

UNREPORTED
IN THE COURT OF SPECIAL APPEALS
OF MARYLAND

No. 1360

September Term, 2014

K&G, LLC, ET AL.

v.

SEATTLE COFFEE COMPANY

Nazarian,
Arthur,
Salmon, James P.
(Retired, Specially Assigned),

JJ.

Opinion by Arthur, J.

Filed: June 15, 2015

*This is an unreported opinion, and it may not be cited in any paper, brief, motion, or other document filed in this Court or any other Maryland Court as either precedent within the rule of stare decisis or as persuasive authority. Md. Rule 1-104.

In this appeal, we review the denial of a motion to vacate a judgment by confession. Holding that the appellants established a substantial and sufficient basis for an actual controversy on the merits, we conclude that the confessed judgment should be vacated to permit the appellants to file a responsive pleading.

FACTUAL AND PROCEDURAL BACKGROUND

A. The Transaction

Grover C. Gedney and Karen Johnson-Gedney (“the Gedneys”) are the joint owners of K&G, LLC (“K&G”), a Maryland limited liability company. On December 29, 2008, K&G purchased a small chain of coffee shops from Seattle Coffee Company (“Seattle Coffee”), a Maryland corporation. The transaction closed for the purchase price of \$1.2 million.

The purchase was financed primarily by K&G’s lender, EagleBank, through a loan backed by the U.S. Small Business Administration. To induce EagleBank to make a \$900,000 small business loan to K&G, Seattle Coffee lent an additional \$100,000 to K&G. To put it more colloquially, Seattle Coffee took \$100,000 of the purchase price in paper rather than cash.

On the transaction date, the parties executed a number of documents: (1) a Note with Balloon Payment, in which K&G promised to repay \$100,000 to Seattle Coffee; (2) a Standby Creditor’s Agreement, in which Seattle Coffee promised EagleBank that it would take no action to enforce its claims against K&G until K&G had satisfied its loan from EagleBank; (3) a Guaranty of Payment, in which the Gedneys agreed to be personally liable

for K&G's payment obligations to Seattle Coffee; and (4) an Indemnity Mortgage, securing the Gedneys' guaranty with two parcels of land.

B. The Note

Under the Note with Balloon Payment ("the Note"), K&G agreed to repay Seattle Coffee the principal sum of \$100,000 plus interest, by making monthly payments from January 2009 through November 2013. On the maturity date in December 2013, K&G owed a final balloon payment for the remaining amount. According to the Note, K&G would owe the entire balance within 15 days after written notice of a default.

The Note included the following confession of judgment clause:

14. **Confess Judgment.** After maturity of this Note (whether by acceleration, declaration, extension, or otherwise), Borrower hereby authorizes any attorney designated by Lender or any clerk of any court of record to appear for Borrower in any court of record and confess judgment against Borrower without prior hearing in favor of Lender for and in the amount of the unpaid balance of the Principal Amount then outstanding plus interest accrued and unpaid thereon, together with costs of suit and attorneys' fees of fifteen percent (15%) of the unpaid balance of the Principal Amount then outstanding.

Immediately below that paragraph, the Note provided:

15. **THIS NOTE IS FURTHER GOVERNED BY THE TERMS OF THAT CERTAIN STANDBY CREDITORS' AGREEMENT, A COPY OF WHICH IS ATTACHED HERETO AS EXHIBIT A.**

The Gedneys signed the Note on December 29, 2008, in their capacities as members of K&G.

C. The Standby Agreement

Seattle Coffee executed the Standby Creditor’s Agreement on December 29, 2008. The document identifies three entities: Seattle Coffee as the Standby Creditor; K&G as the Standby Borrower; and EagleBank as the Lender.¹

The Standby Agreement recites that K&G owes \$100,000 to Seattle Coffee. To induce EagleBank to make the \$900,000 small business loan to K&G, Seattle Coffee agreed that its \$100,000 loan to K&G was a “Standby Loan,” subordinate to EagleBank’s loan. Seattle Coffee agreed “[t]o take no action to enforce claims against [K&G] on the Standby Loan until [EagleBank’s] Loan is satisfied.” Seattle Coffee also agreed “[t]o take no action against [K&G’s] collateral which may also secure the Loan, without written consent from [EagleBank], until [EagleBank’s] Loan is satisfied.”

