

1984

# Guardian State Bank, a Utah corporation v. F.C. Stangl III : Brief of Appellant

Utah Supreme Court

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Harold G. Christensen; George A. Hunt; Snow, Christensen & Martineau; Attorneys for Respondent.

Stephen B. Mitchell; Burbidge & Mitchell; Attorneys for Appellant.

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100-11572

IN THE SUPREME COURT

FOR THE STATE OF UTAH

GUARDIAN STATE BANK, a  
Utah corporation,

Plaintiff and  
Appellant,

**VS.**

F.C. STANGL III,

Defendant and Respondent.

Case No. 20158

APPELLANT'S BRIEF

Appeal from a Judgment of the  
Third Judicial District Court for Salt Lake County  
Honorable Scott Daniels, Judge

STEPHEN B. MITCHELL  
BURBIDGE & MITCHELL  
139 East South Temple, Suite 2001  
Salt Lake City, Utah 84111

Attorneys for Appellant

HAROLD G. CHRISTENSEN  
GEORGE A. HUNT  
SNOW, CHRISTENSEN & MARTINEAU  
10 Exchange Place, 11th Floor  
P. O. Box 3000  
Salt Lake City, Utah 84110

Attorneys for Respondent

**FILED**

OCT 24 1984

Clerk, Supreme Court, Utah

GUARDIAN STATE BANK, a  
Utah corporation,

VS.

Defendant and  
Respondent.

Attorneys for Respondent

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IN THE SUPREME COURT  
FOR THE STATE OF UTAH

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GUARDIAN STATE BANK, a	)	
Utah corporation,	)	
	)	<u>APPELLANT'S BRIEF</u>
Plaintiff and	)	
Appellant,	)	
	)	
vs.	)	Case No. 20158
	)	
F.C. STANGL III,	)	
	)	
Defendant and	)	
Respondent.	)	

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NATURE OF THE CASE

Appellant Guardian State Bank ("Guardian") filed this action to recover the amount due from Respondent F.C. Stangl ("Stangl") on a Promissory Note executed in favor of Guardian dated May 11, 1981, and for fraud and declaratory relief. Stangl admitted liability on that Note but filed a Counterclaim seeking to recover from Guardian on Guardian's indorsement of a previous Promissory Note which Stangl had guaranteed. A Third-Party Complaint filed by Guardian against its attorneys for negligence in the subject transaction is not involved in this Appeal.

DISPOSITION IN THE LOWER COURT

The District Court granted Stangl's Motion for a directed verdict. Judgment was thereafter entered by the Court on June 19, 1984.

## NATURE OF RELIEF SOUGHT ON APPEAL

Guardian seeks an Order reversing the Judgment below in favor of Stangl on his Counterclaim with directions to enter Judgment on the Counterclaim in favor of Guardian, and awarding Guardian its attorneys' fees and costs incurred in the Court below and on Appeal. In the alternative, Guardian seeks an Order reversing the Judgment and remanding the case for a new trial.

## STATEMENT OF FACTS

### A. Preliminary Statement.

The directed verdict in favor of Stangl was only proper if, as a matter of law, reasonable minds could not differ on the facts to be determined from the evidence presented at trial so that Stangl was entitled to Judgment as a matter of law. The District Court was not free to weigh the evidence in deciding the Motion for Directed Verdict and was obligated to view the evidence in the light most favorable to Guardian. See, e.g., Management Committee of Greystone Pines Homeowners Association v. Graystone Pines, Inc., 652 P.2d 896 (Utah 1982); Anderson v. Gribble, 513 P.2d 432 (Utah 1973).

Most of the facts set forth below are undisputed. In those instances where the facts are in dispute, the facts presented by Guardian are set forth in accordance with the foregoing standards and Stangl's conflicting testimony is set forth in footnotes.

### B. Facts.

At all relevant times Stangl was an officer, director and 50% shareholder in Sargetis Fine Cars, Inc. (the "dealership"), which owned and

operated a car dealership in Price, Utah. The other principal of the dealership was John Sargetis ("Sargetis"). Stangl also owned the property upon which the dealership conducted its business and leased that property to the dealership. [R. 341; 604, line 24 - 605, line 1]

On or about August 28, 1979, the dealership obtained a loan in the principal sum of \$150,000.00 from Empire State Bank, which was the predecessor-in-interest to Guardian.<sup>1</sup> To evidence that loan, the dealership executed a Promissory Note (the "original Note") in favor of Guardian in the total principal sum of \$150,000.00, bearing interest at the rate of 1.5% above Chase Manhattan Bank prime, payable upon demand. [Ex. D-1; R. 341; 558, lines 17-25] As a condition of making the subject loan, both Stangl and Sargetis individually were required to and did execute a continuing Guaranty of all the debts and obligations owing to Guardian by the dealership. [Ex. D-2; 341, 560, lines 11-24] Stangl understood at the time he executed the Guaranty that if the dealership did not pay the original Note, he was obligated to do so. [R. 606, lines 5-8]

The dealership subsequently went out of business, and in December 1980, assigned its remaining assets to the National Association of Credit Men ("N.A.C.M.") for liquidation as a Trustee for the benefit of creditors. [R. 653, lines 6-11]

As of April 1981, no principal payments had been made on the original Note for approximately one year. [R. 702, line 23 - 703, line 3]. In April 1981, Russell Webb, who was then the newly installed President of Guardian, met with Stangl at Guardian's offices to discuss the delinquent

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<sup>1</sup> Empire was merged into Guardian in April 1982 [R. 338] and both entities will hereinafter be referred to as "Guardian".

