SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: O. PETER SHERWOOD PART 49
Justice

BLUE WOLF CAPITAL FUND II, L.P.

Plaintiff,

-against-

AMERICAN STEVEDORING, INC, *et al.*,

Defendants.

INDEX NO. 651560/2010

MOTION DATE December 17, 2011

MOTION SEQ. NO. 004

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion for summary judgment

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	1-7, 10
Answering Affidavits — Exhibits	8-9, 11
Replying Affidavits	12

Cross-Motion: ☑ Yes ☐ No

The motion is decided In accordance with the accompanying decision and order in motion sequence 001.

Dated: August 22, 2011

O. P. Sherwood
O. PETER SHERWOOD, J.S.C.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Check one: ☑ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 49

----------X

BLUE WOLF CAPITAL FUND II, L.P.,

Plaintiff,

-against-

AMERICAN STEVEDORING, INC.

Defendant,

and

GENERAL ELECTRIC CAPITAL CORPORATION, KEY EQUIPMENT FINANCE, and BANC OF AMERICA LEASING & CAPITAL, LLC,

Nominal Defendants.

----------X

DECISION AND ORDER

Index No. 651560/2010

Hon. O. Peter Sherwood, J.

This decision and order consolidates Motion Sequence Numbers 001, 003 and 004 for disposition.

This action arises out of a loan transaction. The complaint alleges six causes of action as follows: (1) declaratory judgment, (2) injunction, (3) conversion, (4) recovery of chattels, (5) unjust enrichment and (6) costs of collection. No answer has been filed because the court converted defendant's cross-motion to dismiss to a motion for summary judgment pursuant to CPLR 3211(c). Thereafter the parties charted a summary judgment course and treated defendants' usury claim as a properly pleaded affirmative defense (*see* parties Rule 19-a statements).

In late 2009, defendant American Stevedoring, Inc. ("defendant" or "ASI") sought long and short term financing to continue its operations. Plaintiff Blue Wolf Capital Fund II, L.P. ("plaintiff" or "Blue Wolf") "offered to advance $1 million to [defendant], and to explore a possible equity investment" going forward. (Plaintiff's Response Pursuant to Commercial Division Rule 19-a(b) to Defendant's Statement of Material Facts at 3). The transaction was structured in two phases: an initial loan to sustain defendant in the short term and the possibility of an equity investment once due diligence could be conducted. (Transcript at 7-8).

The short term loan transaction is evidenced by the Loan Agreement (Defendant's Exhibit 3) and Demand Promissory Note (Defendant's exhibit 2), dated January 7, 2010 under the terms of which plaintiff gave defendant a demand loan in the principal amount of $1,130,000 (Plaintiff's Exhibit F) at the stated rate of 12 per cent per annum. (Defendant's Exhibit 2 at 1). Paragraph 2(b) of the Loan Agreement sets out certain fees and deposits associated with the loan as follows:

> "... the Lender may, and is hereby authorized to, withhold from the funding of the Loan (I) a commitment fee in the amount of $50,000, which shall be deemed fully earned upon the funding of the Loan, and shall not be refundable, in whole or in part, at any time or under any circumstances, (ii) the sum of $75,000 as a deposit in respect of the Lender's costs and expenses (including attorneys' fees) relating to the transaction contemplated by this agreement (and, to the extent that such deposit exceeds or is less than the Lender's actual costs and expenses, then a refund of the excess or an additional payment for the overage shall promptly be made to or by the Borrower, as the case may be), and (iii) the sum of $200,000 as a deposit against future commitment fees in the event that the obligations under the Note are rolled over into a future financing transaction between the Lender and the Borrower (provided that (A) the holding of such deposit shall not constitute a commitment with respect to any future transaction, and (B) if a further transaction with the Lender is for any reason not completed by March 31, 2010, or if the Borrower sooner completes a transaction with a person other than the Lender, then the Lender reserves the right to retain all or a portion, of such deposit as compensation for the Lender's time and expenses, as determined by the Lender at its sole discretion."

(Defendant's Exhibit 3 at 1).

The Loan was secured by liens on equipment defendant uses to conduct its business at the Port of New York. The equipment has a market value of over $7.5 million (Defendant's Rule 19-a Statement, ¶ 14). At the closing on January 7, 2010, plaintiff funded the loan less deposits and fees and released to defendant net proceeds of $805,000. By late January 2010, plaintiff determined that it no longer desired to pursue an equity transaction with ASI and thereafter initiated efforts to exit the short term loan.

