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COURT OF APPEALS
STATE OF NEW YORK

ADAR BAYS, LLC,
Respondent,

-against-

GENESYS ID, INC.,
Appellant.

NO. 51

20 Eagle Street
Albany, New York
August 31, 2021

Before:

CHIEF JUDGE JANET DIFIORE
ASSOCIATE JUDGE JENNY RIVERA
ASSOCIATE JUDGE EUGENE M. FAHEY
ASSOCIATE JUDGE MICHAEL J. GARCIA
ASSOCIATE JUDGE ROWAN D. WILSON
ASSOCIATE JUDGE MADELINE SINGAS
ASSOCIATE JUDGE ANTHONY CANNATARO

Appearances:

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Official Court Transcriber



1 CHIEF JUDGE DIFIORE: Well, good afternoon,
2 everyone. Before we begin oral argument this afternoon, on
3 behalf of myself and my colleagues, I'd like to welcome
4 Associate Judges Madeline Singas and Anthony Cannataro to
5 the court. And wish them both a long and happy career here
6 at the Court of Appeals.

7 The first matter on this afternoon's calendar is
8 number 51, Adar Bays versus GeneSYS ID.

9 Counsel?

10 MS. SANTELLI: Good afternoon. May it please the
11 court, my name's Marjorie Santelli. I'm going to represent
12 GeneSYS ID. I'd like to reserve five minutes for - - - or
13 two minutes for rebuttal.

14 CHIEF JUDGE DIFIORE: Two minutes for rebuttal,
15 you may.

16 MS. SANTELLI: The precise issue in this case is
17 whether the conversion option in this case should be
18 considered interest for the usury statute. We say this is
19 an unreserved yes. If you - - - the key to understanding
20 the conversion option just has to do with understanding the
21 option itself.

22 If you look at a typical stock option, it's the
23 right to buy a share of stock for a particular price, for a
24 particular period of time. So if your - - - if your strike
25 price is two dollars and the stock is one dollar, your



1 option isn't worth anything, it's out of the money. But if
2 the stock goes up to say ten dollars, now your option is
3 worth a lot. It's worth eight dollars because it's in the
4 money by eight dollars.

5 If you look at this fixed discount option, it's
6 much different because there's no fixed price. The price
7 is just pegged at forty-five percent below the fair market
8 value.

9 JUDGE WILSON: So Counsel, if I can stop you,
10 over here, sorry. Right here - - -

11 MS. SANTELLI: Yeah.

12 JUDGE WILSON: - - - for a second. If this were
13 instead a fixed price option, would it be valued as
14 interest or no?

15 MS. SANTELLI: A lot less likely. I mean, I
16 think it would depend on if it was in the money at the time
17 it was transferred. You know, there was another case, I
18 think that - - -

19 JUDGE WILSON: When you say time transferred, do
20 you mean when - - -

21 MS. SANTELLI: Oh when it was - - -

22 JUDGE WILSON: - - - the numbers - - -

23 MS. SANTELLI: - - - when it was given to the - - -

24 -

25 JUDGE WILSON: - - - when the note was issued?



1 MS. SANTELLI: Yes. Right. But I mean it - - -
2 that's a much harder question and a much different
3 question.

4 JUDGE WILSON: But presume that typically they're
5 not in the money when the note is issued, right, or at
6 least there's a period of time before they can be
7 converted?

8 MS. SANTELLI: For a typical stock option. But
9 not for these.

10 JUDGE WILSON: Right. I'm - - - yeah, I'm trying
11 to move away from this for a second to ask - - -

12 MS. SANTELLI: Okay.

13 JUDGE WILSON: - - - you about fixed price
14 options.

15 MS. SANTELLI: Yeah. I mean, I think it's not
16 that clear because, you know, you looked at this biometrics
17 case and where they were given valuable options that were
18 well into the money at the time they were issued. And so
19 the court remanded to get a valuation on those options.

20 I mean any fixed priced option there - - - there
21 can be a valuation if you look at the federal court case in
22 Flo, there seemed to be some kind of question as to the
23 valuation there.

24 JUDGE GARCIA: Counsel? Here. I have a little
25 trouble with the phrasing of the question from the circuit.



1 And - - - and I don't mean as a criticism, obviously, it's
2 in - - - though it's a bit difficult for us to answer the
3 way it's phrased. Because the way I look at it, we have a
4 test, our general test for usury, and we have a burden
5 placed on the party raising it. And this seems to ask us
6 as a matter of yes or no, whether this particular set-up in
7 every case is going to be per se usury.

8 MS. SANTELLI: Well if the question is, is it - -
9 - is it interest, so you're looking at - - -

10 JUDGE GARCIA: Yeah, but once we say yes to that,
11 is there any way that it's not a usurious contract?

12 MS. SANTELLI: Well I mean if - - - you have to
13 look at the value of the conversion discount. I mean, if
14 the - - - if the - - - if the discount is, you know - - -

15 JUDGE GARCIA: Yes, but let's say it's anything
16 over twenty-five percent.

17 MS. SANTELLI: I mean, you're looking at basic
18 stock option valuation.

19 JUDGE GARCIA: No, no, no. But my question,
20 though, if it's anything over then twenty-five percent, the
21 answer is once I say that, once I put in as my defense, my
22 burden is met. Once I show you on a piece of paper that I
23 have a discounted option at twenty-five percent or more, I
24 win.