loan and told Stangl that Stangl, as a Guarantor, would have to pay the original Note. Stangl was very cooperative at the meeting and agreed that he had a responsibility to pay the original Note. However, Stangl represented that he was not in a position to pay the full amount of the Note at that time and requested a repayment program whereby Stangl would execute a new Promissory Note payable one-half within sixty or ninety days and the other half within another year. [R. 555, lines 20-23; 561, line 19 - 562, line 10] Stangl told Mr. Webb he was concerned that by paying off the Note he would lose his right to get any recovery from the assets of the dealership being liquidated by the N.A.C.M. [R. 626, lines 19-25] Stangl also told Mr. Webb that he wanted Guardian to give him the original Note and Guaranty so that he could attempt to collect from the assets of the dealership and from Sargetis individually. [R. 510, lines 1-5; 601, Lines 6-10] These terms were agreed to by Mr. Webb. [R. 628, lines 1-7] Stangl did not tell Mr. Webb that he wanted Guardian to indorse the original Note to him so that he could impose liability on Guardian. [R. 514, lines 11-20; 600, Line 25 - 601, line 10] If Stangl would have told Mr. Webb that he would seek to impose liability upon Guardian on the original Note, Guardian would, of course, not have entered into the transaction. [R. 573, lines 14 - 574, line 11]<sup>2</sup>

Although all of the terms with respect to the repayment of the original Note were agreed to by Mr. Webb and Stangl directly, Jerry

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<sup>2</sup> Stangl did not contradict this testimony except to contend that during the meeting he had initially objected to paying the original Note principally because he thought the Note was to be amortized over five years instead of payable on demand. Stangl specifically acknowledged that an agreement had been reached concerning repayment in his meeting with Mr. Webb and that he told Mr. Webb he wanted the Note and Guaranty to try to collect from the dealership. [R. 90, line 21 - 93, line 76; 101, lines 4-13]

Dearinger ("Dearinger"), the lawyer for Guardian, and Bruce Maak ("Maak"), the lawyer for Stangl, were to document the transaction to conform to the agreement reached between Stangl and Guardian. [R. 567, line 22 - 568, line 6; 629, lines 16-24; 674, lines 17-22]

Dearinger and Maak subsequently did undertake to document the agreement. Dearinger testified that in his conversations with Maak, Maak told him that although he had advised Stangl that he thought Stangl had some unspecified defenses on the Guaranty, Stangl wanted to go ahead and make payment to Guardian on his Guaranty. Maak also told Mr. Dearinger that Stangl wanted to protect his good credit in town so he was willing to pay the Guaranty, but didn't have the funds to pay it at that moment, so if transaction was structured so that Stangl could pay the Guaranty over a period of time, Stangl would be willing to pay the Guaranty. Maak told Dearinger that if Stangl paid the loan, he should be assigned Guardian's rights against the dealership and Sargetis upon the original Note and Guaranty, and that the only reason Stangl wanted the original Note and Guaranty was so that Stangl could pursue John Sargetis and the dealership. [R. 640, line 25 - 642, line 1; 645, lines 1-6] Maak told Dearinger that he wanted the transaction structured as a purchase of the original Note with a new Note to make it clear the original Note was not being paid off, consistent with Stangl's concern that by paying the Note he would forfeit any right to recover dealership assets from the N.A.C.M. [R. 670, lines 4-10]<sup>3</sup>

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<sup>3</sup> Although Maak denied that he ever told Dearinger that the only reason Stangl wanted the original Note and Guaranty was to pursue Sargetis and the dealership, he acknowledged that he might have told Dearinger that was one of the reasons. [R. 686, lines 8-13] Maak also acknowledged that he never told Dearinger or Guardian that the reason he wanted the original Note and Guaranty in the form he required was so that Stangl could hold Guardian liable on its indorsement and escape liability to Guardian. [R. 150, lines 18 - 151, line 7]

While Stangl intentionally led Guardian to believe that he intended to pay his obligation to the Bank on the Guaranty by executing a new Promissory Note which would give Stangl additional time for the payment of the obligation, Stangl and his attorney in fact had no such intent. Rather, Stangl intended to attempt to evade any obligation to Guardian on the Guaranty or the new Note by getting Guardian to indorse the original Note with recourse, transfer the original Note and Guaranty to Stangl, and then hold Guardian liable on its indorsement if the amount of the original Note could not be collected from the dealership. [R. 711, line 22 - 712, line 1; 671, line 18 - 672, line 6; 695, lines 7-14; 691, lines 6-19; 637, lines 8-15]

To carry out this scheme, on May 14, 1981, Stangl paid interest current on the original Note in the sum of \$8,104.00 and executed a new Promissory Note in favor of Guardian in the principal sum of \$132,000.00, representing the unpaid principal balance of the original Note. The new Note provided for interest at the rate of 1% above Chase Manhattan Bank prime (one-half percent less than the original Note) and was to be repaid in two equal installments on or before July 10, 1981 and July 10, 1982. The new Note recited it was given for the purchase of the original Note. [Ex. P-10; R. 342; 632, lines 2-8] Pursuant to the agreement of the parties, Guardian at that time also assigned and delivered to Stangl the Guaranty of the original Note which Stangl and Sargetis had executed, and the original Note itself which was indorsed by Guardian. Guardian's indorsement did not contain any indication on its face that it was without recourse. [Exs. D-1 & D-2; R. 342] Immediately upon completing this transaction, it was Stangl's position that he had no further liability to Guardian, which was the result

he intended the transaction to accomplish. [R. 637, lines 8-15; 711, line 22 - 712, line 1] Of Course, this position was not communicated to Guardian.