On March 18, 2010, plaintiff sent defendant a letter demanding immediate repayment of $1,056,569 then outstanding under the Demand Promissory Note and other loan documents, itemized as follows:

> [D]emand is hereby made for the immediate repayment of the $1,056,659 aggregate amount of Obligations now outstanding under the Note and the other Loan Documents, which is the sum of (i) $1,030,000 of principal (representing the original $1,130,000 face amount of the Note minus $100,000 of the $200,000 deposit retained by the Lender pursuant to Section 1(b)(iii) (sic) of the Loan Agreement) plus (ii) $26,569 of unpaid accrued interest under Note from the funding date (January 7, 2010) to the date hereof. The remaining $100,000 of the deposit is being retained by Lender for its own account in accordance with clause (B) of Section 1(b) (sic) of the Loan Agreement.

(Wolf-Powers Aff., Ex. O at 1).

On May 14, 2010, plaintiff sent ASI a second letter demanding payment of $1,172,513, representing "... (I) $1,030,000 of principal, plus (ii) $42,513 of unpaid accrued interest under the Note from the funding date (January 7, 2010) to the date hereof." (Wolf-Powers Aff., Ex. P at 1). Defendant was also informed that the entirety of the $200,000 deposit was being retained by the Lender. (*Id.*) Simultaneously with the sending of the above letter, plaintiff decided to pursue foreclosure on the collateral defendant ASI pledged to secure the loan. (Wolf-Powers Aff. at ¶ 32). On May 15, 2010, just one day after sending the second demand for payment, plaintiff sent a notice of strict foreclosure, dated May 17, 2010. However, this notice "did not include the schedule identifying the collateral" and plaintiff retracted it. (Wolf-Powers Aff. at ¶ 32; Wolf-Powers Aff., Ex. Q).

The parties vehemently disagree as to what happened next.

Plaintiff alleges that on July 14, 2010, it sent a document styled "Notice of Acceptance of Collateral in Full Satisfaction of Debt", pursuant to UCC § 9-620, including an attachment describing the collateral. (Plaintiff's 19-a Statement). Defendant argues that it never received the notice of strict foreclosure. Defendant states that while an envelope did arrive at ASI's office, the envelope allegedly contained only a copy of the March 18 letter referenced above. (Sabato Catucci Aff. at ¶ 24). Defendant argues that it only learned of the foreclosure when plaintiff's counsel contacted him to inform him that plaintiff now owned all the equipment of defendant.

On July 22, 2010 and August 23, 2010, ASI tendered interest payments to plaintiff. Plaintiff alleges that these funds were turned over to its counsel "to be held in escrow for ASI to repurchase

the collateral" (Plaintiff's 19-a Statement), a decision it communicated to ASI on August 24, 2010 (Wolf-Powers Aff. at ¶ 44).

Plaintiff brought Motion Sequence Number 001 by Order To Show Cause to enjoin defendants from using, encumbering, selling or otherwise transferring the equipment that serves as collateral for the loan. Plaintiff's request for a TRO was denied. Plaintiff's motion was held open to be decided along with defendant's cross-motion to dismiss, the latter having been converted pursuant to CPLR 3211(c) into a motion for summary judgment to be decided pursuant to CPLR 3212 by order of this Court dated, November 3, 2010. Thereafter, plaintiff filed a motion for summary judgment (motion sequence number 003). Defendant filed a separate motion for summary judgment (motion sequence number 004). All three motions are decided in this Decision and Order.

ANALYSIS

Summary judgment is a drastic remedy which will be granted only when the party seeking summary judgment has established that there are no triable issues of fact (*see*, CPLR 3212[b]; *Alvarez v Prospect Hosp.*, 68 NY2d 329 [1986]; *Sillman v Twentieth Century-Fox Film Corporation*, 3 NY2d 395 [1957]). To prevail, the party seeking summary judgment must make a *prima facie* showing of entitlement to judgment as a matter of law tendering evidentiary proof in admissible form (*see*, *supra*; *Zuckerman v City of New York*, 49 NY2d 557 [1980]). Once this showing has been made, the burden shifts to the party opposing the motion for summary judgment to rebut the *prima facie* showing by producing evidentiary proof in admissible form sufficient to require a trial of material issues of act (*see, Kaufman v Silver*, 90 NY2d 204, 208 [1997]). The party opposing the motion must assemble and lay bare its affirmative proof to demonstrate the existence of genuine triable issues (*see Corcoran Group, Inc. v Morris* [1st Dept 1985], *affd* 64 NY2d 1034 [1985]). It is appropriate to look beyond the answer and deny summary judgment based upon true facts constituting a meritorious defense alleged in opposition to the motion for summary judgment (see, *Murray Hill Apparel, Inc. v Yunsa*, 18 Misc3d 1115 [A] [Civ. Ct., N.Y. Co., 2008]). Moreover, on a motion for summary judgment, it is not the function of the court to assess credibility (*see, Ferrante v American Lung Assn.*, 90 NY2d 623, 631 [1997]). The court must view the evidence in a light

