

Confessions of a Borrower

The title of this article may lead you to believe that this is a story about confessions of criminal acts or other wrongdoing committed by a borrower. While we may have succeeded in drawing you in to reading a potentially tantalizing tale, this article is really all about *Confessions of Judgment*. What are they? Why are they used? Should lenders require them? Should borrowers agree to them? Are they market? Are they even enforceable?

A confession of judgment provision is a clause included in a promissory note, guaranty agreement, loan agreement or other loan document by which a borrower of a loan (note that, although we use the term "borrower" throughout this article, confession of judgment provisions can readily apply to a guarantor or other obligor on a loan) authorizes the lender to have a judgment entered against the borrower typically for an amount equal to the amount of the loan (principal, interest, fees and charges) remaining unpaid and outstanding, plus attorneys' fees and costs of collection. The most critical and criticized aspect of a confession of judgment provision is that it permits a lender to get a judgment entered against a borrower without advance notice or a hearing.¹ In the absence of a confession of judgment clause, a lender is only able to get a judgment entered against a borrower after first initiating a lawsuit, and then winning the lawsuit on summary judgment grounds or after a trial or hearing on the merits. That could take months, if not years, to achieve; whereas a judgment entered pursuant to a confession of judgment clause in a loan document could be enforced in as little as 22 days.²

Sounds too good to be true (if you are a lender)? Well, that depends. Very few states throughout the country actually honor confession of judgment provisions (often because of due process concerns), and those that do typically regulate when and how the provisions may be used.³ Unlike the District of Columbia, which will only enforce confessed judgments under certain limited post-default circumstances, both Maryland and Virginia will allow a lender to obtain a judgment against a borrower pursuant to a confession of judgment provision; although, in Maryland, confession of judgments are only permissible in connection with loans made for commercial or business purposes. Virginia has even

¹ It is well settled that "due process rights to notice and hearing prior to a civil judgment are subject to waiver." *D.H. Overmyer Co. Inc., of Ohio v. Frick Co.*, 405 U.S. 174, 185 (1972) (citing *National Equipment Rental Ltd. v. Szukhent*, 375 U.S. 311 (1964)).

² In Virginia, an obligor only has 21 days from the date of service of the notice of the judgment to file a motion objecting to the judgment; thus, the lender could enforce the judgment on the 22nd day. See VA. CODE ANN. §8.01-433. In Maryland, an obligor has 30 days from the date of service of the notice of judgment to file a motion objecting to the judgment; thus, a lender could enforce the judgment on the 31st day. See MD R. 2-321.

³ For example, Illinois, Ohio, Pennsylvania, New Jersey, Michigan, and Minnesota permit confession of judgment provisions.

more specific requirements to be met in order for a confession of judgment provision to be enforceable.⁴ To be a valid and enforceable provision in Virginia, the loan document containing the confession of judgment provision must include the following statement in boldface print and eight-point type or larger as a legend on the face page of the loan document:

IMPORTANT NOTICE

THIS INSTRUMENT CONTAINS A CONFESSION OF JUDGMENT PROVISION WHICH CONSTITUTES A WAIVER OF IMPORTANT RIGHTS YOU MAY HAVE AS A DEBTOR AND ALLOWS THE CREDITOR TO OBTAIN A JUDGMENT AGAINST YOU WITHOUT ANY FURTHER NOTICE.

Additionally, in Virginia, the instrument must identify the specific person authorized to confess judgment and the court where judgment can be confessed. In states that do not recognize the enforceability of confession of judgment provisions or where the borrower is organized or domiciled in a state which does not recognize confession of judgment provisions, lenders may have a work-around that would give them the benefit of a confession of judgment provision without running afoul of the particular state's laws: the lender could obtain a confessed judgment in the jurisdiction that recognizes and enforces such provisions and then domesticate the judgment (i.e. have it filed in the borrower's jurisdiction of organization or domicile) for enforcement.