D. The Guaranty and Mortgage

In the Guaranty of Payment, the Gedneys agreed to be jointly and severally liable for all indebtedness incurred by K&G in connection with the Note. The Gedneys further agreed that their guarantee of payment was “in no way conditioned upon or limited by . . . any attempt to collect from the Borrower [K&G.]” The Guaranty specified that, in the event of a default on the Gedneys’ obligations as guarantors, Seattle Coffee could demand immediate payment on the loan balance. A confession of judgment clause provided that, any time after

¹ The agreement is set forth on a form from the U.S. Small Business Administration. A copy of the form is available at <https://www.sba.gov/content/standby-creditors-agreement> (last viewed June 8, 2015).

an event of default, the Gedneys authorized the confession of judgment against them for the balance owed to Seattle Coffee, plus attorneys' fees of 15 percent of the unpaid balance.

The Indemnity Mortgage provided that all obligations under the Guaranty were secured by two parcels recorded in the land records of Baltimore City. The Gedneys signed both the Guaranty and the Mortgage on the transaction date, December 29, 2008.

E. Action for Judgment by Confession

K&G failed to make monthly payments under the Note after August 2013, and then failed to make the balloon payment on the maturity date in December 2013. Consequently, on February 18, 2014, Seattle Coffee filed a complaint for confession of judgment in the Circuit Court for Anne Arundel County. Seattle Coffee alleged that K&G owed an unpaid balance of \$45,558.77, plus \$1,301.44 in interest.

The complaint named K&G as a defendant, relying on the confessed judgment provision in the Note. The complaint also named both of the Gedneys as defendants, relying upon the confession of judgment clause from the Guaranty. Seattle Coffee attached copies of the Note and the Guaranty to its complaint, but did not include a copy of the Standby Agreement that was mentioned in Paragraph 15 of the Note.

On February 26, 2014, the circuit court directed the entry of a confessed judgment against K&G and the Gedneys, jointly and severally, in the amount of \$46,860.21. Citing Md. Rule 2-704, which had just taken effect at the beginning of 2014, the court correctly declined to award attorneys' fees in a lump-sum amount of 15 percent of the unpaid balance.

The court did, however, allow Seattle Coffee to file a supplemental affidavit, in accordance with Rule 2-704, in support of the claim for fees.

On March 20, 2014, the defendants filed a timely motion to vacate the confessed judgment. Their motion stated that Seattle Coffee had “omitted a key document” from its filing – the Standby Agreement. K&G and the Gedneys asserted that the Note was expressly “governed by the terms of” the Standby Agreement, and one term of that Standby Agreement was that Seattle Coffee would “take no action to enforce claims” against K&G until EagleBank’s loan was satisfied in full. In an accompanying affidavit, Mr. Gedney stated that approximately five years of payments remained before K&G’s loan to EagleBank would be fully satisfied.

After a hearing, the circuit court denied the motion to vacate the confessed judgment on August 14, 2014. The defendants filed a notice of appeal within 30 days of the entry of that order.

Several weeks later, on October 14, 2014, the court entered a judgment in favor of Seattle Coffee in the amount of \$2,522.96 in attorneys’ fees and costs. The appellants then filed a second notice of appeal on November 12, 2014 “regarding the Court’s award/entry of judgment of attorney’s fees.”²

² The denial of a motion to open, modify, or vacate a confessed judgment is an appealable order. *E.g., Pease v. Wachovia SBA Lending, Inc.*, 416 Md. 211, 213 (2010); *Nils, LLC v. Antezana*, 171 Md. App. 717, 725 (2006). Here, however, the initial notice of appeal from that order was premature because it was filed before the court had entered a
(continued...)

QUESTION PRESENTED

The appellants' brief contains this one question:

Was the trial court legally correct to deny appellants' motion to vacate the entry of judgment by confession because notwithstanding that the Standby Agreement was attached to the Standby Note and that the Standby Note expressly states that it is governed by the Standby Agreement, appellants were neither party of the Standby Agreement nor the intended beneficiary and are therefore barred from raising it as a defense?

We conclude that the appellants satisfied their minimal burden on their motion to vacate the confessed judgment. Accordingly, we remand the case for further proceedings in the circuit court.

STANDARD OF REVIEW

Pursuant to Md. Rule 2-611(d), a defendant may make a timely motion to vacate a confessed judgment, stating the legal and factual basis for a defense to the claim. "If the court finds that there is a substantial and sufficient basis for an actual controversy as to the merits of the action, the court shall order the judgment by confession opened, modified, or vacated and permit the defendant to file a responsive pleading." Md. Rule 2-611(e).

