

1988

J. Ray Merkley v. John C. Beaslin : Brief of Appellant

Utah Court of Appeals

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UTAH COURT OF APPEALS

UTAH
DOCKET NO.
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DOCKET NO.

880191-CA

IN THE SUPREME COURT OF THE
STATE OF UTAH

J. RAY MERKLEY,

Plaintiff/Appellant,

vs.

JOHN C. BEASLIN,

Defendant/Respondent.

:

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:

:

88-0191-CA

Case No. 870420

BRIEF OF APPELLANT

Appeal from the Seventh Judicial District Court of Uintah
County, State of Utah, the Honorable Dennis L. Draney,
District Court Judge.

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Clerk, Sup

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STATEMENT SHOWING THE JURISDICTION OF THE COURT

AND THE NATURE OF THE PROCEEDINGS BELOW

This court has jurisdiction over this appeal pursuant to §78-2-2(3)(i), Utah Code Annotated, and Rule 3(a), Utah Rules of Appellate Procedure. This appeal is from a final order of the District Court of the Seventh Judicial District Court in and for Uintah County, State of Utah, the Honorable Dennis L. Draney presiding.

STATEMENT OF THE ISSUES PRESENTED FOR REVIEW

1. When did the "legal malpractice" occur, that is, when the respondent first filed the U.C.C. 1 statement with the Lieutenant Governor in 1976, or when he failed to refile it or notify the appellant, his client, that he needed to refile it in May, 1981?

2. In "legal malpractice" cases, when does the Statute of Limitations commence to run? Is it when the malpractice was committed, May of 1981 when the U.C.C. 1 continuation statement was not filed; and/or 1976 when the respondent failed to secure the transaction with a mortgage or like instrument on real property; or, when the damage occurred, with the filing of the bankruptcy in 1983, or when the error and omission was discovered after the filing of the bankruptcy?

3. Are there questions of fact that need to be determined in order to apply the question of law as to when the

Statute of Limitations begin to run, or was it as a matter of law, the date the respondent created the initial contract in 1976?

STATEMENT OF THE CASE

The case involves a claim for professional negligence or legal malpractice resulting in the loss of security to secure a debt. The trial court, in considering the respondent's Motion for Summary Judgment, granted judgment in which the court concluded the professional negligence or legal malpractice, if it occurred, occurred in 1976 when the respondent first created the contract, rather than in 1981 when the respondent failed to either renew a U.C.C. 1 statement or inform the appellant that he needed to renew it. The trial court also refused to apply the discovery rule in determining when the Statute of Limitations commenced running, but rather concluded the applicable Statute of Limitations commenced running when the respondent performed the initial legal services that should have resulted in the securing of the appellant's obligation, and thereby granted Summary Judgment in reliance on the Statute of Limitations issue in favor of the respondent.

STATEMENT OF FACTS

Respondent had been appellant's attorney for many years.

Commencing in approximately 1965, he assisted the appellant in setting up a recreational vehicle business in Uintah County. In 1975 he set up a corporation known as Merkley Motors, Inc., and performed all necessary legal services to effect the transfer of real and personal property into that corporation. (J. Ray Merkley deposition p. 8; John C. Beaslin deposition Exhibit #1; and R. 22)

As of March, 1976, appellant and his then-wife owned 99% of the capital shares of Merkley Motors, Inc. (R. 23) They were offered the sum of One Hundred Twenty Thousand Dollars (\$120,000.00) from certain relatives, collectively referred to as the other Merkleys. (J. Ray Merkley deposition pp. 11-13) Because respondent had been appellant's attorney for many years, and had assisted appellant in all of his business matters in which he needed legal advice, and had performed all necessary functions to incorporate the business and transfer the appellant's real and personal property into the corporate structure, the appellant retained the respondent as his attorney to appropriately prepare the legal documents necessary to effectuate the sale of the capital shares of the corporation to the other Merkleys, and at the same time, to have sufficient security available to cover the sales price in the event of default on the part of the other Merkleys in purchasing the capital ownership interest represented by the shares in the corporation. The

respondent, as the appellant's attorney, undertook to represent the interests of the appellant in the sale of the capital shares of the corporation to the other Merkleys, and agreed to draft the appropriate and necessary legal documents to effectuate the sale of the capital shares of Merkley Motors, Inc., which sale was to be secured by the real property on which the business was located in Vernal, Utah, and by an inventory that was unencumbered which would be in excess of any balance owing to the appellant, the seller. Appellant advised respondent of what the agreement between the buyers and the sellers was to be, namely, that the sale price of One Hundred Twenty Thousand Dollars (\$120,000.00), which represented the value of the inventory and the net equity of the real property was to be structured in such a way as to fully secure the appellant for the unpaid balance of the sale price by a security interest in both the real property and the unencumbered inventory. Respondent agreed to represent the appellant, and prepared a contract of sale. (R. 23-30) He also prepared a financing statement (hereinafter referred to as a U.C.C. 1) which he had filed on May 4, 1976, and in which he listed Merkley Motors, Inc. as the debtor, and had Tal R. Merkley and Charlene Merkley sign, and in which he listed the appellant J. Ray Merkley, and his then-wife Janet Merkley, as the secured parties. (R. 31) The respondent did not, contrary

to appellant's request, secure the real property asset of the corporation by a mortgage or like instrument to the appellant, but rather, in a very unworkable and loose document, merely provided for the escrow of corporate stock, but did not secure the obligation owed by the buyers to the appellant seller. (R. 23-30 and R. 41-45)