Procedurally, in Maryland, after a loan default, a lender looking to obtain the benefits of a confession of judgment clause is required to file a complaint, accompanied by the loan document and an affidavit, indicating the amount owed and the address of the borrower. After the judgment is entered in the docket by the court clerk, a notice of the judgment must then be served on the borrower. The borrower may move to open, modify or vacate the judgment, but only if such a motion is filed timely within a certain number of days from the date on which the borrower was served with notice of the judgment.⁵ To succeed with such a motion, the borrower has the burden of proving that there is a meritorious defense to the claim (as opposed to the lender having to prove that a loan was made, that a default has occurred and that the lender is entitled to declare the loan immediately due and payable in full); thus, a confession of judgment effectively shifts the burden of proof to the borrower.

It is, by all accounts, a very difficult burden for a borrower to meet. In Maryland, for example, a meritorious defense "is not a defense to everything that may have gone before in the long and possibly tortuous financial history between the parties...[it] is a defense challenging i) the execution of the

⁴ VA. CODE ANN. §8.01-433.1.

⁵ In Maryland, an obligor has 30 days from the date of service of the notice of the judgment to file such a motion. MD R. 2-321.

promissory note itself or ii) the amount of debt due on the [loan]."⁶ Because courts have generally limited the grounds for opening, modifying or vacating a judgment entered by confession, the defenses that are typically raised challenge the amount of the judgment, allege some sort of deficiency in the paperwork filed with the court clerk (such as failing to include the original instrument, which fails because Maryland does not require the original), or claim that an unknown loan officer told the borrower that he, she or it did not have to repay all or a portion of the loan. In Virginia, however, a borrower can move to set aside or reduce the judgment "on any ground which would have been an adequate defense or setoff in an action at law instituted upon the judgment creditor's note, bond or other evidence of debt".⁷ Such motions are seldom filed, and even if timely filed, they are rarely successful. Our own firm's Creditor's Rights Practice has only had one case where a motion to open the judgment was granted, but even in that case, summary judgment was entered after a hearing on the merits about a month later. Simply put, a judgment by confession is much simpler and more efficient (i.e., a matter of months) than obtaining a judgment through a full blown litigation proceeding (which can take a year or more).

In some states, such as Maryland and Virginia, there is another, often overlooked, benefit to utilizing a confession of judgment provision if you are the lender of an unsecured loan: it provides an opportunity to automatically secure the loan by attaching the borrower's real property with a judgment lien, giving the lender a secured position over other creditors whose debt obligations may be unsecured. Specifically, in Maryland, when a judgment is indexed and recorded (regardless of whether the judgment resulted from a motion for summary judgment, a hearing on the merits or pursuant to a confession of judgment clause in a loan document), the judgment automatically becomes a lien, in the amount of the judgment, on the borrower's interests in any real property located in the county in which the judgment is entered.⁸ Likewise, in Virginia, a lien on a borrower's real property will "attach and be binding from the time" a confessed judgment is recorded.⁹

When we serve as lender's counsel, we typically recommend the inclusion of a confession of judgment provision in loan documents (assuming the loan documents are governed by the laws of a state, such as Maryland or Virginia, that recognizes and enforces judgments by confession). Alternatively, we may operate under the mandate and guidelines of specific lenders who will not make a loan without such a provision (unless credit approval is granted for omitting it). On the flipside, when we serve as borrower's counsel, negotiating out a confession of judgment provision contained in a loan document is a top priority. In our experience, only those borrowers getting big dollar loans who are also very

⁶ *NILS, LLC v. Antezana*, 171 Md. App. 717, 728 (2006).

⁷ VA. CODE ANN. §8.01-433.

⁸ See *In re Broyles*, 161 B.R. 149, 151 (Bankr. D.Md. Oct. 28, 1993).

⁹ VA. CODE ANN. §8.01-434.

bankable (i.e., those with negotiating leverage) have greater success at negotiating out confession of judgment provisions from loan documents. As for lenders who regularly close loans without confession of judgment provisions or who find themselves having to remove such a provision as a result of the loan document negotiating process, they are not without a remedy. They will simply be left with having to pursue the more drawn-out, customary, old-fashioned way of obtaining a judgment against a borrower through a traditional lawsuit.

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