After Stangl executed the new Promissory Note and acquired the original Note and Guaranty from Guardian, Stangl claims to have made some minimal efforts to collect the original Note from the assets of the dealership and from Sargetis individually. However, no funds were ever collected and Stangl never made any payments on the new Note. [R. 680, line 10 - 681, line 3; 712, lines 15-17] By the Fall of 1981, Stangl undeniably knew that the original Note could not be collected from the dealership because Ford Motor Credit had a perfected security interest in all of the assets of the dealership. [R. 682, lines 10-21] Nevertheless, Stangl made no demand upon Guardian for payment of the original Note until approximately one year later in September, 1982 in response to a demand by Guardian for payment of the new Promissory Note. [R. 342]

Guardian then commenced this action in the Fall of 1982, seeking to recover the amount owing from Stangl on the new Promissory Note. Guardian also sought recovery for fraud based on Stangl's misrepresentations and omissions which induced Guardian to indorse the original Note and assign the Guaranty to Stangl. Finally, Guardian sought declaratory relief with respect to the rights of the parties on the original Note and Guaranty. [R. 2-6] Stangl answered the Complaint admitting liability on the new Note, and filed a Counter-claim seeking to recover from Guardian on Guardian's indorsement of the original Note in an amount in excess of that which was owed to Guardian on the new Note. [R 10-16]

Some months after the action was filed, Guardian was granted leave to file a Third-Party Complaint against its attorneys in the transaction



with Stangl, Jerry Dearinger and the firm of Kirton & McConkie. Guardian sought recovery from the Third-Party Defendants on the basis that if Stangl was entitled to recover from Guardian on its indorsement of the original Note, the Third-Party Defendants were liable to Guardian for negligence. [R. 101-105]

The case went to trial before a Jury on May 21 - 23, 1984. After Guardian and Stangl had rested their cases as against each other, Stangl moved for a directed verdict on the basis that as a matter of law Guardian was indebted to Stangl on the original Note in an amount in excess of Stangl's liability to Guardian on the new Note. [R. 727, line 12; 728, line 17] Guardian also moved for a directed verdict. [R. 751, lines 14-20] Although the District Court believed that the result was "so grossly unfair", the Court did not feel that there was any legal basis upon which to grant relief to Guardian and granted Stangl's Motion for Directed Verdict. [R. 759, line 23 - 760, line 6]

The action between Guardian and the Third-Party Defendants was then submitted to the jury, which determined that the Third-Party Defendants had been 55% negligent with respect to the transaction, that Guardian had been 45% negligent and that Guardian's damages were \$202,021.00. [R. 406-409]

Thereafter, on June 19, 1984, the Court entered its Judgment in favor of Stangl in the net amount of \$2,001.69, together with interest and in favor of Guardian against the Third-Party Defendants in accordance with the jury's verdict in the sum of \$106,711.55. [R. 439-441] No appeal has been filed with respect to the portion of the Judgment in favor of Guardian and against Third-Party Defendants, and that portion of the Judgment has been paid.

Based upon the foregoing facts and for the reasons hereinafter set forth, it is respectfully submitted that the District Court's conclusion that it could not deny Stangl the fruits of his well-devised charade was in error. Guardian submits that it is entitled to Judgment as a matter of law, or at the very least to a new trial.

### ARGUMENT

#### I. EVEN IF GUARDIAN'S INDORSEMENT OF THE ORIGINAL NOTE IS VALID, GUARDIAN IS NOT LIABLE TO STANGL.

Under Section II of this Brief we demonstrate that Guardian's indorsement of the original Note is invalid and unenforceable by Stangl for a number of reasons. However, even if it is assumed for purposes of argument that the indorsement is enforceable, Guardian has no liability to Stangl on the original Note for the reasons set forth below.

#### A. Guardian is Entitled to be Subrogated to All Rights of Stangl Under the Original Note and Guaranty.

Stangl's position in this lawsuit is that because Guardian's indorsement of the original Note did not recite on its face that it was "without recourse" Guardian is liable for the full amount of that Note as a matter of law. Assuming for purposes of argument that the District Court was correct in determining that Guardian is liable to Stangl on Guardian's indorsement of the original Note, Guardian is entitled as a matter of law to be subrogated to all of Stangl's rights with respect to the indebtedness which is the subject of the original Note. Guardian's right of subrogation includes the right to recover from both Stangl and Sargetis on the

continuing Guaranty of that indebtedness which they executed. Consequently, any liability of Guardian on the original Note is offset by Stangl's liability to Guardian on the Guaranty of that Note.

Under the Utah Uniform Commercial Code an indorser is a type of surety. See, e.g., First New Haven National Bank v. Clarke, 368 A.2d 613, 614 (Conn. 1976) ("more than that of any other party to commercial paper, the indorser's liability is like that of a surety."); 2 Hart & Miller, Commercial Paper Under the U.C.C. (1984); J. White & R. Summers, Uniform Commercial Code, p. 426 (1980); Wladis, U.C.C. Art. 3 Suretyship and the Holder In Due Course: Requiem for Good Samaritan, 70 Georgetown Law Journal 975, 979 (1982); Noble, The Surety and Article 3: A New Identity For an Old Friend, 19 Duquesne Law Review 245, 261 (1981); U.C.C Sec. 3-606 Comment 5 ("the suretyship defense stated has been generally recognized as available to indorsers or accommodation parties.")

It has long been the law in this Country, both before and after the Uniform Commercial Code was adopted, that once an indorser, surety or accommodation party pays a note he stands in the shoes of the creditor and is subrogated to all of the creditor's rights not only on the note but on the underlying obligation. For example, in N. J. Gendron Lumber v. Great Northern Homes, 395 N.E.2d 457 (Mass. 1979), the Court held that an indorser who had paid a promissory note could not only recover against the maker but against a guarantor of the obligation represented by the Note. See also, Halpin v. Fankenberger, 644 P.2d 452 (Kan. 1982); Reimann v. Hybertsen, 550 P.2d 436 (Ore. 1976); Simpson v. Bilderbeck, Inc., 417 P.2d 803 (N.M. 1966); Alavolasiti v. Versailles Gardens Land Development Co., 371 So.2d 755 (La. 1979); Mutual Benefit Life Insurance Co. v. McGraw, 259 N.W. 507 (1935);

Miami Mortgage & Guaranty Co. v. Drawdy, 127 So. 323 (Fla. 1930); Northern Bank & Trust Co. v. Slater, Walt & Co., 212 P. 1063 (Wash. 1923); Wallace v. Jones, 72 A. 769 (Md. 1909); Hartzell v. McClurg, 74 N.W. 626 (Neb. 1898); The Surety and Article 3: A New Identity For an Old Friend, 19 Duquesne Law Review 245, 261 (1981); Simpson on Suretyship, Sec. 47 (1950); U.C.C. Sec. 3-606, Comment 1 (recognizing that a surety has a "right of recourse either on the instrument or dehors it.")