25 MS. SANTELLI: Yeah, I mean unless it's not a



1 publicly traded stock or something. I mean, you might be
2 able to - - -

3 JUDGE FAHEY: But wouldn't it - - - let me ask
4 this. Because I think Judge Garcia's question seems to go
5 to the heart of this. Is it the calculation that takes it
6 over twenty-five percent or is it the consistency of the
7 mathematical results that always occur? If you have a
8 thirty-five percent reduction, it always results, it always
9 yields a fixed amount of a fifty-four - - - a fifty-four
10 percent at the end of the conversion. And the only
11 variable is how much of the principle would be converted to
12 stock. So if it was twenty percent, it would be lower than
13 fifty-four percent. But that ratio always holds true. It
14 - - - isn't that the core of your analysis here?

15 MS. SANTELLI: Yes. I mean, you're talking about
16 what are - - -

17 JUDGE FAHEY: So the fixed ratio then is what
18 establishes whether or not it goes over that twenty-five
19 percent. So the question is - - - because it's not going
20 to always take it over, different interest rates below that
21 wouldn't do that, right?

22 MS. SANTELLI: Right. Or - - - and it would
23 depend on what your - - - your stated interest rate is too
24 if there is a stated one.

25 JUDGE FAHEY: But the ratio would always remain



1 the same?

2 MS. SANTELLI: It would. And it's - - - and - -
3 -

4 JUDGE FAHEY: And so the question then would
5 always be, back to what Judge Garcia said, is it just that
6 twenty-five percent threshold, if it takes it over that,
7 bingo, that's it?

8 MS. SANTELLI: I mean, that's the law. You know,
9 I mean - - -

10 JUDGE FAHEY: No, that's not by question to you.

11 MS. SANTELLI: Okay.

12 JUDGE FAHEY: We'll figure out what the law is -
13 - - we're trying to figure that out here today, so - - -
14 but my question to you is, is that what you're arguing as
15 the core of your analysis?

16 MS. SANTELLI: We're basically saying that the
17 conversion discount is so clearly conveys value that it's -
18 - - that you can't ignore it as usury. It's - - - you
19 know, for every hundred dollars that the lender exchanges -
20 - - hundred dollars of debt exchanges, he gets paid with
21 \$154 worth of stock.

22 But I don't know how - - -

23 JUDGE GARCIA: But what - - - but what - - -

24 MS. SANTELLI: - - - you can - - -

25 JUDGE GARCIA: - - - but what you're saying,



1 though, to me is more than that. You're saying all the
2 elements of a criminal usury case are met when you agree to
3 give an option on a stock that trades over the counter, at
4 a certain time in the future, at a fixed discount, but you
5 don't take into account the market, the - - - the nature of
6 the stock trading, nothing. All you have to do to come in
7 and get out of these contracts that you have, are come in
8 and say, look, we agreed to a more than twenty-five percent
9 discount on a very sparsely traded stock, and that's
10 criminal usury, and contract void. That's it.

11 MS. SANTELLI: I think if you had a stock that
12 was so sparsely traded that you didn't want to use fair
13 market value, then that might be something for the courts
14 to - - -

15 JUDGE GARCIA: But then how do we answer this
16 question just as a blanket yes? Isn't it, really depend on
17 whether or not you as the debtor has come into the
18 courtroom to try to get out from performance of this
19 contract and met your very heavy burden to show that this
20 was criminally usurious.

21 MS. SANTELLI: I - - - yeah, I mean, the - - -
22 the certified question seems a little bit narrower to me.
23 But we are talking about if it's - - - if the intent to
24 charge in excess of twenty-nine - - - twenty-five percent
25 is in the four corners of the contract, I mean, that's what



1 we're looking at here.

2 JUDGE GARCIA: But isn't that really the
3 question?

4 MS. SANTELLI: Yes.

5 JUDGE GARCIA: Like - - - and so the question
6 really is, was that the intent? And I think a lot more,
7 perhaps, goes into that because, well, if it was Apple or
8 if you're paying someone off in euros and you're going to
9 discount the rate for the exchange. But if you're talking
10 about a stock like this, maybe that's a harder thing to
11 show in the particular case.

12 So if we answer the question as posed, yes, that
13 never happens. The only thing that happens is any company
14 that agrees to a stock option, no matter how their stock
15 fluctuates, no matter what the situation was when they
16 entered the contract, comes in and says, we entered into an
17 agreement to sell our equity at a more than twenty-five
18 percent discount, we don't have to perform.

19 MS. SANTELLI: Well but you have to remember that
20 each of the events that you claim are going to possibly
21 devalue this - - - this interest, are events of default.
22 You know - - -

23 JUDGE GARCIA: No, they're not. No, they're not.
24 What if your stock just doesn't really trade. What if
25 nobody want - - - it's an over-the-counter stock, right?



1 MS. SANTELLI: Yes.

2 JUDGE GARCIA: There's no market for it. It's
3 not NASDAQ, it's not Apple. So - - -

4 MS. SANTELLI: Well - - -

5 JUDGE GARCIA: - - - you don't have to default.
6 What if nobody's really buying it.

7 MS. SANTELLI: Well if you look at the contract,
8 most of the contracts say, you know, if there's no bid, if
9 you lose the bid, if there is actually nobody buying it,
10 then that's a - - - that's an incident of default. So that
11 the lender can accelerate payment and - - - and sue to
12 collect whatever amount.

