2001

American States Insurance Company v. Miller, Adams and Crawford Construction Company : Brief of Respondent

Utah Supreme Court

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IN THE SUPREME COURT

OF THE STATE OF UTAH

AMERICAN STATES INSURANCE COMPANY,

Plaintiff/Appellant,

v.

MILLER, ADAMS and CRAWFORD CONSTRUCTION COMPANY, dba MAC CONSTRUCTION COMPANY, a corporation, LONNY ADAMS, GLENDA ADAMS, GERALD CRAWFORD, DIANE CRAWFORD and LENORA PHILLIPS.

Defendants/Respondents.

CASE NO. 14444

BRIEF OF RESPONDENTS

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BRIEF OF RESPONDENTS

STATEMENT OF THE NATURE OF THE CASE

Appellant, American States Insurance Company, sued respondents for breach of an agreement of indemnity.

DISPOSITION IN THE LOWER COURT

Default judgment was entered against respondents (R. 28). After the judgment, appellant disposed of collateral given by respondents without attempting to give respondents notice of the disposition (R. 62, 68). Respondents moved to compel satisfaction of the judgment (R. 43, 45) and the court granted the motions as to all respondents (R. 131, 136).

RELIEF SOUGHT ON APPEAL

Respondents seek to have the lower court's granting of the motions to compel satisfaction upheld.

STATEMENT OF THE FACTS

On May 14, 1973, appellant and respondents entered into an agreement under which respondents agreed to indemnify appellants for any amounts appellants might have to pay on a contract bond in connection with a construction project on the LDS temple in St. George, Utah (R. 29-30). When it became apparent that appellant would have to pay on the contract bond, respondent MAC Construction Company assigned to appellant an interest in two mechanics' liens filed by MAC Construction Company on another construction project, the Sunstone Condominiums, as collateral security on the obligation of respondents to indemnify appellant (R. 65-67, 61, 121). The fair market value of the liens was in excess of $13,676.08 (R.117) Appellant then made payments under the bond of $13,363.65 (R. 1-2).

Appellant filed a complaint on April 12, 1974 in the District Court of Washington County, State of Utah, to collect the amount paid under the bond pursuant to the agreement to indemnify (R. 1-11). Default judgment was entered against respondents in the amount of $14,528.38, plus interest and $1,500 attorneys' fees (R. 28). The $14,528.38

included the full $13,676.08 value of the liens as principal amount, although only $13,336.65 of payments were made by appellant on the bond (R. 2). The remainder of the $14,528.38 consisted of interest to date of judgment and costs of suit (R. 23). The agreement of indemnity was reduced to judgment (R. 29-30). The November 11, 1974 Supplemental Order mentioned by appellant in its brief at page 4 does not appear of record. The only mention of the Order on the record is in an affidavit at R. 62.

Respondents failed to respond to the trial proceedings initiated by appellant because Mr. Crawford, president of MAC Construction Company, was under the impression that the transfer of the mechanics' liens to appellant satisfied respondents' obligation to appellant under the indemnity agreement (R. 78), and because Mr. Crawford was under the mistaken impression, after talking with appellant's attorney, that MAC Construction was being sued merely as a formality to enable appellant to enforce its liens against the Sunstone project (R. 78-79). Respondent Lenora Phillips claimed not to have been properly served with process, but the trial court denied her motion to vacate judgment (R. 132).

The Sunstone Condominium project was taken over by Central Valley Development, a corporation. Central Valley Development entered into an agreement with the lienors on the Sunstone property in July of 1974, whereby the lienors

released their liens on certain condominium units in exchange for a pro-rata share of the proceeds of sale of all yet unsold units (R. 85-91). Central Valley later claimed that the mechanics' liens on the Sunstone project filed by MAC Construction Company were invalid and that the amounts claimed by MAC were grossly exaggerated (R. 62). Appellant made no attempt to contact any of the respondents, but unilaterally disposed of the mechanics' liens given by respondents as collateral security. Appellant accepted $6,666.00 from Central Valley to release the liens (R. 68). Appellant never offered the liens to any other buyer (R. 79). Appellant could have notified respondents since an agent of appellant had Mr. Crawford's mailing address, and Mr. Crawford's forwarding address had been left with the Post Office (R. 117). Nevertheless, appellants never contacted any of the respondents (R. 79, 118).

