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Jerry V. Strand v. Prince-Covey and Co., INC., and Almon Covey : Reply Brief

Utah Supreme Court

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IN THE SUPREME COURT
OF THE STATE OF UTAH 1975

JERRY V. STRAND,
Plaintiff-Respondent,

vs.

PRINCE-COVEY & CO., INC., and
ALMON COVEY,
Defendant-Appellant.

BRIGHAM YOUNG UNIVERSITY
J. Reuben Clark Law School

Case No.
13804

REPLY BRIEF OF APPELLANT

PRINCE-COVEY & CO., INC.

APPEAL FROM JUDGMENT
of the
DISTRICT COURT OF THE THIRD
JUDICIAL DISTRICT IN AND FOR SALT LAKE
COUNTY, STATE OF UTAH
Honorable Gordon R. Hall, Judge

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FEB 7 1975

Clerk, Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

JERRY V. STRAND,
Plaintiff-Respondent,

vs.

PRINCE-COVEY & CO., INC., and
ALMON COVEY,
Defendant-Appellant.

Case No.
13804

REPLY BRIEF OF DEFENDANT-APPELLANT

Defendant-appellant Prince-Covey & Co., Inc. submits this reply brief in response to certain new matters raised in the brief of plaintiff-respondent Jerry Strand:

POINT I

ARTICLE 8 OF THE UTAH UNIFORM COMMERCIAL CODE GOVERNS THIS CASE. GENERAL RULES OF CONVERSION ARE NOT APPLICABLE.

Plaintiff argues again in the Brief of Appellee as he argued in the trial court that knowledge of adverse claims

is immaterial in a conversion action (Brief of Appellee at 15-16). While this may be correct with respect to conversion of most goods, it is totally erroneous with respect to conversion of negotiable securities.

Plaintiff does not once cite or consider Article 8 of the Utah Uniform Commercial Code which governs transactions in negotiable securities, but presents for the Court's consideration only general statements from Am. Jur. 2d and a Utah case involving the conversion of seeds. General rules of conversion are not applicable to the conversion of negotiable securities; if they were, the securities would no longer be negotiable, see Restatement (Second) of Torts §233(4).

The pertinent sections of Article 8 are discussed at some length in the Brief of Appellant, and defendant will not belabor the point that they are applicable to and control the issues before this Court. It is sufficient to repeat (1) that §70A-8-301(a) provides that a bona fide purchaser of a security "acquires [it] free of any adverse claims"; (2) that §70A-2-302 defines a bona fide purchaser as one who, among other things, takes a security "without notice of any adverse claim," and (3) that §70A-8-304(2) provides that "notice that the security is held for a third person" neither creates a duty of inquiry nor "constitute(s) notice of adverse claims." The last section cited goes on to require that the purchaser have "*knowledge* that the proceeds are being used or that the transaction is for the individual benefit of the fiduciary or otherwise in breach of duty," before he "is charged with notice of adverse claims." (emphasis supplied).

Plaintiff apparently does not wish the Court to consider the statutes governing his claim because they point directly to its untenability. Almon Covey did *not* have knowledge of plaintiff's claim to ownership of the stock and knowledge cannot be imputed to him through Ted England. From the record before the trial court, the only conclusion consistent with Utah statutory law is that Prince-Covey & Company, Inc. was a bona fide purchaser. At best (for plaintiff), genuine issues as to defendant's knowledge of plaintiff's purported ownership remain in dispute and were not properly disposed of on the motion for summary judgment.

POINT II

DEFENDANT WAS EITHER A BONA FIDE PURCHASER OR A BROKER-SELLER OF THE STOCK CERTIFICATES IN QUESTION.

In his brief, plaintiff argues for the first time that defendant was not a purchaser of the securities in question. This is a reversal of the apparent position taken in his complaint, in which he alleges that defendant was a purchaser:

"On September 13, 1972, the defendant Almon Covey for himself and as agent of Prince-Covey tendered to the lending institution the sums borrowed by Mr. England and in return therefore (sic) received the common stock owned by the plaintiff. Thereafter, contrary to the rights of plaintiff, the defendants *exercised ownership rights* over the common stock of Hoffman Resources, Inc., and, upon information and belief, sold the same." Complaint, ¶8; App. A, Brief of Appellant at 32 (emphasis supplied).