13 But you also have to look at the ability to
14 convert in tranches. Maybe it is a thinly traded stock - -
15 -

16 JUDGE GARCIA: But I guess why - - - my point is,
17 why can't you all think about that when you're entering
18 this contract and say, look, these are all risks by the
19 nature of a microcap stock like this, which is why you're
20 not in the regular credit market, so an eight percent rate
21 isn't going to get you this contract. There has to be some
22 type of upside on an equity in this. But the equity
23 doesn't really trade, it trades in this other kind of
24 market. And there's a lot about the over-the-counter
25 market out there.



1 So can you really say in that situation, in every
2 case, in every company, when you come in and you agree to
3 this type of discount, that's always going to be usury?

4 MS. SANTELLI: I still maintain that - - - I
5 mean, if you look at the record of these cases, they
6 typically don't have any trouble converting. But if you
7 did have a particular stock that you think that - - - that
8 couldn't be valued at the fair market value because of
9 whatever problem, inability to - - - to trade it, whatever,
10 then the court could deviate from market - - - fair market
11 value in that case.

12 JUDGE GARCIA: But aren't you putting then the
13 burden on the lender? Isn't it your burden to come in and
14 say it is, that this was valuable - - - valued at the time
15 - - -

16 MS. SANTELLI: Well, but I mean, I - - -

17 JUDGE GARCIA: - - - at a certain way?

18 MS. SANTELLI: I - - - but I think that if you on
19 the four corners of the contract, you're charging in excess
20 of twenty-five percent interest, using the - - -

21 JUDGE FAHEY: Well, that's the question - - -

22 MS. SANTELLI: - - - corporation discount - - -

23 JUDGE FAHEY: - - - but - - - but what you - - -
24 the argument goes to, the way I understand it - - - and the
25 Union Capital case kind of talked to some of these issues



1 and defendant raises a strong response to that analysis, of
2 calling that analysis fundamental error.

3 I think that's why it goes back to the first
4 question I asked you. Is this conversion rate a fixed
5 component of it that is of this contract that will
6 consistently result in exceeding the criminal usury rate,
7 and it's irrelevant to the potential profit or loss that
8 you - - - that you receive on that, that the fifty-four
9 percent per hundred dollars profit is criminally usurious
10 on its face - - -

11 MS. SANTELLI: Right.

12 JUDGE FAHEY: - - - and that's your argument,
13 isn't it? Your argument is not that it affects - - - it's
14 affected by the potential profit because - - - though I - -
15 - I think it's a reasonable argument. And it's a subtle
16 argument, though, too because it gets into the problem of
17 expectation damages and, honestly, I'm still - - - I have
18 to say, I'm still kind of working my way through this as to
19 how it would always yield a criminal usury rate.

20 Do you know of circumstances where it wouldn't?

21 MS. SANTELLI: No. I mean, like I said, it's
22 only going to be in - - - in the outlier case that's not
23 publicly traded or traded by appointment or something that
24 - - -

25 JUDGE WILSON: Okay. So to that point, do you



1 know whether the commonly used methods for valuing options
2 take into account volatility of underlying asset or trading
3 frequency?

4 MS. SANTELLI: They took - - - certainly take
5 into account volatility, but that's not necessarily going
6 to lower its value because with volatility that means that
7 it can go down, but it can also go up.

8 JUDGE WILSON: Will - will it affect the
9 certainty range of the estimates?

10 MS. SANTELLI: I'm -- - I'm not really sure what
11 you - - - I mean, the basic intrinsic value of any option
12 is the difference in between the strike price and the
13 market price.

14 JUDGE WILSON: Sure.

15 MS. SANTELLI: Beyond that, most of the Black-
16 Scholes type valuations, these equations, they'll option -
17 - - they will value the options that are out of the money
18 at the time they were issued to assess, you know, the
19 likelihood - - - I mean, it - - - be - - - the old cases,
20 like Cleveland v. Loder, recognize that a chance to get
21 more of an usurious rate was worth something. Now those
22 cases were a little bit simpler because the interest rate
23 was already pegged. And so they said, okay, if it's worth
24 more than zero, then it's usurious because we're over the
25 line. So - - -



1 CHIEF JUDGE DIFIORE: Counsel, let me move you to
2 the second issue. And if the interest charged on a loan is
3 determined to be criminally usurious, is the contract void?

4 MS. SANTELLI: I think that it is. I - - - I
5 think we're looking at an interpretation of the usury
6 statute. There's a reference to the criminal - - -
7 criminal code within the usury statute. And I think
8 ultimately comes down to, is this a directive to a private
9 property to sue under 190.40 or is it just a reference to
10 whatever the criminal usury rate is in 190.40 at the time.
11 And so in looking at 190.40, I don't think you can say that
12 parties need to sue under it because it's not - - - it's
13 not a civil statute. There's no - - - there's no
14 indication that private parties can sue under 190.40.

15 Moreover, there's a couple of opinions from this
16 court, I believe, Hammelburger, and the Brewster case where
17 there's some language in the opinion that's fairly clear in
18 that they consider it to be - - - they're incorporating by
19 reference the twenty-five percent rate set forth in the
20 criminal code.

