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EXTENSION OF TIME FOR PAYMENT AS RELEASING SURETIES ON NOTE IN KENTUCKY

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Prior to the enactment of the Negotiable Instrument Act,[1] Kentucky followed the well-settled common law rule that a valid contract made between the payee or holder of a note and the principal debtor therein, whereby time for payment of the instrument was extended beyond its original maturity, released sureties on the note from all liability if the agreement for extension was made without their consent.[2] The rule is the same as to other obligations.[3]

The purpose of this memorandum is to ascertain whether or not that well-settled principle of suretyship has been abrogated in Kentucky by the enactment of the Negotiable Instrument Act, and, if so, the reasons therefor.

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[1] Acts 1904, c. 102, p. 213; Carroll's Kentucky Statutes (1930), Sec. 3720b-1 et seq.

[2] *Norton* v. *Roberts*, 4 T. B. Mon. 491 (1827); *Robinson* v. *Offutt*, 7 T. B. Mon. 540 (1828); *Clark* v. *Patton & Sharp*, 4 J. J. Marsh. 33, 20 Am. Dec. 203 (1830); *Farmers' & Mechanics' Bank of Lexington* v. *Crosby*, 4 J. J. Marsh. 367 (1830); *Sparks* v. *Hall*, 4 J. J. Marsh. 36 (1830); *Helm's Adm.* v. *Young, et al.*, 9 B. Mon. 394 (1849); *Robinson, et al.* v. *Miller*, 2 Bush 179 (1867); *Preston* v. *Henning*, 6 Bush 556 (1869); *Wilson* v. *Davies*, 5 Ky. Op. 725 (1872); *White* v. *Tuber*, 1 K. L. R. 64 (1880) (abstract opinion); *Blades* v. *Robbins*, 9 K. L. R. 197 (1887) (abstract opinion); *Harris-Seller Banking Co.* v. *Bond*, 20 K. L. R. 897, 47 S. W. 764 (1898); *Columbia Finance & Trust Co., Trustee* v. *Mitchell's Adm.*, 24 K. L. R. 1844, 72 S. W. 350 (1903).

[3] The rule was recognized in the following cases although other inequitable dealings were generally present where sureties released: *Craig* v. *Cox*, 2 Bibb. 309, 5 Am. Dec. 609 (1811) (forthcoming bond); *Jones* v. *Bullock*, 3 Bibb. 467 (1817) (injunction bond); *Edwards* v. *Coleman*, 6 T. B. Mon. 567 (1828) (appearance bond); *Sneeds's Exr.* v. *White*, 3 J. J. Marsh. 525, 20 Am. Dec. 175 (1830) (replevin bond); *Reid* v. *Watts*, 4 J. J. Marsh. 441 (1830) (recognizance); *Cooper, et ux.* v. *Fisher*, 7 J. J. Marsh. 396 (1832) (executor's bond); *Blandford's Adm.* v. *Barger*, 9 Dana 22 (1839) (replevin bond); *Tudor* v. *Goodloe*, 1 B. Mon. 322 (1841) (nature of bond uncertain); *Kenningham, et al.* v. *Bedford*, 1 B. Mon. 325 (1841) (nature of bond uncertain); *Mt. Sterling Imp. Co.* v. *Cockrill, et al.*, 24 K. L. R. 1151, 70 S. W. 842 (1902) (supersedeas bond); *U. S. F. & G. Co.* v. *Boyd*, 29 K. L. R. 598, 94 S. W. 35 (1906) (supersedeas bond);, *Caperton's Exr., et al.* v. *State Bank & Trust Co., Trustee, et al.*, 146 Ky. 415, 142 S. W. 1021 (1912) (bond of special commissioner of court); *Henderson* v. *Phoenix Ins. Co.*, 233 Ky. 217, 25 S. W. (2d) 359 (1930) (employee's fidelity bond).

While it has been said that the foundation of the rule is not based on actual damage to the sureties and that the question of damage is therefore immaterial,[4] it has been pointed out that the rule is necessarily based upon the idea of prejudice to the sureties—as otherwise there would be no reason for releasing them—and that the law will presume that the sureties have been prejudiced by such an extension.[5] Although the result reached is the same, the latter view seems more logical.