Defendant does not insist that he was a purchaser of the securities, but only that he was either a purchaser under the broad definition of the Utah Uniform Commercial Code or a broker who acted as agent for England in selling the stock (the latter position being the one that plaintiff apparently now espouses). For purposes of this appeal, it is not terribly important which status is assigned to defendant, since in either case there is a genuine issue of material fact as to defendant's knowledge of plaintiff's alleged ownership interest in the stock, which requires reversal of the summary judgment.

A. The Utah Uniform Commercial Code (U.C.A. §70A-1-201(33)) defines "purchaser" as "a person who takes by purchase" and defines "purchase" as follows:

" 'Purchase' includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property." §70A-1-201(32), U.C.A.

If defendant had "dominion and control" of the securities sufficient for plaintiff to state a cause of action in conversion, he had an "interest" in them within the definition of "purchase" set forth in the U.C.C. If it did not have an "interest" that was "purchased" by the \$4,000 delivered to Murray First Thrift, Mr. England alone must have owned the interest, with no "dominion or control" inhering in defendant. The claim for conversion would then fall of its own weight, or alternatively must be supported by allegations of collusion and conspiracy between

defendant Prince-Covey and England to convert the securities. No such allegations or facts to support them exist in the record.

Stated somewhat differently, the assertion of "dominion and control over . . . goods inconsistent with the owner's rights" (*Allred v. Hinkley*, 8 Utah 2d 73, 76, 328 P.2d 726 (1958)) which is necessary to state a claim in conversion must include an assertion of the converter's interest in the goods. This interest itself may be a proprietary interest, pursuant to which the converter uses the goods or sells them as his own to a third party, or a pecuniary interest by which he asserts a right to the proceeds of the sale. In either event, and particularly in this case, the concept of Prince-Covey's "interest in" the securities cannot be separated from its alleged status as a converter. Whether the interest — the dominion or control — which Prince-Covey asserted was justified in fact and in law is the entire subject of this action.

Since defendant is a purchaser of the stock, the question posed is whether it is a *bona fide* purchaser under U.C.A. §§70A-8-301 and 302 and thus immune from plaintiff's adverse claim. The answer to that issue depends on the factual determination of whether defendant acted in good faith and without notice of adverse claims — questions of material fact which were improperly resolved in the court below and which thus require reversal as elaborated in appellant's brief.

B. Plaintiff asserts in his brief that defendant must be treated as a broker that sold the stock in question. If that is the case, then U.C.A. §70A-8-318 applies:

"An agent or bailee who in good faith (including observance of reasonable commercial standards if he is in the business of buying, selling, or otherwise dealing with securities) has received securities and sold, pledged, or delivered them according to the instructions of his principal is not liable for conversion or for participation in breach of fiduciary duty although the principal had no right to dispose of them."

Under this section, the main question is whether the defendant, acting as selling agent for England, acted "in good faith" in selling the stock. If he did, then he cannot be liable as a converter.

According to the U.C.C., "good faith" means "honesty *in fact* in the conduct or transaction concerned." U.C.A. §70A-1-201(19) (emphasis added). Whether defendant exercised good faith when the instruments in question gave no indication on their face of any adverse interest is certainly a question of fact that could not be resolved from the record before the court below. See *Hartford Accident & Indemn. Co. v. Walston & Co.*, 21 N.Y.2d 219, 287 N.Y.S.2d 58, 234 N.E.2d 230 (1967); *State Bank of Binghampton v. Bache*, 162 Misc. 178, 293 N.Y.S. 667 (1937). It should be noted that §70A-8-318 requires only good faith, whereas §70A-8-302 (defining bona fide purchaser) requires both good faith and lack of notice of adverse claims. By negative inference, then, under §70A-8-318, *notice* of an adverse claim, even as defined in §70A-8-304(2), may not defeat the protection afforded securities brokers who act in good faith. But in any case, the question of good faith presents a material

factual issue, and the trial court erred in granting a summary judgment without resolving that issue.

POINT III

TED ENGLAND'S KNOWLEDGE OF PLAINTIFF'S CLAIM OF OWNERSHIP CANNOT BE IMPUTED TO DEFENDANT.

A principal issue in this case is whether defendant had knowledge of plaintiff's alleged ownership interest in the stock, and whether Ted England's knowledge should be imputed to defendant as a matter of law. If defendant had no knowledge of plaintiff's ownership claim, then it qualifies either as a bona fide purchaser under U.C.A. §70A-8-301, or as a broker acting in good faith under U.C.A. §70A-8-318, thus precluding liability for conversion of the stock.

