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Lessons for Commercial Litigation Counsel re (1) Business Records Hearsay and (2) Partial Conditional Settlements Amongst Multiple Obligated Parties

A recent Court of Appeals decision is a good reminder for experienced lender's litigation counsel and a primer for new counsel. The lessons from this case are:

- A good reminder on the evidentiary foundation required to prove the loan amount owed if you rely on business records detailing the loan's payment history and charges;
- A lender's damages award was not limited to amount claimed in its complaint;
- A guarantor was not entitled to reduced rate of interest in a separate judgment entered for lender against other obligated parties;
- A lender's reasonable approval of a short sale and settlement with other obligated entities is not a failure to mitigate damages; and
- If you take actions in reliance on a promise or agreement that is subject to approval by others, be sure to document the reliance.

The basic facts in *HSBC Bank USA v. Gill, et al.*, 2019-Ohio-2814 (Hamilton Cty. App. July 10, 2019) are common. The bank was assigned a loan to a hotel operator the repayment of which guaranteed by multiple guarantors. The bank's risk was further reduced because the loan partially guaranteed by the Small Business Administration ("SBA"). After payment default by the borrower, the collateral was sold at a short sale with the bank's approval.

The bank then initiated litigation against the guarantors. The initial guarantor litigation against Gill was resolved by a tentative settlement; the settlement was tentative because it had to be approved by the SBA. The bank proceeded to get a judgment against the other guarantor. The bank later settled for less than full payment of that judgment by the other guarantor. The uncollected judgment amount was \$61,475.44.

The SBA declined to approve the bank's settlement with Gill and so the bank again initiated litigation on Gill's guarantee. To Gill's surprise, the trial court entered judgment against Gill for \$145,274.95. Gill appealed.

Hearsay and Corporate Record Evidence. Admittedly, the bank's evidence concerning the loan amount owed was based on hearsay. Specifically, the bank used, and Gill attacked the admission of, a summary detailing the loan amount, interest and costs accrued, and the application of payments against that debt.

The bank's counsel's use of this exhibit required the application of Ohio Rule of Evidence 803(6) which states in part:

(6) Records of Regularly Conducted Activity. A memorandum, report, record, or data compilation, in any form, of acts, events, or conditions, made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record, or data compilation, all as shown by the testimony of the custodian or other qualified witness or as provided by Rule 901(B)(10), unless the source of information or the method or circumstances of preparation indicate lack of trustworthiness.

To meet the rule's requirements, the bank's counsel elicited the following from the bank's employee who was the only witness:

Q. Now, with regard to the payoff, the loan history in Exhibit 12, can you tell the Court what department at BLC prepares the accounting statements or the history statements and payoff statements?

A. That's the loan accounting department. Asset managers need loan payoff statements for motions in litigation. And so asset manager directs the – sends a request to the loan accounting department and they use the software to – that tracks all the payments and fees to generate the payoff statement.

Q. Okay. Now, the payments and fees that get generated on the payoff statement and the loan history, can you tell the Court how the transactions are entered into the system in the first place? Are they done contemporaneously as things happen?

A. So when a payment is received, usually between 24, 48 hours, it's entered into a system called Loan Manager.

Q. And do the people at BLC who enter the information, are they under an obligation to record the information accurately?

A. Yes, they are.

Q. And are they under an obligation to record the information timely?

A. Yes.

The appellate court explicitly stated that this testimony met the requirements of Rule 803(6) quoted above. Responding to Gill's arguments to the contrary, the appellate court said this:

Ms. Branch worked for BLC's parent company, served as an officer of BLC, and was familiar with the Loan Manager system used to create the loan history, knew which department generated it, and relied on its contents in her role as the administrator and day-to-day manager of the loan in issue. She established that the employees of BLC entering the loan information were under an obligation to do so regularly, timely, and accurately. Authentication for purposes of the business-records exception does not require the witness whose testimony establishes the foundation for a business record to have personal knowledge of the exact circumstances of preparation and production of the document. [A] court may admit a document as a business record even when the proffering party is not the maker of the document, if the other

requirements of Evid.R. 803(6) are met and the circumstances suggest that the record is trustworthy. * * * Trustworthiness of a record is suggested by the profferer's incorporation into its own records and reliance on it." [Citations omitted.]

The bank's counsel's elicited testimony and the Gill court's discussion thereof provide a practical guide for counsel who must use the hearsay exception in evidence rule 803 to get a loan payment history into evidence.

The Judgment Amount.

Gill asserted that the bank could not receive a judgment in excess of the amount requested in its complaint. The appellate court rejected this argument by simply referring to Ohio R. Civil P. 54(C) ("[E]very final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded the relief in the pleadings.")

