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Contracts - Security Obtained in Violation of Scale-Down Agreements under Federal Loan Acts

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CASE NOTES

CONTRACTS—SECURITY OBTAINED IN VIOLATION OF SCALE-DOWN AGREEMENTS UNDER FEDERAL LOAN ACTS. S obtained a loan from the Federal Farm Mortgage Corporation under provisions of the *Emergency Farm Mortgage Act* of 1933, 12 U.S.C. §1016. H, a creditor, agreed to scale-down an unsecurred $2,983.13 debt due him from S to $900.00 in order to make S eligible for said loan. S gave the Federal Farm Mortgage Corporation a first mortgage, and secretly gave a note to H for the difference between the amount originally due and the amount H had agreed to accept under the scale-down agreement. H subsequently brought action on his note, recovered judgment thereon, and transferred the judgment for a cash consideration to N. N sought enforcement of the judgment on S's property, and plaintiff Mortgage Corporation brought suit to have the judgment declared void. *Held,* the note given contrary to the scale-down agreement was void as between the parties and a nullity against the federal loan agency. *Federal Farm Mortgage Corporation v. Hatten et al,* 210 La. 249, 26 So. (2d) 735 (1946).

Federal loan acts commonly provide for scale-down agreements and maximum debt limitations. *Emergency Farm Mortgage Act* of 1933, 12 U.S.C. § 1016; *Home Owners' Loan Act* of 1933, 12 U.S.C. §1461 et seq; *National Housing Act,* §203 (b), as amended, 12 U.S.C. §1709 (b). The real purpose of loans made by these federal agencies is to constitute one agency the sole creditor, thereby eliminating by way of compromise all other creditors. *Kniefel v. Keller,* 207 Minn. 109, 290 N.W. 218 (1940). The loan acts contemplate helping a debtor who has demonstrated his inability to operate under his previous load of debts. Secret security given in violation of a scale-down agreement would rebuild the very debt structure which was reduced by the scale-down agreement. *Federal Farm Mortgage Corporation v. Hatten et al,* 210 La. 249, 26 So. (2d) 735 (1946). Moreover, the loan agency itself has an interest to protect. It would find its financial position weakened by allowing secret security to be given by the debtor. *O'Neil v. Johnson et al,* 29 F. Supp. 307 (1939). With the foregoing reasoning evident in nearly all decisions, the courts have without exception held that security given contemporaneously, prior, or subsequent to the execution of such a scale-down agreement is void. *Federal Land Bank of St. Paul v. Koslofsky,* 67 N.D. 322, 271 N.W. 907 (1936). Such security may be in the form of a chattel mortgage, *International Harvester Company v. Young,* 288 Mich. 436, 285 N.W. 12 (1939); a second mortgage upon real property, *Local Federal Savings & Loan Ass'n of Oklahoma City v. Sheets et ux,* 191 Oklahoma 439, 130 P. (2d) 825 (1942); or a note or other advantage, *Anderson v. Nelson,* 110 Colo. 374, 134 P. (2d) 1053 (1943). A party who has made payments on a contract in violation of a scale-down agreement is entitled to reimbursement for payments made. *Anderson v. Nelson,* 110 Colo. 374, 134 P. (2d) 1053 (1943). The loan agency may, with a full disclosure of the facts, consent to a second mortgage upon property on which it holds a first mortgage. However, it must clearly appear that the agency has knowledge. Thus, the alleged knowledge of a fee attorney for the federal loan agency was held not imputable to the agency in *F. S. T. Corporation v. Onorato et al,* N. J. 50 A. (2d) 467 (1947).

From the foregoing it may be observed that a seemingly inflexible rule has been universally followed with respect to security-violating, scale-down agreements. The knowledge of an agency must be unmistakably shown in order to render such contracts valid. Public policy necessitates holding such security void, for the loan acts were intended solely for the benefit of homeowners and farmers, and any benefit to creditors is "purely incidental," *Campbell v. Sutton,* 62 Cal. App (2d) 621, 145 P. (2d) 91 (1944).

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