Even though the respondent attempted to secure the inventory and other personal assets of the corporation by the U.C.C. 1 filing on May 4, 1976, he did not set up any follow-up procedures for the renewal of that document on a periodic basis as required by the U.C.C., nor did the respondent inform the appellant that the document would have to be renewed or refiled on a periodic basis in order to retain its validity. (R. 14-16; J. Ray Merkley deposition pp. 38-46) Respondent continued to handle the legal matters of the appellant as well as the buyers of Merkley Motors, Inc. in several subsequent transactions dealing with the same asset through 1976, 1977, and 1978. (Exhibit #1, deposition of John C. Beaslin) Respondent did not, however, ever advise the appellant that he had not secured the sales agreement by a mortgage or trust deed on the real property, or that the U.C.C. 1 filing would need to be renewed or refiled on a periodic basis in order to retain its validity. (R. 14-16; J. Ray Merkley deposition pp. 38-46) The respondent did not renew the U.C.C. 1 filing in May, 1981, when it

had to be renewed to maintain the security interest on behalf of the appellant, nor did the appellant know that he was supposed to file a renewal. As a matter of fact, respondent's office staff tried to lead appellant to believe that the U.C.C. 1 filings were good indefinitely, and did not need to be renewed. (J. Ray Merkley deposition pp. 37-38)

Merkley Motors, Inc., through its officers, who had been the purchasers from the appellant, filed a bankruptcy on behalf of Merkley Motors, Inc. in the early part of 1983, approximately two years after the U.C.C. 1 filing should have been renewed. Because the U.C.C. 1 filing had not been renewed, appellant lost his security interest in the inventory, which, at the time of the filing of the bankruptcy was in excess of the money owed him by the buyers, and he, accordingly, lost the principal sum of \$54,360.18, plus interest.

SUMMARY OF ARGUMENT

The trial court erred in its determination of when the error or omission occurred, it actually being in 1981, and not in 1976, and also erred in its conclusion as to when the Statute of Limitations commenced running in any event. The decision of the trial court should be reversed.

ARGUMENT

POINT I

THE ERROR OR OMISSION OF RESPONDENT DID NOT OCCUR UNTIL MAY, 1981, WHEN RESPONDENT NEITHER RENEWED THE U.C.C. 1 FILING NOR INFORMED APPELLANT HE HAD TO RENEW THE U.C.C. 1 FILING.

The trial court, in its ruling on the Motion for Summary Judgment, used the contract creation date of March 1, 1976 as the date on which the Statute of Limitations commenced rather than a period five years later, which is the time the error actually occurred.

Section 70A-9-403, UCA, sets the effective periods for U.C.C. 1 filings. Subsections (2) and (3) provide:

"(2) Except as provided in subsection (b) a filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five year period unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of 60 days or until expiration of the five year period, whichever occurs later. Upon lapse the security interest becomes unperfected, unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.

(3) A continuation statement may be filed by the secured party within six months prior

to the expiration of the five year period specified in subsection (2). Any such continuation statement must be signed by the secured party, identify the original statement by file number or by entry numbers and book and page numbers and state that the original statement is still effective. A continuation statement signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with subsection (2) of section 70A-9-405, including payment of the required fee. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in subsection (2) unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. Unless a statute on disposition of public records provides otherwise, the filing officer may remove a lapsed statement from the files and destroy it immediately if he has retained a microfilm or other photographic record, or in other cases after one year after the lapse. The filing officer shall so arrange matters by physical annexation of financing statements to continuation statement or other related filings, or by other means, that if he physically destroys the financing statements of a period more than five years past, those which have been continued by a continuation statement or which are still effective under subsection (6) shall be retained."

Had the contract purchaser filed a bankruptcy any time prior to May 4, 1981, the appellant would have been secured under the U.C.C. 1 filing. The error and omission of the respondent was in not renewing or refiling the U.C.C. 1

prior to May 4, 1981, or advising the appellant that he would have to renew or refile the U.C.C. 1. The trial court applied the Four Year Contract Statute of Limitations, §78-12-25, Utah Code Annotated (1953), however, applied it from the 1976 time mark and not the 1981 time mark. The appellant filed his complaint in July, 1984, a period well within four years from the respondent's failure to renew the U.C.C. 1 filing in May, 1981.

