

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF OHIO  
WESTERN DIVISION

Huntington National Bank,

Case No. 3:09CV408

Plaintiff

v.

ORDER

Michael L. Wallace,

Defendant

This is an action to enforce a cognovit judgment entered in favor of the plaintiff, Huntington National Bank [Huntington or the Bank] against the defendant, Michael L. Wallace. The bank originally filed this suit in the Common Pleas Court of Lucas County, Ohio. Wallace removed it to this court on the basis of diversity of citizenship. Jurisdiction is proper under 28 U.S.C. § 1332.

Pending is Wallace's motion to vacate the judgment. [Doc. 4]. For the reasons that follow, the motion shall be granted.

**Background**

On or about August 9, 2007, Huntington entered into a "First Amended And Restated Loan And Security Agreement" [Loan Agreement] with BellePointe, a company owned by the defendant's

son. The Loan Agreement included a Line of Credit, a Guidance Line for letters of credit and a Term Loan. Each included amended and restated cognovit notes. Wallace was a guarantor of BellePointe's obligations to Huntington under the Loan Agreement.<sup>1</sup>

Section 1.2.1 of the Guidance Line provided:

Notwithstanding anything to the contrary contained herein, the maximum amount available under the Guidance Line, shall be as follows:

from the date hereof through and including 11/30/2007 - \$865,000  
12/01/2007 through and including 12/31/2007 \$250,000  
01/1/2008 and thereafter \$550,000

The cognovit note relating to the Guidance Line contained the same provision.

During the last week of November, BellePointe informed David Kirkley, the Vice-President of Huntington in charge of BellePointe's account, that BellePointe wanted to issue additional letters of credit under the Guidance Line. On December 3, 2007, according to Wallace, and notwithstanding the fact that, as a result of prior advances, more than \$250,000 had been extended under the Guidance Line, Kirkley authorized further advances.

Wallace asserts that no one notified him that Huntington was allowing advances to BellePointe in excess of \$250,000 applicable to advances during December, 2007, and he did not consent to extending credit beyond the limits specified in the Guidance Line.<sup>2</sup> Huntington continued to advance additional funds to BellePointe until February, 2008, at which point it refused to extend

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<sup>1</sup> The guaranty did not extend, however, to the term loan portion of the Loan Agreement. It set a maximum amount of Wallace's obligation relative to the line of credit.

<sup>2</sup> Wallace states that, had Huntington not extended additional advances after November, 2007, BellePointe would likely have been forced to cease operating as of November 30, 2007.

further credit to BellePointe. Thereafter, under the direction of Huntington, the assets of BellePointe were liquidated. Huntington then obtained the cognovit judgment on Wallace's guaranty.

The pending motion to vacate that judgment [Doc. 4] is based on Wallace's contention that Huntington's approval of additional credit under the Guidance Line when, he alleged, BellePointe was in default relieved him of his obligations as guarantor. This is so, he argues, because the Huntington's actions constituted a material variation in his obligations under the Loan Agreement.

The relevant contractual provisions are:

- First Amended and Restated Loan and Security Agreement [Loan Agreement], § 1.2, p. 2.

1.2. Guidance Line for Letters of Credit. From the date hereof until the termination Date, the Bank agrees to issue Letters of Credit and Banker's Acceptances in favor of the Complaint under the guidance line up to a maximum amount as provided in 1.2.1 (the "Guidance Line"). The Guidance Line pursuant to this Section 1.2 will be used to represent the amount available for the Letters of Credit or their subsequent Banker's Acceptances. However, no cash will actually be advanced to the Company and the Guidance Line will not be available for any other purpose.

- Loan Agreement, § 1.2.1, p. 2.

1.2.1 Notwithstanding anything to the contrary contained herein, the maximum amount available under the Guidance Line, shall be as follows:

from the date hereof through and including 11.30.2007 - \$865,000  
12/01/2007 through and including 12/31/2007 \$250,000  
01/1/2008 and thereafter \$550,000

- Loan Agreement, § 1.4, p. 3

1.4 Advances. Subject to availability, the Loans may be disbursed by the Bank to the Company in one or more Advances.

Each Advance under the Line of Credit will be subject to the following conditions:

. . .

(c) No Event of Default or other default shall exist;

. . .

Each Advance under the Guidance Line will be subject to the following conditions:

. . . .