The right of an indorser upon payment of a note to all of the creditor's rights in the note and the underlying obligation is simply one application of the principle of equitable subrogation. That principle is not displaced by the Code, but supplements its provisions. Utah Code Annotated, Sec. 70A-1-103. The purpose of subrogation was set forth by this Court in Allstate Insurance Co. v. Ivie, 606 P.2d 1197, 1202 (Ut. 1980) as follows:

"Subrogation is a creature of equity, its purpose is to work out an equitable adjustment between the parties by securing the ultimate discharge of a debt by the person who, in equity and in good conscience ought to pay it."

Another author describes the principle as follows:

"Upon his payment of the principal's debt, the surety has the right to be substituted to the position of the creditor whom he pays. This is known as the surety's right of subrogation. Whether or not the surety upon payment has taken an assignment from the creditor of the latter's rights, equity will treat him as an assignee. Subrogation is equitable assignment. . . . Subrogation entitles the surety to use any remedy against the principal which the creditor could have used, and in general to enjoy the benefit of any advantage that the creditor had, such as . . . to proceed against a third person who has promised either the principal or the creditor to pay the debt." Simpson on Suretyship, supra., at p. 205. [Emphasis added]

Similarly, in Moyer v. Colyer, 283 P.2d 815 (Okla. 1955), the Court observed:

"What rights did the sureties have upon payment of the note in question? As a general rule where a bill or note has been paid by a party who is only secondarily liable, the party paying will be subrogated to all rights and remedies which were available to the holder or owner of the instrument in order to obtain payment thereof." (Id. at 818)

In the present case, Stangl was clearly a primary obligor on the debt pursuant to his written Guaranty. See, Ex. D-2; Strevell-Paterson Co., Inc. v. Francis, 646 P.2d 741 (Ut. 1982). The evidence produced by Stangl in the Court below did not even approach raising any defense to the Guaranty. The only purported defense raised by Stangl was that sometime after the August 1979 transaction in which he signed the guaranty, he was told that the original Note would be amortized over five years when, in fact, the Note was payable on demand. It is totally irrelevant what Stangl was told after he had already obligated himself on the Guaranty. More importantly, even if the original Note had been payable in installments over a period of five years, the evidence was undisputed that the installments were not paid and in fact no principal had been paid on the original Note for a year before demand was made on Stangl on his Guaranty. Therefore, Guardian legally had the right to accelerate the original Note pursuant to the acceleration provision contained therein and demand payment in full. Kixx, Inc. v. Stallion Music, Inc., 610 P.2d 1385 (Ut. 1980); Commercial Security Bank v. Corporation Nine, 600 P.2d 1000 (Ut. 1979).

Consequently, even if Guardian is liable as an indorser of the original Note, Guardian is subrogated to all Stangl's rights in the original Note and Guaranty and is entitled to collect the full amount of the original Note from Stangl based on the Guaranty. The liabilities, therefore, offset each other as a matter of law.

B. Any Liability of Guardian on its Indorsement Was Discharged  
When Stangl Acquired the Original Note.

Utah Code Annotated, Sec. 70A-3-208 provides:

"Where an instrument is returned to or re-acquired by a prior party . . .any intervening party is discharged as against the re-acquiring party, and subsequent holders not in due course . . ."

Pursuant to this statute, where a prior party to a Promissory Note re-acquires the Note, a subsequent indorser is discharged. Hewett v. Marine Midland Bank, 449 NYS2d 745 (1982); Coplan Pipe & Supply Co. v. Ben-Frieda Corp., 256 So.2d 218 (Fla. 1972).

The courts are divided on the issue of whether one who signs a separate guaranty of a Promissory Note, as Stangl did in this case, is a "party" to that Note for the purposes of Article 3 of the Commercial Code. It is respectfully submitted, however, that the better reasoned cases have held that one who signs a separate guaranty of a Promissory Note is, as to the immediate parties to the transaction, a party to that Note. See, e.g., Commerce Bank of St. Louis v. Wright, 645 S.W.2d 17 (Miss. 1982); Provident Bank v. Gast, 386 N.E.2d 1357 (Ohio 1979).<sup>4</sup> Thus, in Commerce Bank of St. Louis, supra., the Court observed that there was "no logical reason" not to treat a guarantor who signed a separate document guaranteeing a Promissory Note as a party to that Promissory Note and concluded:

"The defendant guarantors were parties to the instrument even though their guaranty was a separate document, or dehors the note itself, since they were known participants in the loan/stock purchase transaction of which the note and guaranty were contemporaneous, integrated events."  
[645 S.W.2d at 21] [Emphasis added]

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<sup>4</sup> Insofar as Guardian can determine, this Court has never decided the issue.

As between the obligors on a negotiable instrument and their immediate obligee, the terms of the instrument must be interpreted together with any other agreements executed as part of the same transaction. Utah Code Annotated, Sec. 70A-3-119(1). The Commercial Code recognizes that as between the immediate parties a negotiable instrument is merely a contract, that ordinary contract principles apply and that the courts will look to the entire agreement between the parties to ascertain their rights and obligations. See, U.C.C., Sec. 3-119, Comment 3; Gensplit Finance Corp., v. Link Power and Machinery Corp., 36 U.C.C. Reporting Service 588 (S.D.N.Y. 1983).