The Court early intimated that some damage to the sureties should be shown before the rule was enforced.[6] An able legal scholar has quite recently expressed the same thought.[7] But it is settled that damage need not be proven.

The reason given for the discharge of the sureties is that the original contract to which they were a party has been altered without their consent and they are therefore precluded by an agreement, to which they were not a party, from either paying the debt at its maturity and proceeding against the principal debtor or from compelling him to pay the note at the maturity to which they consented.[8] Such reason, it is evident, has back of it one and only one idea, and that is the material damage to which sureties would be subjected in event their discharge was not authorized.

As the payee or holder has made a new agreement with the principal debtor, in order for that agreement to be enforcible, it is essential that it contain the necessary elements of any other valid contract. The agreement for an extension must be for a definite time;[9] it must be based upon a valid consideration.[10]

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[4] *Norton* v. *Roberts, supra,* note 2; *Clark* v. *Patton & Sharp, supra,* note 2; *Hays* v. *Twyman,* 8 Ky. Op. 473 (1875); *White* v. *Tuber, supra,* note 2; *Wilson* v. *Briggs, Swift & Co.,* 4 K. L. R. 534 (1882).

[5] *Daviess County Bank & Trust Co.* v. *Wright,* 129 Ky. 21, 110 S. W. 361, 17 L. R. A. (N. S.) 1121 (1908) (an able opinion by Chief Justice O'Rear).

[6] *Brown* v. *Wright,* 7 T. B. Mon. 397 (1828); *Cooper, et ux.* v. *Fisher, supra,* note 3.

[7] Cardozo, *A Ministry of Justice,* 35 H. L. R. 113, 117.

[8] *Norton* v. *Roberts, supra,* note 2; *Farmers' & Mechanics' Bank of Lexington* v. *Crosby, supra,* note 2; *Cooper, et ux.* v. *Fisher, supra,* note 3; *Preston* v. *Henning, supra,* note 2; *Bringar's Adm.* v. *Phillips,* 1 B. Mon. 283, 36 Am. Dec. 575 (1841); *Alley* v. *Hopkins,* 98 Ky. 668, 34 S. W. 13 (1896); *Daviess County Bank & Trust Co.* v. *Wright, supra,* note 5.

[9] *Robinson* v. *Miller, supra,* note 2; *Offutt* v. *Glass,* 4 Bush 486

It is well-settled that the creditor may give whatever indulgence he wishes and be as lenient and passive as he desires to the principal debtor, without releasing the sureties, as long as a definite agreement is not made for such indulgence, leniency or passiveness.[11]

Thus it is seen that for nearly one hundred years prior to the enactment of the Negotiable Instrument Act in 1904, Kentucky followed the common law rule of suretyship that an extension of time given to the principal debtor, based upon a binding contract, released the sureties from their obligations on the note, if made without their consent. The rule was considered as a definite part of the law of suretyship without interfering with laws relating to negotiable instruments.

(1868); *Allgaier & Milton* v. *Scott*, 3 Ky. Op. 268 (1869); *Alley* v. *Hopkins*, *supra*, note 8.

[10] The early authorities presumably held no consideration was necessary. *Morton* v. *Roberts*, supra, note 2.

Payment of legal rate of interest in advance is consideration. *Kenningham* v. *Bedford*, *supra*, note 3; *Preston* v. *Henning*, *supra*, note 2; *Lebus* v. *Robbins*, 8 K. L. R. 966 (1887) (abstract opinion); *Morehead* v. *Citizens Deposit Bank*, 130 Ky. 414, 113 S. W. 501 (1908).

A promise to pay usurious interest is not binding. *Tudor* v. *Goodloe*, *supra*, note 3; *Pyke's Adm.* v. *Clark*, 3 B. Mon. 262 (1842); *Scott* v. *Hall, et al.*, 6 B. Mon. 285 (1845); *Duncan* v. *Reed*, 8 B. Mon. 382 (1848); *Allgaier & Milton* v. *Scott*, *supra*, note 9; *Millitz* v. *Schuff*, 5 Ky. Op. 118 (1872). "Its payment cannot be enforced, and while the promise to pay usury, and not the payment thereof, constitutes the consideration relied on, it is wholly illegal and invalid, although it may have been partly executed, because its full execution cannot be enforced, and therefore the contract for indulgence is not obligatory on either party." *Patton* v. *Shanklin*, 14 B. Mon. 13 (1853).

