1978

Eben Blomquist v. J. Dal Peterson And Karl D. Blomquist, And Minerals Recovery Company, Aka Mineral Recovery Corporation, A Utah Corporation : Brief of Respondent

Utah Supreme Court

IN THE SUPREME COURT OF THE STATE OF UTAH

EBEN BLOMQUIST,)

Plaintiff-Appellant,)

vs.) Case No. 15496

J. DAL PETERSON and KARL D. BLOMQUIST and MINERALS RECOVERY COMPANY, aka MINERAL RECOVERY CORPORATION, a Utah corporation,)

Defendant-Respondent.)

BRIEF OF RESPONDENT

APPEAL FROM THE JUDGMENT OF THE DISTRICT COURT
OF THE THIRD JUDICIAL DISTRICT IN AND FOR
SALT LAKE COUNTY, STATE OF UTAH,
HONORABLE DAVID B. DEE, DISTRICT JUDGE

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BRIEF OF RESPONDENT

STATEMENT OF THE NATURE OF THE CASE

This is an action for the collection of a promissory note.

DISPOSITION IN LOWER COURT

The Third Judicial District Court in and for Salt Lake County, the Honorable David B. Dee, denied plaintiff's motion for summary judgment and granted the motion for summary judgment of defendant Minerals Recovery Corporation.

RELIEF SOUGHT ON APPEAL

Defendant Minerals Recovery Corporation prays the judgment be affirmed, and that it be awarded its costs on appeal.

STATEMENT OF FACTS

On June 11, 1974, a promissory note in the amount of $10,222 was executed by Eben Blomquist, plaintiff, and by

two of the individual defendants, Karl D. Blomquist and J. Dal Peterson. The promissory note did not indicate that it was secured by any collateral; there was no reference to the mining equipment which is the subject of this appeal. In fact, only the following notation appeared at the bottom of the document: "This note is secured by a Security Agreement of even date." (R.48,75.) Notwithstanding the notation on the promissory note, the plaintiff and the individual defendants did not execute a formal, written security agreement pursuant to the Utah Uniform Commercial Code, §§70A-9-101, et seq., Utah Code Ann. (1953). (R.46-48; 88.)

Subsequent to the execution of the promissory note, the plaintiff and the two individual defendants executed a financing statement and filed it with the Secretary of State of Utah on August 7, 1974. (R.48; 73-74.) The document is a standard form UCC-1 financing statement; this fact is evidenced by the notation at the bottom of the statement itself (R.48; 74), and is admitted by plaintiff. (R.88.) The financing statement does not refer to a security interest in any property, nor does it even refer to the promissory note between the parties.

The maturity date of the promissory note was September 1, 1974 (R.48; 75), and evidently, according to plaintiff, the principal amount was never paid. Accordingly,

on August 27, 1976, plaintiff brought an action in the Third Judicial District Court against the two individual defendants in order to collect the principal of the promissory note. The complaint also alleged that payment of the note was secured by a piece of mining equipment, a "belt tank." Since the mining equipment was in the possession of Minerals Recovery Corporation (herein "MRC") at the time the original complaint was filed, MRC was listed as a defendant, too. (R.2-5.)

On October 13, 1976, plaintiff and one of the individual defendants, Karl D. Blomquist, stipulated that the mining equipment could be sold and that the proceeds from the sale could be applied against the outstanding balance of the promissory note. (R.69.) Then, on February 9, 1977, plaintiff obtained a default judgment on the promissory note against the other individual defendant, J. Dal Peterson. (R.39-41.)

On June 9, 1977, plaintiff filed a motion for summary judgment against MRC, contending that the promissory note was secured by the mining equipment in the possession of MRC. (R.67.) On July 11, 1977, MRC filed its own motion for summary judgment. (R.86.) MRC contended that the security interest alleged by plaintiff was not enforceable against it since the plaintiff and the two individual defendants had not executed a valid security agreement, pursuant

to the requirements of §70A-9-203 of the Utah Uniform Commercial Code, covering the promissory note and the mining equipment. (R.22.)

