may be charged by the holder of this Note and paid by the Mortgagor on the indebtedness secured hereby. . . . Should any amount be paid to Mortgagee in excess of such legal rate, such excess shall be deemed to have been paid in reduction of the principal balance of the Note.

201 F.3d 431 (2d Cir. 1999) (as quoted in an unpublished Second Circuit opinion).

[2] Federal Home Loan Mortgage Corp. v. 333 Neptune Avenue L.P., 1999 U.S. App. LEXIS 32056, 1999 WL 390837 (E.D.N.Y. 1999). The case is unpublished and subject to limitations on citation.

[3] *See* Babcock v. Berlin, 123 Misc. 2d 1030, 475 N.Y.S.2d 212 (Sup. Ct. 1984); Bowery Sav. Bank v. Nirenstein, 269 N.Y. 259, 199 N.E. 211 (1935). *See also* Yakutsk v. Alfino, 43 A.D.2d 552, 349 N.Y.S.2d 718 (1st Dep't 1973) (giving credit for excess interest will not cure a usurious loan).

[4] 201 F.3d 431 (2d Cir. 1999).

[5] *See* Simsbury Fund, Inc. v. New St. Louis Assocs., 204 A.D.2d 182, 611 N.Y.S.2d 557 (1st Dep't 1994).

[6] Durst v. Abrash, 22 A.D.2d 39, 253 N.Y.S.2d 351, 355, *aff'd,* 17 N.Y.S.2d 443 (1965) ("[if] usurious agreements could be made enforceable by the simple device of employing arbitration clauses the courts would be surrendering their control over public policy in a way in which the Court of Appeals . . . made very clear could not happen").

[7] This is a characterization with which the author would agree, at least in the world of commercial mortgage loans.

[8] Durst v. Abrash, 22 A.D.2d 39, 253 N.Y.S.2d 351, 356, *aff'd,* 17 N.Y.2d 445 (1965) ("The welter

in its 1994 decision on usury savings clauses, the court suggested that it regards usury savings clauses as the functional equivalent of using arbitration to avoid usury issues.

The question of the enforceability of usury savings clauses has not been resolved by the New York Court of Appeals. The reported cases to date suggest serious skepticism regarding such clauses, though they would appear to do no harm.

In contrast, it is the author's sense that practitioners in this area do place some weight on usury savings clauses. Practitioners may assume that usury savings clauses do work based perhaps on the general theories that: (1) the courts do not like usury law very much; and (2) words in a document usually mean what they say. The preceding discussion demonstrates, however, that neither assumption is necessarily correct in the area of usury savings clauses. Practitioners should place little or no reliance on usury savings clauses. In particular, if counsel is asked to opine that a loan is not usurious, counsel should reach that conclusion based on something other than a usury savings clause.

§ 2.13 Usury Summary and Conclusion

Considered as a whole, the usury exemptions and preemptions summarized above virtually assure that any significant commercial loan, and almost every residential mortgage loan, will be exempt from New York usury restrictions. Aside from the exemptions and preemptions discussed above, particular factual situations may suggest other usury defenses and definitional exclusions found in the cases but not discussed here.

Common escape hatches from usury include:

(1) interest after default or after maturity;

(2) deferred purchase price;[1]

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of legislation in this area makes clear that the concern is one of grave public interest and not merely a regulation with respect to which the immediate parties may contract freely").