The trial court issued an order on December 30, 1975, granting respondents' motions to compel satisfaction of judgment on the grounds that appellant unilaterally compromised and discounted the liens without any effort to give notice to respondents as required by §70A-9-504, Utah Code Ann., which notice could not be waived (R. 130-131). This order was extended, on January 22, 1976, to all of the respondents (R. 136-137).

ARGUMENT

POINT I

THE DOCTRINE OF RES JUDICATA DOES NOT BAR THE MOTION TO COMPEL SATISFACTION OF JUDGMENT

Respondents' motion to compel satisfaction of judgment was not an attempt to set aside the default judgment (R. 28) entered against them by belatedly raising affirmative defenses which should have been filed prior to judgment. Rather, respondents were merely seeking to have the judgment declared paid after appellant had unilaterally and without notice to respondents, disposed of the collateral security provided by respondents. Respondents' contention was that the appellant had paid off $6,666.00 of the judgment by disposing of the collateral for that sum after the judgment had been rendered, and that the Utah Uniform Commercial Code barred the appellant from collecting the excess. This is not an untimely affirmative defense barred by the doctrine of res judicata.

Respondents' claim that the judgment has been satisfied could not possibly constitute an affirmative defense to the action underlying the judgment. Appellant disposed of the collateral after judgment had been rendered, not before.

After judgment the debt is merged into the judgment. As this court stated in Yergensen v. Ford, 16 Utah 2d 397, 402 P.2d 696, 697 (1965):

> [W]hen a valid and final judgment for the payment of money is rendered, the original claim is extinguished, and a new cause of action on the judgment is substituted for it. In such a case, the original claim loses its character and identity and is merged in the judgment (emphasis added).

See also Adams v. Davies, 107 Utah 579, 156 P.2d 207 (1945). Moreover, recovery upon a judgment can be resisted on the grounds that it has ceased to be obligatory because of payment or other discharge. Milwaukee County v. M. E. White Co., 296 U.S. 268, 275 (1935); Tingwall v. King Hill Irr. Dist., 66 Idaho 76, 155 P.2d 605 (1945); Dyal v. Dyal, 65 Ga.App. 359, 16 S.E.2d 53 (1941). Applying collateral security will reduce or eliminate the debt on the judgment. In re Alburtis Silk Ribbon Mills, 243 F. 777 (E.D. Pa. 1917); First National Bank of Custer City v. Calkins, 12 S.D. 411, 81 N.W. 732 (1900).

The only obligation that could possibly be satisfied by appellant's disposing of the collateral security after judgment was the judgment obligation. It is truistic that the payment of a judgment could not be an affirmative defense before judgment is rendered. Appellant itself has conceded that the amount realized from the disposition of the collateral, $6,666.00, should be credited on the judgment (R. 127); this, plus the denial of the deficiency of the judgment, due to appellant's failure to comply with the Utah Uniform Commercial Code, fully satisfies the obligation of respondents

under the judgment. The doctrine of res judicata simply has no application to this case.

POINT II

ARTICLE NINE OF THE UTAH UNIFORM COMMERCIAL CODE PRECLUDES APPELLANT FROM COLLECTING THE DEFICIENCY ON THE JUDGMENT

A. The Utah Uniform Commercial Code is applicable to this case.

Section 70A-9-102, Utah Code Annotated, provides:

> (1) Except as otherwise provided in Section 70A-9-103 on multiple state transactions and in Section 70A-9-104 on excluded transactions, this chapter applies so far as concerns any personal property and fixtures within the jurisdiction of this state.
>
> (a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; and also
>
> (b) to any sale of accounts, contract rights or chattel paper.
>
> (2) This chapter applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This chapter does not apply to statutory liens except as provided in Section 70A-9-310.
>
> (3) The application of this chapter to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this chapter does not apply (emphasis added).

