

Lending Law Update



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Confessions of Judgment Not to Be Taken for Granted

Confessed judgment provisions that authorize banks to enter judgments upon loan defaults have long been a staple of commercial loan documentation in Delaware. Since judgments have priority from the date entered, the purpose of these clauses is to get ahead of other creditors pursuing a borrower or guarantor. Confessed judgment actions start with the entry of the judgment; in other lawsuits, the amount owed the judgment is entered only upon the successful conclusion of the action. If the borrower or guarantor contests the confessed judgment, then the bank must prove at a court hearing that they effectively waived their right to notice and hearing prior to the entry of judgment. For years Delaware banks have relied on the language in confession of judgment clauses to prove effective waiver of these rights. This is not unreasonable, given Delaware case law such as *Pellaton v. Bank of New York*, holding that the bank had proved a knowing, voluntary, and intelligent waiver of the right to prior notice and a hearing, even though the guarantor did not read the loan documents, had no knowledge that the guaranty included a confessed judgment clause, and the guarantor’s attorneys did not review the documents with the guarantor or mention the clause.

New Decision May Require More Reliance on documents may no longer be enough. Last fall the U.S. District Court for the District of Delaware, in *RBS Citizens, N.A. v. Caldera Management, Inc.*, found that a guarantor had not knowingly, voluntarily, and intelligently waived the right to notice and a hearing prior to the entry of judgment. This case is not binding on Delaware courts

because it was issued by a federal court; nevertheless, it is troubling for banks since the court interpreted existing Delaware case law in reaching its decision. The court held that the bank did not establish a valid waiver by only showing that the guarantor (who was a college-educated wife of a real estate developer and who had signed guaranties with similar confession of judgment clauses before) had signed the guaranty. They found that the guarantor did not have the benefit of legal representation in signing the guaranty (despite an opinion letter from counsel stating they represented the guarantor) and stressed that the legal implications of the confession of judgment must be brought to the attention of the guarantor.

Recommendations

The RBS Citizens opinion contemplates loan closings at which bankers, borrowers, guarantors, and their attorneys meet at the same time to sign loan documents—largely obsolete in the age of the Internet. Ideally, the bank should make sure counsel represents the borrower and guarantors and explains the confessed judgment provisions; if not possible, then the bank might require that guarantors who are not themselves sophisticated in commercial lending transactions be represented by counsel; if still unrealistic, then a bank representative should explain that the confession of judgment clause is a waiver of the important constitutional rights of notice and a hearing prior to judgment. Banks also need to revise form commitment letters, notes, and guaranties to make it clearer that an important constitutional right is waived.