The actual payment of usurious interest in advance is consideration. *Kenningham* v. *Bedford*, *supra*, note 3; *Exchange Bank of Ky.* v. *Elgin*, 7 K. L. R. 608 (1886); *Blades* v. *Robbins*, *supra*, note 2; *Young* v. *New Farmers' Bank*, 102 Ky. 257, 43 S. W. 473 (1897).

Payment of past due interest not consideration. *Levy* v. *Roth*, 31 K. L. R. 704, 103 S. W. 292 (1907).

Entry of credit by principal debtor on open account of creditor not consideration. *Anderson* v. *Mannon, et al.*, 7 B. Mon. 217 (1846).

Agreement of creditor to accept monthly payments not consideration. *Thatcher* v. *Pagan*, 11 K. L. R. 903 (1890) (abstract opinion.)

Payment on another note due creditor not consideration. *Western's Adm.* v. *Perkins*, 2 Ky. Op. 495 (1868).

Payment on principal of note when due upon promise of forbearance on the balance then due is not consideration. *Evans* v. *Partin*, 22 K. L. R. 20, 56 S. W. 648 (1900).

[11] *Norton* v. *Roberts*, *supra*, note 2; *Stout* v. *Ashton*, 5 T. B. Mon. 252 (1827); *Ross* v. *Clore*, 3 Dana 189 (1835); *Western's Adm.* v. *Perkins*, *supra*, note 10; *Krupp* v. *St. Martinus Ritter Verein*, 21 K. L. R. 938, 53 S. W. 648 (1899); *Barber* v. *Ruggles*, 27 K. L. R. 1077, 87 S. W. 785 (1905); *Daviess County Bank & Trust Co.* v. *Wright*, *supra*, note 5.

After the enactment of the Act, and up to 1915, the question of the effect of an extension of time upon sureties was before the Court in five cases. In three of the cases,[12] wherein the Act was not mentioned the common law rule was specifically recognized. In the fourth case,[13] the Court, while holding that the Act excluded the defense of presentment, demand and protest as to the surety, did not say that the Act excluded the defense of extension of time and held that the evidence "of the appellant failed to sustain it, and that of the appellee wholly disproved it." In the fifth case,[14] wherein the Act was mentioned on the question of limitations, the Court again held that the evidence did not sustain the contention that an extension of time had been granted.

In 1915, in the case of *First State Bank of Nortonville* v. *Williams*,[15] for the first time, certain sections of the Act were relied on as not releasing sureties by an extension of time granted to the principal debtor. One Brasher executed a note to the Bank which Williams signed as surety, as the Bank knew. When sued on the note Williams pleaded that he was a surety, and that the time of payment had been extended without his knowledge or consent and that he was thereby released.

The Court quoted Section 119 of the Act, providing how the instrument is discharged, and Section 120, providing how parties secondarily liable are released, and then said:

"The Act thus specifies how the instrument, and consequently the parties primarily liable, may be discharged; and the several ways in which parties secondarily liable may be discharged. When speaking of parties primarily liable it contains no provision releasing them by the holder's extending the time for payment or postponing his right to enforce the instrument. When speaking of persons secondarily liable, it does provide that they may be released by such an agreement. The question of a release of a party by the extension of time of payment being thus present in the legislative mind, it is evident that if it was intended that a person primarily liable should be released it

[12] *Morehead* v. *Citizens Deposit Bank*, 130 Ky. 414, 113 S. W. 501 (1908); *Farmers' Bank of Wickliffe* v. *Wickliffe*, 131 Ky. 787, 116 S. W. 269 (1909); 134 Ky. 627, 121 S. W. 498 (1909) (second appeal); *Davis, et al.* v. *Bank of Clarkson*, 144 Ky. 417, 138 S. W. 246 (1911).

[13] *Fritts* v. *Kirchdorfer*, 136 Ky. 643, 124 S. W. 882 (1910).

