1978

Charles R. Kennedy and Rebecca Kennedy v. The Bank of Ephraim et al : Brief of Respondents

Utah Supreme Court

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IN THE SUPREME COURT OF

THE STATE OF UTAH

CHARLES R. KENNEDY and REBECCA KENNEDY, his wife :

Plaintiffs and Appellants, :

vs. :

THE BANK OF EPHRAIM, a Utah corporation, GEORGE BARTON and BERTHA BARTON, his wife, VIRGIL P. JACOBSEN, CURTIS J. ARMSTRONG, L. CANNON ANDERSON and RUEL E. CHRISTENSEN, :

Defendants and Respondents. :

Bank

RESPONDENTS' BRIEF

Civil No. 15694

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AUTHORITIES CITED

STATEMENT OF THE CASE

This case was brought by Plaintiffs, after judgment had been obtained against them on a note held by defendant Bank of Ephraim, to force defendant Bank to apply security held by them against the debt before proceeding against the Plaintiffs on the judgment obtained, and for damages against all defendants arising out of various charges of interference with business relations and harrassment. Defendants Barton counterclaimed on various grounds, including obligations due from the Plaintiffs.

DISPOSITION IN THE LOWER COURT

After trial before the Honorable Peter F. Leary, Judge in the Third Judicial District, sitting with a jury, seven of Plaintiffs' causes of action were dismissed by the Court and the remaining three causes of action were submitted to the jury, resulting in verdicts for Defendants and against Plaintiffs. The counterclaim of defendant Bertha Barton was dismissed by the court, as was one counterclaim of defendant George Barton; the remaining five counterclaims of defendant George Barton were submitted to the jury, resulting in verdicts for defendant Barton on three causes of action and against defendant Barton on two causes of action.

RELIEF SOUGHT ON APPEAL

Respondents respectfully request the Court to sustain the judgment given by the court below.

STATEMENT OF FACTS

Respondents essentially agree with the statement of facts set forth in Appellants' brief, with the following exceptions:

1. Appellants refer (p. 3 of Appellants' brief) to various "considerations" allegedly given by Kennedy to Barton to induce Barton to endorse Kennedy's note with the Bank of Ephraim. Plaintiffs disagree that any such considerations were received by Barton. In particular, a check for $499.98 given by Kennedy to Barton at the time of the loan from the Bank of Ephraim is alleged by Kennedy to have been a "commission" or "finder's fee". The record shows conflicting evidence as to the nature of this check; Barton's testimony (R. 801-802) was to the effect that this was a payment on an existing debt, and not in any sense a "finder's fee".

2. Appellants' reference to the prior judgment obtained against them in Sanpete County, Utah on July 19, 1973 (p. 4 of Appellants' brief) does not fully explain the circum-

stances surrounding that judgment. These circumstances are explained in the affidavit of Judge Maurice Harding, who tried the case on June 29, 1973 (copy of affidavit is contained on R. 311-312). In that affidavit, Judge Harding explains that Charles Kennedy, who was a defendant in that action, on the day before the trial requested another continuance on the basis of defendant Rebecca Kennedy's medical condition. The court instructed Kennedy at that time that a continuance would only be granted if defendant Rebecca Kennedy obtained a medical certificate stating that her medical condition would not allow her to appear in court. Defendants Kennedy failed to provide the certificate and failed to appear in court on the following day - the day of the trial - although they were represented there by counsel. After evidence was heard by the court, defendants' counterclaim was dismissed by the court and judgment was entered in favor of plaintiff Bank of Ephraim.

ARGUMENT

THE JUDGMENTS AGAINST PLAINTIFFS WHICH REQUIRE THEM TO PAY THEIR DEBTS OWING TO THE BANK OF EPHRAIM SHOULD BE UPHELD.

Plaintiffs advance numerous theories throughout their brief as to why this Court should force the Bank to apply the Certificate of Deposit belonging to Barton against the amount owing by the Kennedys on their loan from the Bank. None of these theories withstand thoughtful examination. Correct application of the law to the facts of the case --- as correctly stated --- result in the conclusion that the Kennedys are liable for this debt and must pay the judgment already obtained against them.

Plaintiffs' arguments are a confused mixture of misinterpreted facts, irrelevant authority, unsupported conclusions, and issues that cannot be raised on appeal. They seem to boil down to the following:

1. Barton is obligated to pay this note, through the Certificate of Deposit or otherwise, before the Kennedys become obligated.

