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House Financial Institutions, Housing,
and Urban Development Committee

Ron Zimmerly
HB 67 Opponent Testimony

Chairman Dever and members of the Financial Institutions, Housing, and Urban Development Committee, my name is Ron Zimmerly. I am President and CEO of Liberty National Bank. On behalf of community banks around the state, thank you for permitting me the time today to provide you with further insight into community bank opposition to House Bill 67.

First, I will begin by giving you a little background on Liberty National Bank. We are a small community bank with assets of just under \$300MM, headquartered in Hardin County. We have six offices—our home, or original office located in Ada, Ohio; our headquarters in Kenton; two branches in Bellefontaine, one in Marysville, and our newest location in Westerville. This is our 124th year in business. We are locally owned and locally operated. We primarily serve small businesses, farmers and local consumers with their lending and deposit needs.

House Bill 67 is intended to protect borrowers in commercial transactions. However, the bill carries with it the ability to materially impact community banks' ability in the State of Ohio to prevent or recoup losses that are outside of the banks' control.

Cognovit notes are not used in consumer transactions. They are only used in commercial transactions. Cognovit notes contain a clause warning borrowers in bold, all-caps language that if they sign the loan, the lender can seize assets through a court judgment "without your prior knowledge" should the borrowing party fail to make timely payments. The bold, all-caps clause is located just above the signature block so that it is conspicuous to borrowers.

Banks do not and cannot simply exercise a cognovit just because they decide they don't care for a particular customer or a particular loan. There must be valid, justifiable, and legal reason before a bank can exercise its cognovits provision. The procedure to obtain a cognovits judgment involves the lender's attorney preparing a complaint, answer and a proposed judgment entry. A second party reviews the paperwork and signs the Answer, confessing judgment. The lender's attorney files the paperwork with the court. He/she then takes the paperwork to the judge to be signed. The judge reviews the paperwork to ascertain the legitimacy of the complaint. In other words, is the borrower in material breach of their contract with the lending institution. The original note must be presented when the complaint is filed. The amount due must be specified in the complaint and the judgment. The complaint must state the last known address of the borrower. The complaint must state the loan was a commercial and not a



consumer loan. The complaint must be filed in the county where at least one of the borrowers resides, or, in some cases, where the note was signed.

Ohio courts recognize that cognovits judgments deprive borrower of their day in court. As a result, courts normally have strict interpretations of the regulations and err on the side of the borrower. They do not hesitate to invalidate cognovit judgments for various reasons, including non-monetary defaults, i.e. failure to provide updated information, etc. *Salh Kahn*, at § 14; *Henry County Bank v. Stimmels, Inc.*, 2013-Ohio-1607 (3rd District). Also, the failure to possess or

produce the originally executed cognovit note has been grounds for the invalidation of cognovits judgments. *199 South Fifth Street, LLC* at ¶ 12 and 15; *Foreman* at ¶ 2 of the syllabus.

Borrowers do have the right to challenge a cognovit judgment filed by a bank. They can file a motion for relief from judgment. To prevail, they must show that a meritorious defense exists and the motion was made timely. Since cognovit judgments are of an extraordinary nature, the statutory requirements are strictly construed against the party seeking to take cognovits judgment. A meritorious defense is one concerning the validity of the debt or cognovits note, the status of the debt at the time of the lawsuit, or the procedure used to obtain the judgment. Meritorious defenses include improper procedures in obtaining the judgment, payment or partial payment, and miscalculation of the note balance due at the time of confession of judgment.

As you can see, banks cannot simply just exercise a cognovit judgment on a whim. There must be a legal and legitimate reason to do so. I have been in banking for nearly 30 years, and can think of three times where a cognovit was used.

I would like to give you a recent example of why Liberty National Bank found it necessary to exercise a cognovit and why it could have been detrimental to the bank and its shareholders had HB 67 been enacted at the time.

The Bank had a deposit and loan relationship with a used car dealership for several years. The relationship performed as agreed with no issues over the years. In December of 2016, the Bank became abruptly aware that the customer had been kiting checks between two Banks. This created an overdraft situation with Liberty, which led to a large check loss for the Bank. Further, it caused several checks to bounce on the customer's floor plan loan with the Bank. The customer's floor plan loan was current on all payments, as were the commercial real estate loans. Nonetheless, it was abundantly clear that despite the fact that the loan payments were current, the Bank's collateral position could be jeopardized quickly. The floorplan was secured by used vehicles, some of which had been sold and checks had bounced because of the kite being shut down. Furthermore, auto inventory can quickly be moved, sold, parted out, etc., and borrowers can leave town.

Liberty found it necessary to seek legal counsel, exercise its cognovit, file complaint and obtain judgment. This allowed the Bank to take control of the vehicle inventory. Had the Bank been



required to provide Borrower with thirty days' advance notice, this would have given the ample time to liquidate or hide the inventory. In this case we were dealing with titled vehicles.

However, there are cases where non-titled machinery can disappear in a heartbeat. Livestock can be loaded up and taken to the slaughterhouse overnight, etc. Providing advance notice in certain cases simply provides unethical borrowers too much notice and harms the financial institutions.

In the particular case outlined above. The inventory was moved by the bank and locked down. Bank and Borrower have worked together to liquidate the inventory to retire the debt.

I'd also like to comment on the insinuation that Bank's use cognovit provisions in loans to call notes when economic circumstances change and appraised values depreciate. This is ludicrous. Banks do not want to own real estate. That is the last thing banks want to do. A bank would much rather work with a borrower to be repaid on a loan than to take back a property and recoup a small percentage of what is owed. Banks do not exercise cognovit provisions when borrowers become a few days past due. Typically, a borrower hits at least 90 days past due before a bank begins any kind of legal process, and the Bank has been communicating throughout that timeframe with the Borrower. Banks typically only foreclose on properties as an absolute last resort once all other options are exhausted, minimizing their losses. Banks succeed when their customers succeed. Banks fail when their customers fail.

In closing, the passing of HB 67 would have a negative impact on banks throughout the state of Ohio. This leads to a trickle-down effect. In the commercial banking area, it would change the way lenders approve loans. The passage of the bill will also increase the cost of borrowing money in the form of higher interest rates to offset the increased risk in these transactions. While lenders rarely act on cognovits, it is a last-ditch tool to prevent losses in some rare instances. By exercising a cognovit, foreclosure time can be shortened, saving time and money for all involved. The passage of HB 67 would drive up legal fees for lenders, and draw out the timeline for lenders to recoup losses.

Thank you for your time and consideration; I would be happy to answer any questions you might have.