² (...continued)

judgment that fully adjudicated Seattle Coffee's claims for contract-based attorneys' fees. *See G-C P'ship v. Schaefer*, 358 Md. 485, 487-88 (2000). Nevertheless, the appeal is properly before this Court on the basis of the second notice of appeal, filed within 30 days after the entry of the order that determined the amount of the fee award. *See N. Assurance Co. v. EDP Floors, Inc.*, 311 Md. 217, 222 (1987); *Mattvidi Assocs. Ltd. P'ship v. Nationsbank of Virginia, N.A.*, 100 Md. App. 71, 78 n.1 (1994).

In ruling on the motion, the court “must determine whether the defendant has a potentially meritorious defense to the confessed judgment complaint.” *Schlossberg v. Citizens Bank of Maryland*, 341 Md. 650, 656 (1996). The court does not decide the substantive merits of the controversy, but “merely whether the facts presented by the movants, if believed, would constitute a meritorious defense.” *Shafer Bros. v. Kite*, 43 Md. App. 601, 606 (1979). A meritorious defense is not necessarily a defense that addresses the merits of the underlying transaction, but it may be any defense that has merit. *See Young v. Mayne Realty Co., Inc.*, 48 Md. App. 662, 664-66 (1981) (holding that defense based upon statute of limitations could serve as a ground to vacate confessed judgment even though defense did not address plaintiff’s right of action but only addressed timing of plaintiff’s exercise of that right).

Judgments by confession are disfavored in Maryland. *See Pease v. Wachovia SBA Lending, Inc.*, 416 Md. 211, 230 (2010) (citing *Garliss v. Key Fed. Sav. Bank*, 97 Md. App. 96, 103 (1993)). The Court of Appeals has said that judgments by confession “are to be freely stricken out on motion to let in defenses.” *Schlossberg*, 341 Md. at 655 (citation and quotation marks omitted). Although the moving party bears the burden of presenting evidence sufficient to show the asserted defense, “[t]his burden is not a heavy one[.]” *Gambo v. Bank of Maryland*, 102 Md. App. 166, 185 (1994); *see Billingsley v. Lincoln Nat’l Bank*, 271 Md. 683, 689-90 (1974) (explaining that debtors “are given every opportunity after

judgment to present any defenses which they may have and, in doing so, are merely required to meet a standard that is a minimal obstacle”) (quotation marks omitted).

We have summarized the movant’s burden as follows:

“To be successful in moving to strike a judgment by confession, one must adduce evidence in support of [the] motion sufficient to persuade the fair and reasoned judgment of an ordinary [person] that there are substantial and sufficient grounds for an actual controversy as to the merits of the case. If [the movant] does so, he [or she] is deemed to have met the burden of showing he [or she] has a meritorious defense, without the necessity of showing he [or she] will eventually prevail. This is to say that if the evidence is such that persons of ordinary judgment and prudence could fairly draw different inferences from it, the controversy should not be decided as a matter of law but instead should be submitted to a trier of fact. If a meritorious defense is made out (by affidavits or testimony) . . . , the Court should liberally exercise its equitable jurisdiction over judgments entered by confession and, on application of a defendant who prima facie shows such defense, vacate the judgment to permit a trial on the merits.”

Young, 48 Md. App. at 668 (quoting *Stankovich v. Lehman*, 230 Md. 426, 432 (1963)); see also *Nils, LLC v. Antezana*, 171 Md. App. 717, 727 (2006) (quoting *Remsburg v. Baker*, 212 Md. 465, 469 (1957)) (explaining that motion should be granted “‘if the evidence adduced in support of the motion is sufficient to persuade the fair and reasoned judgment of an ordinary man that there are substantial and sufficient grounds for an actual controversy as to the merits of the case’”).

The ultimate issue of what constitutes a meritorious defense is a question of law. *Gambo*, 102 Md. App. at 185 (quoting *Garliss*, 97 Md. App. at 103). Accordingly, the trial court’s legal conclusions as to “whether the evidentiary proffers of a defendant seeking to open, modify, or vacate a confessed judgment qualify as a meritorious defense[] are reviewed

under non-deferential appellate scrutiny.” *Pease*, 416 Md. at 220 (citing *Nils*, 171 Md. App. at 727-28).

DISCUSSION

Applying those standards to the circumstances of this case, we conclude that the appellants made a prima facie showing of an actual controversy between the parties.

In their motion to vacate the confessed judgment, K&G and the Gedneys asserted that Seattle Coffee did not yet have the right to bring the action. Their motion relied on three facts: (1) the Note expressly provided that it was “governed by the terms” of the attached Standby Creditor’s Agreement; (2) one term of the Standby Agreement was that Seattle Coffee would “take no action to enforce claims” against K&G on the Note until K&G’s small business loan with EagleBank had been satisfied; and (3) the loan from EagleBank was not yet satisfied. They argued that the terms of the Standby Agreement were incorporated by reference into the Note and that the Standby Agreement was a part of K&G’s agreement with Seattle Coffee.