Both motions were heard on July 14, 1977. (R.95.) On September 30, 1977, the court, the Honorable David B. Dee presiding, entered its order, denying the plaintiff's motion for summary judgment and granting the summary judgment motion of MRC. (R.112-113.) The court held in its accompanying Memorandum Decision that:

> . . . a reading of 70-A-9-203 Utah Code Annotated (1953) does not allow the creation of a security agreement under the facts in this case taking the Promissory Note and Financing Statement together with and reading them in the light most favorable to the plaintiff and therefore the plaintiff's Motion For Summary Judgment is denied and the defendant Mineral Recovery Company's Motion For Summary Judgment is granted. (R.124.)

The plaintiff appeals from that decision.

ARGUMENT

Introduction

The plaintiff contends he has a valid and enforceable security interest in the mining equipment currently possessed by MRC. He has based this assertion on the rationale that the promissory note and the financing statement between himself and the two individual defendants meet the requirements of a written security agreement under §§70A-9-203, -204, Utah Code Ann. (1953). In order to determine whether

the parties have properly created a security agreement in the course of their transactions, and thereby obtained a security interest in the mining equipment, attention must first be directed to the specific requirements of the Utah Uniform Commercial Code itself.

A security agreement is an agreement which creates and provides for a security interest,* and a security interest is an interest in personal property which secures payment on performance of an obligation.** Section 70A-9-203(1), Utah Code Ann. (1953), specifies the requisites for the enforceability of a security interest; it provides in pertinent part:

> Subject to the provisions of section 70A-9-208 on the security interest of a collecting bank and section 70A-9-113 on a security interest arising under the chapter on sales, a security interest is not enforceable against the debtor or third parties unless
>
> (a) the collateral is in the possession of the secured party; or
>
> (b) the debtor has signed a security agreement which contains a description of the collateral . . . . (Emphasis added.)

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*Section 70A-9-105(1)(h), Utah Code Ann. (1953).

**Section 70A-1-201(37), Utah Code Anno. (1953).

In addition, §70A-9-204(1), Utah Code Ann. (1953), specifies the requisities for the attachment of a security interest; it provides:

> A security interest cannot attach until there is agreement (subsection (3) of section 70A-1-201) that it attach and value is given and the debtor has rights in the collateral. It attaches as soon as all of the events in the preceding sentence have taken place unless explicit agreement postpones the time of attaching.

The above two provisions, §70A-9-203 and §70A-9-204, incorporate four general requirements for the creation and enforcement against third parties of a valid security interest:

(1) The debtor must acquire rights in the collateral;

(2) The secured party must give value;

(3) There must be an agreement specifically creating or providing for a security interest in particular property; and

(4) The debtor must have signed a security agreement containing a description of the collateral; or the secured party must acquire possession of the collateral.

The first two requirements do not have particular importance in this lawsuit. We are primarily concerned with the last two, since they are responsible for the general imposition on contracting parties of a formal, written security agreement. And, there must be a binding security agreement in

order to make the security interest enforceable against innocent third parties.

It has always been conceded by plaintiff that a formal, written security agreement was never executed by himself and the two individual defendants. (R.46-48; 88.) It is his contention, however, that courts in other jurisdictions have recognized "substitutes" to such formal security agreements. The present inquiry is, therefore, which combination of papers, documents or agreements can qualify under the foregoing provisions of the Uniform Commercial Code to create an enforceable security agreement against third parties. Defendant contends that neither of the two documents before the Court, individually or taken together, constitutes an adequate security agreement which created or provided for a security interest in the mining equipment.

Plaintiff's Promissory Note and the Financing Statement Do Not Create an Enforceable Security Agreement Against Defendant MRC

A. A Financing Statement May Not Be Enforced as a Security Agreement.

When considering whether the financing statement prepared by the parties was to serve as a security agreement, first note that the financing statement was a standard form. This observation is borne out by the notation at the bottom of the financing statement (R.48; 74), and it has been admitted by the plaintiff, too. (R.88.) The overwhelming general rule is that the Uniform Commercial Code

makes no provision for a naked, standard form financing statement to be enforced as a security agreement. See, Mid-Eastern Electronics, Inc. v. First National Bank of Southern Maryland, 380 F.2d 355 (4th Cir. 1967); General Electric Credit Corp. v. Bankers Commercial Corp., 244 Ark. 984, 429 S.W.2d 60 (1968); M. Rutkin Elec. Supply Co. v. Burdette Elec., Inc., 98 N.J.Super. 378, 237 A.2d 500 (1967); Cain v. Country Club Delicatessen, 25 Conn.Supp. 327, 203 A.2d 441 (1964); American Card Co. v. H.M.H. Co., 97 R.I. 59, 196 A.2d 150 (1963).