21 And ultimately, you know, I think one of the
22 other, the Water Chef cases pointed out - - - no, it was
23 actually it was Blue Wolf Capital pointed out that if this
24 violates the criminal code, then an affirmative defense
25 means that the contract is unenforceable. So just about



1 any way you look at it, I think you arrive at the contract
2 either being void or just not enforceable.

3 CHIEF JUDGE DIFIORE: Thank you, Counsel.

4 Counsel?

5 MR. KEHRLI: Good afternoon, Your Honors. May it
6 please the court, Kevin Kehrli of the firm Garson, Segal,
7 Steinmetz, Fladgate, for respondent Adar Bays, LLC.

8 I'd like to begin by correcting the sleight of
9 hand that has led this court to ask, what do we do with
10 this option, what do we do with this warrant? This
11 instrument, this convertible note, is not only an option.
12 Appellant asked the court to treat it as an option and
13 wholly disregard the fact that there is the potential, very
14 good potential, that this loan will be repaid after one
15 year with eight percent interest, and the option will never
16 be exercised.

17 Now here's why that's important. If we are to
18 presume that this is an option or a warrant only, and that
19 this will in fact be exercised no matter what - - -

20 JUDGE RIVERA: But you did demand part of the
21 loan payment - - -

22 MR. KEHRLI: We did. But a usury - - -

23 JUDGE RIVERA: - - - you did - - - you did
24 actually exercise the option; am I missing something?

25 MR. KEHRLI: No, you're correct. But a usury



1 determination is made at the time of contracting. So we
2 don't look - - - we don't look backwards to determine what
3 happened. We have to look at the four corners of the note
4 and determine what may happen.

5 JUDGE RIVERA: Well that's - - - isn't that true
6 for any loan if - - - if the interest that's stated is
7 above the number regardless of whether or not it - - - the
8 loan will be paid in time, that you never really receive
9 the - - - the loaner never really receives the usurious
10 amount, doesn't matter.

11 MR. KEHRLI: Correct. But that's a different
12 situation here.

13 JUDGE RIVERA: Um-hum.

14 MR. KEHRLI: What - - -

15 JUDGE WILSON: So when - - - when Adar Bays
16 entered into this transaction, did they make a projection
17 about the range that it would yield?

18 MR. KEHRLI: Not that I know of. I - - - I can
19 say that - - -

20 JUDGE WILSON: So that - - - your understanding
21 is they just invested the money without having an idea of
22 how much they'd get back?

23 MR. KEHRLI: I'm sure internally they do. I'm
24 not aware of that number.

25 JUDGE WILSON: Well wouldn't that internal



1 evaluation be evidence of whether the loan is usurious or
2 not? I mean, suppose it said, as soon as day 180 hits,
3 we're going to convert the first tranche in the sequence,
4 and we expect to get 240 percent return on our investment.

5 MR. KEHRLI: Possibly. But appellant forecasts
6 it being fifty-four percent. I forecast it being eight
7 percent. My client could forecast it being something else.

8 JUDGE WILSON: Yeah, I guess - - - but that - - -
9 the question there is that's because you're both sort of
10 arguing what it might be off the face of the contract, but
11 I guess I'm saying, isn't it possible that there exists
12 extrinsic evidence that would allow a valuation firm to say
13 - - - or another way to look at it would be, okay, you
14 clearly wouldn't be willing to lend them eight percent
15 flat, right; is that a fair assumption?

16 MR. KEHRLI: Yes.

17 JUDGE WILSON: So that this option was worth
18 something to you at the time you entered into it. And the
19 question is what?

20 MR. KEHRLI: That's not the question for a usury
21 determination. That - - -

22 JUDGE WILSON: Why not?

23 MR. KEHRLI: - - - that's a question for a
24 business practice. But for a usury determination, you have
25 to look at the contract. The extrinsic - - - extrinsic



1 evidence is irrelevant.

2 I do want to just get - - - finish that - - -
3 earlier point - - -

4 JUDGE WILSON: But don't we - - -

5 MR. KEHRLI: - - - I was trying to make - - -

6 JUDGE WILSON: I'm sorry. Don't we need to know
7 whether the intent was usurious?

8 MR. KEHRLI: We do.

9 JUDGE WILSON: And so if the internal documents
10 say we intend to get thirty percent interest on this,
11 that's irrelevant?

12 MR. KEHRLI: It's - - - it's not irrelevant.
13 That would speak to the intent. But I don't think that's
14 any sort of calculus of what actually the doc - - - of what
15 the document says, which is the calculus you need to make
16 for a usury determination.

17 JUDGE WILSON: So your - - - your position is we
18 cannot - - - the courts cannot look at anything other than
19 the four corners of the document to determine whether it's
20 usurious?

21 MR. KEHRLI: I believe that that is the case law
22 as it stands. But it must be usurious on the four corners
23 of the note.

24 JUDGE WILSON: Okay.

25 JUDGE FAHEY: Well I thought the case law was



1 it's usurious at the time it's entered into.