To follow the application by the trial court of the Statute of Limitations beginning to run in 1976 rather than in 1981, you achieve a result of having the Statute of Limitations expire one year before the error in not renewing the U.C.C. 1 filing occurred. The trial court plainly used the incorrect date as the starting point by taking the date of the original contract rather than the date five years later when the security for the benefit of the appellant was lost by the respondent's failure to act.

This court recently held in Brigham Young University v. aulsen Construction Company, et al., 68 UAR 5 (Utah 1987):

"The general rule is that a cause of action accrues upon 'the happening of the last event necessary to . . . the cause of action.'" [Citing Becton Dickenson & Co. v. Reese, 668 P.2d 1254, 1257 (Utah 1983)]

In this case the last event necessary to the cause of action was the failure to file the continuation statement for the U.C.C. 1 in May, 1981.

POINT II

THE STATUTE OF LIMITATIONS DID NOT COMMENCE TO RUN UNTIL PLAINTIFF DISCOVERED, OR IN THE EXERCISE OF REASONABLE CARE SHOULD HAVE DISCOVERED, THE WRONG COMPLAINED OF, AND THE INSTANT LAWSUIT WAS, THEREFORE, TIMELY.

If the court agrees with the appellant's first point, it is really not essential to discuss this point as to the loss of the security interest in the personal property covered by the U.C.C. 1 filing, however, the court may, nonetheless, want to consider this point relative to the respondent's failure to secure the obligation created by the sales contract by an appropriate mortgage or trust deed. While this point should not affect the running of the time for the error and omission in not renewing the U.C.C. 1 filing, it is worthy of consideration relative to the loss of the security in the real estate because that error and omission occurred in 1976. It was not, however, discovered until some time later, nor did the damage result until some time later.

The time when the Statute of Limitations commences to run has, for many years, been evolving into a rule of reason. In legal malpractice cases, various state courts have adopted rules of reason in determining when the Statute of Limitations commences to run. Two different rules have evolved, namely, the Damage Rule and the Discovery Rule. To

be considered under either rule is the fact of the fiduciary relationship that exists between an attorney and a client. This court has recognized that trust and confidence are basic to the attorney/client relationship. See Smoot v. Lund, 13 Utah 2d 168, 369 P.2d 933 (1962); Omega Inv. Co. v. Woolley, 72 Utah 474, 271 P. 797 (1928). Because of the fiduciary nature of the attorney/client relationship, the courts that have considered the question of when the Statute of Limitations commences to run have adopted one of two rules, both of which bring you to the same point. The one rule is known as the Damage Rule, and simply stated, is that there must be actual injury before the cause of action accrues. The other is the Discovery Rule, which is that the Statute of Limitations does not begin to run until the injured party discovers, or in the exercise of reasonable care should discover, that there is a wrong to be complained of.

The Damage Rule has grown from a 1967 District of Columbia decision of Fort Meyers Seafood Packers, Inc. v. Steptoe & Johnson, 381 F.2d 261 (DC Cir. 1967) which involved a three-year occurrence limitation. On May 16, 1962, the attorneys prepared a contract for providing that a present American registry of the boats would be maintained. On July 25, 1962, the boats arrived in Venezuela and were impounded because their entry under American registry was

illegal. Suit was not filed until July 22, 1965, more than three years after the negligent advice was given, but less than three years since the seizure of the boats. The United States Court of Appeals noted the divergence of use in various jurisdictions concerning whether negligence or injury initiated the start of the statutory period. The District Court had chosen the Occurrence Rule, but the Appellate Court said:

"We see no good reason for drawing such a distinction between malpractice suits and other negligence actions. The impounding of the boats might have been found to be an injury that resulted from Appellees' legal advice. Since the suit was filed within three years, we think it was timely."

Since the Fort Meyers Seafood Packers decision, the Damage Rule has been adopted by court decision in Arizona, California, Delaware, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Missouri, Nevada, New Mexico, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Tennessee, Texas, and Wisconsin. See Mallen & Levit, Legal Malpractice, Second Edition, §390, Note 11 (1981).