For example, in Gensplit Finance Corp., Plaintiff sought recovery based upon Defendant's unrestricted indorsement of two Promissory Notes. The Court denied Plaintiff's Motion for Summary Judgment on the ground that parole evidence was admissible to show that the Notes were indorsed pursuant to a separate agreement between the parties which severely limited Defendant's liability, stating:

"It is well established that, as between immediate parties, a negotiable instrument--or, indeed, its indorsement--is merely a contract . . . which purpose the court must attempt to carry out. As between these two parties, the purpose should not be drawn merely from the indorsement on the Veko notes. Before us is a transferee who seeks full recovery against its immediate transferor by inviting our attention only to two documents on the grounds they are promissory notes. . . . [W]e decline this invitation, and, thus deny plaintiff's Motion for Summary Judgment." [36 U.C.C. Reporting Service at 593-594] [Emphasis added]

As between the immediate parties to the original Note in this case, there simply is no logical reason why Stangl's rights and obligations should hinge on the question of which piece of paper he signed his guaranty. Both the original Note and Guaranty must be read together in

determining the rights and obligations of the parties. Stangl's liability for payment of the original Note to Guardian was the same as if he had signed his name on the back of the original Note with the words "payment guaranteed". Utah Code Annotated, Sec. 70A-3-416(1) and (5); Strevel Patterson Co., Inc. v. Francis, 646 P.2d 741 (Utah 1982); Hopkins v. First National Bank, 551 S.W.2d 343 (Texas 1977). In either event, Stangl would have been an original obligor on the indebtedness represented by that Promissory Note. Rice v. Traveler's Express Co., 407 S.W.2d 534 (Texas 1966).<sup>5</sup> Therefore, Stangl should be treated no differently than if his guaranty was contained on the Note itself. Viewed in this manner, Stangl's reacquisition of the Note discharged Guardian's liability as a subsequent indorser as a matter of law under the authorities cited above.

Finally, even if this Court chooses not to follow those cases which have held one who signs a separate guaranty to be a technical party to the Promissory Note, it is nevertheless submitted that the same rationale under which a prior party to a Promissory Note is not liable to a subsequent party applies in this case to prevent Stangl from charging Guardian with liability on its indorsement. Under Utah Code Annotated, Sec. 70A-3-414, indorsers are liable to one another in the order in which they indorse a Promissory Note which is presumed to be the order in which their signatures appear on the Note. The rationale of Utah Code Annotated, Section 70A-3-208 quoted above is that since a prior party on a Note is liable to the

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<sup>5</sup> In fact, Stangl's liability to Guardian was no different than if he had been a co-maker of the Note. In this regard, where a co-maker pays and reacquires a Note, liability of all persons on the Note is discharged. Bourg v. Wiley, 398 S.2d 13 (La. 1981).



subsequent indorser, the prior party should not be able to improve his position by acquiring the Note and then seeking to impose liability on the subsequent indorser. U.C.C. Sec. 3-208, Comment 1. In the case at bar, prior to acquiring the original Note, Stangl was clearly liable to Guardian for payment of the Note. Stangl should not be allowed to improve his position as against Guardian by acquiring the Note.

C. An Accommodation Party is Not Liable to the Party Accommodated.

Under Utah Code Annotated, Sec. 70A-3-415(5), an accommodation party is not liable to the party accommodated. In the present case, Guardian was merely an accommodation indorser because Guardian indorsed the original Note solely to allow Stangl to attempt to collect against the maker. As against Stangl, it is clear that parole evidence is admissible to prove Guardian indorsed for accommodation only. Utah Code Annotated, Sec. 70A-3-415(3); U.C.C. Sec. 3-415, Comment 1.

Gibbs Hoyl Co. v. Collentro and Collentro, Inc., 252 N.E.2d 217 (Mass. 1969) is closely on point. In Gibbs, the payee on a Promissory Note sought to recover from an indorser. The indorser presented parole evidence that he had only indorsed the Note to enable the payee to discount the Note. The court held that the indorser was not liable because an accommodation indorser is not liable to the party accommodated. See, also, Deems v. Wilson, 151 S.E.2d 230 (Ga. 1966); United Refrigerator v. Applebaum, 189 A.2d 253 (Penn. 1963); Gensplit Finance Corp. v. Link Power and Machinery Corp., supra.

Stangl undeniably knew that Guardian only indorsed the original Note to enable Stangl to collect from the dealership and Sargetis. Hence, Guardian is entitled to Judgment as a matter of law. And, even if some factual issue exists as to whether Guardian was an accommodation indorser, the District Court clearly erred in not submitting the question to the Jury.

II. GUARDIAN'S INDORSEMENT OF THE ORIGINAL NOTE IS INVALID AND UNENFORCEABLE.

Even if, contrary to what is argued above, Guardian's indorsement of the original Note, on its face, rendered Guardian liable to Stangl, that indorsement is invalid and unenforceable by Stangl because: (a) Guardian was fraudulently induced to indorse the original Note; (b) the original Note and Guaranty were only delivered to Stangl for the special purpose of collecting against the dealership and Sargetis; (c) Guardian indorsed the original Note and assigned the Guaranty based upon a mistake of fact induced and known by Stangl; (d) Stangl gave no consideration to Guardian to acquire the original note and Guaranty; and (e) Stangl did not act in good faith in the transaction. The District Court should have directed a verdict for Guardian on these issues, or, at the very least, should have submitted these issues to the Jury.

At the outset, it should be noted that the parties stipulated below that Stangl was not a holder in Due Course of the original Note. Thus, any defense that is a defense to a simple contract constitutes a defense to Stangl's enforcement of Guardian's indorsement of that Note. Utah Code Annotated, Sec. 70A-3-306.

A. Guardian Was Defrauded Into Delivering the Original Note and Guaranty to Stangl.

The evidence was undisputed in the Court below that the original Note and Guaranty were transferred to Stangl in reliance upon his representation that he simply wanted all of Guardian's rights in the original Note and Guaranty to attempt collection from the dealership and Sargetis. Contrary to what Guardian was intentionally led to believe, Stangl's admitted intent throughout the transaction was to evade liability to Guardian by obtaining Guardian's indorsement on the original Note and holding Guardian liable on that indorsement. The evidence was also undisputed that Stangl had no intention of paying the new Note of May 11, 1981 at the time he executed the new Note unless and until he collected the original Note.

1. Misrepresentation concerning purpose of acquiring original Note and Guaranty.

The Utah Supreme Court case of Berkeley Bank For Co-ops v. Meibose, 607 P.2d 798 (Ut. 1980), is similar to the case at bar. In Berkeley, this Court held that Defendants were not liable on promissory notes which they had executed because the purpose of those notes had been misrepresented. In so holding, this Court observed:

" . . . A statement of future intention is actionable if a fraudulent intention existed at the time the deceitful statement was made. [citations omitted] In the instant case the jury found the necessary fraudulent intent at the time that representations as to future conduct were made by the defendant.