Section 70A-9-102(2) indicates that the creation of statutory liens is not covered by the chapter on secured transactions. Mechanics' liens are statutory liens, under Title 38 of the Utah Code. Nevertheless, §70A-9-102(3) provides that

the chapter on secured transactions does apply to security interests in a secured obligation itself secured by a transaction or interest to which the chapter on secured transactions does not apply; the fact situation in this case falls under this provision. The creation of the mechanics' liens was governed not by the commercial code, but by Title 38 of the Utah Code. However, when the liens were transferred as collateral security, the Commercial Code began to govern the transactions concerning the liens. The illustration contained in Official Comment Four to Section 9-102 of the Uniform Commercial Code makes this clear:

> The owner of Blackacre borrows $10,000 from his neighbor, and secures his note by a mortgage on Blackacre. This Article is not applicable to the creation of the real estate mortgage. Nor is it applicable to a sale of the note by the mortgagee, even though the mortgage continues to secure the note. However, when the mortgagee pledges the note to secure his own obligation to X, this Article applies to the security interest thus created, which is a security interest in an instrument even though the instrument is secured by a real estate mortgage. This Article leaves to other law the question of the effect on rights under the mortgage of delivery or non-delivery of the mortgage or of recording or non-recording of an assignment of the mortgagee's interest. See Section 9-104(j).

In Riebe v. Budget Financial Corp., 264 Cal.App.2d 576, 70 Cal.Rptr. 664, 658 (1968), the court held that a security interest in a secured obligation which is in turn secured by a lien on real estate is governed by Article Nine of the Uniform Commercial Code. See also Black v. Sullivan

48 Cal.App.3d 557, 122 Cal.Rptr. 119, 124 (1975); Bank of California v. Leone, 37 Cal.App.3d 444, 112 Cal.Rptr. 394, 396 (1974). In E. Landau Industries, Inc. v. 385 McLean Corp., 5 U.C.C. Rep.Serv. 1279 (N.Y.Sup.Ct. 1969), it was held that a mortgage of a leasehold interest constitutes personal property, and that where the mortgage is given to secure payment of a second obligation, the second holder of the mortgage is subject to the provisions of Article Nine of the Uniform Commercial Code in the enforcement of his rights as against the assigning party. In the recent case of In re Western Leasing, Inc., 17 U.C.C. Rep. Serv. 1369, 1374 (U.S. Dist.Ct.D.Ore. 1975), the court stated that:

> Regardless of whether there is [an] exclusion of subject matter, there is a clear intention in [U.C.C. 9-102(3)] to carry into all exclusionary provisions the distinction between a security interest in a secured obligation and the secured obligation itself and to apply all provisions of the Commercial Code to the interests arising by reason of the sale of chattel paper (emphasis added).

See also Bank of Broadway v. Goldblatt, 103 Ill.App.2d 243, 243 N.E.2d 501 (1968); Levine v. Pascal, 94 Ill.App.2d 43, 236 N.E.2d 425 (1968) (in both cases beneficial interests in land trusts were held covered by U.C.C. Art. Nine); White & Summers, Uniform Commercial Code, 773 (1972); 4 Anderson, Uniform Commercial Code, 24 (2d ed. 1971).

B. Failure to give notice of disposal of security bars collection of any deficiency.

Under Article Nine of the Code, there is a duty on the part of the secured party to give notice to the debtor prior to disposition of the collateral security supplied by the debtor. U.C.A. §70-9-504(3) provides:

> Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notificiation of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor . . . (emphasis added).

Moreover, this duty to notify may not be waived. U.C.A. §70A-9-501(3) provides:

> To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied . . .
>
> (b) Sebsection (3) of Section 70A-9-504 and subsection (1) of Section 70A-9-505 which deal with disposition of collateral . . . .

The Code places such emphasis on the duty to notify because notice is essential to the debtor's being able to protect his interests, for example, by bidding in at the sale or by redeeming under U.C.A. §70A-9-506. In the present case notice would have allowed respondent to challenge Central Valley's claim that the liens held by appellant were invalid or grossly exaggerated.

Appellant argues that, notwithstanding the Uniform Commercial Code, the requirement of notice was waived in this case through the waiver of notice provision contained in the

agreement of indemnity. Appellant contends that this provision now has res judicata effect. This is not so. The failure of notice could not have occurred until after judgment when the appellant unilaterally disposed of the collateral security. It could not possibly have been an affirmative defense before judgment and is not now barred by the doctrine of res judicata. See, e.g., United Pentacostal Church of Louisville v. Milam, 527 P.2d 1171, 1172 (Colo.App. 1974); Meder v. CCME Corp., 7 Wash.App. 801, 502 P.2d 1252, 1254 (1972); Herl v. State Bank of Parsons, 195 Kan. 35, 403 P.2d 110, 115 (1965).