(b) Each of the representations and warranties contained in Section 3 are true and correct as of the date of each advance;

. . . .

(d) The term of any Letter of Credit, and their subsequent Banker's Acceptances, shall not extend beyond September 30, 2008;

. . . .

- Loan Agreement, § 2.2, p. 4

2.2 Interest Payment Date. Interest on Advances will be calculated on a 360-day year basis and will be based on the actual number of days elapsed. Payments of principal and/or interest on the Line of Credit shall be as provided in the Revolving Note. Payments of principal and/or interest on the Term Loan shall be as provided in the Term Note. Payments of principal and/or interest on the Guidance Line shall be as provided in the Guidance Note. No interest will be charged on the Guidance Line until the Letters of Credit or Banker's Acceptances are redeemed but fees on the Letters of Credit will be due in accordance with the terms of the Letter of Credit Documents and fees on the Banker's Acceptance will be due in accordance with the Acceptances Agreement.

- Loan Agreement, § 9.12, p. 21-22.

9.12. Certain Defined Terms As used in the Loan Documents, the following terms shall have the meanings set forth below. Additional defined terms may appear elsewhere in the loan documents.

. . . .

"Advance" means, as applicable, a future advance of funds with respect to the Line of Credit, the Term Loan, or, an advance made by the Bank to a beneficiary pursuant to a Letter of Credit or its subsequent Banker's Acceptance.

- Loan Agreement, § 3.8

3.8. No Defaults. No event has occurred and no condition exists which with the passage of time would constitute an Event of Default pursuant to this Agreement.

- Amended and Restated Demand Guidance Line Note Cognovit, p. 1

The proceeds of the loan evidenced hereby may be advanced, repaid and readvanced in partial amounts during the term of this note ("Note") and prior to maturity. Each advance will be made to the undersigned upon receipt of the Bank of the undersigned's application therefore and disbursement instructions, which will be in such form as the Bank may from time to time prescribe. The Bank will be entitled to rely on any written communication requesting in advance and/or providing disbursement instructions therefor, which is received by it in good faith by anyone reasonably believed by the Bank to be an authorized agent of the undersigned.

- Amended and Restated Demand Guidance Line Note Cognovit, p. 1

PRINCIPAL BALANCE SCHEDULE

Notwithstanding anything to the contrary contained herein, the maximum amount available under the Guidance Line, shall be as follows:

from the date hereof through and including 11/30/2007 - \$865,000

12/01/2007 through and including 12/31/2007 \$250,000

01/1/2008 and thereafter \$550,000

- Continuing and Limited Guaranty [Wallace Guaranty], p. 1

Subject to the limitations above, Guarantor hereby promises that if one or more of the Obligations are not paid promptly when due, he will pay the Obligations to Bank, irrespective of any action or lack of action on Bank's part in connection with the acquisition, perfection, possession, enforcement or disposition of any or all Obligations or any or all security therefor or otherwise, and further irrespective of any invalidity in any or all Obligations, the unenforceability thereof or the insufficiency, invalidity or unenforceability of any security therefor.

- Wallace Guaranty, p. 2

Guarantor agrees that no extension or time, whether one or more, nor any other indulgence granted by Bank to Debtor, or to any other guarantor, or any of them, and no omission or delay on Bank's part in exercising any right against, or in taking any action to collect from or pursue Bank's remedies against Debtor or any other guarantor, or any of them will release, discharge or modify the duties of Guarantor hereunder. Guarantor agrees that Bank may, without notice to or further consent from Guarantor, release or modify any collateral, security or other guaranties now held or hereafter acquired, or substitute other collateral, security or other guaranties, and no such action will release, discharge or modify the duties of Guarantor hereunder. Guarantor further agrees that bank will not be required to pursue or exhaust any of its rights or remedies against Debtor or any other guarantor, or any of them, with respect to payment of any of the Obligations, or to pursue, exhaust or

preserve any of its rights or remedies with respect to any collateral, security or other guaranties given to secure the Obligations, or to take any action of any sort, prior to demanding payment from or pursuing its remedies against Guarantor.

## **Discussion**

### **1. Applicable Standard**

Under the cognovit provisions of Ohio statutory law, a debtor in a non-consumer transaction can empower his creditor to create an instrument that the creditor can thereafter produce in the event of default and obtain judgment against the debtor without hearing or notification. O.R.C. § 2323.13.