"It can hardly be maintained that the general moral level of business and other financial relationships would be enhanced by a rule of law which would allow a person to

defend against a willful, deliberate fraud by stating, 'you should not have trusted or believed me' or 'had you not been so gullible you would not have been [so] deceived.' [citations omitted] The rules governing fraud should foster intercourse based on trust, forthrightness, and honesty." (Id. at 805.)

In the Court below, Stangl argued that no cause of action for fraud existed because Stangl had never expressly told Guardian that he would not seek to impose liability on Guardian by virtue of its indorsement and that Stangl had no duty to affirmatively disclose that such was his intention. This argument is not in accord with the law. Once Stangl undertook to tell Guardian why he wanted the original Note and Guaranty, he was obligated to tell Guardian the whole truth and not to mislead or deceive Guardian by omitting material facts. See, e.g., Vokes v. Arthur Murray, Inc., 212 So.2d 906 (Fla. 1968); Daive v. American Universal Insurance Co., 417 A.2d 2 (N.H. 1980); Heise v. Pilot Rock Lumber Co., 352 P.2d 1072 (Ore. 1960); Simpson v. Western National Bank of Casper, 497 P.2d 878 (Wyo. 1972).

This principle was recognized by the court in Heise v. Pilot Rock Lumber Co., supra., at p. 1078, where the Court stated:

"'Though a buyer is not bound to answer a seller's inquiries relative to the property being purchased and sold, in the absence of special circumstances, yet if he does answer, he must answer truthfully. [citations omitted] He must make a full and fair disclosure and not conceal pertinent or material information. . . .

"'. . . 'Fraud may be predicated upon an equivocal, evasive, or misleading answer calculated to convey a false impression even though it may be literally true as far as it goes. A partial and fragmentary disclosure accompanied by willful concealment of material and qualifying facts is not a true statement and is often as much a fraud as an actual representation.'"

Similarly, in Simpson v. Western National Bank of Casper, supra., at p. 880, the Court observed:

"It is certainly true that any active conduct or words which tend to produce an erroneous impression may amount to fraud, and half the truth may be a lie in effect.

"Even when a party is under no duty to speak regarding a matter, if he does speak, he must speak the truth and make a full and fair disclosure.

"If in addition to the party's silence there is any statement, even any word or act on his part, which tends affirmatively to a suppression of the truth, to a covering up or disguising the truth, or to a withdrawal or distraction of the other party's attention or observation from the real facts, then the line is overstepped, and the concealment becomes fraudulent." [Emphasis added]

Stangl's admitted purpose in seeking to obtain the original Note and Guaranty was to totally escape any liability on his Guaranty. He suppressed this fact from Guardian and disguised his real intent for one obvious reason: Stangl knew if he told Guardian the true reason he wanted the original Note and Guaranty, Guardian would never have agreed to the transaction and would have immediately sued him on his Guaranty. Although Stangl's scheme was undeniably clever, it was nevertheless fraudulent.

2. Misrepresentation of intent to pay the new May 11, 1981 Note.

Stangl also fraudulently induced Guardian to indorse the original Note and assign the Guaranty to him by Stangl's fraudulent conduct in executing the new Note of May 11, 1981.

By executing the new Note, Stangl unconditionally promised to pay Guardian \$132,000.00 together with interest, payable in two installments on or before July 10, 1981 and July 10, 1982. Contrary to the promise contained in the new Note, Stangl in fact admittedly had no intention whatsoever of paying any portion of that Note unless, until and only to the extent he collected the original Note. While intentionally leading Guardian to believe that he intended to honor his obligation on the

Guaranty by paying the new Note, Stangl in fact made the promise contained in the new Note simply as part of his well disguised charade aimed at evading his legal obligation on his Guaranty. Stangl's scheme of promising to pay the new Note when he had absolutely no intention of performing that promise constituted clear, palpable fraud on his part. Berkeley Bank for Co-ops v. Meibose, supra.; Munson v. Raudonis, 387 A.2d 1174 (N.H. 1978).

B. The Original Note and Guaranty Were Only Delivered to Stangl to Allow Him to Attempt Collection Against the Other Parties.

Under Utah Code Annotated, Sec. 70A-3-306, Guardian is not liable to Stangl on the indorsement of the original Note if, as Guardian contends, that Note was only given to Stangl for the special purpose of enabling Stangl to attempt to collect from the dealership and Sargetis. That special purpose may be proven by parole evidence. Berkeley Bank for Co-ops v. Meibos, supra.; Ventures, Inc. v. Jones, 623 P.2d 145 (Ida. 1981).

Thus, in the Ventures, Inc. case, the Court held that Defendants were not liable on certain promissory notes because there had been an oral agreement that the notes were simply given as additional interim security for an underlying debt and that the notes would only be in effect until a second mortgage was substituted on the property. In reaching this conclusion, the Court observed:

"Post-UCC cases interpreting Chapter 3 have generally held that one not a holder in due course takes a note subject to the defense that delivery was for a special purpose only and that proof of such delivery pursuant to an alleged collateral agreement is not precluded by the parole evidence rule. [citations omitted]" (Id. at 149)

Similarly, in American Under. Corp. v. Rhode Island Hosp. Tr. Co., 303 A.2d 121 (R.I. 1973), the Court held the Defendant bank was not

liable on its unrestricted indorsement of a draft because the draft had only been delivered for a special purpose, which purpose could be proven by parole evidence.