2. There was an oral agreement that the Certificate of Deposit should be the first source of funds on default.

3. Barton and the Bank conspired, and/or Barton used undue influence in his position as Bank Director, to see that Barton would never have to pay the note.

4. The equities of the case require Barton, rather than the Kennedys, to pay the note.

5. Res judicata does not apply.

These arguments will be addressed, and refuted, separately in the remainder of this brief.

A. The Kennedys, as makers and principal debtors on the note, are primarily liable for this debt, while Barton, as a guarantor or accommodation endorser, is only secondarily liable.

The last renewal note on the loan to the Kennedys (copy attached to Exhibit 58-d), upon which a judgment was had against the Kennedys on July 19, 1973, was signed by both of the Kennedys individually and was endorsed on the back by Barton as follows:

> For value received, we hereby guarantee payment of the within note, waiving demand of payment, protest and notice of non-payment.
>
> /s/ Charles R. Kennedy
> /s/ Rebecca Z. Kennedy
> /s/ George Barton

The signature of Barton on the back of the note, under words of guarantee, evidences his status as a guarantor of the note, rather than as a comaker with the Kennedys. Language almost identical to the above endorsement signed by Barton

was held by the Supreme Court of North Dakota to create a guarantor relationship. In Northern State Bank v. Bellamy, 19 N.D. 509, 125 N.W. 888 (1910), the Court held that one who endorses a promissory note, "For value received, I hereby guarantee the payment of the within note and hereby waive presentment, demand, protest, and notice of protest," and receives no consideration or benefit from the loan made to the principal debtor upon the execution of the note, is a guarantor of payment.

The contract of guaranty creates a secondary liability. Ibid.; Charlestown Five Cents Sav. Bank v. Wolf, 309 Mass. 547, 36 N.E.2d 390 (1941). In Charlestown the Supreme Judicial Court of Massachusetts said:

> "The word 'guarantee' appearing in the memorandum [on the face of the note] suggests, not a primary, but a collateral undertaking. The ordinary meaning of the word is that someone else is primarily liable for a debt and that the guarantor will pay it if the primary debtor does not." 36 N.E. 2d 390 at 391.

Under the Uniform Commercial Code, as enacted in Utah, Barton is an accommodation party and has a right of recourse against the Kennedys, the accommodated parties:

Utah Code Annotated, 1953, as amended, §70A-3-415:

> (1) An accommodation party is one who signs the instrument in any capacity for the purpose of lending his name to another party to it.
>
> **********
>
> (5) An accommodation party is not liable to the party accommodated, and if he pays the instrument has a right of recourse on the instrument against such party.

When he signed this note as guarantor, Barton lent his name to the Kennedys to enable them to get the loan. He did it at their request and he received none of the proceeds of the loan --- the Kennedys used the proceeds to purchase land in Montana which they still own. Plaintiffs argue that Barton received consideration for lending his name (Appellants' brief, pp. 3 & 6), but these were disputed facts in the trial (R. 685-689, 740-741, 793-794, 801-802, 807-808). Barton's testimony was that he accepted the check for $499.98 given to him by Kennedy at the time of the original loan from the Bank as payment on an existing debt owed him by Kennedy, and not as a "commission" for lending his name on the loan (R. 801-802). However, even if Plaintiffs had established that Barton received some consideration for the lending of his name, that would not affect his status as an accommodation party. "Paper may be accommodation paper,

although 'induced' by a nominal, or even actual, consideration;" the test is whether the accommodation party received value for lending his name, rather than on the instrument. 11 C.J.S., Bills & Notes §742.

Under §70A-3-415, U.C.A., 1953, and the law governing the guaranty relationship, Barton's obligation on the note is secondary to that of the Kennedys. The Kennedys, as principal debtors and accommodated parties, are primarily liable for this note, and their assets should be exhausted before recourse is had to Barton, either through his certificate of deposit or his other personal assets.

B. Since Plaintiffs introduced no evidence at trial regarding an alleged oral agreement concerning the use of the Certificate of Deposit as first source of funds on default, that issue cannot be raised on appeal.

A large part of Appellants' brief (pp. 5-10 of the brief) presupposes the existence of an oral agreement that the Certificate of Deposit was to be the first source of funds on default and cites authority which is supposedly to the effect that such an oral agreement can be an enforceable modification of the loan contract between the Bank and the Kennedys. This seems to be the major contention of the Plaintiffs' appeal with respect to the Bank, and it is an

agrument that must fail because the Plaintiffs did not address the issue at the trial and did not produce any evidence whatsoever that would tend to show the existence of such an oral agreement.