The illegality of the waiver of notice provision in the agreement of indemnity was not and could not have been decided by the default judgment. The mere reduction to judgment of an agreement containing an unlawful provision does not override the express statutory mandate and public policy of this State to protect the debtor's interests by requiring the secured party to give notice of disposition of collateral. The waiver of notice provision was void from its inception, and the default judgment did not clothe it with validity. The notice requirement was binding on appellant both before and after judgment. Appellant asserts that the Utah Rules of Civil Procedure, Rule 55(a)(2), made it exempt from the requirement in U.C.A. §70A-9-504(3) that notice must be given to the debtor when a secured party disposes of collateral. Rule 55(a)(2) only provides that procedural notice to a party in

default need no longer be given. It does not exempt secured parties from giving the required substantative notice under U.C.A. §70A-9-504(3). Rule 55 is a rule of civil procedure and does not purport to govern secured transactions, and should not be interpreted to do so. Furthermore, in this case the collateral was disposed of after suit, after judgment, and the required notice under U.C.A. §70A-9-504(3) can in no sense be interpreted as "procedural".

In the present case an attempt to give notice by appellant would not have been futile. Appellant had respondent Crawford's address, and the Post Office had his forwarding address (R. 117); but appellant never even tried to give notice.

The remedy for failure to even attempt to give notice under U.C.A. §70A-9-504(3) is that the secured party must take only the amount collected on disposition of the collateral and is barred from collecting any deficiency.

In refusing to allow the secured party to collect the deficiency after disposing of collateral without notice to the debtor as required by Section 9-504(3) of the Uniform Commercial Code, the court in Skeels v. Universal C.I.T. Credit Corp., 222 F.Supp. 696, 702 (W.D. Pa. 1963), modified on other grounds, 335 F.2d 846 (3d Cir. 1964), said:

> [T]o permit a recovery by a security holder of a loss in disposing of collateral when no notice has been given, permits a continuation of the evil which the Commercial Code sought to correct . . .

> In my view it must be held that a security holder who sells without notice may not look to the debtor for any loss (emphasis added).

The Supreme Court of Nebraska has also held that the secured party must notify the debtor of disposition of the collateral as a condition precedent to recovering a deficiency. In Bank of Gering v. Glover, 192 Neb. 575, 223 N.W.2d 56 (1974), the court stressed the mandatory language of Section 9-504(3) which provides that "reasonable notification . . . shall be sent by the secured party", and found it significant that this mandatory language occurred in the very section that affirms the right to a deficiency judgment after sale of the collateral. The court construed Section 9-504 to mean that "If the creditor wishes a deficiency judgment, he must obey the law. If he does not obey the law he cannot secure a deficiency judgment." 223 N.W.2d at 59.

In Atlas Thrift v. Horan, 27 Cal.App.3d 999, 104 Cal.Rptr. 315 (1972), the court held notice of disposition of collateral to be a condition precedent to recovery of the deficiency, pointing out that Section 9-507, which allows a cause of action in the debtor for any loss he sustains by reason of the secured party's failure to give notice, is not an exclusive remedy, and does not purport to have any bearing on the right to recover the deficiency after sale of collateral. Likewise, U.C.A. §70A-9-507(1) should not be construed as exclusive, nor as affecting the right to any deficiency.

Rather the solution to the deficiency issue should be sought in U.C.A. §70-9-504, which does purport to bear on the right to recover the deficiency, and which requires notice be given as a condition precedent, as the Nebraska court has pointed out supra. See also J. T. Jenkins Co. v. Kennedy, 45 Cal.App.3d 474, 119 Cal.Rptr. 578 (1975); Barber v. LeRoy, 40 Cal.App.3d 336, 115 Cal.Rptr. 272 (1974); In re Carter, 511 F.2d 1203 (9th Cir. 1975).

