

Inside NY Limits On Creditor Use Of Confessions Of Judgment

By **Robert Fryd and Andrew Coyle** (March 9, 2020)

Last year, New York amended Section 3218 of its Civil Practice Law and Rules to prohibit the use of confessions of judgment against out-of-state debtors. Although the amendment has been in effect for six months, many still appear to be unaware of it, and several issues raised by the amendment remain to be resolved by the courts.

Among these issues are (1) whether debtors, who previously lacked standing to challenge their creditors' filings of confessions of judgment in an improper county, may now do so, and (2) whether a confession of judgment which, under the amendment, can no longer be filed against a nonresident will nevertheless qualify as an "instrument for the payment of money only" for purposes of CPLR 3213 and the expedited procedure of a motion for summary judgment in lieu of complaint authorized thereby.

Regardless of how these issues are ultimately decided, practitioners, lenders and creditors will now need to consider other types of security to use in place of the no-longer-usable confession of judgment from an out-of-state borrower/debtor.

Background

New York law has long permitted a creditor to obtain a money judgment against a debtor by simply filing a confession of judgment — an affidavit signed by the debtor — with a county clerk within the state. The use of confessions of judgment is governed by CPLR 3218. Prior to the amendment, creditors could file a confession of judgment and obtain judgment thereon in either "the county where the [debtor] reside[d]" or, if the debtor was a nonresident, in the county in which entry was authorized in the affidavit from the debtor.

Hence, a creditor could obtain a judgment in New York — without the need to file and prosecute a lawsuit — against even an out-of-state debtor, as long as the debtor's affidavit authorized the filing of the confession in a specified county.

Confessions of judgment have been an important tool in connection with various transactions, including forbearance and settlement agreements. For instance, a defendant can sign a confession of judgment to be held in escrow to secure its obligations under a settlement agreement; if the defendant subsequently defaults on its obligations under the agreement, the confession will be released from escrow and judgment can then be entered against the defendant for the amount confessed. In this context, the confessed amount often exceeds the settlement amount, thereby incentivizing the plaintiff to agree to a compromise, and the defendant to comply with its obligations under the agreement.

New York, however, has always placed restrictions on the use of the confessions of judgment. For example, judgment cannot be entered against the debtor if more than three years has elapsed since the signing of the confession.[1] Judgment by confession may also not be entered after the debtor's death.[2]



Robert Fryd



Andrew Coyle

The 2019 Amendment to CPLR 3218

The recent amendment to CPLR 3218 places additional restrictions on the use of confessions of judgment. The amendment provides that confessions of judgment may now be entered only in the county in New York in which the debtor resided at the time the confession was signed, or the county in New York in which the debtor resides at the time of entry. The previous provision authorizing the filing of a confession of judgment against a debtor who was not a resident of New York, but nevertheless authorized entry of judgment in New York, has been deleted. Under the current law, a business entity is a resident of any county in which it has "a place of business."^[3]

Notably, a confession may still be filed against an out-of-state resident if that person was a resident of New York at the time the affidavit was signed. A confession may also still be filed against a debtor who is a resident of New York at the time of filing, even if that person resided elsewhere when he or she signed the confession.

The amendment was effective as of Aug. 30, 2019, and applies to all confessions of judgment, including those signed prior to such date.

The impetus for the change in the law was public outcry related to the abuse of confessions of judgment, particularly by "unscrupulous creditors," often outside of New York. According to the sponsors of the bill:

"[I]n recent years, creditors, often from out-of-state, have entered confessions of judgment in various New York counties against debtors who themselves are out-of-state small business owners with no connection to New York. This practice has resulted in some unscrupulous creditors using New York law and procedure to freeze and then seize debtors' assets based on a judgment entered in a venue far from where the agreement was executed and the parties reside, making it difficult for a debtor to contest abusive conduct by a creditor."

And, in his 2019 Justice Agenda, Gov. Andrew Cuomo proposed legislation to address the abuse of confessions of judgment by predatory lenders in such situations:

"Firstly, New York will codify an FTC rule that prohibits confessions of judgments in consumer loans; secondly, prohibit the use of confessions of judgement in small business loans under \$250,000, situations where business owners may struggle to afford representation and should not be forced into waiving their legal rights; and finally, stop lenders from exploiting New York courts for nationwide collections by requiring that any permissible confession of judgment enforced in New York courts have a nexus to business activity in New York."

Despite the stated purpose of the amendment, and despite Cuomo's suggestion that the changes apply only to consumer transactions or small business loans under \$250,000, and only to transactions with a nexus to New York, the 2019 amendment to CPLR 3218 as actually enacted applies to the use of confessions of judgment in any amount by all lenders or creditors against all out-of-state borrowers/debtors, not just predatory lenders outside of New York or in connection with transactions having no nexus to New York.

Indeed, not only did the New York state Legislature fail to tailor the statutory amendment in accordance with the governor's proposal, but it is still considering even broader amendments to further restrict the use of confessions of judgment. For instance, S.B. S3851, if passed, would prohibit the use of a confession of judgment, even against New York borrowers/debtors, in connection with "any contract or agreement for a financial

product or service.”