The issue of the existence of the alleged oral agreement was not raised by the Plaintiffs in their Amended Complaint, in any of the depositions, or in any of their answers to interrogatories. It was raised for the first time in the affidavit of Charles Kennedy dated March 14, 1977, which was submitted just before the hearing on the Bank's last Motion for Summary Judgment before trial. Because of the existence of this issue, the Motion for Summary Judgment was denied and the Bank was compelled to go through a lengthy trial. At the time of the hearing on the Motion for Summary Judgment, counsel for the Bank, believing that the last-minute allegation concerning an oral agreement was made in bad faith and for the purpose of delay, went on record to this effect and to the effect that if bad faith could be proved he would ask for sanctions.

Plaintiffs' conduct at trial evidences the total lack of substance in this allegation. At no time while questioning witnesses did counsel for Plaintiffs even address the issue. That such an oral agreement existed was disputed by

Defendants and unsupported by the circumstances surrounding the taking of the loan, as revealed by the evidence actually given at trial. The record shows that Barton was questioned directly by counsel for Defendants as to whether such an oral agreement existed, and he flatly denied it. (R. 795). He was not cross-examined on this point, nor was Kennedy or any other of Plaintiffs' witnesses directly questioned on this issue. The record also shows that the Certificate of Deposit was not put up by Barton until 60-90 days after the loan was made to the Kennedys (R. 723-724, 769, 785-787, 795, 897-900), that it was put up at the request of the Bank president and in order to satisfy the bank examiners, when the Kennedys failed to secure the loan (R. 897-900, 909), and that Kennedy assured Barton many times that he would never have to repay the loan (R. 737, 741-742, 900). All of the evidence on the record supports the opposite conclusion from that urged by Plaintiffs --- that no agreement ever existed to the effect that the Certificate of Deposit would be the first source of funds on default.

Since Plaintiffs raised the issue of an alleged oral agreement, and since they would gain if it were shown to exist, they had the burden of proof of establishing its

existence. This burden of proof was not met; in fact, Plaintiffs made no offers of proof whatsoever at trial. They never even addressed the issue, much less brought forth any evidence. Plaintiffs' proposed instruction No. 6 (R. 498), dealing with such an oral agreement, was properly refused by the court below. "It is error to instruct the jury upon issues raised by the pleadings . . . unless there is evidence to support them." Bethel v. Thornbrough, 311 F.2d 201, 203 (CA 10, Colo., 1962); 75 Am. Jr. 2d, Trial §651.

Since Plaintiffs did not establish the existence of the alleged oral agreement at trial, they cannot argue its existence to this Court now. As a result, the arguments and authorities contained in their brief which bear on the effect such an agreement would have on the parties' obligations are irrelevant and should be disregarded by this Court.

C. The Bank, at their election, may pursue their remedies against the Plaintiffs and not against the Guarantor Barton.

At several points in their brief Plaintiffs hint at some kind of conspiracy between the Bank and Barton, or the use of undue influence on Barton's part, to see that Barton would never have to pay on the note. On page 9 of Plaintiff's brief they state that the next fundamental answer [as to

why Barton should be forced to pay the debt] arises from the unique relationship obviously inherent where Barton is both a Director and a substantial shareholder of the Bank and is in a position to influence the Bank management to pursue only Kennedy rather than pursuing him". After thus specu-ating on the possibility that a bank director could use undue influence in such a situation, Plaintiffs leap to the concluded fact: "Such improper influence should not be countenanced by this Court". The second proposition does not follow from the first, and there is no evidence to support it. On page 5, Plaintiffs refer to a "knowing and intentional plan implemented by the Bank and Barton to relieve Barton of any responsibility whatever," and through-out the brief there are other references to such a plan. Plaintiffs presented no evidence at the trial, however, to support their allegations of conspiracy and undue influence. These are serious allegations, and cannot be inferred from thin air. In the absence of any evidence supporting these accusations they must be disregarded.

Plaintiffs seem to think that it is somehow wrong of the Bank to try to get the principal debtor on a loan to pay back the money he borrowed. On page 10 of their brief they say that "For the Bank to proceed without enforcing the just

obligation against Barton or the collateral is both immoral and unlawful". It is neither immoral nor unlawful. It is entirely equitable and is firmly supported by the law.