In the Brief of Appellant, defendant argued at length that Ted England's knowledge cannot be imputed to Prince-Covey because their positions were adverse in this transaction [Brief of Appellant at 8-18]. This argument is based on rules of agency law that have been announced in Utah and embodied in §279, Restatement (Second) of Agency. In response to this, plaintiff argues in effect that because Mr. England and Mr. Covey were in each other's company when the stock was obtained from Murray First Thrift and sold, there existed a "joint" and "mutual" interest between them that encompasses the entire relationship and transaction (Brief of Appellee at 8-9). Because of plaintiff's unusual notions of what constitutes adverse positions, a brief recapitulation of the relationship between Prince-Covey and England seems appropriate.

First, the two were in the position of creditor-debtor. These positions must be considered adverse; if they are not, a creditor's suit against his debtor would be dismissed for failure to state an adverse claim. It was this adverse creditor-debtor relationship which induced England to pay defendant the proceeds derived from the sale of the stock. The phrase "adverse party" as used in §279 of the Restatement (Second) of Agency must mean that a claim or demand exists or may arise between the principal and agent that is cognizable in an adversary legal action. Such a claim is present in all the cases cited by defendant in its brief, and is obviously present in this case.

Plaintiff implies that Prince-Covey and England had a "joint" or "mutual" interest in having the debt extinguished. This is analogous to arguing that plaintiff and defendant in this action have a joint and mutual interest in having the claim resolved by a final order of the court. Such mutual interests are irrelevant to whether the adverse claim between them defines them as adverse parties.

Secondly, it is uncontroverted that England never informed Mr. Covey of plaintiff's purported ownership interest in the stock. It was necessary that England conceal whatever knowledge he had of such ownership interests to serve his own personal interests, i.e., to extinguish his debt and to preserve the stock from defendant's execution on it.¹ In the course of such concealment, he estab-

¹ It should be remembered that plaintiff owes defendant Prince-Covey \$34,696.16 from a prior lawsuit based upon plaintiff's failure to pay for securities he ordered purchased for his account. Had defendant known of plaintiff's claimed ownership it would have levied upon the stock to satisfy this prior judgment.

lished yet another "adverse position" with defendant; for defendant potentially has a claim against England based on the numerous breaches of duty inherent in his deceit.

Plaintiff in his brief asserts that England and defendant "divided" the proceeds of the sale of the stock (Brief of Appellee at 9). This is a distortion of the facts. Defendant and England did not "divide the proceeds"; rather, the proceeds were used to reduce England's indebtedness to defendant. Defendant clearly gave value for the portion of the proceeds of the stock which it received.

On the issue of imputation of knowledge, plaintiff-appellee sets out several sections from the Restatement (Second) of Agency, none of which are applicable in this case. The sections cited by plaintiff do not apply where, as in this case, the agent (England) and the principal (defendant) were acting as adverse parties, and where the agent was *not acting as* an agent in any manner in the transaction in question.

Section 271 of Restatement (Second) of Agency, on which plaintiff relies to establish defendant's "notice" of his claim, defines situations where a principal or a third party will be bound by notification to or from the principal's agent when the agent is acting in his own interest, but is apparently acting for his principal. The comments and illustrations to this section make clear that the rule of this section applies only when notification is to the agent *as* an agent. Consider, for example, Example 4 to Comment (a):

"Before tearing down a building adjoining T's building, T sends to P's apparently authorized

agent, A, a letter telling what he plans to do. A, hoping harm will come to P, does nothing. T has satisfied any requirement of notifying adjoining owners."

Furthermore, the instant case does not involve "notification" in any sense. Nothing is alleged either in the complaint or anywhere else that would reasonably imply that plaintiff gave some notification to England which would bind the principal defendant. Rather, plaintiff is attempting to impute England's *knowledge* to Prince-Covey in circumstances where their interests were adverse, *c.f.*, Comment (d), Restatement (Second) of Agency, §282.

Section 274, Restatement (Second) of Agency, by its terms, applies only where the agent, in his capacity as acting agent, acquires property *for* the principal. The comments to this section, and the case law which it embodies, make clear that it is primarily a rule of restitution. Comment (b) provides in part:

"The rule stated in this Section is not primarily a rule of agency, but of restitution. The *prima facie* liability of the principal exists because of unjust enrichment. If the property is obtained by conduct for which the principal is not responsible, he is protected by a change of position. On the other hand, if the agent is guilty of tortious conduct for which the principal was responsible, a change of position is no defense."