The reasoning underlying this position was aptly expressed in Needle v. Lasco Industries, Inc., 10 Cal.App.2d 1105, 89 Cal.Rptr. 593 (1970). In that case, a retailer was being supplied with merchandise for sale on a consignment basis to its customers by a wholesaler. The retailer sold some of the merchandise without paying the wholesaler, whereupon the latter ceased to provide any more merchandise. Later, a representative of the wholesaler met with the president of the retailer to discuss the delinquest account. The wholesaler offered to deliver additional merchandise provided the retailer would furnish security in the form of its inventory and accounts receivable. The retailer agreed to do so, and the wholesaler filled in the blanks of a document entitled "Financing Statement." The document was executed on behalf of the retailer by its president and vice president, and on behalf of the wholesaler by its secretary.

It was thereafter filed in the office of the secretary of state.

The wholesaler resumed supplying merchandise to the retailer. The retailer's business continued to be poor, and eventually the retailer was forced to make a general assignment to the plaintiff, a third party, in the approximate amount of $6,000 for the benefit of its creditors. At that same time, the retailer owed the wholesaler approximately $4,600; accordingly, the wholesaler claimed that it was entitled to the entire amount due to it, on the basis that it was a preferred creditor under the financing statement. The plaintiff brought an action for declaratory relief against the wholesaler, putting in issue only one matter pertinent here: Whether the financing statement constituted an enforceable security agreement.

The trial court concluded that the financing statement was a valid security agreement, and the plaintiff appealed. The California Court of Appeals reversed, basing its reversal on two considerations. First, the financing statement failed to express any evidence of an agreement by the debtor to grant the claimants a security interest in specific collateral. Second, although the financing statement described the collateral, there was no indication of the underlying obligation for which the collateral was security. For all that appeared from the writing, the obligation secured may have been a loan from the wholesaler to the

retailer which was subsequently repaid and might not have encompassed the retailer's obligation to the wholesaler for merchandise delivered. A security interest is collateral which secures payment or performance of an obligation, and the security agreement is effective only according to its terms between the parties and against third parties. At a minimum, therefore, the terms must recite the obligation secured. The court suggested that the appropriate language was a grant of a security interest "to secure the performance of the obligation set out in paragraph 1," i.e., a paragraph in the agreement which fully sets out the obligation.

Plaintiff in the instant case must agree with the foregoing reasoning, for in his trial memorandum he stated:

> The financing statement of the instant case contains no language specifically granting a security interest, nor are any of the terms of the agreement specified. It is arguable that the statement does not contain language sufficient to evidence the requisite intent to grant a security interest. (R.91.)

It should be borne in mind that a financing statement and a security agreement serve entirely different functions. The security agreement embodies the entire obligations, responsibilities and arrangements between the parties. The filing of a financing statement, on the other hand, is ". . . but . . . a single step in the means by which the

rights and priorities of a secured party are 'perfected'." Mid-Eastern Electronics, supra, 380 F.2d at 356. It is simply a notice that the party who has filed it may have a security interest in the collateral which the statement describes. Therefore,

> . . . it is clear that the rights of a third person do not depend upon whether he has examined any financing statement. If the [creditor] and [debtor] had executed a security agreement but had not filed a financing statement, the security agreement would not make the [creditor] a preferred creditor even though none of the other creditors bothered to ascertain whether a financing statement had been filed . . . The necessary corollary of this proposition is that a financing statement filed with respect to a security agreement which never comes into existence is a nullity. Needle v. Lasco Industries, Inc., Cal.App.2d 1105, 1108, 89 Cal.Rptr. 593, 596 (1970). (Emphasis added.)