Upon default, the holder of a note may proceed against either the maker or the guarantor, or both, at his option. 12 Am. Jur. 2d, Bills and Notes §1090. Similarly, the holder of a note isn't bound to sue an endorser for the protection of the maker. Ibid. Since the liabilities of a primary obligor and a secondary obligor are several, and not joint, if the holder gets a judgment against the maker that does not release parties who are secondarily liable on the note. Ibid., §959. However, even if the holder voluntarily releases a party secondarily liable, the principle debtor must still pay the debt. In First & Citizens Nat. Bank of Elizabeth City v. Hinton, 216 N.C. 159, 4 S.E.2d 332, 333 (1939), where the holder of notes discharged the accommodation endorser, and the maker then claimed that his liability should be reduced to the extent of the notes signed by the accommodation endorser, the Supreme Court of North Carolina said:

> "But while the release of the maker from his obligation releases the surety or endorser, since it discharges the debt, and while partial release has the same effect

> pro tanto, the release of the surety or accommodation endorser does not relieve the principal debtor. There is no obligation between the maker and the accommodation endorser that the latter shall pay the debt, and there is no equity in favor of the maker to require that the endorser shall do so."

Additionally, there is no requirement that the holder of a note attempt to collect against the collateral before proceeding against the endorsers or maker. Hurt v Citizens Trust Company, 128 Ga. App. 224, 196 S.E.2d 349 (1973). This rule is especially appropriate where collateral has been supplied by the accommodating party rather than by the maker. A holder's authority to sue upon the note without first exhausting his security has been codified in Utah through the adoption of the Uniform Commercial Code. Utah Code Annotated, 1953, as amended, §70A-9-501 provides in part:

> When a debtor is in default under a security agreement, a secured party...may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure.

Prior to the enactment of the Uniform Commercial Code in 1965, §78-37-1 of the judicial code required a creditor to first exhaust his security before he could get a deficiency judgment, whether the mortgage was on realty or on chattels. This statute was amended in 1965 to be consistent with the provisions of the Uniform Commercial Code, and it now applies

only to mortgages on real property. This modification was explained in Justice Ellett's concurring opinion in Olsen v. Chappell, 20 U.2d 115, 433 P.2d, 1011, at 1012 (1967):

> "The cited statute, (78-37-1), U.C.A. 1953) prior to 1965 did provide that mortgages on realty and chattels must be foreclosed before deficiency could be taken against the mortgagor; and had this statute been the law at the time this suit was brought, we can be sure it would have been raised and argued to us here. However, the statute cited was amended by Chapter 172, Laws of Utah 1965, so as to delete the reference to personal property. Now, the mortgagee need not foreclose a chattel mortgage before suing upon the note..."

These authorities clearly establish that the Bank has a right to proceed against the Kennedys, who are the principal debtors on this note, without being legally required to proceed at the same time against a person who is only secondarily liable.

D. It is equitable that the Plaintiffs should be required to pay this debt.

In discussing the equities of this case (Appellants' brief, pp. 9-10), Plaintiffs claim that Barton should be forced to repay this loan, rather than the Kennedys, because "he agreed to do so, and the Bank accepted the obligation in reliance on the expectation that Barton would pay or that the Certificate would be used to pay". These statements are simply false. Barton did not unconditionally agree to pay

the loan --- he agreed to guarantee it; that is, to pay it only in the event that the Kennedys defaulted on the loan and had absolutely no assets to pay it. And the Bank did not loan the Kennedys the money in the expectation that Barton would pay it back; they fully expected that the Kennedys, who received the money from the loan, would pay it back. That is the usual creditor-debtor understanding. Barton's position was understood from the first to be one of secondary liability only; he was to provide insurance for the loan in the event of absolute default by the Kennedys.

Because the Kennedys were the parties who benefited from the loan, it would only be equitable to require them to pay it back. Barton never received any of the proceeds from the original loan or from any of the renewals had by the Kennedys (R. 721, 305-306). The proceeds from the original loan were used by the Kennedys to purchase land in Montana (R. 721, 733) which they still own, and the proceeds from the various renewals were used in Mr. Kennedy's business ventures.

Over the years, Barton repeatedly went out of his way to help his friend Kennedy with the Bank loans. He originally recommended the Kennedys for a loan with the Bank of Ephraim at their request (R. 894), and he signed that note

as guarantor, again at Kennedy's request (R. 895-896). When the Kennedys failed to secure their loan as Barton had expected they would, and the Bank requested Barton to attach his own Certificate of Deposit to the note in order to satisfy the bank examiners, he did so (R. 785-787). Over the years he repeatedly helped the Kennedys to get renewals and extensions on their loans (R. 735-739). And in 1972, in order to enable the Kennedys to get still another extension, Barton paid $4,095 worth of interest on the loan (R. 726, 737-738, 914-918), an amount which the Kennedys did not repay, and which was awarded Barton in the court below. At about the same time that Barton was paying the interest on the Kennedys' loan, and unknown to him, they were borrowing money on their Montana land, which was not applied to the Bank of Ephraim loan, or used to repay Barton (R. 731-732, 799).

