Supreme Court of Ohio Clerk of Court - Filed February 24, 2020 - Case No. 2019-1314

IN THE SUPREME COURT OF OHIO

Sutton Bank,	)	
	)	Supreme Court Case No. 2019-1314
Appellant,	)	
	)	On appeal from the Portage County Court of
v.	)	Appeals, Eleventh Appellate District
	)	
Progressive Polymers, LLC, et al.,	)	Court of Appeals
	)	Case Nos. 2018-P-0079 and 2019-P-0001
Appellees.	)	

MERITS BRIEF OF AMICUS CURIAE OHIO CREDIT UNION LEAGUE IN SUPPORT OF APPELLANT SUTTON BANK

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INTRODUCTION

The Ohio Credit Union League agrees with Appellant Sutton Bank's proposition of law—courts should follow traditional rules of contract interpretation when analyzing cognovit provisions—and submits this amicus brief to make three points in further support.

First, Sutton Bank's arguments are bolstered by Ohio caselaw explaining that, when synthesizing statutorily-mandated language in a contract that contains other contract provisions, courts determine the meaning of disputed terms by first examining the relevant legislative design and statutory purpose for the mandatory language. They then interpret the disputed terms in a way that harmonizes the legislative design of the mandatory language with the surrounding contractual language. Here there is no dispute that the legislative design and purpose of the warning mandated by R.C. 2323.13(D) is to provide a warning to borrowers, not lenders. Considered this way, it is even clearer that Sutton Bank, Judge Trapp, and the trial court are all correct that the parties intended the note's definitions of "you" and "your" to have a different meaning in the statutorily-mandated warning than in the other parts of the contract. In any event, this Court should at a minimum make clear that the statutory warning for cognovit provisions should be interpreted in the same way other mandatory-language provisions in contracts are interpreted, which is by first considering the legislative design and statutory purpose of the mandatory provision and then harmonizing the provision with the surrounding contract.

Second, credit unions, like banks, use cognovit provisions. To the extent the Court of Appeals' decision was influenced by a mistaken belief that cognovit provisions unduly disadvantage borrowers, credit unions have a distinct and useful perspective to offer this Court. The unique structure of credit unions ensures their lending practices, including cognovit provisions, do not just benefit lenders, but also protect and advance the interests of borrowers. That is because credit unions are member-owned, not-for-profit cooperative financial institutions

that serve their fields of membership under the general oversight of boards of directors comprised of and elected by their members. As a result, there is a close and unique relationship between credit unions and their member-owners, who not only use their credit union's financial services, but also participate in the governance of their credit union and have voting rights. Also, while other financial institutions operate with the purpose of maximizing shareholder profit, the purpose of credit unions is to return benefits to their member-owners, who are also their customers. This member-owner structure creates strong incentives for credit unions to ensure their members are well served and that their needs are met—including by offering loans that are protected in part with cognovit provisions.

Third, the Ohio Credit Union League agrees with the Ohio Bankers League and the Community Bankers Association of Ohio that cognovit provisions are an important tool in the lending practices of all types of Ohio lenders. Cognovit provisions decrease transaction costs and minimize risks, which allows lenders to offer lower cost loans to a greater number of borrowers with more flexible terms. Weakening these provisions would therefore harm Ohio lenders and borrowers alike.

STATEMENT OF INTEREST

The Ohio Credit Union League is a state-level, not-for-profit trade association whose mission is to promote the common welfare of credit unions and offer professional programs and services that encourage the growth and effective operation of its members. This includes political and regulatory advocacy for members; providing information on legal compliance, educational opportunities, professional development, and benchmarking; and assisting with media relations and outreach solutions.

The League is the only state trade association for Ohio's credit unions, and, along with its affiliates, serves nearly all of Ohio's 260 credit unions and their 3,046,000 members. The

League advocates for the rights and interests of all credit unions in Ohio, regardless of membership. Here, the League supports the position taken by the Appellant Sutton Bank, and the other aligned *amici*, including the Ohio Bankers League and the Community Bankers Association of Ohio.

STATEMENT OF FACTS

The Ohio Credit Union League adopts and incorporates the Statement of Facts as presented in the Merits Brief by Plaintiff-Appellee Sutton Bank.

ARGUMENT IN SUPPORT OF THE PROPOSITION OF LAW

> **Proposition of Law:** Although cognovit clauses are construed strictly against those enforcing them, courts must still follow traditional rules of contractual interpretation when analyzing those clauses.

I. Courts must consider the legislative design behind mandatory contract language when interpreting contractual terms.

Judge Trapp and Sutton Bank have persuasively demonstrated that the meaning of the terms in the cognovit provision derives not just from the contract's definition section, but also from the statutory regime requiring Sutton Bank to include a precise statutory warning. The Ohio Credit Union League writes separately to emphasize that Sutton Bank's and Judge Trapp's views are consistent with Ohio law that where "the parties adopt the disputed contract language because [the] law requires them to do so," "Ohio law gives meaning to the disputed contract language *by looking first to relevant legislative design*." (Emphasis added.) *Swain v. Wells Fargo Bank, N.A.*, 54 F. Supp.3d 850, 856 (N.D. Ohio 2014).

