IN THE COURT OF APPEALS OF TENNESSEE
EASTERN SECTION AT KNOXVILLE

FILED

August 22, 1996

Cecil Crowson, Jr.
Appellate Court Clerk

RICHARD P. JAHN, JR., LIQUIDATING TRUSTEE FOR CRESCENT OAKS INVESTMENTS, LTD., AND AS BANKRUPTCY TRUSTEE FOR RICHARD CARMACK,

Plaintiff/Appellant

v.

J. FRANK HARRISON, JR.

Defendant/Appellee

HAMILTON CHANCERY

No. 03A01-9604-CH-00132

REVERSED AND REMANDED

Richard P. Jahn, Jr., Chattanooga, For the Appellant

John W. Murray, III, Chattanooga, For the Appellee

O P I N I O N

INMAN, Senior Judge

Crescent Oaks Investments, Ltd. was a Limited Partnership engaged in the business of constructing and operating apartment complexes. It had only one general partner, Richard E. Carmack.

A project known as Crescent Oaks was completed in 1980. Cost overruns were troublesome. When finally adjusted, these overruns amounted to $325,742.00 for which the limited partnership (acting through its general partner, Carmack) delivered to Carmack its promissory note dated December 15, 1983 and payable on December 5, 1993 with a floating rate of interest. We refer to this note hereafter as the “1983 note.”

An amendment to the Partnership Agreement specifically authorized the

execution and delivery of the note to Carmack. It was carried on the books of the limited partnership as a long-term debt, and its validity is not questioned.

Carmack thereafter fell into hard financial times. He borrowed $218,000.00 from Harrison, the appellee, which was evidenced by a promissory note dated October 23, 1989, secured by the signatures of his two sons and by a second deed of trust on lots in Jackson Square Subdivision.

This first mortgage was foreclosed about one year later, causing Harrison some anxiety, to alleviate which he requested additional security.

Carmack met with Harrison's attorney on December 8, 1990 to discuss the demand of Harrison for additional security. Carmack revealed that the Limited Partnership owed him about $400,000.00 (this is the 1983 note with accrued interest) which was "evidenced by two promissory notes *recently* issued" {actually, the preceding day).

Carmack agreed to assign one of these notes to Harrison as "new" collateral.

"Sometime in December 1990," Carmack, Jr., using the 1983 note as a guide, drafted a promissory note payable to Carmack, Sr. by the Limited Partnership in the amount of $200,000.00 (the 1990 note). This note is dated December 7, 1990 and was payable "when the Crescent Oaks Apartment is sold."

The "other note" was never issued.

On January 25, 1991, Carmack, by written instrument, "assigned, sold, conveyed, set over and transferred to Harrison all of his right, title or interest in the 1990 note, as security for and payment of his note to Harrison, though not in extinguishment of it."

In course, the Limited Partnership also fell into hard financial times and sought bankruptcy protection, which was successful to the extent a new lender was discovered who paid the defaulted first mortgage. Carmack's 1983 note survived the bankruptcy, but the second mortgage securing its payment was required to be released, and certain restrictions were imposed with respect to the allocation of cash

flow. The note was kept with Carmack's personal papers initially, but thereafter was lodged in a safe at a relative's house. Carmack petitioned for bankruptcy and, on May 15, 1995, one of his sons delivered the note to the bankruptcy trustee.

The note is unmarked, it bears no endorsements or notations. The Trustee considered it to be an asset of Carmack's bankruptcy estate, collectible to the Trustee for the benefit of the general creditors of Carmack.

The Trustee filed this action for a declaratory judgment that:

(1) the Limited Partnership is under no duty or obligation to pay "any debt to Carmack or to Harrison under the December 9, 1990 note";

(2) the 1983 note be declared to be the property of Carmack's bankruptcy estate.

The defendant admitted that the December 7, 1990 note was drawn by Carmack on the Partnership payable to Carmack and assigned to the defendant as "collateral to secure payment of the 1989 note" (the personal loan from Harrison to Carmack).

The defendant alleged that he was not made aware of the 1983 note "at the time"; although Carmack's financial statement, delivered to Harrison, listed it as an asset, Carmack did not proffer it as security for the loan. He alleged that Carmack intended the 1990 note *to represent a partial replacement for the debt evidenced by the 1983 note*, which Carmack had authority to issue as a general partner of the Limited Partnership.

In short summary, the defendant insisted that the 1990 note, assigned to him[1] as security for the personal loan to Carmack, was a "partial replacement" of the 1983 note and that Carmack simply "never got around" to the execution of another note representing the balance of the 1983 note.

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[1]The 1990 note was non-negotiable because it was not payable at a definite time.

The Chancellor agreed, finding that the $200,000.00 note (the 1990 note) was a valid obligation of the Partnership, executed in partial replacement of the 1983 note, and was properly pledged to secure the personal obligation of Carmack to Harrison. We are constrained to disagree for the reasons hereafter appearing.

The issue is whether the 1983 note was canceled, and the standard of review is *de novo* on the record accompanied with a presumption that the judgment is correct unless the evidence otherwise preponderates. TENN. R. APP. P. 13(d).

Recourse must first be had to the controlling statutes and thereafter to the Partnership Agreement:

T.C.A. § 61-2-403 provides that ". . . a general partner of a limited partnership has the rights and powers . . . of a partner in a partnership without limited partners."

T.C.A. § 61-1-108 relating to partnerships without limited partners provides:

> Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member, binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact he has no such authority.