[1] *See, e.g.,* Mandelino v. Fribourg, 23 N.Y.2d 145, 295 N.Y.S.2d 654, 242 N.E.2d 823 (1968); Christopher v. Gurrieri, 238 A.D.2d 299, 655 N.Y.S.2d 654, 655 (App. Div. 1997) (mem.) (where promissory note arose from purchase of business, it "was neither a loan nor a forbearance . . . but was in the nature of a purchase money mortgage which is not subject to the usury laws"). *See, e.g.*, Mandelino v. Fribourg, 23 N.Y.2d 145, 295 N.Y.S.2d 654, 242 N.E.2d 823 (1968); Christopher v. Gurrieri, 238 A.D.2d 299, 655 N.Y.S.2d 654, 655 (App. Div. 1997) (mem.) (where promissory note arose from purchase of business, it "was neither a loan nor a forbearance . . . but was in the nature of a purchase money mortgage which is not subject to the usury laws"). *Compare* Babinsky v. Skidanov, 12 A.D.3d 271, 784 N.Y.2d 504 (1st Dept. 2004) (even if a purchase-money mortgage were exempt from civil usury, it remains subject to criminal usury); C&M Air Sys., Inc. v. Custom Land Dev. Group II, 262 A.D.2d 440, 692 N.Y.S.2d 146 (App. Div. 1999) (interest rate defined in the documents as "the highest rate of interest permitted," without deciding whether the transaction was an exempt purchase money loan); Jean v. RS & P/WV-II Ltd. P'ship, 2006 NY Slip Op 51630U (N.Y. Sup. Ct. 2006) (citing Babinsky and C & M and holding that a purchase money mortgage is exempt from civil usury, but not criminal usury). *But see*, Bruce J. Bergman, Bergman on New York Mortgage Foreclosures § 6.03 (LexisNexis Matthew Bender) (since purchase money mortgage is neither a loan nor a forbearance, "[c]riminal usury should have no relationship" to a purchase money mortgage and noting that case law has never distinguished between civil and criminal usury in exempting purchase money mortgages from usury); Bruce J. Bergman, (True)

(3) waiver;

(4) burdens of proof;

(5) standing (the usury defense is available only to the original borrower);

(6) application of another state's law;[2]

(7) estoppel (including the borrower's delivery of an estoppel certificate[3] or an assignee's assumption of the loan;[4] and

(8) other equitable defenses.

Does title insurance solve any possible usury problem? No. The American Land Title Association 1992 standard loan policy of title insurance expressly excludes any coverage for usury.[5] In addition, the New York title insurance industry's rate manual does not allow title insurance companies to insure against usury risks, such as by issuing a usury endorsement.

Given how easy it is to steer clear of usury problems in New York commercial

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Purchase Money Mortgage and Usury, NYSBA, Jan. 2006, at 30 (arguing that a purchase money mortgage does not constitute a true loan, and hence usury should be irrelevant, because it first requires a "loan"). The usury exemption for deferred purchase price may also be available to a third-party lender that finances an acquisition. Dallas v. Dallas, 182 A.D.2d 1039, 582 N.Y.S.2d 835, 836 (3d Dep't 1992) ("[a] mortgage given to secure money, borrowed for the purpose of purchasing real property, is generally held to be a purchase-money mortgage, notwithstanding that the mortgage was given to a person other than the seller," citing Barone v. Frie, 99 A.D.2d 129, 472 N.Y.S.2d 119, 121 (App. Div. 1984)). *But see* (Bruce J. Bergman, *Usury and the Purchase Money Mortgage—An Appellate Division Faux Pas (?)(!)*, N.Y. St. B. Ass'n Real Prop. L. Sec. Newsl., Jan. 1993, at 4 (describing Dallas case as "manifestly incorrect"). *See generally*, Bruce J. Bergman, *Purchase Money Mortgages Require Careful Drafting to Avoid Later Difficulties*, N.Y. St. B. Ass'n J., Nov./Dec. 2002, at 29, 30 (includes overview of usury issues in purchase-money loans). There is no reason to think that New York's usury exemption for purchase-money mortgages applies only to first mortgages, although the author is not aware of any authority on point.

[2] Typically, it is the other way around. Parties to substantial credit transactions in other states try to apply New York law, as more fully described in Chapter 17.

[3] In Hammelburger v. Foursome Inn Corp., 54 N.Y.2d 580, 446 N.Y.S.2d 917, 919, 431 N.E.2d 278 (N.Y. 1981), the Court of Appeals concluded that, based on delivery of an estoppel certificate in connection with an assignment of the loan, the mortgagor "will be estopped from asserting the defense of criminal usury" unless the assignee knew about the problem or knew that the estoppel certificate was obtained under duress. *But see* § 2.06 *above* (criminal usury remedies enforceable only by state). If criminal usury arises whenever the rate exceeds 25 percent per annum, how could an assignee claim ignorance of the criminal usury problem? Answer: the rate in the documents might have been 24 percent, but if the original lender had extracted a 10 percent loan fee, not mentioned in the documents, this would probably bring the effective interest rate above 25 percent, depending on the term of the loan. Such a loan might be criminally usurious, but the assignee might not know it. If an estoppel certificate can immunize an otherwise usurious loan, can the original holder use this principle protectively, such as by requiring the borrower to deliver an estoppel certificate either at the closing or shortly thereafter to induce the holder to agree to some modification of the loan? Can the original holder rely on such an estoppel certificate?

