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Despite Recent Appellate Rulings, Beware of Issues Related to Enforcement of Cognovit Notes / Foreign Confessions of Judgment in Indiana

Provisions in loan documents providing for judgment by confession in the event of default are not uncommon. How and when these provisions can be enforced in Indiana continues to be an area of dispute. The Indiana Court of Appeals has previously explained that “[a] cognovit is a legal device by which a debtor gives advance consent to a holder’s obtaining a judgment against him or her, without notice or hearing. A cognovit clause is essentially a confession of judgment included in a note whereby the debtor agrees that, upon default, the holder of the note may obtain judgment without notice or a hearing. . . . The purpose of a cognovit note is to permit the noteholder to obtain judgment without the necessity of disproving defenses which the maker of the note might assert. . . . A party executing a cognovit clause contractually waives the right to notice and hearing. . . .” *Jaehnen v. Booker*, 806 N.E.2d 31, 34 (Ind. Ct. App. 2004) (citing Am. Jur. 2d. Judgments § 235). Using a cognovit provision to obtain a judgment by confession is appealing to creditors because it reduces the time and attorney fees expense of obtaining a judgment following a default.

The Indiana Court of Appeals issued two recent decisions reaffirming that the Full Faith and Credit Clause of the Federal Constitution trumps Indiana’s statutory prohibition against enforcement of a foreign judgment arising from a confession of judgment contained in a cognovit note. See *EBF Partners, LLC v. Evolving Sols. Inc.*, 95 N.E.3d 145 (Ind. Ct. App. 2018) and *EBF Partners, LLC v. Novabella, Inc.*, 96 N.E.3d 87 (Ind. Ct. App. 2018).

In both cases, New York based EBF Partners, LLC (“EBF”) purchased accounts receivable from the debtor defendants under the terms of purchase agreements that provided for application of New York law. All of the defendants were Indiana residents or businesses. The defendants each also executed an Affidavit of Confession of Judgment, known as a cognovit note, which allowed EBF to obtain a money judgment against them upon default. Following defaults, EBF filed the Affidavits of Confession of Judgment with a New York court, along with EBF’s affidavit of debt, and obtained judgments in New York without providing notice to defendants and without a hearing.

EBF attempted to domesticate the foreign judgements in Indiana. The Indiana trial court refused to domesticate the foreign judgments finding that “[c]ognovit notes are prohibited in

Indiana." *Novabella*, at 10 (citing *Jaehnen v. Booker*, 806 N.E.2d 31, 34 (Ind. Ct. App. 2004), *trans. denied.*) Indiana has numerous statutes which on their face appear to prohibit domestication and enforcement of a foreign judgment obtained through a cognovit note. Indiana has codified its definition of a cognovit note at Indiana Code section 34-6-2-22. While Indiana does have a statute entitled "Confession of judgment authorized" at Indiana Code Section 34-54-2-1, the statute does not authorize a unilateral filing by a creditor, but rather an event requiring notice to the debtor and an opportunity to be heard.

Indiana courts have defined the "evil" being prevented by prohibiting cognovit notes as that of obtaining a judgment against a party without service of process or the opportunity to be heard. *Jaehnen*, 806 N.E.2d at 36. Indiana Code section 34-54-3-2 prohibits the execution of an agreement or stipulation that is "in connection with the execution of any negotiable instrument or other written contract to pay money" and is executed "before a cause of action on the instrument or contract has accrued." *Id.* Additionally, Indiana Code section 34-54-3-3 states that a contract, stipulation, or power of attorney "given or entered before a cause of action accrues on a promise to pay is void." *Id.* Indiana Code section 34-54-3-4 provides that certain foreign judgments are unenforceable, including a judgment from another state that is based upon an agreement or stipulation that is prohibited by Indiana statute. In Indiana, the legislature considers the "evil" of cognovit notes so great that it is a misdemeanor to "procure another" to execute a cognovit note or to attempt to enforce within Indiana a foreign judgment based upon a cognovit note. *Id.* (citing Indiana Code Section 34-54-4-1, which provides that a person who knowingly commits such actions commits a Class B misdemeanor).

EBF appealed the Indiana trial courts' rulings. In both *Novabella* and *Evolving*, the Court of Appeals reversed the trial court explaining that, even though cognovit notes are prohibited in Indiana, a valid foreign judgment based on a cognovit note must be given full faith and credit in Indiana. *Evolving*, 95 N.E.3d at 148; *Novabella*, 96 N.E.3d at 92-93 (citing *Cox v. First Nat. Bank of Woodlawn*, 426 N.E.2d 426, 430 (Ind. Ct. App. 1981)). "The general rule in Indiana, based upon the authority of the Federal Constitution and 28 U.S.C.A. § 1738, is that judgments of a sister state court will be given full faith and credit by Indiana courts." *Cox*, 426 N.E.2d at 429-30. The only way that the trial court could have properly refused to afford full faith and credit to the New York confessed judgment was if the New York court lacked subject matter jurisdiction or personal jurisdiction, but defendants failed to make these arguments. *Novabella*, 96 N.E.3d at 93-94.

The Court of Appeals held that because the New York confessed judgments appeared on their face to be rendered by a court of competent jurisdiction and defendants did not challenge the jurisdiction of the New York court to enter the confessed judgment, the trial court was required to afford full faith and credit to the New York judgments. *Id.*

Despite the holdings in *Novabella* and *Evolving*, not every foreign judgment based on a cognovit note is enforceable in Indiana. As noted by the Court in *Novabella*, each case is fact sensitive and the debtors could have challenged the entry of the judgments in New York because the applicable purchase agreement states the cognovit is only allowed "[i]f permitted under the laws of the state in which the [debtor] resides" *Novabella*, 16 n.11. However, the Indiana Court

of Appeals held that debtor’s “recourse to challenge the New York confessed judgment lies in the New York court.” *Id.*

Given Indiana’s prohibition on cognovit notes, and the potential for statutory criminal penalties, creditors should seriously consider the risks of using cognovit notes for loan enforcement in Indiana. While the creditor was successful in the *Novabella* and *Evolving* cases, out-of-state creditors should consult with knowledgeable Indiana legal counsel before attempting to domesticate and enforce foreign judgments in Indiana, especially foreign judgments based upon a cognovit note.

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