The undisputed evidence presented by Guardian in the Court below compels the conclusion the original Note was only delivered to Stangl to allow him to pursue collection from the other parties liable. Indeed, unless the agreement between the parties is so interpreted, the agreement was an absurdity in that Guardian released Stangl from an indebtedness of \$132,000 and agreed to affirmatively be liable to Stangl for substantial sums. In this regard, where there is a choice, a contract should be interpreted to bring about an equitable result rather than a harsh or inequitable one. Wingets Inc. v. Bitters, 500 P.2d 1007 (Ut. 1972). Further, an interpretation of a contract which renders the contract an absurdity or illusory should be avoided. Kansas State Bank & Trust Co. v. DeLorean, 640 P.2d 343 (Kan. 1982); Marathon Steel Co. v. Tilley Steel, Inc., 136 Cal.Rptr. 73 (1977). Finally, the literal terms of a contract may be qualified by the context, purpose and circumstances of the contract to make it a rational instrument. Fay, Spofford & Thorndike, Inc. v. Mass. Port Authority, 387 N.E.2d 206 (Mass. 1979).

C. Guardian's Indorsement Should Be Reformed or Rescinded Because of Mistake of Fact.

Guardian indorsed the original Note because it was under the belief that Stangl was agreeing to pay his obligation under the Guaranty and was only getting the original Note and Guaranty in order to attempt to collect the same from the dealership and Sargetis. Stangl knew of

Guardian's mistaken belief and in fact Stangl induced that belief. Consequently, Guardian's indorsement should be reformed so that the indorsement is "without recourse" or, at the very least, Guardian's indorsement should be rescinded.

It is well-settled in Utah that a party to a contract is entitled to reformation of the contract where the contract does not in fact correctly embody the oral agreement of the parties, the complaining party entered into the contract based upon unilateral mistake and the other party engaged in inequitable conduct. Thompson v. Smith, 620 P.2d 520 (Ut. 1980); McMahon v. Tanner, 249 P.2d 502 (Ut. 1952); Mawhinney v. Jensen, 232 P.2d 769 (Ut. 1951). It is respectfully submitted that reformation is most appropriate in this case. Stangl represented he simply wanted the original Note to go after the dealership and Sargetis, Guardian agreed to give him the original Note for that purpose and Stangl knew that was the agreement Guardian intended to enter into with him. Under such circumstances, Stangl should be held to that agreement.

The circumstances under which the unilateral mistake of one party to a contract can form the basis for rescission of that contract were discussed by this Court in the recent case of Tolboe Construction Co. v. Staker Paving & Construction Co., 682 P.2d 843 (Ut. 1984). There, the Defendant had submitted a paving bid which was substantially lower than any of the other bids received by Plaintiff. After receiving the bid, the Plaintiff called Defendant, told Defendant the bid was low and that Defendant should review the bid. Defendant subsequently re-examined its calculations and reconfirmed the bid to Plaintiff. Nevertheless, this Court held that the Plaintiff could not enforce the bid against Defendant, stating:



"'[K]nowledge by one party that the other is acting under mistake is treated as equivalent to mutual mistake for purposes of rescission.' [citations omitted] Relief from mistaken bids is consistently allowed when one party knows or has reason to know of the other's error and the requirements for rescission are fulfilled.

"Likewise, under the latter doctrine (palpable mistake), if the offeree caused, knew of, should have known of or had reason to know of the offerer's mistake, the mistake is 'palpable' and as such may be rescinded by the offerer." (Id. at 846)

The Tolboe Court went on to note that, "where an offer is so inconsistent with the true value of the bargain that a reasonable person would know the offerer made a mistake in his evaluation" then offeree should be charged with knowledge of the mistake. To the same effect, see Ashworth v. Charlesworth, 231 P.2d 724 (Ut. 1951); Puget Sound National Bank v. Selivanoff, 514 P.2d 175 (Wash. 1973); 13 Williston on Contracts, Sec. 1548 (3rd Ed. 1970); Restatement of Contracts 2d, Sec. 153.

In arguing the Motion for Directed Verdict, Stangl contended for the first time that Guardian was not entitled to equitable relief on the basis of mistake because by suing on the new Note Guardian had elected its remedy. It is respectfully submitted this contention is without merit.

In the first place, Guardian sought declaratory relief as to the rights and liabilities of the parties on the original Note. In deciding the declaratory relief cause of action the Court was required to achieve complete justice between the parties even if that meant granting relief not specifically prayed for by a party. Eye Dog Foundation v. State Board of Guide Dogs, 432 P.2d 717, 721 (Cal. 1967). A request for declaratory relief is equitable in nature and a Court is authorized to grant any equitable relief, such as reformation or rescission, even if not specifically requested. Seventeen Hundred Peoria, Inc. v. City of Tulsa, 422 P.2d 840, 844 (Okla. 1966); Benton v. Benton, 528 P.2d 1244 (Kan. 1974).

Second, under Rule 54(b) of the Utah Rules of Civil Procedure, a Court is empowered to grant any relief to which a party is entitled based on the evidence and is not limited by the prayer of the Complaint. Pope v. Pope, 589 P.2d 752 (Ut. 1978); Palombi v. D & C Builders, 452 P.2d 325 (Ut. 1969); Smith v. Zepp, 567 P.2d 923 (Mont. 1977). Specifically, a Court may grant equitable relief such as reformation or rescission where appropriate even though damages have been sought. cf. Garland v. Garland, 165 F.2d 131 (10th Cir. 1948).

D. Stangl Gave No Consideration for Guardian's Indorsement of the Original Note.

Stangl cannot impose liability upon Guardian on its indorsement of the original Note because Stangl gave no consideration to Guardian for the original Note and Guaranty. As of the time he received the original Note and Guaranty, Stangl was absolutely obligated to Guardian to pay the debt by virtue of his Guaranty. Consequently, Stangl's execution of the new Note whereby he promised to pay the debt in the future, rather than immediately as he was obligated to do under the Guaranty, did not constitute consideration for Guardian's indorsement of the Note.