2 MR. KEHRLI: Correct.

3 JUDGE FAHEY: So you would still get to the
4 intent then behind it in a criminal statute, wouldn't you?

5 MR. KEHRLI: Yes.

6 JUDGE FAHEY: So it - - - so it doesn't have to -
7 - - so Judge Wilson's point is correct then, you're looking
8 to - - - you are looking at - - - the question is when do
9 you look at it, right?

10 MR. KEHRLI: Correct. Yes.

11 JUDGE FAHEY: All right.

12 MR. KEHRLI: I - - - I think that there's two
13 different - - - I keep saying the word calculus. But
14 there's the calculus of the interest rate and there's the
15 calculus of intent. Now what Your Honor asked may - - -
16 may impact both. And it may have impacted the decision to
17 enter into the note. But it does not impact the interest
18 rate on the face of the note.

19 JUDGE FAHEY: Can I ask you this? Do you dispute
20 the math that thirty-five percent discount on a hundred
21 dollars on - - - the discount rate as applied here will
22 always yield a fifty-four percent increase?

23 MR. KEHRLI: That's the sleight of hand that I -
24 - - that I was mentioning - - -

25 JUDGE FAHEY: Well, no, you dispute the math.



1 Forget the - - - forget the analytical sleight of hand
2 argument, I understand that.

3 Do you dispute the math?

4 MR. KEHRLI: I do not dispute the math. And I -
5 - - but dispute that that is the reason why the lower
6 courts - - -

7 JUDGE FAHEY: Go ahead - - -

8 MR. KEHRLI: - - - decision - - -

9 JUDGE FAHEY: - - - tell me why.

10 MR. KEHRLI: They -- - the speculation that the
11 lower courts discussed is the speculation of whether that
12 option would ever be exercised.

13 JUDGE FAHEY: Um-hum.

14 MR. KEHRLI: We don't know.

15 JUDGE WILSON: So let me just stop you again. So
16 if the discount instead had been a ninety-nine point nine
17 percent discount on the trading price, you would have the
18 same argument?

19 MR. KEHRLI: Correct. We don't know if - - -

20 JUDGE WILSON: You don't know if it - - -

21 MR. KEHRLI: - - - that would ever be exercised.

22 JUDGE WILSON: - - - would convert. Okay.

23 MR. KEHRLI: And if we were to presume that this
24 is always going to be exercised, it's always going to yield
25 that fifty-four percent, and that the loan would never be



1 repaid in cash, that's no longer a loan. That is a strict
2 - - - that is strictly a simple warrant, and warrants are
3 not subject to a usury defense. So the presumption will
4 have to cut both ways.

5 If we're going to presume what appellant says,
6 that this will always be converted at a rate of fifty-four
7 percent, then we are no longer talking about a loan - - -

8 JUDGE WILSON: And what if we - - - what if we
9 assign a probability to that instead of assuming one or the
10 other?

11 MR. KEHRLI: If we assume a - - - a probability -
12 - -

13 JUDGE WILSON: A probability.

14 MR. KEHRLI: - - - of a combination of the two?

15 JUDGE WILSON: A probability of conversion.

16 MR. KEHRLI: Still speculative. I think we can -
17 - - we can say, yes, one conversion took place, the rest
18 was eight percent. We can balance the fifty-four percent
19 return on the one conversion with the eight percent return
20 on the remaining balance. I believe that comes in to about
21 seventeen percent. That's permissible. Would \$10,000 get
22 it over that \$25,000 mark? But we don't know that at the
23 time of contracting, and that is when we need to make this
24 usury determination.

25 JUDGE WILSON: I guess what I'm asking is at the



1 time of contracting, based on empirical evidence, could one
2 - - - could an expert for example assign a probability to
3 conversion?

4 MR. KEHRLI: Possibly. It would take a lot of -
5 - - a lot of speculation and a lot of market predictions.

6 JUDGE WILSON: Well why market - - -

7 MR. KEHRLI: That would be - - -

8 JUDGE WILSON: - - - why market - - - why market
9 predictions? Because aren't you indifferent to the market
10 price?

11 MR. KEHRLI: No.

12 JUDGE WILSON: Why not?

13 MR. KEHRLI: So if the market price is trending
14 downward - - -

15 JUDGE WILSON: Yep.

16 MR. KEHRLI: - - - and I execute a conversion -
17 - -

18 JUDGE WILSON: Yep.

19 MR. KEHRLI: - - - I have my discount. That's
20 fair, we're not disputing that. But if it's still - - -

21 JUDGE WILSON: And if you don't care at that
22 point - - - at the point you execute that conversion, you
23 don't really care what the market price is?

24 MR. KEHRLI: We care if it's still going down - -
25 -



1 JUDGE WILSON: Well - - -

2 MR. KEHRLI: - - - because we have three days to
3 get the shares - - -

4 JUDGE WILSON: Yeah, but that's the future. You
5 care about what's going to happen to it, but you don't care
6 about what has happened to it, where it's trading at the
7 moment you convert.

8 MR. KEHRLI: Correct. The ratio will always be
9 the same.

10 JUDGE WILSON: Yep. Yep.

11 MR. KEHRLI: I apologize. But there are market
12 considerations that would impact whether or not we ever
13 submit that conversion. And I apologize for continuously
14 using we, but I mean my client. If they ever submit the
15 conversion, that's - - - that's the speculation. There's -
16 - - there are four different intervenors, as I will call
17 them, that could prevent these contingencies from happening
18 where this - - - these - - - this conversion would never
19 take place.