Additionally, the defendants contended that the Note was a negotiable instrument under the Uniform Commercial Code and that the Standby Agreement was a separate agreement that provided a defense to the obligation. They argued that their obligations under the Note were “modified, supplemented, or nullified” by the Standby Agreement. They relied upon section 3-117 of the Commercial Law Article of the Maryland Code (1975, 2013 Repl. Vol.), which provides:

Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented, or nullified by an agreement under this section, the agreement is a defense to the obligation.

In response, Seattle Coffee asserted that K&G was not a party to the Standby Agreement. Seattle Coffee pointed out that section 3-117 of the Commercial Law Article applies only to an agreement between “the obligor[,]” K&G, “and a person entitled to enforce the instrument[.]” Seattle Coffee contended that the Standby Agreement was only between the two creditors, Seattle Coffee and EagleBank. Seattle Coffee further argued that the defendants could not, as third parties, enforce promises that Seattle Coffee had made to EagleBank, for the benefit of EagleBank.

The circuit court agreed with Seattle Coffee’s position. In its written order, the court explained: “An unambiguous interpretation of the cited statute supports Seattle Coffee Company’s stance that the statute is inapplicable to undisputed facts as alleged[.]” The court also reasoned that K&G did not have third-party beneficiary status to enforce the Standby Agreement.

In this appeal, K&G and the Gedneys have abandoned their asserted defense under the Commercial Law Article. They no longer contend that the Standby Agreement was a “separate agreement” that altered their payment obligations. They argue only that the terms of the Standby Agreement, including the provision that Seattle Coffee would “take no action

to enforce claims” against K&G until the EagleBank loan was satisfied, were incorporated into the Note. Relying on “the plain and ordinary meaning of Paragraph 15,” they argue that the terms of the Standby Agreement govern, and thus “control and have precedent over,” the terms from the Note. Put differently, they do not seek to invoke a “separate agreement” between Seattle Coffee and EagleBank, but they only seek to invoke Paragraph 15 of the debt contract between Seattle Coffee and K&G.

Without reaching the ultimate merits of this defense, we conclude that the appellants satisfied their minimal burden on their motion to vacate the confessed judgment. The Note states that it is “governed by the terms of” the Standby Agreement. Thus, even though K&G is not a party to the Standby Agreement itself, a reasonable person could reasonably conclude that the terms of that agreement, including the restrictions on Seattle Coffee’s ability to enforce its claims until the EagleBank loan is satisfied, became a part of the Note and “governed,” restricted, or limited Seattle Coffee’s rights under the Note. A person in K&G’s position at closing, with a Note that is expressly “governed” by the Standby Agreement and the Standby Agreement that expressly restricts Seattle Coffee’s ability to enforce its claims, would certainly understand that Seattle Coffee’s ability to confess judgment under the Note was, or at least might be, limited by Seattle Coffee’s agreement to subordinate its rights to those of EagleBank. *Cf. Lema v. Bank of America*, 375 Md. 625, 638-39 (2003) (where agreement between bank and depositor stated that it “shall be governed by the terms and conditions” of a separate agreement between bank and depositor, both agreements “constitute

the contract”). In sum, because K&G’s arguments and evidentiary proffers were sufficient to persuade persons of fair and reasoned judgment that there are substantial and sufficient grounds for an actual controversy as to the merits of the case, the circuit court should have vacated the confessed judgment and permitted the case to advance to the stage of responsive pleadings. *See Young*, 48 Md. App. at 668-69.

In advocating a contrary conclusion, Seattle Coffee does not advance any argument about the meaning of Paragraph 15 and its statement that the Note is “governed by the terms of” the Standby Agreement. Instead, Seattle Coffee contends that the defendants did not adequately present their current theory to the trial court. In Seattle Coffee’s view, the defendants relied solely on a defense under the Commercial Law Article in the trial court and then raised the current theory for the first time at the appellate level.

Although K&G’s circuit court pleadings were not a model of clarity, the record does not support Seattle Coffee’s contention that the defendants failed to raise this issue in the trial court. In the memorandum supporting their motion, the defendants stated: “The Standby Note itself incorporates the Standby Agreement by reference in Paragraph 15 Accordingly, . . . the Standby Agreement is part of the agreement between the Defendants and Plaintiff here.”