[14] *Southern National Bank* v. *Schinkler, et al.*, 159 Ky. 372, 167 S. W. 148 (1914); 160 Ky. 813, 170 S. W. 813 (1914) (second appeal). See also *Levy* v. *Roth*, *supra*, note 10, and *Daviess County Bank & Trust Co.* v. *Wright*, *supra*, note 5, where the notes were executed prior to the Act, but the extension was granted after the effective date of the Act.

[15] 164 Ky. 143, 175 S. W. 10.

would have so provided in the Act. Having covered the entire subject of discharge and release from liability, and having provided that parties secondarily liable may be released by an extension of time, without any such provision affecting parties primarily liable, it is reasonable to conclude that the legislature did not intend that parties primarily liable should be so released."

After the decision in the Williams case the question was again before the Court on four occasions. In one case,[16] wherein the Act was brought to the attention of the Court, the common law rule was recognized. In two of the cases,[17] the rule was recognized although the Act was not mentioned. In the fourth case,[18] where the note contained an express provision waiving the defense of extension of time for payment, the Court, presumably recognizing the conflict in its previous rulings on the subject, held that the provision in the note was controlling and that, therefore, "we need not inquire whether under the Negotiable Instrument Act a surety may be released by an extension of time granted to his principal."

The vast majority of jurisdictions have accepted the reasoning in the Williams case on the question.[19] A late recognized authority on the subject of Negotiable Instruments, was of the opinion that such a situation was covered by Section 119 (4) of the Act, providing that the instrument is discharged by any act that will discharge a simple contract, and that if this is not so then it should be regarded as an omitted case governed by the law merchant under Section 196 of the Act.[20] The latter section is not a part of the Kentucky Act.

The Act is silent as to the effect on a party primarily liable if the holder releases collateral belonging to the principal debtor. It is likewise silent on the question of the holder's failing to apply a deposit of moneys, which is in his possession, belonging to the principal debtor at the maturity of the note in liquidation or payment thereof. Yet it is held that the release of collateral by the holder to the principal debtor,[21] and the failure of the

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[16] *Marshall* v. *Hollingsworth*, 166 Ky. 190, 179 S. W. 34 (1915).

[17] *Staib* v. *German Ins. Bank*, 179 Ky. 118, 200 S. W. 322 (1918); *Wagers* v. *Black*, 212 Ky. 361, 279 S. W. 342 (1926).

[18] *Peoples State Bank* v. *Atwood*, 212 Ky. 462, 279 S. W. 670 (1926).

[19] See cases collected in 48 A. L. R. 715; 65 A. L. R. 1425.

[20] Brannan, *The Negotiable Instrument Law* (3rd Ed.) (1920), p. 313.

[21] *Royster* v. *Heck*, 14 K. L. R. 141, 266 (1892); *Elsey* v. *Peoples Bank of Bardwell*, 166 Ky. 386, 179 S. W. 392 (1915); 168 Ky. 701, 182 S. W. 873 (1916) (first opinion withdrawn and holding that such de-

holder to apply a deposit held at the maturity of the note,[22] will release the sureties from all liability on the instrument and that such defenses have not been abrogated by the Negotiable Instrument Act. If the legal maxim, "the expression of one thing is the exclusion of another"—on which the reasoning in the Williams case is based—is to be applied, logical consistency would require its application to other defenses as well as that of extension of time for payment. That the question of extension of time was in the mind of the legislature, as evidenced by the fact that the Act provides for the discharge of a party secondarily liable by an extension of time, does not seem a complete answer.

As the Court has declared that a payee of a note cannot be a holder in due course,[23] and as Section 58 of the Act specifically provides that a negotiable instrument in the hands of any holder other than a holder in due course is subject to the same defenses as if it were non-negotiable, the above section should be controlling and the sureties allowed to rely on the common law defense of extension if the note is in the hands of the payee. In other jurisdictions, wherein a payee cannot be a holder in due course, it is so held.[24]

It would seem that on principle and upon a fair construction of the Act, there is no reason to change the common law rule and that the conclusion reached in the Williams case is

fense was abrogated by the Act); *Darland* v. *First National Bank*, 177 Ky. 261, 197 S. W. 826 (1917); *Southern National Life Realty Corporaton* v. *Peoples Bank of Bardstown*. 178 Ky. 80, 198 S. W. 543 (1917) (overruling second and reinstating first opinion in *Elsey* v. *Peoples Bank of Bardwell*). Opinion modified, 179 Ky. 113, 200 S. W. 313 [1918]).