20 Respondent is one of them. They could say low
21 risk, we want to take the low risk group, we'll take eight
22 percent. Appellant is another per - - - another inter - -
23 - potential intervenor. They could fire their transfer
24 agent. I know counsel mentioned those are all events of
25 default, but those aren't breaches of contract. It's not a



1 - - - it's not a breach of contract until that default
2 interest rate of twenty-four percent is not paid.

3 So it is meant to protect the conversion right,
4 but a breach such as firing their transfer agent, or an
5 event of default such as firing their transfer agent, does
6 not result in a fifty-four percent interest rate as - - -
7 as appellant seeks to - - - to impress upon this court. It
8 results in a twenty-four percent interest rate, which is
9 perfectly within the scope of New York's usury laws.

10 Intervenor number three is the SEC. We don't
11 know what the SEC is going to do. The SEC could take a
12 look at appellant's quarterly statement for the year 2016
13 and find something fishy, put a freeze on their stock or
14 delist their stock completely. Conversion right will never
15 happen.

16 The last as I mentioned is the market itself. As
17 the court was asking, what if no one's buying the stock.
18 Appellant said, well, there's an event of default for that
19 if it goes no bid. Suppose it's somewhere in between.
20 Suppose that there's a thousand - - - that it - - - a
21 thousand bids per day. In this instance, in the
22 transaction hearing, 436,000 shares were converted.

23 Now a sophisticated investor would look to the
24 trading - - - average trading volume and foresee that and
25 probably not get themselves into that situation, but that



1 means the conversion will never happen. If it did happen,
2 all of the sudden there was a decrease and there's a
3 thousand shares being traded a day, and Adar Bays is stuck
4 sitting with 436,000, guess where that stock price is
5 going? Down, down, down, down, down, down, way below that
6 fifty-four percent.

7 So there - - - I could keep going on and on with
8 different circumstances which would cause this conversion
9 right to never be exercised. But the point is, in a
10 situation where - - -

11 JUDGE RIVERA: I'm getting a little confused with
12 this last point you're making - - -

13 MR. KEHRLI: I'm sorry. Sorry.

14 JUDGE RIVERA: - - - because if - - - if you've
15 got this discount, and it's not a one percent discount,
16 it's quite a significant discount, aren't you always - - -
17 even if the price begins to drop, aren't you always making
18 - - - that's their argument. Aren't you always making a
19 certain percentage that's above the percent that's
20 acceptable under our statutes? Aren't you then exceeding
21 what would be the criminal usurious rate?

22 MR. KEHRLI: If I may give you a - - -

23 JUDGE RIVERA: I - - - I - - - that's what I - -
24 -

25 MR. KEHRLI: - - - two-part answer?



1 JUDGE RIVERA: - - - understood the argument to
2 be. Perhaps, I misunderstood. I'll check with them when
3 we get back to them.

4 MR. KEHRLI: There are a few different ways to
5 answer Your Honor's question. But the first is I - - -

6 JUDGE RIVERA: But that's what you've done with
7 the discount? That's the whole point of a discount - - -

8 MR. KEHRLI: Correct.

9 JUDGE RIVERA: - - - that no matter how low this
10 goes, you're getting much more than anyone else would get
11 for the amount that you used to buy.

12 MR. KEHRLI: To an extent, that's correct. I
13 think there are several issues. First, if it is trending
14 downward - - - I - - - I think I had in our papers, and on
15 a single day, within thirty days of this transaction, the
16 price dropped forty percent in one day.

17 JUDGE RIVERA: Yeah.

18 MR. KEHRLI: A discount - - - while it's fifty-
19 four percent more, the discount is actually thirty-five
20 percent.

21 JUDGE RIVERA: Yeah.

22 MR. KEHRLI: So forty eats that whole discount up
23 in a single day. We don't know.

24 JUDGE RIVERA: Um-hum.

25 MR. KEHRLI: We - - - we have no idea.



1 The - - - the second point is - - -

2 JUDGE WILSON: So you really, you're just saying
3 that after you've exercised the conversion option, you - -
4 - now we're not talking about the note anymore, we're
5 talking about the stock you now hold, there's market risk
6 associated with that stock? It could be because of your
7 conversion, but it could be because of the company's
8 business performance or because of something else.

9 MR. KEHRLI: Correct. But it's that exact risk
10 that disincentivizes potential conversions which undermines
11 the presumption that appellant wishes this court to make
12 that the conversions will always happen. And that - - -

13 JUDGE FAHEY: And can I - - -

14 MR. KEHRLI: - - - this discount will always be
15 in - - -

16 JUDGE RIVERA: Well it - - - it might
17 disincentivize a certain amount of conversion, right? I
18 mean, you have to get - - -

19 MR. KEHRLI: It might.

20 JUDGE RIVERA: Assuming for one moment, we're not
21 talking about the other potential events that Judge Wilson
22 has correctly pointed to, but just talking about the effect
23 that the exercise of the option might otherwise have on
24 this price, I think if you've got more to continue to
25 exercise this option on, you're not necessarily looking to



1 get rid of the fatted cow that's feeding you here. Am I
2 misunderstanding?