While the Utah court has not yet been called upon to rule on the question of when the Statute of Limitations begins to run in a legal malpractice case, this court has ruled in recent years, under similar circumstances involving a fiduciary relationship, that the Statute of Limitations does not begin to run until the injured party discovers, or

in the exercise of reasonable care should discover, that there was a wrong to be complained of. It is really immaterial whether you apply the Damage Rule or the Discovery Rule, under the facts of this case, because the time which the Statute would begin to run is the same. This court, in Stewart v. K & S Company, Inc., 591 P.2d 433 (Utah 1979), was called upon to determine when the Statute of Limitations commenced running against a stockholder who brought a lawsuit against corporate officers. The question was whether you should apply an Occurrence Rule, which was applied by the trial court in this case, and which would have barred the plaintiff's claim by the three year Statute of Limitations. In opting not to apply the Occurrence Rule, this court stated:

"In addressing this issue, this principle is to be borne in mind: where there is a fiduciary relationship, such as between corporate officers and a stockholder, the Statute of Limitations does not begin to run until the stockholder discovers, or in the exercise of reasonable care should discover, that there is a wrong to be complained of; and it hardly needs to be stated that this rule has application where funds are wrongfully withheld from stockholders."

While this case is dealing with a different statute than was being dealt with in the Stewart case, the principle is essentially the same because of the fiduciary relationship that exists between the attorney and his client, which

is probably of a higher quality, and in which there is more trust and confidence reposed than that of a corporate officer toward a stockholder.

Whether you apply the Damage Rule or the Discovery Rule, the evidence in this case is clear that the appellant did not discover, and would have no reason to be on inquiry to make a discovery of the respondent's legal malpractice until he attempted to enforce his security interest after his obligor's bankruptcy was filed. Until that time payments were made by the contract buyers, and there was no reason for him to make an independent determination, based upon the trust he had reposed in the respondent, to determine whether the respondent had done what he had been hired to do, namely, to secure the transaction with a security interest in both real property and personal property.

The damage did not occur, and the respondent's error and omission would not be reasonably discoverable, until it was necessary for the appellant to take some action to execute on his security after his contract buyers filed the bankruptcy. If you do not apply such reasoning, then it is incumbent on all clients to hire a second attorney every time their initial attorney prepares a contract for them because, in the usual course of events dealing with contracts that extend over a period of years, the event that gives rise to a cause of action will not occur until after

the Statute runs in many contract cases. The nature of the relationship of the attorney/client is such that the client of necessity reposes great confidence and trust in his attorney, and is not likely to seek a second opinion to have another attorney review the work of the first attorney.

This court in Brigham Young University v. Paulsen Construction Company, et al., 68 UAR 5 (Utah 1987), had occasion to discuss the Discovery Rule, but not to apply it because of the peculiar facts of that case in that BYU knew of its cause of action against Paulsen for a sufficient period of time prior to the running of the Statute of Limitations to have commenced their action in a timely fashion, but consciously elected not to until after the Statute had run. The court cited, however, Mevers v. McDonald, 635 P.2d 84, 86 (Utah 1981), where it sanctioned the invocation of the Discovery Rule when the "application of the general rule would be irrational or unjust." The concurring opinion of Justice Howe, concurred in by Associate Chief Justice Stewart, cited a Federal Court of Appeals for the Tenth Circuit decision which has application in this case. In citing City of Aurora v. Bechtel Corporation, 599 F. 2d 382 (10th Cir. 1979), Justice Howe, noting the case involved a professional malpractice claim where the Discovery Rule was applied, stated:

"*** Logically, I cannot see why if we applied the Discovery Rule in cases for professional negligence, the same rule should not also be applied in cases for breach of contract where the breach is a latent defect in the construction which becomes apparent only after the Statute of Limitations has otherwise run.*** The Statute of Limitations does not begin to run on a negligence claim until the damage is discovered, which may be after the limitation on a contract action has expired."

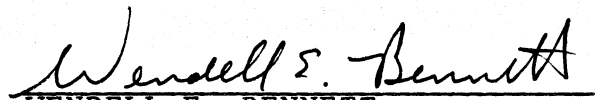
CONCLUSIONS

The trial court used the wrong date in determining when the malpractice occurred relative to the filing of the U.C.C. 1, and as a matter of law the correct date should have been May, 1981, and not May, 1976. This action was filed in July, 1984, well within the four years allowed by the Contract Statute of Limitations.

The trial court further erred in the application of the Occurrence Rule, with the occurrence being the creation of an inadequate contract in 1976, rather than the application of the Discovery Rule, or the Damage Rule, which would have the logical baseline date as to when the Statute commenced to run as a reasonable time after the filing of the bankruptcy and the appellant's discovery that the respondent had not filed a U.C.C. 1 renewal in 1981, or secured the obligation of the buyers with an appropriate lien against the real property.

The Summary Judgment of the trial court should be reversed, and the case remanded for a trial on its merits for a determination of whether the respondent committed legal malpractice, and the damages that have resulted to the appellant as a result thereof.

Respectfully submitted this 2nd day of February, 1988.


WENDELL E. BENNETT
Attorney for Appellant

MAILING CERTIFICATE

I do hereby certify that I mailed a copy of the foregoing to Henry S. Nygaard, attorney for respondent, 333 North 300 West, Salt Lake City, Utah 84103, on this 2nd day of February, 1988.

