Second Circuit Decision Addresses New York Usury Laws and Post-Default Mortgage Loan Obligations

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On March 30, 2020, the U.S. Court of Appeals for the Second Circuit affirmed several holdings of the District Court for the Eastern District of New York requiring a commercial mortgage borrower to pay default interest at a rate of 24 percent, effective as of the date of the default. In *1077 Madison Street, LLC v. March*, the defendant borrower, an individual, raised numerous defenses to the enforcement of a mortgage foreclosure action related to a 2007 mortgage in the original principal amount of $211,000, secured by a mixed-use commercial property in Queens, New York. Notably, the borrower raised an unsuccessful usury defense against the calculation of interest due made by a court-appointed referee.

In 2014, the plaintiff, a holder of the mortgage at issue by assignment, commenced its foreclosure action against the borrower, citing February 1, 2008 as the date of the default. Following the plaintiff's successful motion for summary judgment, and the borrower's unsuccessful subsequent motion for reconsideration, a court-appointed referee calculated the amounts then due on the mortgage and underlying promissory note. The referee calculated the interest at the default rate contained in the mortgage loan documents, 24 percent, calculated as of the date of the default, which resulted in a total amount due of approximately $596,700, of which $383,736 was interest alone. Subsequently, the District Court entered an order of foreclosure and sale, which the borrower appealed.

After a series of proceedings, the borrower appealed the decision, raising challenges to all findings of the lower court, including three in particular with respect to the calculation of interest in the referee's report, alleging, in part:

1. that the default date of February 1, 2008 should have been determined at a hearing;
2. that the 24 percent default interest rate violates a New York civil usury statute, which caps interest at 16 percent (in New York, interest charged in excess of 25 percent or more may constitute criminal usury); and
3. that the calculation of interest should have been made as of the date of acceleration, and not the date of default.

The appellate court rejected each of these three arguments — the first, due in part, to the borrower's prior admission of the default date, and the third, due to express provisions in the loan documents which provided that default interest shall accrue from the date of the default. The second argument was also rejected based upon express loan document provisions in which the borrower had agreed to pay default interest at the stated rate in the event of a default. The court further cited several precedent cases that clearly foreclose the argument, citing the fact that state usury limitations do not apply to defaulted obligations. As a result, the borrower was ultimately held liable to pay interest at the default rate provided for in the loan documents as of the date of the default itself.

For lenders making commercial mortgage loans in New York, it is well known that New York General Obligation Law § 5-501(6)(b) provides that usury does not apply to loans made in excess of $2.5 million. However, the Second Circuit's holding in the case at hand (in which the original amount of the loan was only $211,000), has made it clear that lenders must carefully evaluate the default and usury provisions contained in their mortgage loan documents for smaller transactions as well to ensure that no rights or remedies are being left on the proverbial table. Further, it should be noted that the defense of civil usury is not available to all borrowers in New York, as it may not be asserted by limited liability companies or corporations. The Second Circuit's ruling in this case affirms that default interest rates in excess of the state civil usury limitations of 16 percent are not applicable to defaulted obligations, and that an

individual borrower in New York waives their rights to assert a civil usury defense post-default, regardless of the amount of the loan, or the ultimate rate of default interest, if such rate of interest is specifically provided for in the mortgage loan documents.

If you have questions or would like further information, please contact Kristen E. Andreoli (andreolik@whiteandwilliams.com; 212.631.1256), C. Jason Kim (kimcj@whiteandwilliams.com; 212.714.3077), Timothy E. Davis (davist@whiteandwilliams.com; 215.864.6829) or another member of our Real Estate and Finance Groups.

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