3 MR. KEHRLI: No, Your Honor's absolutely correct.
4 But the keyword to that is it might. And we don't know -

5 JUDGE FAHEY: Can I - - - can I just - - -

6 MR. KEHRLI: - - - at the time.

7 JUDGE FAHEY: - - - can I take you on - - - on
8 just the second point because your time's almost up.

9 You argue that this contract shouldn't be void ab
10 initio if it's a criminal usury contract. So I - - - my
11 understanding of the public policy of the state is - - - is
12 that a civil usurious loan is over sixteen percent in this
13 situation. And they are void.

14 And - - - but you're arguing that a twenty-five
15 percent criminal usury rate would not be void. Explain to
16 me the basis for your argument.

17 MR. KEHRLI: So I'll - - - I'll try to quickly go
18 through this. There's a clear hierarchy developed through
19 the statutory framework.

20 JUDGE FAHEY: Um-hum.

21 MR. KEHRLI: Sixteen percent is meant to protect
22 the most vulnerable, the individuals, the least
23 sophisticated.

24 JUDGE FAHEY: Sure.

25 MR. KEHRLI: Sixteen percent and void they get



1 the most protection.

2 Tier two, corporations. They're sent outside of
3 the statute to 190.40, to a higher interest rate - - -

4 JUDGE FAHEY: Yeah but see you're analysis just
5 relies on the penal law. The GOL 5-511, sub 1, says all
6 loans with an interest rate greater than that permitted,
7 shall be void.

8 MR. KEHRLI: So 5-511 - - -

9 JUDGE FAHEY: So - - - go ahead.

10 MR. KEHRLI: - - - 5-511 specifically references
11 5-501.

12 JUDGE FAHEY: Um-hum.

13 MR. KEHRLI: And specifically does not reference
14 190.40, right? So if 521 prohibits corporations from
15 asserting usury under 501, then the remedy for that same
16 defense that they are not entitled to - - - to assert
17 shouldn't be presumed. What we look at is - - -

18 JUDGE FAHEY: So the public policy of the State
19 of New York should say a civil loan that's usurious is void
20 ab initio, but a criminal loan is not?

21 MR. KEHRLI: I think the policy would look to - -
22 - to whom the statutes were intended to protect. So - - -

23 JUDGE FAHEY: So you see - - - so - - - well I -
24 - - I thought the interest rates really operated to do
25 that. But go ahead, tell - - -



1 MR. KEHRLI: The remedy also - - - also operates
2 to do that. I think if you look in 5-511, at the bottom of
3 that - - - that provision, it does make a carve out for
4 lending institutions - - -

5 JUDGE FAHEY: Um-hum.

6 MR. KEHRLI: - - - where I'm not saying that Adar
7 Bays is a traditional lender - - -

8 JUDGE FAHEY: Right.

9 MR. KEHRLI: - - - as - - - as envisioned by this
10 statute. But it does create a different remedy. It does
11 create a carve out that says that interest rate, that's not
12 going to be void. We're just going to either adjust the
13 interest rate or void the usurious aspect of the interest.
14 But that bank is still entitled to principle and payment.

15 CHIEF JUDGE DIFIORE: Counsel, your time has
16 expired. But Judge Garcia has a last question for you.

17 JUDGE GARCIA: Yeah. Sorry, I have a math
18 question. \$5,000 was the amount you converted, right? It
19 translated into roughly 440,000 shares?

20 MR. KEHRLI: That's correct.

21 JUDGE GARCIA: That - - - again, here's the math
22 question. That to me comes out that - - - to a little more
23 than one cent a share, right, .0108 or sometime like that?

24 MR. KEHRLI: That's correct.

25 JUDGE GARCIA: The market price then if you



1 bought 5,000 per share comes out to .016 or something like
2 that. Like the - - - what's the delta - - - what's the
3 difference between what the market price was set at versus
4 the exercise price?

5 MR. KEHRLI: On the date of - - -

6 JUDGE GARCIA: Yeah.

7 MR. KEHRLI: - - - the exercise? I believe the
8 market - - - I don't believe it, I'm reading it - - - the
9 market price was .024 versus the conversion price of .011.
10 So it's- - -is .013 is the delta.

11 JUDGE GARCIA: Zero one three. Okay. Thank you.

12 CHIEF JUDGE DIFIORE: Thank you.

13 MR. KEHRLI: And if I may add - - - I know my
14 time is up. If I may add, that delta is not charged to the
15 appellant as would make - - - have you believe. And that
16 argument's in the papers. I did just want to emphasize
17 that.

18 CHIEF JUDGE DIFIORE: Thank you, counsel.

19 MR. KEHRLI: Thank you, Your Honors - - -

20 CHIEF JUDGE DIFIORE: Counsel - - -

21 MR. KEHRLI: - - - for your time.

22 CHIEF JUDGE DIFIORE: - - - you have your two
23 minutes of rebuttal time.

24 MS. SANTELLI: Yes, that - - - I would like to
25 take note that they're ignoring this twenty-day low



1 baseline, which is why you get some odd numbers. What they
2 actually got in return for their conversions was far above
3 fifty-four percent gain if you look at the chart in the
4 brief. But - - -

5 JUDGE GARCIA: But counsel, let me ask you this.
6 If they had - - - and I think this goes to something Judge
7 Wilson was asking about. Let's say they do have
8 calculations and an analysis from the time of the loan that
9 says, look, based on the market fluctuations and the
10 liquidity in the market, we value this at a thirty-five - -
11 - thirty-five at least percent discount of what any trading
12 price pegged in that ten-day period might be. They have
13 that. But we answer this certified question and say, yes,
14 this represents a usurious interest rate. That doesn't
15 matter?

