

1989

Western Fiberglass, Inc. v. Kirton, McConkie & Bushnell : Brief of Respondent

Utah Court of Appeals

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Joseph R. Fox; Attorney for Appellant.

Stephen B. Nebeker; Thomas L. Kay; Ray, Quinney & Nebeker; Attorneys for Respondent.

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UTAH COURT OF APPEALS
BRIEF

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IN THE SUPREME COURT
OF THE STATE OF UTAH

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WESTERN FIBERGLASS, INC.,
a Utah corporation,

Plaintiff-Appellant

v.

KIRTON, McCONKIE & BUSHNELL,
a professional corporation,

Defendant-Respondent
and Cross-Appellant.

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: Supreme Court
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: Appeal No. 880032
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BRIEF OF RESPONDENT AND CROSS-APPELLANT
KIRTON, McCONKIE & BUSHNELL

Appeal from a Jury Verdict from
Third Judicial District Court for Salt Lake County,
State of Utah
Honorable Leonard H. Russon, District Judge

Stephen B. Nebeker (A2371)
Thomas L. Kay (A1778)
RAY, QUINNEY & NEBEKER
400 Deseret Building
79 South Main Street
P. O. Box 45385
Salt Lake City, Utah 84145-0385

Attorneys for Respondent and
Cross-Appellant
Kirton, McConkie & Bushnell

Joseph R. Fox
9160 South 300 West
Sandy, Utah 84070

Attorney for Appellant
Western Fiberglass, Inc.

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AUG 19 1989

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Plaintiff-Appellant	:	Supreme Court
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Stephen B. Nebeker (A2371)
Thomas L. Kay (A1778)
RAY, QUINNEY & NEBEKER
400 Deseret Building
79 South Main Street
P. O. Box 45385
Salt Lake City, Utah 84145-0385

Attorneys for Respondent and
Cross-Appellant
Kirton, McConkie & Bushnell

Joseph R. Fox
9160 South 300 West
Sandy, Utah 84070

Attorney for Appellant
Western Fiberglass, Inc.

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JURISDICTION AND NATURE OF THE PROCEEDINGS

This Court has appellate jurisdiction of this case pursuant to Utah Code Annotated Section 78-2-2(3)(j) because it is an appeal taken from a final judgment in a civil matter.

This matter was heard by a jury in the Third Judicial District Court, the Honorable Leonard H. Russon presiding. After a six-day trial, the jury found in favor of the defendant, Kirton, McConkie & Bushnell, and returned a special verdict accordingly. Defendant's post-trial motion for indemnification for attorneys' fees was denied. Kirton, McConkie & Bushnell requests that the jury verdict be affirmed and that the denial of its motion for indemnification be reversed.

ISSUES PRESENTED FOR REVIEW

(1) Whether the trial judge erred in refusing to admit into evidence the affidavit of Robert Bailie and certain testimony of Ivan Radman.

(2) Whether the jury's finding of contributory negligence is supported by competent evidence.

(3) Whether the damage award should be reversed as based on speculation or conjecture.

ISSUE ON CROSS APPEAL

Whether Kirton, McConkie & Bushnell, as an agent of Western Fiberglass, Inc., is entitled to indemnification for its costs, expenses, and attorneys' fees incurred in defending Western Fiberglass' legal malpractice suit against it.

DETERMINATIVE STATUTORY PROVISIONS AND RULES

Rule 103(a)(2) of the Utah Rules of Evidence:

(a) Effect of Erroneous Ruling. Error may not be predicated upon a ruling which admits or precludes evidence unless a substantial right of the party is affected, and

(2) Offer of Proof. In case the ruling is one excluding evidence, the substance of the evidence was made known to the court by offer or was apparent from the context within which questions were asked.

Rule 801(c) of the Utah Rules of Evidence:

The following definitions apply under this article:

(c) Hearsay. "Hearsay" is a statement, other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted.

Rule 802 of the Utah Rules of Evidence:

Hearsay is not admissible except as provided by law or by these rules.