B. A Promissory Note May Not Be Enforced as a Security Agreement.

Similar to the naked financing statement, a promissory note cannot substitute for a valid and enforceable security agreement since it does not usually contain "granting" language. This issue was adequately addressed by an opinion from New Jersey, First County National Bank & Trust Co. v. Canna, 124 N.J.Super. 154, 305 A.2d 442 (App.Div. 1973). In that case, the court had before it both a homemade promissory note which stated that the loan was for the purchase of an automobile, and the automobile certificate of title on

which appeared a notation that the lender was a secured party. The latter notation was required in order to perfect the lender's security interest. There was no document formally entitled "security agreement." The court was asked to construe the documents before it as constituting a security interest under the New Jersey Commercial Code. In holding that they could not be so interpreted, the court stated:

> By its very nature an agreement creating a security interest in collateral, of necessity, must contain language that grants or creates a security interest in the collateral. In short, the language must be such as to clearly indicate that the debtor intended to thereby specifically grant to the creditor a security interest in the collateral. Absent such language the writing does not constitute a security interest. 305 A.2d at 446.

Accordingly, the court held that a promissory note which does not contain language granting a security interest in collateral, even where it recites the data relating to collateral as security, is not thereby converted into a security agreement. The decision in Canna was based on the absence of language in any of the documents which granted a security interest. The court implied that if there were such granting language in a promissory note or elsewhere, it would have found a valid security agreement.

In the instant case, neither the promissory note nor the financing statement contain language, as required by

Canna, to grant a security interest in the mining equipment. The promissory note does not refer to any collateral, nor mention the grant of a security interest; it only recites that it is secured by a security agreement of even date. Moreover, the financing statement only recites that "this financing statement covers the following types (or items) of property:", and then the statement refers to the mining equipment. Neither instrument clearly shows that the debtor intended to grant a security interest and, therefore, neither document can be held to grant a security interest to the plaintiff.

C. The Promissory Note and Financing Statement, Taken Together, May Not Be Enforced as a Security Agreement.

As in other contract settings involving a statute of frauds requirement, two or more writings can often be incorporated to satisfy the written security agreement requirement under §70A-9-203 and §70A-9-204. Similar to a financing statement or a promissory note, the determining factor is whether the multiple documents, taken together, clearly reveal a specific grant by the debtor of a security interest in the collateral.

An illustrative case is In re Carmichael Enterprises, Inc., 9 U.C.C.Rep. 990 (N.D.Ga. 1971). There, the court determined that a financing statement sufficed as a valid security agreement since it was attended by numerous

other documents. For example, the creditor offered in evidence a letter from its assistant credit manager to the vice president of the debtor corporation. The letter stated, in part:

> In accordance with our several phone conversations, the following will outline our requirements which will enable us to extend additional time on the payment of your indebtedness to us. Our arrangement will be formalized by a loan agreement containing the following provisions:
>
> * * *
>
> 5. Execution of a Financing Statement in which accounts receivable inventory and proceeds thereof are provided as collateral for the above indebtedness. . . .

In addition, the creditor offered to the court another letter and financing statement which were subsequently sent to the debtor corporation. The letter set forth the terms of the loan agreement and recited that in consideration for the creditor's acceptance of the debtor's notes to cover its debt, the debtor must agree to execute and return the enclosed standard form financing statement. The second letter was, in turn, signed on behalf of the debtor corporation by its vice president, bearing the date of his signature and the notation: "Agreed." The financing statement, enclosed in the letter, was also signed on behalf of the debtor corporation by its vice president. On the basis of this extensive documentation, the court held that the creditor obtained a security agreement from the debtor.

A similar result was expressed in In re Truckers International, Inc., Sage v. City of Mount Vernon, 17 U.C.C.Rep. 1337 (W.D.Wash. 1975). In that case a bankrupt truck dealer had not signed a document officially designated as a security agreement with a truck manufacturer. Nevertheless, the combination of the following multiple documents executed between the parties required the conclusion by the court that a security agreement, sufficient under the Uniform Commercial Code, had been executed: A dealership agreement, a financing statement, a signatory authorization (under which specified representatives of the manufacturer were appointed agents for the dealer and were permitted to execute notes and security instruments on behalf of the dealer and in favor of the manufacturer), and a dealer note. It was the court's conclusion that, taken as a whole, the preceding documentation contemplated and provided for secured credit transactions between the parties.

