

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

MEMORANDUM

To: Members, House Committee on Small Business
From: Chairwoman Nydia M. Velázquez
Date: June 25, 2019
Re: Full Committee hearing: “Crushed by Confessions of Judgment: The Small Business Story”

The House Committee on Small Business will meet for a hearing titled “Crushed by Confessions of Judgment: The Small Business Story.” The hearing is scheduled to begin at **11:30 A.M. on Wednesday, June 26, 2019 in Room 2360 of the Rayburn House Office Building.** The hearing will enable the Committee to examine the practice of merchant cash advance companies requiring small businesses to sign a confession of judgment as a condition of receiving a funds. Members will hear from a variety of witnesses detailing the legalities of the practice, its use, and impact on small business borrowers. The witnesses will be:

- Mr. Hosea H. Harvey, Law Professor and Consumer Finance Law Expert, Philadelphia, PA
- Mr. Jerry Bush; Former Owner, JB Plumbing & Heating of Virginia, Inc., Roanoke, VA
- Mr. Shane Heskin, Partner, White and Williams, LLP., Philadelphia, PA
- Mr. Benjamin R. Picker, Shareholder, McCausland Keen + Buckman, Devon, PA

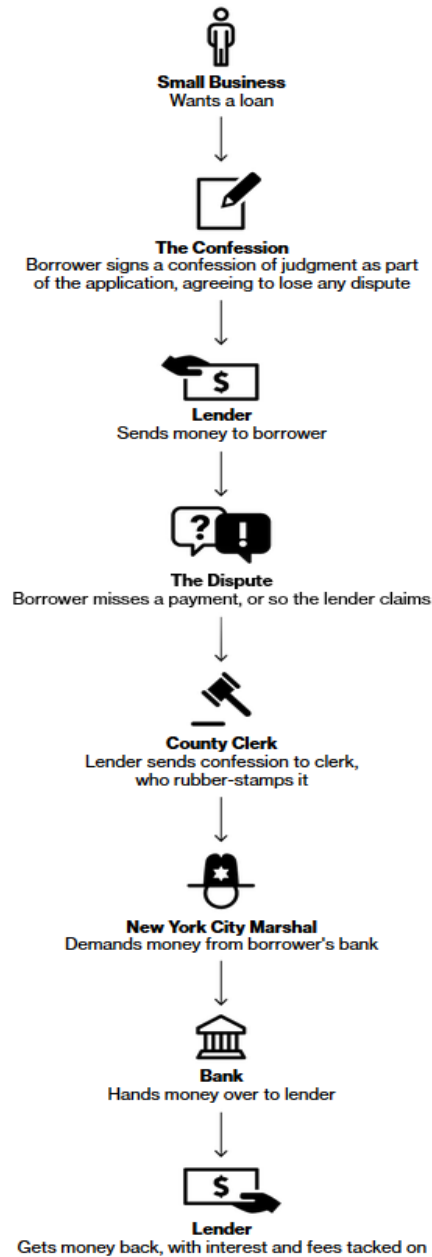
Background

A “confession of judgment” is defined as “a person’s agreeing to the entry of judgment upon the occurrence or nonoccurrence of an event, such as making a payment.”¹ It is essentially an agreement by which a borrower agrees to an eventual judgment of liability against them, without normal due process protections such as notice, a hearing, and judicial review. Many merchant cash advance companies require borrowers to sign a confession of judgment as a condition of receiving the cash advance. Oftentimes, these cash advances can cost the equivalent of 400 percent or more in annualized interest.² A creditor then only needs to present a signed confession of judgment to a county clerk once a dispute arises between the parties. Once a borrower misses a payment or some other dispute arises between the borrower and lender, the lender sends the signed confession of

¹ Confession of judgment, BLACK’S LAW DICTIONARY 361 (Bryan A. Garner ed., 10th ed. 2014).