Rule 51 of the Utah Rules of Civil Procedure:

At the close of the evidence or at such earlier time as the Court reasonably directs, any party may file written requests that the Court instruct the jury on a law as set forth in said requests. The Court shall inform counsel of its proposed action upon the requests prior to instructing the jury; and it shall furnish counsel with a copy of its proposed instructions, unless the parties stipulate that such instructions may be given orally or otherwise waive this requirement. If the instructions are to be given in writing, all objections thereto must be made before the instructions are given to the jury; otherwise, objections may be made to the instructions after they are given to the jury, but before the jury retires to consider its verdict. No party may assign as error the giving or the failure to give an instruction unless he objects thereto. In objecting to the giving of an instruction, a party must state distinctly the matter to which he objects and the grounds for his objection. Notwithstanding the foregoing

requirement, the appellate court, in its discretion and in the interests of justice, may review the giving of or failure to give an instruction. Opportunity shall be given to make objections, and they shall be made out of the hearing of the jury.

Arguments for the respective parties shall be made after the court has instructed the jury. The Court shall not comment on the evidence in the case, and if the Court states any of the evidence, it must instruct the jurors that they are the exclusive judges of all questions of fact.

Utah Code Ann. Section 16-10-4(2)(a)-(c):

A copy of this section is attached to this brief as Addendum 3.

STATEMENT OF THE CASE

A. Nature of the Case. This is an action brought by Western Fiberglass, Inc. against Kirton, McConkie & Bushnell for negligence in representing Western in a sale of equipment to United Fiberglass, Inc. Western claimed that Kirton, McConkie & Bushnell (1) failed to perfect a security interest in United's accounts receivable, and (2) failed to inform Western Fiberglass that Western's right to repossess the equipment upon United's default was subject to the liens of a bank.

B. Course of Proceedings. This case was tried to a jury from December 1, 1987, through December 9, 1987. The matter was submitted to the jury by special verdict.

C. Disposition at Trial Court. At the close of Western's case, Kirton, McConkie & Bushnell moved the court for a

directed verdict. The court took the motion under advisement.¹ The case was submitted to the jury by a special verdict. As to the equipment claim, the jury found that Kirton had a duty to advise Western Fiberglass, Inc. that Western's right to take the equipment from United Fiberglass, Inc. upon default was subject to the lien of the bank. The jury also found that Western was so advised. As to the accounts receivable claim, the jury found that Western subordinated its interest in United's accounts receivable to Sovran Bank and that Western and Kirton were both 50 percent negligent.

Following the trial, Kirton, McConkie & Bushnell moved the court for an order requiring Western Fiberglass to indemnify Kirton for the attorneys' fees and expenses incurred by it in defending this action. The court denied Kirton's motion.

D. Facts Relevant to Issues Presented for Review. In 1978, Ivan Radman formed Western Fiberglass, Inc. ("Western"), a Utah corporation, and became its president. Prior to coming to Salt Lake City in 1978, Mr. Radman had been a successful businessman in Australia, where he had owned and managed a

¹Following the trial, Judge Russon denied the motion for a directed verdict as moot in light of the jury's verdict. Judge Russon indicated that had the jury returned a verdict for plaintiff, he would have given "very, very serious consideration" to granting the motion. Judge Russon also wanted this Court to know his feelings on this point. Vol. 492 at 17-18.

construction company and two insulation manufacturing companies. As the manager of these companies, Mr. Radman personally negotiated all of their contracts. Vol. 507 at 31-35.

Western was formed for the purpose of manufacturing insulation. Following construction of its plant in 1980, Western began to produce fiberglass insulation. It also sought potential buyers for the equipment it had developed to produce fiberglass insulation. In early 1982, Mr. Radman negotiated a contract for the sale of equipment to an Italian company. The Italian buyer required Western to obtain and deliver a letter of credit to guarantee Western's performance. Mr. Radman negotiated and drafted this contract. He also translated it from English to Italian. Western used no lawyer in the Italian transaction. Vol. 507 at 41-45. Later, the Italian company defaulted and made a claim on Western's letter of credit. Vol. 507 at 45-47.

In June of 1982, Western was approached by a Virginia company called United Fiberglass, Inc. ("United"), regarding a purchase of fiberglass manufacturing equipment. Vol. 507 at 51. United had previously been a manufacturer of rockwool insulation. However, after only a week of producing rockwool insulation, United's equipment burned up. United had no insurance for the loss, and was forced to file a Chapter 11 bankruptcy. At the time United contacted Western, United was attempting to come out of bankruptcy as a fiberglass insulation manufacturer. Vol. 509 at 151-52.

