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of the decree is to unduly restrict the people of Floyd County in their free choice of hospitalization. 29

E. R. WEBS

CONTRACTS—IS A NEW AMORTIZATION PLAN FOR PAYMENT OF A MORTGAGE CONTRACT A NOVATION IN KENTUCKY?

A stockholder in an insolvent national farm loan association sought payment of the face value of his stock. A mortgage contract between the stockholder and the association had been made in 1926 as a condition precedent to a loan granted by the Federal Land Bank of Louisville. 1 Subsequent to amendment of the Farm Loan Act in 1933 a new agreement had been made which stipulated that the unpaid amount of indebtedness should be repaid on an amortization plan. Plaintiff contended, inter alia, that by reason of the “new contract” his liability as a stockholder should be determined by the provisions of the amendment. The court denied recovery, holding that the amendment relied on applied only to contracts, debts or engagements of the association entered into after 1933. The court further stated that the new agree-

29 (1939) 38 Mich. Law Rev. 242, 244.

1 One desiring to borrow money from a Federal Land Bank must become a shareholder in the Farm Loan Association; as such a shareholder, prior to 1933, he was individually responsible, not only for the amount represented by his shares, but in addition thereto to the extent of the amount of stock owned by him at its par value. See Byrne v. Federal Land Bank of St. Paul, 61 N. D. 265, 237 N. W. 797 (1931). However, in 1933 the Farm Loan Act was amended to read: “... the shareholders of national farm loan associations shall not be held individually responsible for any contract, debt, or engagement of such association entered into after June 16, 1933”. (Italics added.) 12 U. S. C. A. sec. 744a. Thus if, and only if, the new agreement discharged and took the place of the existing loan contract it was a “contract, debt, or engagement of such association entered into after June 16, 1933”. The purpose of the amendment is not entirely clear. If it contemplated a different degree of liability for all who became stockholders after 1933, then the court’s concern as to a novation, or new contract, was unnecessary. If it is to be construed literally to apply to contracts made after 1933, it must be decided whether the new agreement novated the old.

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ment did not constitute a novation or otherwise affect the stockholder's original liability. *Bracken-Robertson National Farm Loan Association et al. v. Downing et al.*, 281 Ky. 167, 135 S. W. (2d) 421 (1939).

Etymologically novation is from *novare*, meaning to "make new". Logically it may denote the substitution of a third person for one of the two parties to a relationship, or it can just as accurately indicate the substitution of a new relation between the same parties. At common law the term is usually applied only to a situation where the substituted contract has a new party, while the civil law usage is not so limited. Thus in Louisiana a substituted contract between the same parties is a novation. However, in a number of common-law jurisdictions both the civil law and common law definitions have been used. One of these is Kentucky.

As would be expected, such an interchanging of terminology has led to a certain degree of confusion. Various elements have been emphasized in pointing out what constitutes a novation in Kentucky. The substitution of a new debtor or creditor, an intention to replace an existing obligation, and the finding of a new consideration have all been used as essential factors. In at least one instance there has been an attempt to generalize by setting out certain requisites for the new contract. The case of *Davies County Bank and Trust Co. v. Wright*, says:

". . . a novation is the making of a new contract, its elements being the same as in the first contract, which are parties, a meeting of the minds and a consideration."

But the same observations might be made of any contract.

If a criterion is desired which can be applied to all cases, and more particularly to the instant case, it must result from a compilation of illustrative decisions. There is little doubt that there must be a prior contract which is discharged by a new obligation supported by new consideration. These essentials being characteristic of all cases, the narrow question remains in each individual case whether it is necessary that a new party be substituted in the new contract. Until *Watts' Admr. v. Smith*, it seemed well settled in Kentucky that a novation occurred only when the new contract involved a third person. In this

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2 VI Williston, Contracts (Revised ed., 1938) Sec. 1865.
7 Davies County Bank and Trust Co. v. Wright, 129 Ky. 21, 110 S. W. 361 (1908).
9 250 Ky. 617, 620, 63 S. W. (2d) 796 (1933).
case a mortgage note was never released of record, but a new note and mortgage was executed between the same parties. The court held squarely that there was a novation saying:

"The parties are agreed that a 'novation' is a contract between the parties whereby, for a valuable consideration, a creditor agrees to cancel an old obligation and to substitute in its place a new one. . . . To this we may add that it is not essential that the assent to the terms of the novation be shown by express words to that effect, but the same may be implied from the circumstances attending the transaction. . . ."