A similar result was reached in the opinion of In re Munroe Builders, Inc., 20 U.C.C.Rep. 739 (W.D.Mich. 1976). There, the defendant had entered into a written contract with a municipality for the construction of a ski resort building. In order to obtain the necessary construction proceeds, the defendant executed four promissory notes with a bank. The notes contained various descriptions of security. The first bore the notation: "Chocolay Township Warming House"; the second bore the notation: "Chocolay

Township Warming House"; the third bore the notation: "Secured by check assignment"; and the fourth bore no description of security. Later, in a letter to the supervisor of the municipality, the defendant wrote the following:

> . . . I, the undersigned, president of Munroe Builders, Inc., hereby request and authorize you to send all the money due this complany (sic) upon completion of the warming house project to the Peoples State Bank of Munising to be credited to my account for payment of the construction loan granted to us for construction of subject project.
>
> This authorization is voluntarily given to procure construction funds for the above project and it is irrevocable. 20 U.C.C.Rep., at 740.

The municipal supervisor, in turn, wrote the bank that the "assignment" was accepted subject to the rights of the municipality. There was no filing of a financing statement by either party, the defendant corporation or the bank. On this basis, the court concluded that the four promissory notes and the two letters, taken together, satisfied the requirements for a valid, written security agreement between the parties. See also, Morey Machinery Co., Inc. v. Great Western Industrial Machinery Co., 16 U.C.C.Rep. 489 (5th Cir. 1975).

It is absolutely essential to observe that the foregoing cases require the multiple documents to evidence the specific intent of the debtor to grant a security interest in particular property to the creditor. Those multiple

documents which satisfy this requirement typically involve more significant and detailed documents, and a greater number, than are involved in the instant case. Even the opinions cited by the plaintiff in his appeal brief evidence this conclusion. (Brief of Appellant, at 7-8.) For instance, In re Amex-Protein Development Corp., 504 F.2d 1056 (9th Cir. 1974), a promissory note, a financing statement and several invoices; In re Numeric Corp., 485 F.2d 1328 (1st Cir. 1973), a financing statement, a resolution of the corporate directors of the debtor establishing that an agreement in fact existed to give the secured party a security interest, and an itemization of the collateral; In re Penn Housing, 367 F.Supp. 661 (W.D.Pa. 1973), a financing statement, eleven promissory notes, an acknowledgment of the debt by a letter which also pledged security, and an extensive course of dealing between the parties; In re Matronics, Inc., 2 U.C.C.Rep. 364 (D.Conn. 1964), a financing statement, a promissory note, and a loan agreement.

There are, of course, numerous cases in which the courts have concluded that the parties failed to create a valid and enforceable security agreement, notwithstanding the existence of multiple documents between them. See, e.g., Crete State Bank, Crete, Nebraska, v. Lauhoff Grain Co., 195 Neb. 605, 239 N.W.2d 789 (1976); L and V Co. v. Asch, 267 Md. 251, 297 A.2d 285 (1972). There are two such

opinions which are strikingly similar to the instant case. Both involved a promissory note and a financing statement, and in each case the court concluded that the parties had not created a valid and enforceable security agreement between themselves. The first is Kaiser Aluminum & Chemical Sales, Inc. v. Hurst, 176 N.W.2d 166 (Iowa, 1970). In that case the plaintiff sold farm supplies to the defendant, and the defendant executed a promissory note in payment of the account. The note contained the following handwritten notation: "This note covered by security agreement dated March 9, '67." Thereafter, a financing statement was executed by the plaintiff and defendant and appropriately filed. No formal security agreement was signed, either then or later.

Sometime later, the defendant sold his farm produce to third parties and neglected to pay his note. Accordingly, the plaintiff started an action to collect the amount due it, relying upon the claim that the execution of the promissory note and the financing statement, together with the filing of the latter document, created a security interest in the farm produce. In its opinion the court provided the following discussion:

> The cases uniformly hold that a financing statement does not ordinarily create a security interest. It merely gives notice that one is or may be claimed. The same authorities hold a financing statement may double as a security agreement if it contains appropriate language which grants

a security interest. The financing statement now before us contains no language which can be interpreted as granting such an interest.

It is apparent a financing statement was not intended under the Uniform Commercial Code to serve as a security agreement. Section 554.9402, Code of Iowa, provides in part:

> (1) A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. . . .