In support of his position, plaintiff quotes Comment (c) to §274 incompletely, omitting the last half of the sentence which gives meaning to the statement:

"Where an agent, having no power to bind the principal by the transaction, acquires property from a third person by fraud and, without the principal's knowledge, transfers it to the principal to make up for past or future embezzlements, the principal takes it subject to a constructive trust, *since he is enriched to the extent of the value of the property thus transferred and has given nothing in exchange.*" (emphasis supplied).

In this case, there is no allegation of embezzlement and defendant gave value in exchange for the stock or its proceeds by extinguishing England's debt.

Consider also Comment (d);

"The rule stated in this Section does not apply where the agent obtains property on his own account and subsequently, as a vendor, transfers it to his principal. In such cases, the agent is not acting as agent in the transaction, and, therefore, the principal may be a bona fide purchaser; if he is, he is not required to surrender the subject matter. *See §279*" (emphasis supplied).

In summary, the rule stated in §274 of the Restatement (Second) of Agency covers situations and defines responsibilities where an agent has improperly obtained property from a third person and used it *for* his principal's benefit without the principal's knowledge, and the principal has given nothing of value, nor changed his position in reliance upon the benefit conferred. These are simply not the circumstances of this case, for which the comments to §274 direct attention to §279.

Plaintiff also asserts that the rule of Restatement (Second) of Agency, §282, is applicable to this case, emphasizing subsection (2)(c). The comment to this subsection states:

"(h). . . . If the principal receives a benefit as the result of the conduct of an agent, he cannot keep the benefit and escape responsibility for the means by which it has been acquired, *unless he takes as a bona fide purchaser*, (see Comment (j)) or unless there is otherwise a change in his position (see Comment (k))" (emphasis supplied).

Comment (j) is on all fours with the instant case and states explicitly that §279 governs bona fide purchaser issues.

"(j). *Principal as Bona Fide Purchaser*. If the principal obtains title to property because of the independent fraud of his agent, he may still be a bona fide purchaser if, without knowledge of the fraud, he pays value to the agent or to another. Thus, as stated in §279, if he deals with the agent as an adverse party and receives as a purchaser property which the agent had obtained by fraud, he may keep it. So, if an agent having embezzled from his principal has replaced the embezzled funds with others which he has stolen, the principal is protected if, with or without knowledge of the embezzlement, he settles accounts with the agent."

Comment (m) further explains the relationship between §§279 and 282.

"The rule stated in this Section is to be contrasted with the rule stated in §279, which states the rule which is applicable when the agent is dealing with

the principal. In that situation, the agent is not only acting adversely to the principal but is known by the parties to be acting as an adversary party; the agent's knowledge with reference to the transaction no more affects the principal than the knowledge of any third person, whereas under the circumstances dealt with in this Section, the agent is acting or purporting to act for the principal, and the latter is bound by his knowledge under any of the circumstances stated in subsection (2).

Plaintiff's reliance on §282 is unfounded. The issue before the trial court and this Court was and is whether defendant's status as a bona fide purchaser can be defeated by the imputation of Ted England's knowledge to it. The trial court's imputation of England's knowledge ignores the rule summarized in §279 of Restatement (Second) of Agency from decisions of this Court and most other jurisdictions. The very sections of the Restatement on which plaintiff relies point to the rule of §279 as governing this case.

Plaintiff also cites §§235 and 236 of the Restatement (Second) of Agency. These sections deal with whether an agent is acting within the scope of employment. Section 235 provides:

"An act of a servant is not within the scope of employment if it is done with no intention to perform it as a part of or incident to a service on account of which he is employed."

It is puzzling that plaintiff would cite this action since it directly supports defendant's position that England was not acting within the scope of his employment in the

transaction that is the subject matter of this case. By no reasonable stretch of the imagination can it be argued that England's transfer to defendant of the proceeds from the sale of the stock in question was within the scope of his employment as an account broker employed by defendant.

Section 236 states the obvious principle that:

“Conduct may be within the scope of employment, although done in part to serve the purposes of the servant, or of a third person.”

This is certainly not to say that conduct is always within the scope of employment when done to serve the purposes of the servant or of a third person, as plaintiff would apparently have the Court believe. Clearly, conduct may also be outside the scope of employment, although done to serve the agent's interest, and that is often the case.

Plaintiff's reliance on the cases cited in his brief is misplaced. These cases involve either an agent acting *as* an agent or enunciate general principles of conversion that do not apply to the conversion of negotiable securities. See Restatement (Second) of Torts, §233(4).