During the summer of 1982, Robert Bailie, of United, and Mr. Radman, of Western, negotiated a contract pursuant to which Western would sell fiberglass insulation manufacturing equipment to United. After Mr. Bailie and Mr. Radman negotiated the terms of the contract, United's attorneys drafted a written Equipment Purchase Agreement in September, 1982, in which Western would sell the equipment to a Virginia limited partnership, who would then lease the equipment to United. Vol. 507 at 51-53. The agreement provided, in pertinent part, for deferred payments of a portion of the purchase price, a security interest to Western in an escrow account, a letter of credit obligation on the part of Western, and a default provision entitling Western to remove its equipment upon United's default. Exh. 1-P, ¶¶ 2.02, 3.01, 3.02, 6.03. Also, as part of the transaction, Mr. Radman was to become a member of United's board of directors and a shareholder and participate in the management of United. Vol. 508 at 20.

After the Equipment Purchase Agreement was negotiated and drafted, Mr. Radman brought the agreement to Dwight Williams at Kirton, McConkie & Bushnell ("Kirton") and asked Mr. Williams to give it a "quick review." After reviewing the agreement, Mr. Williams told Mr. Radman that there were certain provisions of the contract that were not in Western's best interest, such as the letter of credit obligation by Western with no corresponding obligation on the part of United. Mr. Williams also said he would have done things differently if he had been involved in the

negotiations. Mr. Radman then asked Mr. Williams to talk to United's attorneys and get them to change the agreement. Vol. 508 at 46-47, 111-12.

When Mr. Williams contacted United's attorneys about changing the agreement, United's attorneys told him that the agreement was a "done deal" and that they were not going to renegotiate it unless everything was renegotiated, including the price to be paid to Western. Mr. Williams reported this conversation to Mr. Radman. Mr. Radman told Mr. Williams that Western was not willing to reopen negotiations and that Western would have to live with the contract as is. Vol. 508 at 112-13.

After this conversation and until the final agreement was signed in May of 1983, Mr. Radman consulted with Mr. Williams and other attorneys at Kirton regarding specific revisions to the agreement. Revisions were made in the agreement to reflect United's request for a change in financing from a lease arrangement to a direct purchase by United with bank financing. When the financing changed, Mr. Williams told Mr. Radman that Western's right to take back its equipment upon default by United would be subject to the liens of the bank. Vol. 508 at 101. Both Mr. Bailie and United's attorney, Dan McCormack, also told this to Mr. Radman. Vol. 509 at 50-51, 162. Because the equipment sold by Western was to be encumbered by bank liens, United gave Western a security interest in a portion of United's accounts receivable. Vol. 508 at 114-15; Exh. 11-P, ¶ 2.03.

During the same period of time (September, 1982 through May, 1983), Mr. Radman negotiated directly with the attorneys for United. He wrote to United's attorneys and they wrote to him. Vol. 507 at 68-72; Exhs. 2-P, 3-P, 8-D, 102-D. Mr. Radman spoke to United's attorneys by phone on numerous occasions without Western's attorneys present. Vol. 507 at 64-67; Exh. 52-D; Vol. 509 at 128-29, 140-41, 155-56, 163-66. He met twice with United's attorneys in Virginia without Mr. Williams present, including an all-day meeting one month before the final agreement was signed. Vol. 509 at 87-88, 153-54, 165; Exh. 123-D at 87-88. In addition to receiving correspondence directly from United's attorneys, Mr. Radman also received other letters and documents regarding the transaction, which he neither read nor remembered giving to Mr. Williams. Vol. 507 at 73-75.

Shortly before the agreement was signed, Mr. Williams advised Mr. Radman to have someone at the closing in Virginia who could make certain that everything was taken care of. Vol. 508 at 88, 118-19. Mr. Radman said that it would be too expensive to send someone. Mr. Williams offered to combine the closing with another trip he had scheduled to Washington D.C. so that Western would not have to pay for Mr. Williams' travel time and expenses, but Mr. Radman said "no" and that he would have United's attorneys take care of any necessary filings. Vol. 508 at 79-80, 87-89.

The closing took place in Virginia without either Mr. Radman or anyone from Kirton present. Although Mr. Radman told

Mr. Williams that he would have United's attorneys take care of the necessary filings, United's attorneys did not file any financing statements on the accounts receivable. Following the closing, Western manufactured the equipment and installed it in United's plant in January of 1984. At that time Western received certain payments, as called for in the agreement.