Wallace brings this motion under Fed. R. Civ. P. 60(b), but Ohio law controls the standard for vacating a cognovit judgment. Where a federal procedural rule does not directly conflict with state law, the district court must evaluate “whether failure to apply the state law would lead to different outcomes in state and federal court.” *Cohen v. Office Depot, Inc.*, 184 F.3d 1292, 1297 (11th Cir. 1999), *vacated in part*, 204 F.3d 1609 (11th Cir. 2000) (citing *Hana v. Plumer*, 380 U.S. 460, 4466 (1965)).

Rule 60(b) does not address the standards for setting aside a cognovit judgment, nor is there federal common law on that issue. Ohio courts, however, have established such standards. *See Livingston v. Rebman*, 169 Ohio St. 109 (1959). *E.g.*, *GTE Automatic Elec. Inc. v. ARC Industries, Inc.*, 47 Ohio St. 2d 146, 146 (1976); *Medina Supply Company, Inc. v. Corrado*, 116 Ohio App. 3d 847, 850 (1996). Because failure to apply the Ohio standard could lead to different outcomes in state and federal court, Ohio law controls.

Under Ohio Civ. R. 60(B), a party seeking relief from judgment must demonstrate that he: 1) has a meritorious defense; 2) is entitled to relief under one of the grounds stated in 60(B); and 3) makes the motion within a reasonable time. *GTE Automatic, supra*, 47 Ohio St. 2d at 146. Due to

the “harsh results of the cognovit procedure, namely, that the defendant has never received a day in court or chance to be heard,” a party seeking relief from cognovit judgment need only show that he has a meritorious defense his motion is timely raised. *Lykins Oil Company v. Pritchard*, 169 Ohio App. 3d 194, 197 (Ct. App. 2006); *see also Medina Supply, supra*, 116 Ohio App. 3d at 850. I resolve any doubts in favor of a trial on the merits. *General Motors Acceptance Corp v. Deskins*, 16 Ohio App. 3d 132, 133 (1984).

Wallace’s motion, filed eleven days after entry of judgment, is timely. The only issue is whether Wallace has a meritorious defense.

## **2. Whether Wallace Asserts a Meritorious Defense**

Wallace argues that Huntington materially altered the nature of Wallace’s guaranty when it advanced funds to BellePointe in excess of the amounts specified in the Guidance Line. Huntington argues that this ground is not a meritorious defense and denies that any material alteration has occurred.

### **A. Whether Material Alteration is a Meritorious Defense**

The first question is whether the type of defense Wallace alleges – material alteration of the cognovit note – constitutes a meritorious defense under Ohio law. A material alteration is the “destruction of the old provision in the matter altered, and an attempt to foist a new provision on the other party to the contract. *American Bonding & Trust Co. v. Baltimore & O.S.W.R. Co.*, 124 F. 866, 887 (6th Cir. 109

A meritorious defenses to a cognovit note “is one that goes to the integrity and validity of the creation of the debt or note, the state of the underlying debt at the time of confession of judgment, or the procedure utilized in the confession of judgment on the note.” *First Natl. Bank v.*

*Freed*, 2004 Ohio 3554, \*2 (Ohio Ct. App. Jul. 6); *see also First Merit Bank, N.A., v. NEBS Financial Servs., Inc.*, 2006 Ohio 5260, at \*3 (Ohio Ct. App. Oct. 5).

Judgment debtors may have a meritorious defense to a cognovit note “attacking the validity and the amount of the judgment against them” where a debtor alleges that the party enforcing judgment has breached the underlying contract. *Lykins Oil Company v. Pritchard*, 169 Ohio App. 3d 194, 199 (Ct. App. 2006). In *Lykins*, the court held that travel plaza owners were entitled to relief from the cognovit judgment entered against them by a gasoline supplier. *Id.* The travel plaza owners alleged that “they had paid for fuel that was not delivered” and that the fuel delivered was not of the agreed brand. *Id.* at 198. The owners further alleged that the gasoline suppliers failed, as agreed, to secure the best fuel price, provide pooled-profit margins, and to deliver credits for imaging support. *Id.* Based on these allegations, the court concluded that the trial court abused its discretion in denying the travel plaza owners’ Ohio Civ. R. 60(B) motion for relief. *Id.* at 199.