² Zachary R. Mider & Zeke Faux, *New York Weighs Law to Crack Down on Predatory Loans With 400% Rates*, THE WASHINGTON POST, June 18, 2019, https://www.washingtonpost.com/business/on-small-business/new-york-weighs-law-to-crack-down-on-predatory-loans-with-400percent-rates/2019/06/17/d08bf442-90e6-11e9-956a-88c291ab5c38_story.html (last visited Jun 24, 2019).

judgment to a county clerk, who enters judgment against the borrower.³ The lender then takes the judgement to the local marshal, who demands the money allegedly owed to the lender from the borrower's bank.⁴ The lender then takes the money from the borrower's bank, with interest and fees added.⁵ At this point, a borrower's account will usually be frozen, and in some cases despite a borrower's compliance with daily debt payments. The graphic below illustrates the process.



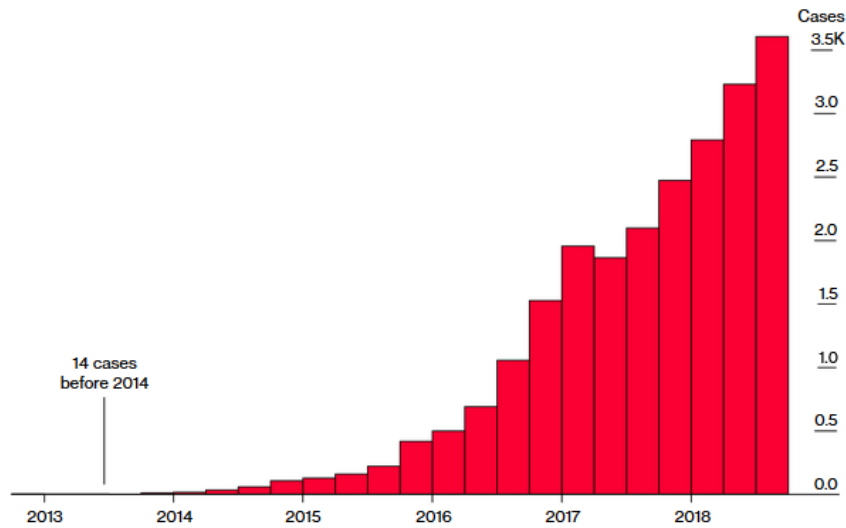
Source: Bloomberg

³ Zachary R. Mider & Zeke Faux, *Sign Here to Lose Everything - Part 1: "I Hereby Confess Judgment"*, BLOOMBERG, 2018, <https://www.bloomberg.com/graphics/2018-confessions-of-judgment/> (last visited Jun 24, 2019).

⁴ *Id.*

⁵ *Id.*

Some states outlawed these instruments in the middle of the 20th century, and the Federal Trade Commission (FTC) banned them for consumer loans in 1985 as part of a regulation known as the “Credit Practices Rule.”⁶ However, courts in numerous states, including New York, continue to recognize them for commercial loans.⁷ This has effectively turned New York into a hub of processing confessions of judgment – in the first five months of 2019, merchant cash advance companies obtained more than 5,500 New York court judgments against borrowers, about the same monthly pace as in 2018.⁸ The graph below shows the recent sharp rise in the use of confessions of judgment in New York courts.



Source: Bloomberg

Current Issues

In late 2018, Bloomberg ran a five-part series of articles on the merchant cash advance industry and specifically, its tendency to abuse confessions of judgment as a way of short-circuiting the commercial debt collection process.⁹ Notably, the series described cash advance companies using confessions of judgment that were forged or materially altered, falsely accusing borrowers of missing payments, and overstating the balance allegedly due.¹⁰ Lenders would sometimes make more money by declaring a default and seizing a borrower’s cash than they could by getting paid

⁶ See *supra* note 3; see also *infra* note 21. The Credit Practices Rule declares it a violation of Section 5 of the Federal Trade Commission Act “for a lender or retail installment seller directly or indirectly to take or receive from a consumer an obligation that... [c]onstitutes or contains a cognovit or confession of judgment.” By its plain terms, however, the Rule only applies “in connection with the extension of credit to consumers in or affecting commerce.” The Rule defines “consumer” as “a natural person who seeks or acquires goods, services, or money for personal, family, or household use.” Thus, by its terms, the Rule does not protect corporations, limited liability companies, or other business entities from the adverse consequences of confessions of judgment.

⁷ See *supra* note 3.

⁸ See *supra* note 2.

⁹ See *supra* note 3.

¹⁰ *Id.*

back on schedule.¹¹ The Bloomberg series also highlighted the devastating impact this abusive practice has on entrepreneurs, their businesses, and their families.