In *Barsh v. Mullins*, 338 P.2d 845 (Okla. 1959), by plaintiff's own description of the case, the agent was acting as agent “in the performance of a duty that [the principal] had given him the authority to perform.” Contrary to plaintiff's assertion, it was the dissent in that case, not the majority, that relied upon §282 of the Restatement (Second) of Agency.

Plaintiff cites two cases, *Moses v. Archie McFarland & Son*, 119 Utah 602, 230 P.2d 571 (1951), and *Thirteenth and Washington Street Corp. v. Nelson*, 123 Utah 70, 254 P.2d 847 (1953), in support of his argument that defendant ratified the acts of England's conversion by accepting the benefits of the sale of stock. Each of these cases involves situations where the agent was acting as agent, in contrast to the case at hand. Furthermore, the principles of ratification enunciated in them do not apply to circumstances involving a bona fide purchaser or broker-seller of negotiable securities.

In *Malia v. Giles*, 100 Utah 562, 114 P.2d 208 (1941), the statute in force at that time required that the owner endorse stock for transfer or that written authority of the agent must accompany a certificate. In that case, neither of those elements were present, and the court held that such absence "is a warning to others to deal at arms length" 114 P.2d at 211. The case is clearly inapplicable because under present statutes there are no such requirements for the transfer of stock in bearer form.

In *Latsis v. Nick Floor*, 99 Utah 214, 104 P.2d 619 (1940), it was held that where an agent entered into a lease agreement with the third party and the third party made valuable and permanent improvements on the property, the principal may not accept the benefits of that performance and deny the liabilities, provided that the principal has knowledge of such benefits. Once again this case deals with an agent dealing with a third party as an agent of the principal and has no application to this case, where England was not acting as defendant's agent. More-

over the rules regarding ratification of contracts are inapplicable to bona fide purchasers of negotiable securities, which must be governed by Article 8 of the Utah Uniform Commercial Code.

As pointed out in defendant-appellant's brief, *Allred v. Hinkley*, *supra*, correctly states the general law of conversion. However, as explained in defendant's brief (Brief of Appellant at 8-18), those rules do not apply with respect to a bona fide purchaser of negotiable securities. Where negotiable securities are involved, the Utah Uniform Commercial Code controls, and a bona fide purchaser or a broker who sells in good faith is protected against an adverse claim sounding in conversion. See U.C.A. §§70A-9-301(2) and 70A-8-318.

POINT IV

THE DEPOSITION OF PLAINTIFF STRAND DOES NOT DETERMINE THE OWNERSHIP AND DATE-OF-NOTICE ISSUES.

The deposition of plaintiff Strand was not a part of the record before this Court when appellant's brief was prepared. Defendant does concede, however, that, in view of absence of affidavits or other evidence controverting plaintiff's depositional testimony, the trial court at the hearing on the motion for summary judgment, if it considered the deposition at all, was left with the choice of accepting or doubting the statements therein only on the basis of the inherent credibility of the deposition itself. The portions of it quoted in the Brief of Appellee are average examples of the directness of plaintiff's answers

and the general probative value of the information elicited from him. The problems with Strand's status as pledgor of the stock, and the consequent issue of his right to immediate possession discussed in the Brief of Appellant at 21-22, are never clearly explained. On the one hand, Mr. Strand testifies that England was constantly indebted to him; on the other, that stock with a value of \$12,000 to \$15,000 was pledged by him to England in consideration of a debt of \$1,500 that he owed England. (Deposition of Jerry Strand at 4-6 and 11-13.) Nevertheless, the ownership and conversion-date issues set out in the Brief of Appellant at 18-25 were not strongly urged at the hearing for summary judgment, and it would be unreasonable to expect a trial court to give a deposition the attention that would reveal the infirmities that defendant maintains inhere in Strand's testimony. The deposition is now in the record. Defendant respectfully submits that it deserves the consideration of this appellate Court to determine its value for establishing the facts which plaintiff claims it proves.²

CONCLUSION

For the reasons stated in this reply brief and the Brief of Appellant, plaintiff's contentions that defendant was not a bona fide purchaser are without foundation and

² Internal contradictions and infirmities in testimony may of course always be considered by the trier of fact. This Court has stated that it will review the record on appeal from summary judgment in the light most favorable to the party against whom judgment is entered. *Gammon v. Federated Milk Producers Ass'n, Inc.*, 11 Utah 2d 421, 360 P.2d 1018 (1961).

genuine issues of material fact remained in dispute when the trial court entered its summary judgment. The judgment should accordingly be reversed.

Respectfully submitted,

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