[4] Geddes Savs. & Loan Ass'n v. Mishel, 89 A.D.2d 792, 453 N.Y.S.2d 517 (4th Dept. 1982).

[5] *See* "Exclusion from Coverage" No. 5 in the ALTA 1992 Loan Policy of Title Insurance, reprinted in Appendix D.

transactions, though, the lack of title insurance protection against New York usury rarely causes concern in this area of practice.

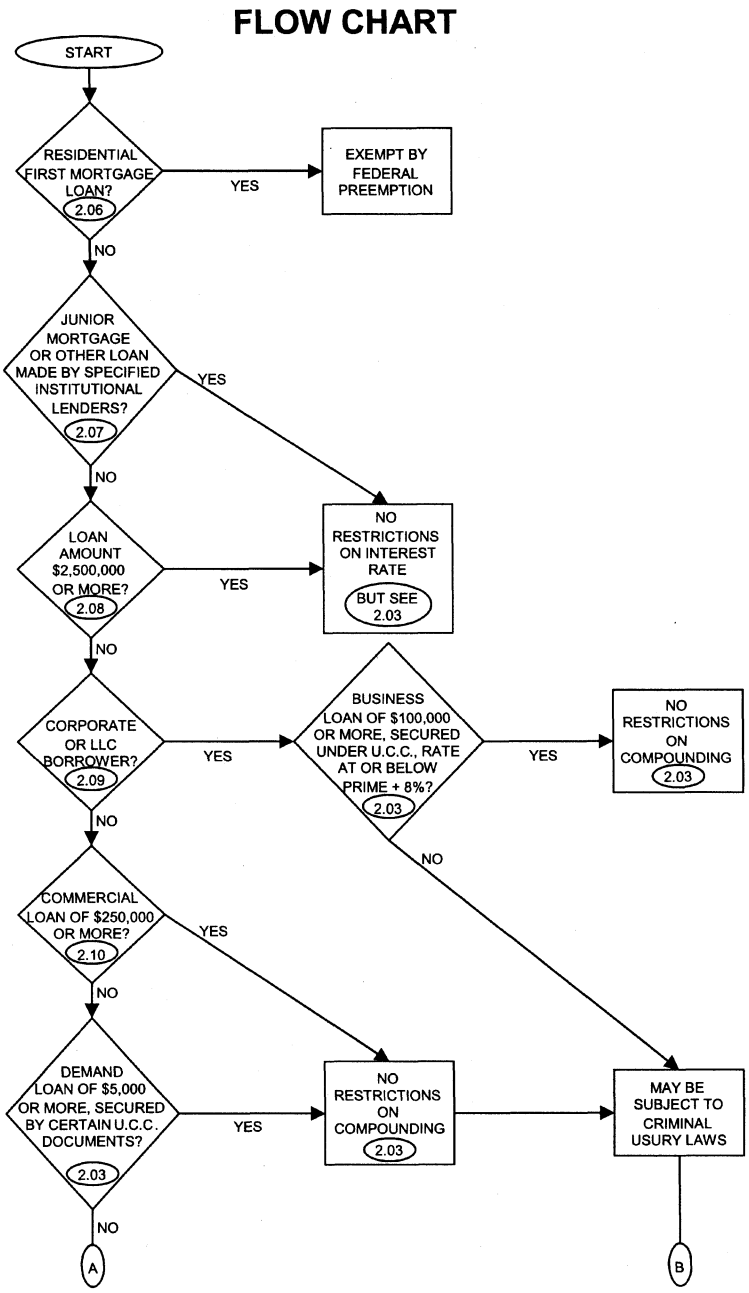
§ 2.14 Usury Flowchart

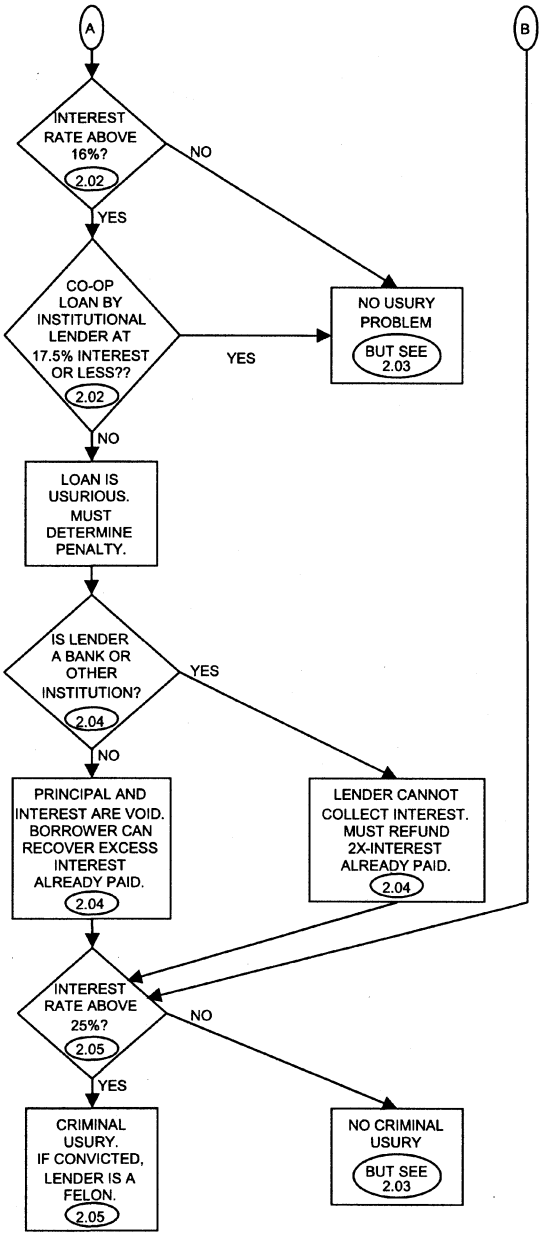
The following flowchart tries to summarize New York's usury maze. The flowchart analysis begins with the oval marked "START." It continues down the page. Lines indicate the sequence of issues to consider. Diamond boxes indicate decision points, each with a question that can be answered "YES" or "NO." Depending on the answer, the analysis continues down one path or the other.

The paths of analysis sometimes lead to more diamond boxes, each another decision point. Eventually, all roads lead to rectangles, representing conclusions. Some of these rectangles represent incomplete conclusions. In those cases, the rectangle has a second path leading out of it, and the analysis continues down that path because one must ask more questions.