For example, in Baggs v. Anderson, 528 P.2d 141 (Ut. 1974), this Court held that the Defendant's promise to pay three \$200.00 payments which he was already obligated to make to Plaintiff, did not constitute consideration for Plaintiff's agreement to relieve him from the payment of any further support money. The Court opined:

" . . . we cannot see wherein the defendant gave any consideration for the claimed agreement that he would not have to pay any future support money. That is, he neither

gave anything of value, nor suffered any legal detriment for that promise. Under the decree he was already obligated to make the payments of \$200.00 per month. Such an agreement to do that which one is already required to do does not constitute consideration for a new promise." [Id. at 143]

Even if Stangl had some colorable defense to enforcement of the Guaranty so that his liability on the Guaranty was doubtful and disputed, Stangl still gave no consideration because if Stangl can recover on the indorsement he unilaterally improved his position rather than suffering any legal detriment or conferring on Guardian any legal benefit.

As of the May 1981 transaction, Guardian had a claim against Stangl on the Guaranty which at the very least represented a serious liability to Stangl. Assuming for purposes of argument that Stangl's view of the law is correct with respect to Guardian's liability on its indorsement, by entering into the transaction with Guardian he completely extinguished any liability on the Guaranty. Further, Guardian was immediately liable to Stangl on its indorsement of the original Note for an amount in excess of Stangl's liability on the new Note.<sup>6</sup> Consequently, the net effect of the transaction was to immediately erase any liability of Stangl to Guardian and to immediately create a substantial debt from Guardian to Stangl. Further, because the original Note provided for interest at a higher rate than the new Note, Guardian's liability to Stangl

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<sup>6</sup> Under Utah Code Annotated, Sec. 70A-3-501(4), if Guardian's indorsement is otherwise enforceable, Stangl had no obligation to attempt to collect the original Note from any other party before demanding payment from Guardian and Guardian was immediately liable on its indorsement.

would continue increasing as time passed. Simply put, Stangl did not intend to nor did he suffer any legal detriment or confer any legal benefit on Guardian.

E. Stangl Cannot Hold Guardian Liable On Its Indorsement Because He Did Not Act In Good Faith.

Under the Commercial Code, every contract or duty imposes an obligation of good faith in its performance or enforcement. Utah Code Annotated, Sec. 70A-1-203. "Good faith" is defined by the Code to mean "honesty in fact in the conduct or transaction concerned." Utah Code Annotated, Sec. 70A-1-201(19). Where a party to a contract fails to act in good faith he cannot enforce the specific provisions of the contract which are affected by his lack of good faith. See, e.g., Ralston Purina Co. v. McNabb, 381 F.Supp. 181 (D. Tenn. 1974); Eckstein v. Cummins, 321 N.E.2d 897 (Oh. 1974).

Stangl's conduct in the present transaction didn't even approach a standard of good faith under any definition. At the very time he was entering into a transaction designed to lead Guardian to believe he would pay his obligation, Stangl secretly intended to evade that obligation all together. The Commercial Code was not intended to reward bad faith, no matter how cleverly disguised.

III. GUARDIAN SHOULD BE AWARDED ITS ATTORNEYS' FEES.

Both the new Note and the Guaranty provide for attorneys' fees to be awarded Guardian in the event of legal action. Consequently, Guardian should be awarded its attorneys' fees incurred both in the Court below and

on appeal if this Court reverses the District Court's Judgment and directs that Judgment be entered in favor of Guardian. Management Services v. Development Assoc., 617 P.2d 406 (Ut. 1980).

#### CONCLUSION

Stangl played an ingenious "shell game" with Guardian. If Stangl's position is correct, he strolled into Guardian's office in May of 1981 owing Guardian in excess of \$130,000 and walked out a few minutes later not only being free of debt to Guardian but with Guardian actually owing him money, all the while making Guardian believe he had agreed to pay his obligation like a good, honest businessman.

The District Court reluctantly concluded that it could not deny Stangl the fruits of his charade even though the result was "so grossly unfair". However, the governing principles behind the Commercial Code and contractual relations in general do not sanction the absurd, illusory and inequitable result for which Stangl contends. Whether this case is viewed from the standpoint of the technical effect of Guardian's indorsement of the original Note or viewed from the standpoint of the enforceability of that indorsement, Stangl is not entitled to evade his obligation which now stands at over \$200,000.

There can be no doubt that Stangl led Guardian to believe that by executing the new Note in the May 1981 transaction, he was agreeing to pay his obligation to Guardian strictly in accordance with the terms of that Note, and that Stangl knew that was the result Guardian intended from the transaction. It is respectfully submitted that for the reasons hereinabove set forth, this Court should hold that this result is precisely what the

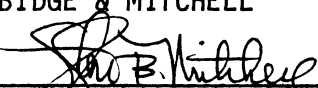
transaction did in fact accomplish and that the Judgment on the original Note in favor of Stangl should be reversed with directions to enter Judgment in favor of Guardian together with reasonable attorneys' fees.

In this regard, Guardian submits that for complete justice to be done in this case, the amount of the Judgment in favor of Guardian should be the full balance of the new Note without any credit for the amount of damages awarded against the Third-Party Defendants on condition that any amounts collected by Guardian over and above what Guardian is now out of pocket be paid directly to the Third-Party Defendants to reimburse them for what they have paid Guardian. If this Court declines to so rule, then Judgment should be entered in favor of Guardian for the remaining balance of the new Note after crediting the payment from the Third-Party Defendants.

DATED this 24<sup>th</sup> day of October, 1984.

BURBIDGE & MITCHELL

By

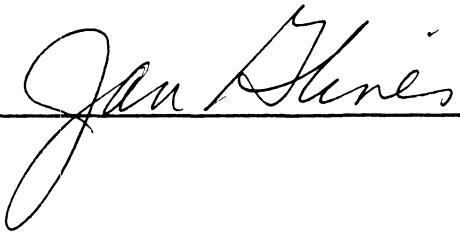
  
STEPHEN B. MITCHELL

Attorneys for Appellant

MAILING CERTIFICATE

I HEREBY CERTIFY that a copy of the foregoing was mailed to the  
following on the 24 day of October, 1984:

Harold G. Christensen  
George A. Hunt  
Attorneys for Stangl  
10 Exchange Place, 11th Floor  
P. O. Box 3000  
Salt Lake City, Utah 84110

  
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