most favorable to the party opposing the motion and must give that party the benefit of every favorable inference (*see*, *Negri v Stop & Shop, Inc.*, 65 NY2d 625 [1985]).

A. *Plaintiff's motion for partial summary judgment.*

By Motion Sequence Number 003, plaintiff moves for partial summary judgment pursuant to CPLR 3212(e) for an order declaring that strict foreclosure occurred, directing the Sheriff or the designated Marshall to seize the equipment pursuant to CPLR 7101 and holding defendant liable on the third, fourth, fifth and sixth causes of action of the complaint. Plaintiff argues that it strictly foreclosed on defendant's collateral by accepting collateral in full satisfaction of the debt pursuant to Unified Commercial Code § 9-620(c)(2) which provides:

> (2) a debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:
>
> (a) sends to the debtor after default a proposal that is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;
>
> (b) in the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and
>
> (c) does not receive a notification of objection authenticated by the debtor within 20 days after the proposal is sent.

It is undisputed that defendant failed to object formally to the foreclosure. As a result, plaintiff insists that they have successfully foreclosed on defendant's collateral. Defendant objects on the grounds that it was never served a notice of foreclosure.

Whether by its own actions Blue Wolf abandoned or withdrew the offer is an open question. Blue Wolf acknowledges that on July 22, 2010, less than 20 days after sending the Notice, it received and retained an interest payment from ASI. The tender is not consistent with acceptance of an offer to retain the collateral in full satisfaction of the loan. Plaintiff purports to have turned these funds over to its counsel to be held in escrow for ASI to "repurchase" the collateral even though plaintiff plainly did not "own" the collateral on July 22, 2010. Plaintiff accepted and held the $45,279.14 interest payment made by defendant after the alleged Notice of Strict Foreclosure was sent and

received. Plaintiff accepted and retained a second such payment made on August 23, 2010. On August 24, 2010, Blue Wolf advised ASI that the interest payments were being held "on account." In any event, ASI effectively objected to the Notice by tendering an interest payment on July 22, 2010, after receipt of the Notice. The motion must be denied.

Even if the court were to assume ASI had not made an objection, questions of fact exist as to whether reasonable notice of foreclosure was sent by plaintiff to defendant. Two factors cast doubt on plaintiff's claim of proper service of the Notice. First, plaintiff already served one deficient notice on defendants on May 17, 2010, which it had to retract. (Wolf's Rule 19-a Statement, ¶ 56). Second, General Electric Capital Corporation, a senior secured lien holder, also did not receive the July 14, 2010 Strict Foreclosure letter as plaintiff sent it to the wrong address. (Turetsky Aff., n. 3).

B. *Defendant's motion for summary judgment.*

By Motion Sequence Number 004, defendant moves for summary judgment declaring the underlying loan unenforceable by reason of an alleged criminally usurious interest rate and for an order dismissing the complaint. The motion is granted.

New York recognizes two types of usury: civil and criminal. Civilly usurious interest rates exceed 16%. Criminally usurious interest rates exceed 25%. (*see* Gen. Obligations Law 5-501). Traditionally, corporations were excluded from asserting the defense of usury. However, by statute, a corporation may assert the defense of criminal usury. Penal Law § 190.40 penalizes as a felony, the knowing unauthorized loaning of any amount at an interest rate that exceeds 25% per annum. General Obligations Law § 5-521(3) permits corporations to interpose a claim of criminal usury as described in Penal Law § 190.40 as an affirmative defense to an action seeking repayment of the loan. (*see Funding Group, Inc. v Water Chef, Inc.* 19 Misc 3d 483,491 [Sup Ct, NY Co 2008]).

In order to prevail on a defense of criminal usury, the defendant must plead and prove that the lender (1) knowingly charged, took or received (2) annual interest exceeding 25% of the amount borrowed (*see id* at p 488). As to the first element, the defendant must offer clear and convincing evidence of a general intent to take interest at a greater rate than that allowed by law. (*see Freitas v Geddes Savings and Loan Assn*, 63 NY2d 254,265 [1984]). Where the usury cannot be discerned

from the four corners of the loan instrument and there exists a bona fide dispute as to the import of fees extraneous to the loan, the existence of usury is a question of fact (*see id*).

