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STATEMENT TO THE OHIO HOUSE OF REPRESENTATIVES
FINANCIAL INSTITUTIONS, HOUSING, AND URBAN DEVELOPMENT
COMMITTEE ON H.B. 67 (Cognovits)

May 2, 2017

Chairman Dever, Vice-Chair Sprague, Ranking Member Smith, and members of the Financial Institutions, Housing and Urban Development Committee, my name is Tyson Crist. I am a Partner of the law firm Ice Miller, LLP. I have been in practice for over 16 years, in the Bankruptcy & Financial Restructuring Group at Ice Miller. I am currently the Chair of the OSBA's Banking, Commercial & Bankruptcy Law Committee, which I have served on in various capacities as long as I have been practicing. I testify today, on behalf of our OSBA Committee, which opposes House Bill 67. In short, cognovit lending in Ohio is a long-standing practice that has survived all legal challenges. This legislation would negatively impact financial institutions and the practice of members of our OSBA Committee.

I have reviewed much of the testimony submitted in support or in favor of H.B. 67 and find it to be one-sided and not reflective of what actually happens with cognovit notes on a day-to-day basis from the perspective of an attorney. I fear that H.B. 67 is being pushed through based on a select few sensationalized circumstances that may not be accurate and do not paint the whole picture. And it appears to be an attack on the enforcement of contracts. There is no reason to change the law on this subject as there is a very well-established case law and practice currently in place, as well as the commercial practices of banks, all of which could be up-ended if H.B. 67 is passed, with a number of potential consequences that the proponents are not voicing. If the elimination of the use of cognovits notes in Ohio makes it harder for businesses to get loans, or if it causes those businesses to pay increased interest rates because of the increased costs and delays that the lender will experience if the loan goes bad, does that help business in Ohio?

The bottom line is that this legislation will most likely have the practical effect of increasing the costs to lenders of making commercial loans in Ohio because it will turn what would be an expedited process that quickly weeds out non-meritorious defenses into a year or more of litigation with significantly increased legal fees. These costs will be passed on to other borrowers. And, it may make lenders more cautious in extending loans in the first place—stricter underwriting standards—to impose stricter financial covenants, and increase interest rates, possibly for the very same borrowers that are advocating for the elimination of cognovit notes.

Practitioners on our Committee have reported that in some commercial cases, in which the loan documents were not prepared in Ohio and do not have cognovit provisions, the issue of default, although clear from a factual perspective, is often tied up through various delays in court for 1-3 years, all the while the lender has to continue to spend legal fees on what is a non-performing loan, with no realistic prospect of ever being paid. If a borrower has defaulted on the contractual terms it negotiated, and has not cured those defaults, and if the lender has complied with all the due process requirements, what is the point of then requiring the lender to forego its contractual rights and endure significant delay and incur substantial further costs to enforce the

terms of its contract? The elimination of cognovits will further tie up the courts and require lenders to spend more in legal fees. And the supposed evils that this legislation attempts to prevent are already proscribed by time-tested, existing statutes and case law. In reality, this is an effort to delay and add expense to the process of enforcing commercial contractual obligations. Is that the message we want to convey, that Ohio is not in favor of enforcing contractual obligations?

Obviously, cognovit notes can only be used in Ohio for commercial loans. In this context, it streamlines litigation and reduces costs (both for lender and borrower), with procedural safeguards, for loans that go into default. It is simply the enforcement of a contract. The borrower has previously been notified, via the statutorily required language, that by signing a cognovit note this is the process that can be employed if they default on the loan. It is the terms of the contract that are enforced; it is not an arbitrary, out-of-the-blue decision by a financial institution. There has to be a default based on the terms of the contract, whether that is due to (a) maturity of the loan, (b) an installment payment default, or (c) a covenant default. And in the context of interest only construction loans, sometimes the financial covenants can be just as (or more) important than the payment obligations, prior to maturity. These are not mere technicalities; these are bargained-for contractual rights.

Over the years, the process and procedure to take cognovit judgments, which is set forth in R.C. § 2323.13, has been challenged in pretty much every respect, and has always been upheld as complying with due process of law, the United States Constitution and the Ohio Constitution. *See, e.g., D. H. Overmeyer Co. Frick Co.*, 405 U.S. 174 (1972). The Ohio Supreme Court, Board of Commissioners on Grievances & Discipline has, in recent years, confirmed that this process is ethical. *See* Ohio Eth. Opinion 2014-3, 2014 WL 4402836, *Confession of Judg. Pursuant to a Warrant of Attorney in a Cognovit Note* (Aug. 8, 2014) (superseding and updating the holding in Advisory Opinion 93-3 due to the change from the Ohio Code of Professional Responsibility to the Ohio Rules of Professional Conduct). It is far from an easy matter to obtain a cognovit judgment. Not only the creditor's attorney, but the attorney engaged to confess on behalf of the obligor, as well as the judge that reviews the pleadings, vet the propriety of entering the judgment in compliance with the statutory safeguards. And, even if entered, there is a well-established, relaxed threshold to set aside the judgment under Civil Rule 60(B), should there be any meritorious defense or any impropriety or non-compliance with the statutory requirements, notwithstanding the prior vetting by two attorneys and a judge. This process has stood the test of time in Ohio. There is nothing that has changed as of late; no reason why the way in which commercial lending is done in Ohio should be changed at this time.

There has been a suggestion that Indiana recently did away with cognovit notes and there have been no negative impacts, so Ohio should do the same. This is not true. Indiana diverged from Ohio (and Illinois) in this regard long ago and has not used cognovit notes since at least 1927, as confirmed by case law (currently, I.C. 34-54-4-1). For examples of corroborating case law and materials, see the following:

- *Peoples Nat'l Bank & Trust Co. v. Pora*, 212 Ind. 468 (1937) (noting that cognovit notes were then legal in Illinois, but had been outlawed in Indiana under former Section 2-2904 (section 399) and 2-2906 (section 398)).

- *Bank of Waukegan v. Freshley*, 421 F.Supp. 1033, 1035 (N.D. Ind. 1976) (citing a 1971 Indiana statute for the proposition that: "It is clear in Indiana that cognovit notes have been specifically outlawed by statute (I.C. 1971, 34-2-26-1).

- Griffith, *Limitations; cognovit notes*, 17 Ind. Law Encyc. Judgment § 137 (citing case law from 1924 to 1967 on the issue of cognovit notes).

- Edwards, *Constitutionality, construction, application, and effect of statute invalidating powers of attorneys to confess judgment or contracts giving such power*, 40 A.L.R.3d 1158 (citing Indiana case law on cognovits dating from 1931 to 1962).

In short, I know of no states in which cognovit notes for commercial loans have been recently eliminated, which would provide any basis for comparison or projection of what impact H.B. 67 may have on commercial lending within Ohio.

Respectfully, I submit, on behalf of my OSBA Committee, that H.B. 67 will do more harm than good, at the behest of a vocal minority, and which will have a negative impact on commercial lending in Ohio.

I would be happy to answer any questions you may have.