Under the facts of this case it would not be equitable to require Barton to repay the Kennedys' loan when the Kennedys have sufficient assets to meet this obligation. It is their debt and it is just that they should pay it.

E. Res judicata applies to bar relitigation of Plaintiffs' liability to the Bank.

Another large part of Appellants' brief (pp. 16-21) involves an attempt to explain why the doctrine of res judicata should not apply in this case with regard to their claims against the Bank, if that doctrine was used by the trial court as a reason for dismissing various causes of action of the Plaintiffs. If this was a reason used by the court below, consideration of the two cases --- this case and the action by the Bank against the Kennedys which resulted in a judgment on July 19, 1973 --- will show that res judicata was applicable.

The prior judgment was conclusive as to Plaintiffs' liability on the note owing to the Bank. In this action Plaintiffs are now attempting to assert, as causes of action, a number of reasons why they should not be compelled to pay that judgment. All of these issues, as far as they concern the Bank, either were or should have been raised as defenses or counterclaims by the Kennedys in the prior action. Whether or not they were raised there, if they are relevant to the issue of Plaintiffs' liability, they are now barred by res judicata from asserting them. Under the doctrine of res judicata, the conclusiveness of the prior judgment extends not only to matters actually determined but also to other matters which could properly have been raised and

determined therein. Rhodes v. Jones, 351 F.2d 884 (CA 8 Minn., 1965). In Todaro v. Gardner, 3 U.2d 404, 285 P.2d 839 (1955), this Court said that:

> "Generally, a judgment in favor of the plaintiff is an adjudication, not merely as to the existence of the plaintiff's cause of action, but as to the non-existence of any defenses thereto." 285 P.2d 839 at 841.

And in the same case, the Court held:

> "A counterclaim not presented to the court on a matter involving the same transaction is forever barred." 285 P.2d 839 at 842.

This latter holding was said to follow from the "compulsory counterclaim rule," codified as Rule 13(a) Utah Rules of Civil Procedure, Utah Code Annotated, 1953, which provides in part:

> "A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction."

Under these authorities, Plaintiffs cannot now raise issues which could properly have been included in the prior action.

A related claim of Plaintiffs' is that this is not the same cause of action. They point out that the prior action was for a judgment on a note, then describe this case as

involving tort claims plus "additional claims relating to the certificate" (p. 19 of Appellants' brief). It is not the labels used which determine whether the cause of action is the same. In Rhodes v. Jones, supra, it was said:

> "A 'cause of action' is a situation or state of facts which entitles a party to sustain an action and gives him the right to seek judicial interference in his behalf." 351 F.2d 884 at 886.

Whatever names the Plaintiffs use, they are attempting to deny their liability to the Bank, and that question has already been settled.

Plaintiffs assert that res judicata cannot apply because their counterclaim was not heard on the merits in the prior action. Their counterclaim was dismissed at trial because they presented no evidence in support of their allegations. What is important to determining whether a judgment was on the merits is whether the parties had an opportunity to be heard. In 50 C.J.S., Judgments §627 it is said:

> "It is not necessary, however, that there should have been a trial. If the judgment is general, and not based on any technical defect or objection, and the parties had a full legal opportunity to be heard on their respective claims and contentions, it is on the merits, although there was no actual hearing or argument on the facts of the case."

Since Plaintiffs had an opportunity to be heard, the judgment was on the merits, whether or not the Plaintiffs chose to substantiate their claims.

The only necessary parties to the question of liability on the loan made by the Bank to the Kennedys, were the Bank and the Kennedys. As far as the issue of Plaintiffs' liability is concerned, it must be considered determined by the July 19, 1973 judgment. The Plaintiffs cannot now readjudicate this same issue under a claim that the parties are different, since it was incumbent on them to join any parties they felt to be necessary in the prior action, after naming them in any possible counterclaims. Since Plaintiffs failed to do so, they should not now be allowed to relitigate the same issue.

CONCLUSION

Plaintiffs' arguments on appeal are totally without merit and the judgment for the Bank rendered below should be sustained.

Respectfully submitted,

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CERTIFICATE OF MAILING

I hereby certify that two true and correct copies of the foregoing Respondents' Brief were mailed, postage prepaid, this 17th day of August, 1978 addressed to the following:

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