At the motions hearing, the court further inquired into the meaning of that clause:

THE COURT: This note is further governed by the terms of that certain standby creditor’s agreement, a copy of which is attached hereto as Exhibit A. What is governed by – what does that mean?

[APPELLEE]: My position is that it means that there – my client knew that his note was subject to that agreement, meaning that he was subject to Eagle Bank enforcing that agreement. He knew he had an agreement with Eagle Bank and that Eagle Bank could enforce the terms therewith.

THE COURT: All right. [K&G], what do you think it means?

[APPELLANTS]: I think governed by means just what it says, Your Honor. It is manifest and it is governed by. It is incorporated by reference and the terms of the standby creditor’s agreement govern the terms of the note. They are over the terms of the note, over and above any other terms that one finds in the note. And the terms of the standby creditor’s agreement says shall not take any action, shall not enforce, shall not do anything to enforce the note unless and until the Eagle Bank loan is satisfied.

The court’s order expressly recognized that the defendants had made two distinct arguments. The court wrote:

Defendants argue that Seattle Coffee Company is barred from taking any action against Defendants based on the Standby Agreement providing that any such action is prohibited until EagleBank’s loan is satisfied. It is undisputed that the Eaglebank loan is still outstanding. *Additionally*, Defendants argue that, pursuant to MD. CODE ANN., COMM. LAW § 3-117, their obligation to pay the Note was modified by the Standby Agreement, which is a “part and parcel of the transaction in which Plaintiff received the Standby Note.”

(Emphasis added.)

In light of these exchanges, we reject Seattle Coffee’s contention that K&G did not raise the issue of whether the Standby Agreement is incorporated into and governs the Note. We agree that K&G and the Gedneys could have made a better presentation and could have articulated their positions more clearly to the trial judge. Nonetheless, they said enough to

preserve the issue for our review. The essence of their argument on appeal is substantially identical to an argument that they raised in the trial court.³

As a final argument, Seattle Coffee itself seeks to raise an issue that was neither presented to nor decided by the trial court. Seattle Coffee argues that, even if Paragraph 15 of the Note provides a basis for a controversy on the merits of claims against K&G, the Gedneys' personal obligations under the Guaranty are independent from the Note. Unlike the Note, the Guaranty instrument does not state that it is "governed by" the terms of the Standby Agreement. The Standby Agreement neither mentioned the Guaranty nor expressly limited Seattle Coffee's right to take action against the Gedneys. In addition, the Guaranty expressly provided that the Gedneys' obligation to pay was not conditioned upon any attempt to collect from K&G.

In sum, Seattle Coffee suggests that, even if the confessed judgment against K&G must be vacated, the judgment should be affirmed as to the Gedneys. It is difficult to envision how Paragraph 15 of the Note could provide a defense to claims raised against the

³ Seattle Coffee does contend, correctly, that this issue does not plainly appear to have been *decided* by the trial court. The court's opinion focused almost entirely on the issue of whether the Standby Agreement modified K&G's obligations under the Note, without addressing whether the Note was governed by the terms of the Standby Agreement. Such an issue, which plainly appears to have been raised in, but not decided by, the trial court, is nonetheless properly preserved for our review. *See* Md. Rule 8-131(a) ("Ordinarily, the appellate court will not decide any other issue unless it plainly appears by the record to have been *raised in or decided by* the trial court") (emphasis added); *Scapa Dryer Fabrics, Inc. v. Saville*, 418 Md. 496, 525 n.16 (2011) (invoking Rule 8-131(a) to consider issue presented to, but not decided by, circuit court).

Gedneys under the Guaranty. Nevertheless, we do not think that an appellee’s brief is the appropriate procedural vehicle to introduce and then decide this new question. *See Young*, 48 Md. App. at 667 (declining to hear an argument in support of confessed judgment because “no such argument was made at the hearing below, nor did the trial judge make any such finding”); *see also Gordon v. State Nat’l Bank of Bethesda*, 249 Md. 378, 383 (1968) (stating that “[c]ertainly” an issue regarding the denial of motion to vacate confessed judgment “cannot be raised for the first time in” appellate court).

On remand, the trial court should permit K&G and the Gedneys to file a responsive pleading in which they may raise a defense based on the terms of the Note. The ultimate merits of that defense, as to each of those defendants, should be decided in the first instance at the trial level.

**JUDGMENT OF THE CIRCUIT
COURT FOR ANNE ARUNDEL
COUNTY VACATED. CASE
REMANDED FOR FURTHER
PROCEEDINGS CONSISTENT WITH
THIS OPINION. COSTS TO BE PAID
BY APPELLEE.**