Swain involved a dispute over whether mandatory language crafted by the Department for Housing and Urban Development appearing in all Federal Housing Administration insured mortgages established a floor or a ceiling for the amount of insurance lenders could require borrowers to obtain. Federal courts were divided over the question, but critical here, the court

said that under Ohio law, where the parties included the disputed language because they were required to do so by law, the court must find the meaning by first looking to the legislative design behind the mandatory language. The disputed, mandatory contract language was implementing a minimum flood insurance requirement, and with that in mind, the only reasonable interpretation of the contract language was that the contract established a floor on the amount of required insurance, and a lender could require more.

The Court should take the same approach in this case—interpreting the statutorily-mandated language in the cognovit provision by first considering the legislative design of the mandatory warning. Nobody disputes the mandatory language implements a statutory warning to borrowers, not lenders. So just as in *Swain*, this Court should supply a meaning to the disputed contract language that is consistent with the legislative design of the statutorily-mandated language. That is the meaning Judge Trapp applied, which is that the parties clearly meant "you" and "your" to have a different meaning in the statutorily-mandated warning than in the other parts of the contract.

This Court has taken the same approach in other cases. *Swain* relied heavily on *Reagans v. MountainHigh Coachworks, Inc.*, 117 Ohio St.3d 22, 2008-Ohio-271, 881 N.E.2d 245. In *Reagans*, a loan disclosure, note, and security agreement between the bank and buyers of an $85,000 motor home included a statutorily-mandated notice that "any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained with the proceeds hereof." *Id.* at ¶ 9. The buyers first sued the motor home sellers for selling a lemon, obtaining a judgment under the Ohio Consumer Sales Practices Act for $200,000, which reflected trebled actual damages and attorney fees. Then the

buyers sued the bank based on the mandatory contract language stating that the bank was subject "to all claims" that the debtor-buyers could assert against the sellers.

Refusing to read that mandatory language in isolation from the statutory regime that produced it, this Court rejected the debtor-buyers' argument. Instead, the Court reasoned that the mandatory language "was designed to preserve to borrowers under a consumer loan contract the claims or defenses a buyer would have against a seller that breached its duties in a sales transaction," but it was not designed to "create new rights or defenses." *Id.* at ¶ 32. In particular, it was not designed to act as a weapon against innocent creditors. *Id.* at ¶ 35. The buyers' remedy against the bank was therefore limited to the amount of money the buyers had paid, and the bank did not incur additional derivative liability for the sellers' misdeeds even though that is what the mandatory language, read in isolation, suggested.

Ohio's approach to synthesizing statutorily-mandated provisions in contracts with other contractual terms is consistent with the approach of other states. *See Smith v. Reverse Mortgage Sols., Inc.*, 200 So.3d 221, 227 (Fla. App. 2016) ("We are compelled to construe a contract consistent with specific statutes that regulate and govern the contract.") It is also consistent with how other courts have applied statutory provisions to cognovit provisions in loan documents. For example, the Michigan Court of Appeals has explained that the "rules of contract interpretation are instructive when considering the validity of a cognovit provision." *USA Jet Airlines, Inc. v. Schick*, 247 Mich.App. 383, 404, 638 N.W.2d 112, (2001). In *Schick*, a pilot agreed he would repay training expenses if he left his employment within a year, but he attempted to avoid a cognovit provision enforcing that agreement in his employment contract. He argued the cognovit did not comply with Michigan's requirement that the provision must be distinct from the underlying agreement. The Court of Appeals concluded the cognovit provision

was "distinct" because the defendant used bold and capitalized letters along with distinct spacing and alignment.

As is true here, the Michigan court explained that "allowing defendant to circumvent the clear language of the distinct cognovit would undermine its important role in the commercial context of providing a measure of security for creditors." *Id.* at 405 (quotations omitted). Also, similar to Ohio's history with cognovit provisions, "[t]he cognovit has an extensive history in Michigan, and [Michigan] courts have traditionally recognized the instrument as a valid tool creditors may use to secure payment of an obligation." *Id.* at 397 (quotations omitted); *see also D. H. Overmyer Co. Inc., of Ohio v. Frick Co.*, 405 U.S. 174, 178, 92 S.Ct. 775, 31 L.Ed.2d 124 (1972) ("In Ohio the cognovit has long been recognized by both statute and court decision.")

In sum, while Ohio law strictly construes cognovit provisions, courts still should apply contract interpretation principles when synthesizing statutorily-mandated contract language with other contract provisions.

II. Credit unions, which are member-owned and member-controlled, are uniquely structured to ensure they protect the interests of their borrowers, all of whom must be credit union members.