Recent Activity

As noted previously, the FTC banned the use of confessions of judgment in consumer lending in 1985 as part of the Credit Practices Rule.¹² Earlier this year, the FTC opened an investigation into potentially unfair or deceptive practices in the merchant cash advance industry, including the use of confessions of judgment in commercial lending.¹³ The Director of the FTC's Bureau of Consumer Protection, Andrew Smith, has said the FTC's probe is in an early stage, and that either civil actions or new regulations may result.¹⁴ He also said FTC could make a rule, or bring an enforcement action against a company that is using confessions of judgment in an unfair way.¹⁵

The State of New York is also addressing this issue. After the Bloomberg series was published, the New York Attorney General's office opened a probe into the issue, and three county clerks who together had handled almost half of the industry's caseload stopped processing most judgments by confession.¹⁶ Meanwhile, the New York State Assembly is taking steps to ban confessions of judgments against individuals and businesses located outside the state.¹⁷ Nevertheless, one small business debt consultant has said "[t]he filing of COJs is just as rampant as ever."¹⁸

In the 115th Congress, Rep. Nydia M. Velázquez introduced bipartisan and bicameral legislation to prohibit confessions of judgment at the federal level in commercial lending transactions.¹⁹ Specifically, the bill would have amended the Truth In Lending Act to prohibit any creditor from "directly or indirectly tak[ing] or receiv[ing] from a borrower an obligation that constitutes or contains a cognovit or confession of judgment" "in connection with the extension of credit in or affecting commerce."²⁰ The bill would have therefore codified the FTC's Credit Practices Rule's

¹¹ Zachary Mider & Zeke Faux, *New York Weighs Law to Crack Down on Predatory Loans With 400% Rates*, BLOOMBERG, 2019, <https://www.bloomberg.com/news/articles/2019-06-17/new-york-state-weighs-law-to-curtail-predatory-lending-abuses> (last visited Jun 24, 2019).

¹² *See supra* note 3.

¹³ Zachary Mider & Zeke Faux, *FTC, Manhattan Prosecutors Probe Costly Small-Business Loans*, BLOOMBERG, 2019, <https://www.bloomberg.com/news/articles/2019-05-23/ftc-manhattan-prosecutors-probe-costly-small-business-loans> (last visited Jun 24, 2019).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Zachary R. Mider & Zeke Faux, *New York Moves to Ban Confessions of Judgment for Out-of-State Loans*, THE WASHINGTON POST, June 21, 2019, https://www.washingtonpost.com/business/on-small-business/new-york-moves-to-ban-confessions-of-judgment-for-out-of-state-loans/2019/06/21/9cd8602e-9427-11e9-956a-88c291ab5c38_story.html (last visited Jun 24, 2019).

¹⁷ Assemb. B. A7500A, 2019-2020 Legis. Sess. (N.Y. 2019); Zachary Mider & Zeke Faux, *New York Weighs Law to Crack Down on Predatory Loans With 400% Rates*, BLOOMBERG, 2019, <https://www.bloomberg.com/news/articles/2019-06-17/new-york-state-weighs-law-to-curtail-predatory-lending-abuses> (last visited Jun 24, 2019).

¹⁸ *See supra* note 11.

¹⁹ Small Business Lending Fairness Act, H.R. 7354 115th Cong. (2018).

²⁰ *Id.*

prohibitions on confessions of judgment in the consumer lending context while expanding the Rule's protections to business contracts.²¹

Conclusion

As predatory small business lenders continue to evolve and find creative ways around the law, Congress must similarly be proactive in addressing those predatory practices and rooting out abuses in the realm of small business lending. Though there are numerous such practices that may rise to the level of demanding Congressional attention, the rampant abuses of confessions of judgment in small business lending must be highlighted and addressed legislatively. To that end, numerous governmental entities at the state and federal levels have joined Congress in seeking to curtail or outright prohibit this abusive practice. This hearing will accordingly give Members an opportunity to learn more about the legalities of the practice, its use, and impact on small business borrowers.

²¹ Cong. Research Serv., *Agreeing in Advance to Lose? Legal Considerations in Regulating Confessions of Judgment*, LSB10239 (June 13, 2019).