The loan is not usurious on its face: the stated interest is 12% annually. (Wolf-Powers Aff., Ex. G at 1). However, ASI contends that because fees were subtracted from the loan amount, the effective rate of interest is much higher - - between 31.25% and 197%, depending on the method of calculation - - and is criminally usurious. It is undisputed that three types of fees were subtracted from the face amount of the loan before disbursement to defendant: a commitment fee of $50,000, an expense reserve of $75,000 and an investment evaluation deposit of $200,000. (Defendant's Exhibit 3 at 1).

In New York, "when a lender charges legal interest on the full amount of his loan but requires a portion thereof to remain in his possession as security for its repayment, the transaction is usurious because the borrower does not receive the use of the full sum upon which interest is charged." (*see Vee Bee Service Co. v Household Finance Corp.*, 51 NYS2d 590 [Sup Ct Special Term 1944] *see also Hope v Contemporary Funding Group*, 128 AD2d 673 [2d Dept 1987] [discount retained by lender construed as interest] and *Band Realty v North Brewster*, 37 NY2d 460 [1975] [calculations of interest in cases involving lender discounts]). The court is required to look at the nature of the transaction, rather than the terms used in the Loan Agreement to determine whether a particular charge is disguised interest. (*see Vee Bee* at 598; *Tuition Plan, Inc. v Zicari*, 70 Misc2d 918, [District Ct Suffolk Cty 1972] ["This court is not bound to categorize this transaction by applying blinders to its eyes and merely viewing the language used in the agreement"). Where fees, while technically not interest, are "unreasonable and confiscatory in nature" they will be held to be "unenforceable when examined in the light of the public policy expressed in Penal Law § 190.40 which makes an interest charge of more than 25% per annum a criminal offense." (*Sandra's Jewel Box Inc. v 401 Hotel, L.P.*, 273 A.D.2d 1, 3 [1st Dept 2000]).

This is not a case where there is a bona fide dispute as to the import of fees that are extraneous to the loan (*see Freitas*, 63 NY2d at 265). Plaintiff elected to retain the various fees within a very short time after the transaction closed. The retained fees are (1) a $50,000 commitment fee retained at funding (Defendant's Exhibit 3 at 1); (2) the entirety of the $200,000 "investment

evaluation deposit" (Wolf-Powers Aff., Ex. O at 1) and all of the $75,000 deposit relating to the original transaction. (Parikh Aff. at 3).

Defendant received proceeds in the amount of $805,000 but was charged interest at an annual rate of 12 percent on $1,130,000. As calculated by plaintiff and not disputed by plaintiff, the rate of interest charged on the loan is 57.14 percent, assuming that the $325,000 of fees are found to constitute additional interests (*see* Defendant's Memorandum of Law in Support of Motion for Summary Judgment, p.10).

The Loan Agreement identifies a "commitment fee" of $50,000 which is deemed "earned upon funding of the Loan" (Loan Agreement, ¶ 2[b]). Although the New York State Banking Regulations are not applicable to the loan at issue here, the regulations provide a useful definition of the phrase "commitment fee". It is a "reasonable fee in consideration for the legally enforceable written commitment of the lender to reserve funds for future disbursement to the borrower" 3 NYCRR 4.3. The unsigned term sheet prepared by Blue Wolf "for discussion only" ("Term Sheet") and now identified by plaintiff as funds "earmarked for the future loan" (Plaintiff's Memorandum of Law – in Support of Cross-Motion for Summary Judgment, p. 18) does not constitute a "legally enforceable written commitment" (banking Regs 6, 4-3) in any sense. It is unsigned and thus is not binding. The legend on the Term Sheet, "for discussion only," confirms the non-binding character of the document. The "commitment fee" must be construed as additional interest charged to defendant (*see Vee Bee*, *supra*).

Regarding the $75,000 retained by plaintiff "as a deposit in respect to Lender's costs and expenses ... relating to the transaction contemplated by this Agreement" (Loan Agreement, §2[b]), there is no evidence attached to the motion showing that plaintiff incurred costs and expenses amounting to $75,000 in connection with due diligence efforts. Instead, plaintiff relies on its interpretation of the terms of the Loan Agreement and provides only a general statement of its due diligence expenditures. The statement does not show that the funds were retained for any legitimate, business-related purpose (*see* Parikh Aff., Ex. A). The statement consists of only a single line representing $76,437.51 in "accrued" "general expenses" through March 18, 2010 and legal through March 31 relating to "all transactions." There is no itemization of the "costs and expenses" (Loan Agreement, §2[b]) incurred. Further, the transaction closed on January 7, 2010 but plaintiff purports

to have incurred chargeable expenses through March 31, 2010, a period of almost three months after the closing.