The Partnership Agreement provides:

> Power and Authority of General Partner. The General Partner shall have complete and exclusive control over the management of the Partnership business and affairs, and the Limited Partners shall have no right to participate in the management of conduct of the Partnership business or affairs nor any power or authority to act for or on behalf of the Partnership in any respect whatsoever. Except as otherwise specifically provided in this Agreement, the General Partner shall have the right, power and authority on behalf of the Partnership and in its name, to exercise all of the rights, powers and authority of a partner of a partnership without limited partners under the Tennessee Uniform Partnership Act.

The defendant argues that Carmack was authorized by the statute and the Partnership Agreement to "execute and deliver the 1990 note in replacement for the 1983 note . . . " in accordance with the testimony.

Carmack testified that he considered the 1983 note "null and void," because he intended that the 1990 note would replace it. He was somewhat vague about the balance of the 1983 note, since the amount of the 1990 note was one-half of the 1983 note. Since he was the payee and holder of the note, this testimony in ordinary circumstances would be significant and possibly contrary to the contentions of the Trustee; but, the testimony comes in hindsight, after the Trustee has taken possession of the note and asserted a differing scenario, thus casting a shadow upon it. His testimony is supported by his son, Carmack, Jr. who typed the 1990 note--using, as we have said, the 1983 note as a guide--at the request of his father. He, too, considered the 1983 note to have been replaced by the 1990 note.

Militating against the testimony of Carmack and son are these undisputed facts:

(1) None of the Limited Partners was aware of the 1990 note. While the defendant argues that the partnership has in no way been harmed by the "transaction," this essentially begs the question and is not relevant to the dispositive issue.

(2) While the Partnership Agreement was amended to authorize *in haec verba* the execution and delivery of the 1983 note, no such authorization was sought for the 1990 note.

(3) The 1983 note was shown on the books of account of the Partnership; the 1990 note was not.

(4) The CPA who had done all of Carmack's personal and business accounting for twenty years was unaware of the 1990 note until March 1994, nearly three years after its execution and delivery.

(5) The 1990 note nowhere refers to the 1983 note, and there is no *prima facie* indication that it was executed and delivered in lieu of the 1990 note.

(6) Although Carmack testified that the Partnership had "recently issued two notes" in replacement of the 1983 note, only one note was issued.

(7) The defendant accepted the 1990 note per assignment without verification and did not notify the Partnership of the assignment.

(8) The records of the Partnership reflect nothing about the 1990 note.

(9) On March 16, 1992, Carmack confirmed by letter to CPA Henderson *that the 1983 note remained due and payable*, principal $325,742.00 plus interest of $123,799.68 as of December 31, 1991. *This occurred eleven (11) months after the 1990 note was allegedly delivered in replacement of the 1983 note.*

(10) Carmack certified an audit of Crescent Oaks for 1992 reflecting that the 1983 note remained due and payable.

(11) Carmack again certified a 1993 audit that the 1983 note was due and payable, principal $325,742.00 plus interest of $203,932.20 as of December 31, 1993. This certification was made on April 5, 1994, after he filed in bankruptcy, *more than three years after the execution of the 1990 note*.

(12) In June 1993, Carmack, responding to Harrison's request for an update on his assets advised him that "his note from Crescent Oaks payable to me" (the 1983 note) was worth about $525,000.00.

As we have said, the Chancellor found that Carmack intended to cancel and did cancel the 1983 note by the issuance of the 1990 note, i.e., that a novation occurred. We cannot agree.

A novation is a contract which substitutes a new obligation for an old one which is thereby extinguished.[2] *Blaylock v. Stephens*, 258 S.W.2d 779, 781 (Tenn. App. 1953). The burden of proving a novation is upon the defendant, *Bank of Crockett County v. Cullipher*, 752 S.W.2d 84, 89 (Tenn. App. 1988), and must be clearly established by evidence of the discharge of the original debt by express

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[2]But a renewal of a previous note does not *per se* extinguish the original note. *Commerce Union Bank v. Burger-in-a-Pouch, Inc.*, 857 S.W.2d 88, 90 (Tenn. 1983).

agreement or by the acts of the parties clearly showing the intention to work a novation. *Id* and cases cited.

In the case at bar, the 1990 note was for an amount less than one-half of the note allegedly replaced; the due date was changed from definiteness to one of indefiniteness; on three occasions after the 1990 note was executed -- ranging from 12 months to three years -- Carmack represented and affirmed that the 1983 note remained due and payable; and the records of the Partnership nowhere reflected the 1990 note.

Given these undisputed facts, it is clear that the defendant failed to prove -- much less "clearly establish" that a novation occurred. Moreover, T.C.A. § 47-3-605 (47-3-604 effective July 1, 1996) provides the exclusive means for the discharge of negotiable instruments. *Commerce Union Bank*, 657 S.W.2d 88, 91 (Tenn. 1983). It is provided that:

> (1) The holder of an instrument may even without consideration discharge any party;
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> (a) in any manner apparent on the face of the instrument or the endorsement, as by intentionally cancelling the instrument or the party's signature by destruction or mutilation, or by striking out the party's signature, or
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> (b) by renouncing his rights by a writing signed and delivered or by surrender of the instrument to the party to be discharged.
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> T.C.A. § 47-3-605 (1992).

The Chancellor found that Carmack renounced his rights under the 1983 note by executing a new note. We do not agree for the reasons heretofore expressed, emphasizing that Carmack expressly certified on three occasions ranging from 12 months to 3 years after the 1990 note was issued that the 1983 note remained viable. This undisputed conduct completely negates any assertion of renunciation or any inference of it.

We conclude that the 1983 note was not canceled or replaced and remains a valid, enforceable obligation payable to his bankruptcy estate. The evidence

preponderates against the judgment, which is reversed at the costs of the appellee, and the case is remanded for all necessary purposes.

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William H. Inman, Senior Judge

Concur:

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Don T. McMurray, Judge

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Herschel P. Franks, Judge