Credit unions trace their origins to mid-19th century Europe, where they were designed as cooperative associations to provide credit to borrowers of limited means who shared some commonality, such as geographic location. *Nat'l Credit Union Admin. v. First Nat. Bank & Trust Co.*, 522 U.S. 479, 494 n.6, 118 S.Ct. 927, 140 L.Ed.2d 1 (1998). Starting in the 1920s, states began chartering credit unions, which were similarly distinguished by the common bond among their members. *Id.* That bond was critical because it led to a more cooperative relationship between the borrower and lender, which in turn minimized lending risk. In fact, during the Great Depression, none of the states' credit unions were involuntarily liquidated even though there were widespread bank failures at both the state and national level. *Id.*

More than just not contributing to the Great Depression, Congress recognized credit unions were a critical tool for the recovery. They allowed borrowers who could not obtain capital from banks to obtain credit at reasonable interest rates, and increased credit to marginal borrowers was the sort of financial lubricant the economy needed to restart. *Id.* at 515 (O'Connor, J., dissenting). Accordingly, Congress passed the Federal Credit Union Act, 12 U.S.C. § 1751 *et seq*. The "sponsors of the legislation emphasized that the cooperative nature of credit unions allowed them to make credit available to persons who otherwise would not qualify for loans." *Id.* at n.6. While states had already chartered credit unions, Congress believed that a federal system would more rapidly grow the number of credit unions, in turn making more capital available on a nationwide basis. Lawrence D. Wickter, Jr., *First National Bank and Trust Co. v. National Credit Unions Administration: An Orphan of the Chevron Doctrine*, 11 DePaul Bus. L.J. 443, 446–47 (1999).

Under the Federal Credit Union Act, as it applies today, credit unions are not-for-profit, member-owned cooperatives. *Id.* at 447; *see also* 12 U.S.C. § 1759 (establishing membership requirements). They are governed by a board of directors that comprise and are elected by the credit union's members. *Id.* All members have an equal vote regardless of the amount of money they have on deposit with the credit union. Membership is limited to those who share "a common bond of occupation or association," or to groups "within a well-defined neighborhood, community, or rural district." 12 U.S.C. § 1759 (b)(1), (b)(2)(A), (b)(3). Likewise, Ohio state law has authorized credit unions with purposes and a common bond requirement that are the same in the aspects relevant here. *See* R.C. 1733.03 ("The purpose for which a credit union may be formed is to promote thrift among its members, and to that end to establish, on a cooperative basis, facilities for savings, credit for provident and productive purposes, assistance to members

in budgeting and money management and the effective use of their assets and resources, and all activities necessary or incidental thereto"); R.C. 1733.05(F) ("Credit unions qualified to do business in this state have a common bond of association for the purpose of forming and operating a corporate credit union.")

The mutual ownership and cooperative structure are what give credit unions their unique character, and there are three aspects of that character that are especially important here. First, credit unions are democratic in nature. Because they are member owned and controlled, and the members select the directors (who must also be members), the credit unions' management practices are aligned with the interests of the member-customers.

Second, and relatedly, they have no outside shareholders, so they of course do not pay dividends to outside shareholders. This eliminates any incentive for unfair lending, and it diminishes the incentive to undertake risky loans.

Third, because there is a sense of ownership, community, and association among the members, those making lending decisions will often know more about borrowers. On the other side of the deal, because the borrowers share a bond with the lenders deriving from ownership and membership, the borrowers are less likely to default.

At bottom, the member-owned, member-controlled structure of credit unions creates strong incentives for credit unions to ensure their members are well-served and their needs are met. The credit unions promote "cooperative values, such as volunteerism and mutual service, toward the objective of promoting thrift among members and creating a source of credit for provident and productive purposes." Wickter, Jr., *supra* at 447 (quotations omitted). Any notion that the cognovit provisions in credit union loans unduly disadvantage borrowers is belied by the ownership and control structure of credit unions—ultimately, borrowers own and control the

credit unions just as much as any other members, which protects against practices that are unfair to borrowers.

III. Cognovit clauses are important to credit union lenders and borrowers in much the same way they are important to other lenders.

The Ohio Credit Union League agrees with the explanations in the amicus briefs of the Ohio Bankers League and the Community Bankers Association of Ohio regarding the importance of cognovit provisions in Ohio lending practices. In short, cognovit provisions significantly lower the transaction costs for loans—most importantly, the costs of collection for defaulted loans. By lowering the costs of collection, lenders, including credit unions, can offer loans with lower interest and other more favorable terms. Of course, if cognovit provisions are weakened, the costs of collection will rise, and loans become more expensive for borrowers. Additionally, underwriting standards would need to change to account for the increased risk.

This in turn makes it more difficult for borrowers, especially businesses with more limited means, to obtain credit. More expensive loans, and underwriting changes that make fewer borrowers eligible for loans, necessarily means fewer borrowers will have access to credit. While that would be a problem for all lenders in Ohio, it is an especially acute concern for credit unions because the inspiration for their creation was to make credit available for borrowers whose interest might be best served through a cooperatively structured and motivated financial institution with a purpose embedded in community health and the provident use of credit. Also, weakening cognovit provisions increases lending risks by making the collection process slower, and as a result making it easier to dissipate assets. As explained above, credit unions are member-owned, so these losses are borne by the credit union members themselves, not shareholders.

CONCLUSION

For the foregoing reasons, the Ohio Credit Union League respectfully requests that this Court reverse the Court of Appeals' decision.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing was served, by regular U.S. Mail, postage prepaid, this 24th day of February, 2020, upon the following counsel of record:

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