The Loan Agreement states that "the sum of $200,000 [was to be retained] as a deposit against future commitment fees in the event that the obligations under the Note are rolled over into a future financing transaction" (Loan Agreement, §2[b]). In the demand letter dated March 18, 2010, plaintiff states that it retained $100,00 of the $200,00 "for its own account" but now admits it had "accrued" some undetermined sum less than $76,437.51 in general expenses as of that date (*see* Parikh Aff., Ex. A). By that time, Blue Wolf had already concluded that it would not enter into the equity transaction and had turned its attention to finding a viable exit from the loan already extended (Parikh Aff., ¶ 4). The expenses which plaintiff states exceeded $350,000 as of November 23, 2010, do not relate either "to the transaction contemplated by [the loan] agreement" or to a "future commitment" against which fees might be charged (Loan Agreement, ¶2[b]). These expenses, if indeed they were incurred, appear to relate to plaintiff's collection efforts. In any event, General Obligations Law §5-501 provides that interest includes "any and all amounts paid directly or indirectly... for the account of the lender." The claim by plaintiff that these funds were retained after the default and may not be considered in the usury analysis, is meritless. The demand letter of March 18, 2010, the date the loan was called and prior to any alleged default, states that "$100,000 of the deposit is being retained by the lender for its own account." (Wolf-Powers Aff., Ex. O at 1).

The alterative claim that the $200,000 represents a contingency payable in the event the equity transaction failed to close by March 31, 2010 and may not be considered as part of any usury analysis, is also meritless. Where, as in this case, the contingency requiring an increased payment to the lender is outside the control of the debtor, funds payable based on that condition or contingency constitutes additional interest (*see Diehl v Becker*, 227 NY 318, 326 [1919]; *McGee v Friedman,* 38 Misc 817 [Sup Ct Schenectady Co 1931]).

In face of clear evidence showing interest charges and retention of funds at a criminally usurious rate, defendant must demonstrate the existence of facts tending to show that the funds retained are not disguised charges (*see Machinery Funding Corp. v Stan Loman Enterprises, Inc.* [1st Dept 1982]. The $50,000 commitment fee lacks the characteristics of such a fee. The $75,000 deposit referred in the Loan Agreement was intended to cover "Lender's costs and expenses

(including attorney's fees relating to the transaction contemplated by [the loan] agreement" but plaintiff has offered no evidence that these funds were used for that purpose and if so, that the legitimate expenses incurred amounted to $75,000. The sum of $200,000 was retained by plaintiff under the terms of the Loan Agreement as a "deposit against future commitment fees" (Loan Agreement, ¶2[b]). Plaintiff admits, however, that it retained these funds long after it had decided against making any future commitment. These sums must be attributed to interest. The aggregate interest charged on the loan exceeds 25% and is criminally usurious.

Unlike the civil usury statute, the criminal usury laws do not void the loan (*see In re Venture Mtg. Fund, LP*, 282 F3d 185[2d Cir 2002]). The statute permits the corporate borrower to interpose an affirmative defense of criminal usury "in any action" (General Obligations Law § 5-521[1] and [3]. This case is an "action" and the statute applies. The affirmative defense is valid and operates as a bar to any action seeking to enforce the Loan Agreement (*see Funding Group, Inc.*, 19 Misc 3d at 492). The case must be dismissed.

It is hereby

ORDERED that plaintiff's motion for a preliminary injunction (Motion Sequence Number 001) is DENIED, the court having decided plaintiff's motion for partial summary judgment and defendant's motion for summary, and it is further

ORDERED that plaintiff's motion for partial summary judgment (Motion Sequence Number 003) is DENIED; and it is further

ORDERED that defendant's motion for summary judgment (Motion Sequence Number 004) is GRANTED and the complaint is dismissed in its entirety with costs and disbursements to defendant, American Stevedoring, Inc., and against plaintiff, Blue Wolf Capital Fund II, L.P., as taxed by the Clerk of the Court; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

This constitutes the decision and order of the court.

E N T E R,

DATED: August 22, 2011

O. P. Sherwood

O. PETER SHERWOOD, J.S.C.