

Confession of Judgment Key Loan Provision

By

Every commercial loan made by a bank or other financial institution includes a promissory note which is the borrower's "promise" to pay back the loan. The note contains all of the important terms of the transaction, including the interest rate, the amount of the monthly payment and the date the loan matures. If the borrower makes all of his payments on time and pays off the note at the maturity date, all is well. *What happens when the borrower falls behind and cannot make the required payments?*

Most commercial lenders will work with a delinquent borrower to reach a mutually acceptable payment plan. If the borrower fails to adhere to the payment plan and the loan falls further into default, the lender may "pull the plug," accelerating the entire loan and taking the borrower to court to collect the debt. This can be a long drawn out process; it could take the lender many months, if not years, to obtain a court judgment. In the meantime, the borrower may dissipate his assets so that when the lender finally obtains the judgment, the borrower's assets are gone and the lender is left holding the bag.

As with many states, Maryland has a procedure which allows the lender in commercial loans only - and with the borrower's consent - to include a *confession of judgment provision* in the note. This provision may not be used in any consumer transactions, such as family mortgage loans, home equity loans, auto loans and any loan which does not qualify as a business or commercial loan under Maryland law.

In a note with a confession of judgment provision, the borrower agrees that if he defaults on a commercial loan, the lender can immediately obtain a court judgment against the borrower without having a trial. Upon default by the borrower and at the lender's request, the clerk of court will enter a judgment against the borrower for whatever amount is owed on the note. The procedure is fairly simple and can be completed in a matter of hours. Without such a provision, it could take months if not years for the lender to secure a judgment.

Why would a borrower ever consent to such a provision? The answer is simple. Many lenders will not make a commercial loan without a confession of judgment provision in the note. The borrower's choice is either to take a loan that includes the provision or look elsewhere. Since most lenders will not make a commercial loan without such a provision, the borrower is likely to have it in his note regardless of which bank ends up making the loan.

The news is not all bad for the borrower. In Maryland, the law allows the borrower to go into court and ask the judge to "open, modify or vacate the judgment." The court will only do so, however, if the borrower can demonstrate that he has a meritorious defense to the claim. At that point, the court does not decide the merits of the borrower's claim, but simply determines whether there is any basis for the defense raised by the borrower. If the court finds there is no basis, the judgment stands. If it decides there is a basis, the judge will open, modify or vacate the judgment so that the borrower can file a responsive pleading. In that event, the case will proceed as any other case and at some future point will be decided on the merits in a full trial. Meritorious defenses which justify setting aside the judgment include forgery, fraud or a challenge to the amount claimed to be owed.

Prior to preparing the note and other loan documents, a commercial lender will sometimes issue to the borrower a term sheet or "commitment letter," setting forth in a condensed form all the material terms of the loan which the lender is offering to the borrower. A careful lender will include in the commitment letter a requirement that the note contain a confession of judgment provision. When accepted by the borrower, the commitment letter then serves as the framework for the more comprehensive note and other associated loan documents.

Borrowers should pay close attention to all the terms of the commitment letter and are advised to seek experienced legal counsel to review the commitment letter prior to acceptance. Frequently, borrowers overlook this step, making it difficult if not impossible for an attorney to negotiate terms which have

already been agreed to by the borrower in the commitment letter. Of course, the note and other loan documents should also be carefully reviewed by counsel prior to signature.