The Supreme Judicial Court of Maine agrees with the California cases that Section 9-507(1) does not create an exclusive remedy and that failure to give notice under Section 9-504(3) results in a denial of the deficiency to the secured party. In Camden National Bank v. St. Clair, 309 A.2d 329 (Me. 1973), the court explains that given the learning and experience of the drafters of the Uniform Commercial Code, if they had intended Section 9-507(1) to be the exclusive remedy they would have been scrupulously careful to state it.

In Turk v. St. Petersburg Bank & Trust Co., 281 So.2d 534 (Fla.Dist. Ct. App. 1973), the court held that "In the absence of a required notice by the secured creditor pursuant to [U.C.C. §9-504(3)], the creditor forfeits his right to any deficiency against any debtor not so notified." 281 So.2d at 536. The court looked to the common law on deficiency judgments and concluded that the right to the deficiency can only accrue after strict compliance with the relevant statutes.

For law prior to the adoption of the Code, see C.I.T. Corp. v. Haines, 212 A.2d 436 (Me. 1965) and the cases cited therein at 439, which are analogous to the present case, although they deal with the resale of repossessed property under a conditional sales contract. Cf. Calhoun v. Universal Credit Co., 106 Utah 166, 146 P.2d 284 (1944) (after granting an extension of time, seller required to give notice as condition precedent to repossession). The most recent Florida case holding notice of disposition of collateral a condition precedent to the recovery of a deficiency is Hepworth v. Orlando Bank & Trust Co., 323 So.2d 41 (Fla.Dist.Ct.App. 1975).

The cases discussed here are not exhaustive of those cases holding a creditor is denied a deficiency for failure to notify the debtor on disposition of collateral. See the cases collected in Annotation, 59 A.L.R.3d 401, 409-412 (1974), as well as the recent decisions of the Georgia and Iowa Supreme Courts: Gurwich v. Luxurest Furniture Mfg. Co., 233 Ga. 934, 214 S.E.2d 373 (1975); Federal Deposit Ins. Corp. v. Farrar, 231 N.W.2d 602 (1975).

This line of cases, which clearly represents the majority rule, is the better view. These cases recognize that for the law to effectively protect the interests of the debtor, the requirement that the secured party give notice to the debtor must have teeth. A suit for damages against the creditor is not always an effective remedy since, for various

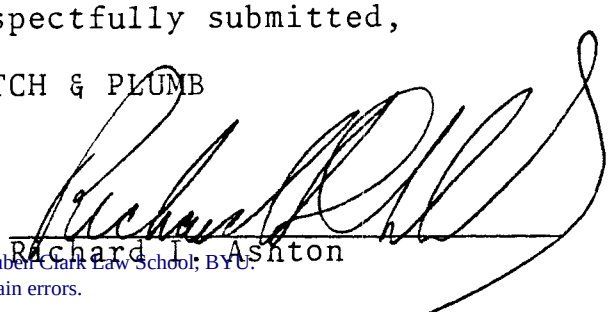
reasons, the debtor may not always be able to bring such a suit. On the other hand, denying the creditor the right to collect a deficiency will protect the debtor's interest. The notice requirement is intended to provide the debtor with a chance to see to it a fair price is obtained on the sale of the collateral, or to redeem the collateral himself. If the creditor will not follow this simple requirement of the law, he has taken upon himself any risk of loss on the resale. It would be unfair to hold the debtor liable for loss on the resale when he was not given the opportunity to protect himself.

CONCLUSION

Since satisfaction of judgment could not possibly have arisen as a defense before judgment, respondents' motion to compel satisfaction of judgment could not be barred by the doctrine of res judicata. Rather, the lower court was correct in granting the motion because with the amount realized on disposal of the liens and with the denial to appellant of any recovery of the deficiency under Utah Uniform Commercial Code Article Nine, the judgment was fully satisfied. The ruling of the trial court should be upheld.

Respectfully submitted,

HATCH & PLUMB

By 
Richard J. Ashton

CERTIFICATE OF MAILING

On this 22nd day of June, 1976, I mailed a true copy of the foregoing Brief of Respondents, by first-class mail with postage thereon fully prepaid, to J. Anthony Eyre, Esq., of Kipp & Christian, attorneys for the appellants herein, 520 Boston Building, Salt Lake City, Utah 84111.