In the instant case the court apparently felt that an adjudication of plaintiff's rights involved the question of novation, and yet no attempt was made to distinguish or discuss the effect of the Watts case. There are two possible explanations of the position taken in the principal case: (1) Either the court confused novation with the settled rule that a mortgage is not discharged or lien affected by a change in form of the debt secured, or in the form of evidence of it; or (2) the Watts case was considered unimportant because, in the opinion of the court, the substitution of a long time amortization plan of payment did not amount to a new contract.

Support for the first explanation is found in the fact that the principal case cited only one case, that of Commonwealth Life Ins. Co. v. Louisville Ry. Co., which said:

"It is well settled that a mortgage is not discharged or its lien affected by any change in the form of the debt which it secures, or in the form of the evidence of it, so long as a novation is not executed. . . ."

The limitation placed on this holding by the phrase "so long as a novation is not executed" indicates that the Commonwealth Life Ins. Co. case is only authority for the proposition that a mortgage is not discharged. But the instant case does not involve that precise point. It is concerned rather with the rights accruing under a new agreement which alters the manner of paying an existing debt.

The second alternative explanation places the principal case in a more tenable position. Kentucky is without authority on the particular type of change which the existing debt underwent here, that of amortization. However, in the somewhat analogous instance of renewing a note, the existing obligation is usually not novated.22 Similarly where a new instrument was executed which recited "due $100.00 balance on mortgage" there was no novation, for the purpose of the

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21 250 Ky. 617, 620, 63 S. W. (2d) 796, 798 (1933).
22 234 Ky. 802, 809, 29 S. W. (2d) 652, 655 (1930).
instrument was merely to show the balance due. On the other hand, Richard v. Davis’ Assignee holds that:

"While a mere renewal of a note is not a satisfaction of it, yet if, in the absence of fraud or mistake, the creditor obtains an additional advantage of legal value, and the new rights and interests intervene, this fact, in the absence of an agreement to the contrary, operates as a novation and extinguishes the first debt."

In the absence of more than analogous authority the actual change which took place in the existing debt in the principal case should be pointed out. The original plan of payment is not given, but the plan of amortization in the subsequent agreement was a new one provided for by the amended act, calling for seventy-one semi-annual installments September 1, 1935, and ending March 1, 1971. Even though it be admitted that the interest on such an obligation is not a part of the debt, it can be forcibly argued that one who gives up the use of his money for such a long period has suffered a detriment. Likewise, the one who receives its use obtains a benefit. As the court correctly points out: "the original obligations stood unaffected by the agreement except that more liberal terms with respect to amortization payments were granted the borrower ....", but it is conceivable that the exception overshadows the general statement. The fundamental upon which the practice of amortization payments rests is the economic concept of time utility as applied to money. It is increasingly difficult, in a time of fluctuating monetary standards, to divorce the monetary unit from that which it represents, the debt. Aside from its metallic content, money has no value except in relation to its use at a particular time, and unless the obligation in the instant case has the same value in 1971 that it had in 1933, it has in fact been changed.

The foregoing analysis leads to the conclusion that (1) the term novation as used in Kentucky is not limited to a situation where the existing obligor or obligee is replaced by a third party, but is equally applicable when there is a substitution of a new agreement between the same parties; and (2) that a new agreement setting out a more liberal amortization plan for payment of an existing debt, in the absence of authority, should in fact change the entire obligation and create a new debt.

Although the decision of the instant case can rest on other grounds, it is submitted that the court failed to take advantage of an opportunity to clarify the Kentucky law in regard to novations, and might well have reached a contrary result without a strained interpretation of the new agreement pleaded by plaintiff.

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