16 MS. SANTELLI: I mean, they only loan to
17 companies that they think - - -

18 JUDGE GARCIA: No, but my question, would that
19 matter if they had that information, if we answer the
20 Second Circuit's question yes.

21 MS. SANTELLI: I - - - I'm not really sure
22 because, you know, you're just - - - you're talking about
23 intent, and intent is looking at the four corners of a
24 document. And I'm certain that that sort of analysis would
25 - - - would certainly help, but - - -



1 JUDGE GARCIA: But how could it, if you're saying
2 on the face of the document now with this exercise rate
3 discounted at more than twenty-five percent - - -

4 MS. SANTELLI: Yeah.

5 JUDGE GARCIA: - - - that's a usurious rate on
6 the face of the document?

7 MS. SANTELLI: It is.

8 JUDGE GARCIA: Why would we look at - - - why
9 would a court look at that then?

10 MS. SANTELLI: I don't think they need to. I
11 mean - - -

12 JUDGE GARCIA: So in any case, then, we would
13 assume usurious intent from a discounted rate like this?

14 MS. SANTELLI: I think you could have a
15 presumption, sure.

16 JUDGE GARCIA: Isn't that really then get back to
17 my initial question, which is the burden. If it's not
18 clear on the face of the contract if that's possible under
19 this scenario, isn't it the debtor's burden to come in and
20 show that that's not true? That, sure, this is possible,
21 but the valuation at the time of the loan was reflected - -
22 - it wasn't thirty-five percent is usurious. Like, isn't
23 that your burden?

24 MS. SANTELLI: I - - -

25 JUDGE GARCIA: And what we're doing by answering



1 the question yes, it - - - my hesitation is here, is we're
2 just shifting the burden then, in a case where it's in a
3 liquid market.

4 MS. SANTELLI: But I mean, if the - - - if the
5 interest - - - if the stated rate is twenty-six percent,
6 you've - - - I guess you've shifted the burden too. You
7 know, we're looking at something that - - - they're - - -
8 they almost always do the conversions. I know that my
9 opponent is saying that this is something we might not
10 exercise, but - - -

11 JUDGE GARCIA: Yeah, I'm not worried so much
12 about the not exercise part. I'm worried more about saying
13 in every case, no matter how speculative the ability to
14 value an asset might be, once - - -

15 MS. SANTELLI: Well, I mean, we're - - -

16 JUDGE GARCIA: - - - you have the discount - - -

17 MS. SANTELLI: - - - talking about the fair
18 market value of stock that's publicly traded. I'm not sure
19 where valuing - - -

20 JUDGE GARCIA: But there's different ways of
21 publicly trading, right? Like, NASDAQ's one way to
22 publicly trade and over the counter is a very different way
23 to publicly trade, right?

24 MS. SANTELLI: Well but at - - - at the core,
25 you're talking about what a willing buyer and a willing



1 seller agree on. I don't - - - I mean, it - - - it's a
2 different market, but it's not a different way of valuing
3 things.

4 JUDGE GARCIA: But you need to have a buyer,
5 right?

6 MS. SANTELLI: Yes. And if you don't have a
7 buyer, the - - - the company's in default, but - - -

8 JUDGE GARCIA: But doesn't - - -

9 MS. SANTELLI: - - - in - - -

10 JUDGE GARCIA: - - - that go - - - yeah, but you
11 may have - - - doesn't that go to the point about how much
12 the stock, especially when you're talking about these types
13 of valuations and there's microcaps, how much the stock is
14 going to fluctuate in a day, in an hour?

15 MS. SANTELLI: Yes. But the stock can also - - -

16 JUDGE GARCIA: Should I sell it?

17 MS. SANTELLI: - - - it can also go up in a day,
18 an hour.

19 JUDGE GARCIA: Sure.

20 MS. SANTELLI: I mean - - -

21 JUDGE GARCIA: But that is - - - that's the - - -
22 that's the problem, right? Like, that's - - - that's what
23 you're trying to figure out when you enter into the
24 contract. So if he - - - and I don't know this, but if
25 that company had information showing frequency of these



1 trades, willing buyers and sellers, over the counter
2 market, this is the range that I could take a haircut on
3 here on a valuation, on an ability to get any value out of
4 the conversion, and they don't convert all, they convert
5 \$5,000, so he would - - - that party doesn't ever get to
6 show that this is - - - this is presumed actually to be a
7 usurious business? Like, that the fact that you're
8 entering into this, and you have this discount is criminal
9 usury?

10 MS. SANTELLI: Yes. I mean, it wrecks a lot of
11 companies.

12 CHIEF JUDGE DIFIORE: Thank you, counsel.

13 (Court is adjourned)

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C E R T I F I C A T I O N

I, Amanda M. Oliver, certify that the foregoing transcript of proceedings in the Court of Appeals of Adar Bays, LLC v. GeneSYS ID, Inc., No. 51 was prepared using the required transcription equipment and is a true and accurate record of the proceedings.

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