Gill's second damages related argument was more interesting. Gill asserted that damages should have been capped at the amount awarded against the other guarantors (\$461,477.44) less the proceeds collected from those other guarantors (\$400,002.00), or \$61,475.44 plus statutory interest of \$14,033.66 (calculated at the statutory post-judgment rate of 3 percent for 2015 and 2016 and 4 percent for 2017). After agreeing that Gill "should receive credit for payments made by other guarantors," the appellate court disagreed with the rest of Gill's position. You will recall that Gill had reached a tentative settlement with the bank – as a result, Gill "declined to participate in the prior proceeding" involving the other guarantors, and thus Gill "cannot now try to reap the benefits of that. (sic)"

Turning to Gill's argument on the interest rate applicable to the judgment against Gill, the appellate court said:

[Gill invites] us to impose the (much lower) Ohio post-judgment interest rate rather than the prevailing rate under their guaranty. But [Gill cites] no authority for the notion that nonparties can benefit from the post-judgment interest rate when they were not parties to the underlying judgment [the judgment entered in the first litigation against the other

guarantors]. The plain language of R.C. 1343.03(B) militates against that interpretation, describing post-judgment interest in terms of it being in effect after a “judgment, decree, or order for the payment of money rendered in a civil action based on * * * a contract * * *.” There is no reason to conclude that nonparties to a judgment, decree, or order would be bound by this statute. [Gill is] liable to [the bank] on an independent guaranty, and we are not persuaded that [Gill is] entitled to enjoy the reduced rate of interest tied to a separate judgment.

In other words, Gill was harmed for bowing out of the bank’s initial litigation before the SBA approved the settlement because the judgment against the other guarantors did not apply to him and thereby cap the judgment amount and post-judgment interest rate. This result might have been obviated by a different settlement structure – a settlement that kept Gill as a party to the first litigation but capped Gill’s liability at the agreed amount in exchange for Gill not mounting any defense to protect the guarantors collectively.

Gill next tried to convert its contribution right against the other guarantors (if any) into a shield against the bank arguing that the bank’s settlement with the other guarantors was a failure to mitigate the bank’s damages vis-a-vis Gill. The appellate court rejected this argument noting (i) Gill benefitted from payment of any part of the remaining deficiency by the other guarantors, and (ii) Gill did not offer any evidence that the bank did not “diligently [liquidate] the underlying property and” pursue “collection actions against the other guarantors first.”

Gill’s Exit From the Initial Case. After reaching the tentative settlement, Gill’s exit from the first litigation included dismissal of claims against the other guarantors. Asserting promissory estoppel, Gill argued that this change in position made the settlement agreement binding despite the fact it had not yet been approved by the SBA.

Rejecting this argument, the appellate court held that there was no contemporary evidence that Gill relied on the settlement when they dismissed their claims against the other guarantors.

A Final Note re SBA Guaranteed Loans. I have sued to collect many loans made by lender clients and supported by SBA guarantees. In all cases where there is a settlement for less than the principal amount owed, SBA approval was sought before the settlement was final. That practice is consistent with this testimony from the Gill case bank's witness who said "she only had authority to resolve a defaulted loan if it is given to her by the people that own the loan [effectively the SBA], and that they needed SBA approval 'if [they were] not going to get the full principal back."

Gill's experience is a warning to counsel who litigate the collection of SBA guaranteed loans. Helpfully, the court of appeals decision hints at a possible solution for Gill's timing problem – delay dismissal from the first litigation until the bank has the authority to enter into a final settlement or the SBA approves that settlement.

The Gill court said:

The principal on this loan was not satisfied until August 2017, well after [Gill] tentatively settled and released . . . cross-claims in 2015. The record lacks any evidence that [Gill] relied on the tentative settlement in releasing . . . cross-claims; even if there were, the evidence presently within the four corners of the record suggests that any such reliance may not have been reasonable given the tentative nature of the settlement.

Between this quote and the above-quoted testimony of the bank's witness, it seems that the settlement could have been made final and not tentative (subject to SBA approval) had Gill settled after the loan's principal balance was collected.

Conclusion.

At first glance, the Gill case seems routine and the loan structure (borrower, guarantors, and SBA guarantee) is common. A closer look, however, reveals some helpful lessons.

[Vince Mauer](#) has a master's degree in Business Administration and passed the CPA exam. Licensed to practice law in Ohio and Iowa, he has represented financial institutions in litigation matters for over 30 years. For more information on this topic, contact Vince Mauer

at vmauer@fbtlaw.com.

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