If a judgment debtor can show that the parties, by mutual agreement, orally modified a cognovit note after signing, the judgment debtor also has a meritorious defense. *Your Financial Community of Ohio, Inc. v. Emerick*, 123 Ohio App. 3d 601, 606 (Ohio Ct. App. 1997) (trial court abused its discretion in overruling debtor’s motion for relief from judgment). In *Your Financial Community*, the court concluded that the trial court abused its discretion in denying defendant’s Ohio Civ. R. 60(B) motion for relief from cognovit judgment without an evidentiary hearing. *Id.* at 609. Judgment debtor alleged, without affidavit or other evidentiary materials, that the parties had

orally modified the cognovit note such that it was not due and payable until the sale of certain real estate. *Id.* at 604.<sup>3</sup>

Like the breach alleged in *Lykins* or the modification in *Your Financial Community*, a material alteration brings the validity and amount of judgment into question. Like an oral modification by mutual consent, a material alteration destroys the original agreement. The alleged material alteration in this case, like the breach in *Lykins*, is brought about by the party seeking judgment. If Wallace alleges facts indicating that the cognovit note has been materially altered through Huntington's conduct, he has a meritorious defense.

**B. Whether Wallace Has Alleged  
A Material Alteration of the Cognovit Note**

For Huntington to have materially altered the contract, it must have acted inconsistently with the plain language of the cognovit note. Wallace argues Huntington violated the Loan Agreement and Guidance Line by making advances to BellePointe that caused the underlying debt to exceed the loan limits, and while BellePointe was in default.

Huntington disputes that the advances were inconsistent with the cognovit note for two reasons. First, Huntington asserts that when BellePointe sought additional advances during the last week of November, it was not yet in default, as the amount available through November 30, 2007, was \$865,000. Second, Huntington asserts that even if, as Wallace contends, Huntington did not approve the request for additional advances until after December 1, 2007, and even if BellePointe

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<sup>3</sup> Cognovit notes, like contracts generally, "may be modified by oral agreement." *Your Financial Community*, *supra*, 123 Ohio App. 3d at 606.

were in default under the Guidance Line as of that date, the following “indulgence” provision permitted Huntington to act as it did, and still recover against Wallace on the cognovit:

Guarantor agrees that no extension of time, whether one or more, nor any other indulgence granted to Bank by Debtor, or to any other guarantor, or any of them, and no omission or delay on Bank’s part in exercising the right against, or in taking any action to collect from or pursue Bank’s remedies against Debtor or any other guarantor, or any of them, will release, discharge or modify the duties of guarantor hereunder.

Guaranty agreements are construed similarly to any other contract, *Med Billing, Inc. v. Med. Mgmt. Sciences, Inc.*, 212 F.3d 332 (6th Cir. 2002), and therefore the court need not look beyond the plain language of the agreement. *Ueblacker v. Cincom Systems, Inc.*, 48 Ohio App. 3d 268 (1988).

The first issue is the meaning of § 1.2.1 of the Guidance Line, which provides:

Notwithstanding anything to the contrary contained herein, the maximum amount available under the Guidance Line, shall be as follows:

from the date hereof through and including 11/30/2007 - \$865,000  
12/01/2007 through and including 12/31/2007 \$250,000  
01/1/2008 and thereafter \$550,000

Wallace argues that this provision limits Huntington from making advances to Bellepointe in excess of \$250,000 on or after December 1, 2007.

Huntington argues that this provision, and specifically the \$250,000 limitation as of December 1, 2007, limits only how much was available to Bellepointe for letters of credit and banker’s acceptances and when those amounts were available to Bellepointe – not advances. Huntington does not dispute that it made *advances* in excess of \$250,000 to Bellepointe after December 1, 2007, or that it did not notify Wallace or seek his consent to make those advances. Rather, Huntington argues that § 1.2 of the Loan Agreement permits advances on and after December 1, 2007, and through September 30, 2008, to pay Bellepointe’s draw requests under

letters of credit and banker's acceptances – including those requested and approved on or before November 30, 2007.