Most boxes on the flowchart contain small reference number(s). Each such number refers to a section of this chapter, directing the reader to the discussion of the particular issue. That discussion contains citations, details, qualifications, and more information to consider. The flowchart should be considered only in the context of this chapter as a whole.

My thanks to Cathleen Rooney of the Latham & Watkins LLP New York word processing team for her work in preparing the flowchart for this edition of the book.


FLOW CHART
START
RESIDENTIAL FIRST MORTGAGE LOAN? 2.06
YES
EXEMPT BY FEDERAL PREEMPTION
NO
JUNIOR MORTGAGE OR OTHER LOAN MADE BY SPECIFIED INSTITUTIONAL LENDERS? 2.07
YES
NO
LOAN AMOUNT $2,500,000 OR MORE? 2.08
YES
NO RESTRICTIONS ON INTEREST RATE BUT SEE 2.03
NO
CORPORATE OR LLC BORROWER? 2.09
YES
BUSINESS LOAN OF $100,000 OR MORE, SECURED UNDER U.C.C., RATE AT OR BELOW PRIME + 8%? 2.03
YES
NO RESTRICTIONS ON COMPOUNDING 2.03
NO
NO
COMMERCIAL LOAN OF $250,000 OR MORE? 2.10
YES
NO
DEMAND LOAN OF $5,000 OR MORE, SECURED BY CERTAIN U.C.C. DOCUMENTS? 2.03
YES
NO RESTRICTIONS ON COMPOUNDING 2.03
MAY BE SUBJECT TO CRIMINAL USURY LAWS
NO
A
B



The numbers in the ovals indicate the section cross-reference where these topics are covered in the text.