Quite obviously, if the security interest may come into existence after the financing statement is filed, such statement does not create the lien.

We hold that the financing statement signed by the parties and filed with the recorder . . . afforded plaintiff no security interest in the [farm produce] sold by defendant . . . . (All emphasis the court's.) 7 U.C.C.Rep. at 732.

The second opinion is Barth Brothers v. Billings, 68 Wis.2d 80, 227 N.W.2d 673 (1975). In that case two separate parties both made claims against the defendant. One of the plaintiffs based its claim on four promissory notes signed by the defendant. All four notes contained a notation which basically provided that each of them was

secured by a financing statement filed with tle local registrar of deeds. Financing statements for three of the notes were appropriately filed within ten days of the notes being signed. The plaintiff claimed that it had a security interest in the defendant's property based on the notes signed by the defendant with the notation that they were secured by filed financing statements.

The court disagreed, holding that there is no valid security interest where the debtor executes a promissory note and signs a financing statement, but does not sign a security agreement. The court accepted the reasoning of the majority of the courts that a financing statement may double as a security agreement only if it contains appropriate language which grants a security interest. No security interest existed in the case because the financing statements did not contain any language granting such an interest.

The two documents in the instant matter are similar to those in Kaiser and Barth Brothers. The promissory note does not refer to collateral or to a security interest. Rather, the note's only significant notation is that it was allegedly "secured by a security agreement of even date." Of course the security agreement to which the note refers never existed, either then or now. The only additional document which the parties executed was the financing statement. And it, too, is barren of language sufficient to

justify the conclusion that through it the plaintiff obtained a security interest in the mining equipment. These documents, together or separately, are not the equivalent of a formal security agreement as required by the Utah Uniform Commercial Code.

The main opinion on which the plaintiff relies is In re Center Auto Parts, 6 U.C.C.Rep. 398 (C.D.Calif. 1968). (Brief of Appellant, at pp.10-15.) In Auto Parts, a promissory note and a financing statement were held to constitute a security agreement. The crucial factors relied upon by the court were the contemporaneous signing of both documents by the debtor and the following language in the promissory note: "This note is secured by a certain financing statement." The opinion is inapplicable in the instant matter for at least two reasons. First, it represents a minority view. In fact, an opinion cited by the plaintiff in his own appeal brief wholly rejected it. (Brief of Appellant, at pp.9, 13.) In Evans v. Everett, 10 N.C.App. 435, 179 S.E.2d 120 (1971), the North Carolina Court of Appeals provided the following comment on the Auto Parts opinion:

> In Center, the federal trial court, reviewing a decision of a referee in bankruptcy held those words to be sufficient to create or provide for a security interest. A description of the collateral was provided by the financing statement, which, it was stipulated, was the only one between the parties. Even if it were stipulated that the note and the

> two financing statements in the present case were the only ones between the parties. we do not regard the words, "This note is secured by Uniform Commercial Code financing statement of North Carolina" is a sufficient grant of a security interest, and therefore do not consider the reasoning in that case persuasive. 8 U.C.C.Rep. at 1367.

Second, the crucial language in the Auto Parts opinion (i.e., "this note is secured by a certain financing statement"), is different from that in the instant matter (i.e., "this promissory note is secured by a security agreement of even date"). In Auto Parts, the promissory note might have led an inquirer to the written document which the parties intended all to see, namely, the financing statement. Thus, by looking to the financing statement, the property provided by the debtor as security for the loan was identified. In the instant case, any inquirer who had read the promissory note would have looked in vain for the security agreement to which it refers.

CONCLUSION

Neither of the two documents before the Court, individually or taken together, constitute an adequate security agreement under the relevant provisions of the Utah Uniform Commercial Code. The plaintiff did not obtain a security interest in the mining equipment possessed by MRC.

The Summary Judgment should be affirmed and defendant should be awarded its costs on appeal.

DATED this 17th day of February, 1978.

Respectfully submitted,

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Certificate of Service

I hereby certify that two true and correct copies of the foregoing Brief of Respondent were mailed, postage prepaid, to Lorin N. Pace and Randall Bunnell, attorneys for plaintiff-appellant, 431 South Third East, B-1, Salt Lake City, Utah, this 17th day of February, 1978.