[22] *Pursifull* v. *Pineville Banking Co.*, 97 Ky. 154, 30 S. W. 203 (1895); *Bank of Taylorsville* v. *Hardesty*, 28 K. L. R. 1285, 91 S. W. 729 (1906); *Planters State Bank* v. *Schlamp*, 124 Ky. 295, 99 S. W. 216 (1907); *Burgess* v. *Deposit Bank of Sadieville*, 30 K. L. R. 177, 97 S. W. 761 (1906); *Southern National Life Realty Corporation* v. *Peoples Bank of Bardstown, supra*, note 21; *Fitzpatrick's Adm.* v. *Citizens Bank & Trust Co.*, 231 Ky. 202, 21 S. W. (2d) 254 (1929).

Deposits made subsequent to the maturity of the note will not release sureties. *Farmers National Bank* v. *Jones, et al.*, 234 Ky. 591, 28 S. W. (2d) 787, 70 A. L. R. 335 (1930).

Money on deposit at maturity of note for payment of designated creditors does not release sureties. *Royse* v. *Winchester Bank*, 148 Ky. 368, 146 S. W. 738 (1912).

[23] *Southern National Life Realty Corporation* v. *Peoples Bank of Bardstown, supra*, note 21.

[24] *Supra*, note 19.

unsound. The Negotiable Instrument Act is not and was not intended to be complete codification of all laws relating to negotiable instruments and, therefore, where a situation is not covered by the Act, the common law must be looked to.[25]

It cannot be said that the rule is inequitable to the creditor because it is never applied unless the holder knew at the time the extension was granted of the surety co-maker relationship.[26] Parol evidence that one is in fact a surety is admissible.[27]

In view of the authorities on the question today, it would seem clear that Kentucky has not committed itself to the proposition that the Negotiable Instrument Act has abrogated the common law rule.

When the question is again presented to the Court it would seem that the Williams case must necessarily be overruled if the note is in the hands of the original payee.[28] There seems no good reason why the defense should not be allowed even if the note is in the hands of a holder in due course.

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[25] "Our conclusion, then, is that, where the negotible instrument act speaks, it controls; where it is silent, resort must be had to the law merchant or the common law regulating commercial paper." *Mechanics' & Farmers' Bank* v. *Katterjohn*, 137 Ky. 427, 125 S. W. 1071 (1910).

[26] *Neel* v. *Harding*, 2 Met. 247 (1859); *Champion* v. *Robertson*, 4 Bush 17 (1868); *Young* v. *New Farmers' Bank*, 102 Ky. 257, 43 S. W. 473 (1897); *Harris-Seller Banking Co.* v. *Bond*, 20 K. L. R. 897, 47 S. W. 764 (1898); *Turner* v. *Farmers' Bank*, 22 K. L. R. 787, 58 S. W. 695 (1900).

[27] *Lewis* v. *Hardin*, 5 B. Mon. 564 (1845); *Brown* v. *Berry*, 7 Ky. Op. 179 (1873); *Chapeze* v. *Young*, 87 Ky. 476, 9 S. W. 399 (1888); *Young* v. *New Farmers' Bank*, *supra*, note 26; *Craddock* v. *Lee*, 22 K. L. R. 1651, 61 S. W. 22 (1901); *Morehead* v. *Citizens' Deposit Bank*, *supra*, note 12; *Swearington's Exr.* v. *Tyler*, 132 Ky. 458, 116 S. W. 331 (1909); *Basket & Nicholas* v. *Rudy*, 186 Ky. 208, 217 S. W. 112 (1919).

But holder cannot show indorser was in fact a surety. Ky. Statutes, Sec. 481; *First National Bank* v. *Bickel*, 143 Ky. 754, 137 S. W. 790 (1911).

[28] Subsequent to the decision in the Williams case the court held that a payee could not be a holder in due course. *Supra*, note 23.