The bill defines “financial product or service” as any “financial product or financial service offered or provided by any person regulated or required to be regulated by the superintendent of financial services pursuant to the banking law or the insurance law or any financial product or service offered or sold to consumers.” The Consumer Protection Committee is currently considering proposed bill S3851.

The federal government has also contemplated consumer protection bills restricting the use of confessions of judgment. For example, the proposed Small Business Lending Fairness Act (H.R. 3490) would prohibit the use of a confession of judgment in connection with any “extension of credit or creation of debt in or affecting commerce.” On Nov. 19, 2019, the House Financial Services Committee approved H.R. 3490 by a vote of 31 to 23. To date, however, neither the House of Representatives nor the Senate has taken further action on the bill.

Open Issues Under CPLR 3218 as Amended

Although both the state Legislature and Congress have considered additional proposals to further restrict the use of confessions of judgment, the only amendment that has become law in New York to date is the amendment to CPLR 3218, which prohibits the filing of a confession of judgment against an out-of-state resident. In at least two respects, however, issues under the amendment, and/or resulting from it, remain to be decided by the courts.

First, long-standing precedent holds that a judgment debtor cannot seek to vacate a judgment on the basis that a confession was filed in the wrong county.[4] However, given that the premise of these cases was the belief that CPLR 3218 was intended to protect bona fide creditors, whereas the 2019 amendment to CPLR 3218 discussed herein was clearly intended for the protection of borrowers, it remains to be seen whether debtors will now be permitted to object to the entry of judgment by confession in an improper county.[5]

Second, since the 2019 amendment to CPLR 3218 on its face applies to all affidavits of confession of judgment executed by out-of-state debtors, even those executed before the Aug. 30, 2019, effective date of the amendment, lenders/creditors holding such affidavits may seek to use them in any way possible, such as by way of a CPLR 3213 motion for summary judgment in lieu of complaint, if the affidavits are held to be instruments for the payment of money only for purposes of CPLR 3213.[6] And, if they are, the courts may also have to decide whether an affidavit authorizing entry of judgment in New York, in connection with a transaction and parties having no other nexus to New York, constitutes a consent to the jurisdiction of the New York courts.

Conclusion

Parties to litigation and financial transactions must now be vigilant when drafting settlement or loan documents to account for the recent changes in the law.

New York will no longer permit filing of confessions of judgment against any debtor who was not a resident of New York when the confession was signed and who is not a New York resident at the time the creditor seeks to file the affidavit and have judgment entered thereon. Settlement agreements, forbearance agreements and loan documents that provide for or require a confession of judgment against an out-of-state debtor should be altered in light of these amendments.

Lenders and other creditors would be well-advised to seek new forms of security when dealing with nonresidents, including, among other things, real estate mortgages, Uniform Commercial Code Article 9 security interests and/or promissory notes. Without the previously routine confession of judgment, and without any alternative form of security against nonpayment and the delay that would be engendered by having to start a brand new lawsuit based on a default under a settlement or forbearance agreement, lenders and creditors may be less inclined to settle their claims for less than the full amount owed to them.

Robert Fryd is a partner and Andrew T. Coyle is an associate at Warshaw Burstein LLP.

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[1] CPLR 3218(b).

[2] Id.

[3] Id.

[4] See *Steward v. Katcher*, 283 A.D. 50 (1st Dep't 1953) (holding that defendants were not entitled to challenge entry of judgment by confession in an improper county, as the venue provisions under the extant statute were designed to protect bona fide creditors rather than the debtor); see also *6th Ave. MCA Fund L.P. v. Wealth Preserv. LLC*, Index No. 54662/2017, 2017 N.Y. Misc. LEXIS 3840, at *3 (Sup. Ct., Westchester Cty. Sept. 20, 2017).

[5] See *Takat Gems USA v. Flex Funding, LLC*, Index No. 519643/19, 2020 N.Y. Misc. LEXIS 377, at *3 n.1 (Sup. Ct., Kings Cty. Jan. 15, 2020) ("Future cases will determine whether . . . [the] change [to CPLR 3218] likewise now affords a judgment debtor the ability to vacate a confession of judgment filed in the wrong county or whether such filing is void even as to the debtor").

[6] See *Sternlicht v. JMJ Films, Inc.*, Index No. 156028/2015, 2016 N.Y. Misc. LEXIS 1052, at *5 (Sup. Ct., N.Y. Cty. Mar. 7, 2016) (holding a confession of judgment "is clearly an instrument for the payment of money only"); see also *Mod-Pac Corp. v. Peter V. Hires*, Index No. 815921/2019 (Sup. Ct., Eric Cty. Nov. 26, 2019) (seeking summary judgment in lieu of complaint based upon confession from out-of-state resident signed prior to amendment to CPLR 3218, which is barred from filing under the new law).