Huntington's interpretation is more plausible. The Loan Agreement includes a separate definition of "advances" that distinguishes it from the "maximum amount available" referenced in § 1.2.1. An "advance" is an "advance made by the Bank to a beneficiary pursuant to a Letter of Credit or its subsequent Banker's Acceptance." Loan Agreement, § 9.12, p. 22. The maximum amount available under the Guidance line represents the "amount available for the Letters of Credit or their subsequent Banker's Acceptances," not the actual funds disbursed to Bellepointe through advances. *See* § 1.2. Because § 1.2.1 does not limit advances, Huntington did not materially alter the agreement simply by advancing funds in excess of the limits to Bellepointe.

Second, the parties dispute whether Huntington materially altered Loan Agreement by advancing funds to Bellepointe with knowledge that Bellepointe was in default. Section 1.4 of the loan agreement provides, in part, that:

Each Advance under the Guidance Line will be subject to the following conditions:  
(c) No Event of Default or other default shall exist.

Wallace argues that Huntington knew Bellepointe was in default as of December 1, 2007, and that Huntington should have refused to approve Bellepointe's request for letters of credit. Huntington admits it advanced over \$400,000 default notwithstanding, but argues that § 1.2 gave Huntington the option of making advances or not, at its discretion. Because the plain language of § 1.4 bars advances in the event of default, Wallace's interpretation of the terms is sensible. Because the advances significantly increased Wallace's exposure, Huntington's conduct materially departed from the terms of the agreement.

Third, Huntington argues that select provisions of the Guarantee give Huntington the right to forgive or ignore default without altering its rights against Wallace. The Wallace Guaranty Agreement, page 1, states:

Guarantor hereby promises that if one or more of the Obligations are not paid promptly when due, he will pay the Obligations to Bank, irrespective of any action or lack of action on the Bank's part in connection with the acquisition, perfection, possession, enforcement or disposition of any or all Obligations. . . . Guarantor agrees that no extension of time, whether one or more, nor any other indulgence granted to Bank by Debtor, or to any other guarantor, or any of them, and no omission or delay on Bank's part in exercising the right against, or in taking any action to collect from or pursue Bank's remedies against Debtor or any other guarantor, or any of them, will release, discharge, or modify the duties of guarantor.

Huntington argues, based on this provision, that even if Bellepointe were in default when Huntington advanced it funds, this was a mere "indulgence" that does not materially alter the contract or affect Huntington's rights against Wallace in any way.

As Wallace notes, this broad reading of Guaranty provision treats it as a waiver of Huntington's obligation to comply with the Loan Documents. "Indulgence" connotes a favor or accommodation of the debtor, such as an extension of time. *See Toland v. Key Bank of Wyoming*, 847 P.2d 549, 555 (1993) ("indulgence" is limited to extensions of time for payment, and contract terms permitting indulgences do not waive all suretyship defenses). This provision does not override § 1.4 of the Loan Agreement, which prohibits making advances during an event of default. *See Frost National Bank v. Burge*, 29 S.W.3d 580, 590-91 (Tex. App. 2000) (courts should not extend a guarantor's obligation beyond the written terms of the agreement by implication).

The indulgence provision, therefore, does not excuse Huntington's breach of § 1.4. Wallace, in conclusion, has a meritorious defense that Huntington materially altered the terms of the agreement.

### **C. Whether Wallace Alleges Sufficient Facts**

Wallace's burden is only to allege a meritorious defense, not prove that he will prevail. *Myers v. McGuire*, 80 Ohio App. 3d 644 (1992). The movant must, however, "allege operative facts with enough specificity to allow the trial court to decide whether a meritorious defense exists." *Advanced Clinical Management, Inc. v. Salem Chiropractics Ctr., Inc.*, 2004 Ohio 120 (Ohio Ct. App., Start County Jan. 12). These facts must be more than mere allegations. *Urbana College v. Conway*, 29 Ohio App. 3d 13 (1985).

Even if Wallace had initially failed to allege sufficient facts to support his defense, he has subsequently submitted an affidavit describing the above-referenced facts. Wallace alleged sufficient facts for this court to evaluate whether his defenses are meritorious.

### **Conclusion**

For the foregoing reasons, it is

ORDERED THAT Wallace's motion to vacate cognovit judgment [Doc. 4] be and hereby is granted.

A scheduling conference is set for September 21, 2009 at 11:30 a.m. to determine the deadlines for further proceedings.

So ordered.

/s/James G. Carr  
James G. Carr  
Chief Judge