Two months after installation of the equipment and after a bad experience with the letter of credit in the Italian transaction (Vol. 507 at 84), Western asked United to release Western from the obligation to continue the letter of credit. Vol. 507 at 85-87; Exh. 42-D. United denied the request. Vol. 507 at 87-88; Exh. 31-D. A couple of months later, United needed to borrow additional funds from Sovran Bank, its primary lending institution. Sovran Bank would not advance further funds unless Western agreed to subordinate its security interest in United's accounts receivable to that of the bank. Western agreed to subordinate to the bank and also agreed to release its interest in United's accounts receivable in exchange for United releasing Western from the letter of credit obligation. Vol. 507 at 93-98, 151-54; Vol. 509 at 104-106; Exhs. 20-P, 16-P, 33-D, 19-D. After Western had subordinated and released its security interest in the accounts receivable, Mr. Radman told Kirton about these actions. Vol. 509 at 105-107; Exh. 17-D. Then, in July of 1985, United went out of business because of problems with the equipment. Vol. 509 at 51.

The money United collected from its accounts receivable was not enough to pay the loans to Sovran Bank. Vol. 509 at 10-13. The loans to Sovran Bank were eventually paid by personal guarantors. Vol. 510 at 14-15.

SUMMARY OF ARGUMENT

Western's case centers on two acts of alleged malpractice: (1) the alleged failure of Kirton to inform Western that Western's priority in certain equipment was subordinate to a bank, and (2) Kirton's alleged failure to perfect a security interest in accounts receivable of United Fiberglass. The jury found that Western had been told that the bank would have a superior interest in the equipment. The jury also found that Kirton had a duty to perfect the security interest in the accounts receivable, but that Western was 50 percent negligent because of the actions Western took.

Western appeals the jury's findings on both the equipment and the accounts receivable claims. With respect to the equipment claim, Western alleges prejudicial error because the judge refused to admit into evidence an affidavit of Robert Bailie, and the judge refused to admit into evidence certain testimony of Ivan Radman concerning actions Western claims it would have taken had it "known" that its right to repossess the equipment would be subordinate to the rights of the bank.

Western's claims about the Bailie affidavit are unfounded for three reasons. First, Mr. Bailie was on the stand at the request of Western, and as such, Western had the opportunity to question Mr. Bailie about the substance of the affidavit. Second, Western did not preserve the issue for appeal by making a proffer. Rule 103 of the Utah Rules of Evidence clearly requires the party to preserve any evidentiary issues by revealing the substance of the evidence to the court. Third, Western offered no reason why the affidavit should be admitted into evidence. Affidavits are classic examples of hearsay evidence, and Western has claimed no exception to the hearsay rule that would justify admission of this document into evidence.

Western's allegations of error, as they relate to the exclusion of the Radman testimony, have even less basis. Not only did Western fail to make a proffer, which is grounds in and of itself for rejecting Western's argument, but the issue is moot. The jury found that Western was told that its right to repossess the equipment would be subordinate to that of the bank. There is evidence to support this finding. In light of the jury's finding, the exclusion of any additional testimony regarding what Western "would have done had it known that its claim would be subordinate to that of the bank" at best constitutes harmless error.

With respect to the accounts receivable claim, Western claims two errors: (1) that the jury's finding that the plaintiff was 50 percent negligent is not supported by the evidence, and

(2) that the jury's determination of the amount of damages is not supported by the evidence. Kirton agrees that the jury's determination of the amount of damages is unsupportable, but, unlike Western, Kirton claims there is no competent evidence of damages. The only evidence that Western introduced to prove damages was the balance sheet showing the book amount of accounts receivable. Western introduced no evidence showing that the accounts receivable had a fair market value equal to the value shown on the balance sheet. As for the question of whether competent evidence exists to support the finding of 50 percent comparative negligence, the transcript is replete with testimony upon which the jury could base its finding, including Western's refusal to permit Kirton to attend the closing, Western's attempt to reduce attorney's fees by insisting that United's counsel file the financing statements (as opposed to Kirton), and Western's release/subordination of its security interest in the accounts receivable.

Kirton has filed a cross appeal in this case. Section 16-10-4(2)(c) of the Utah Business Corporation Act requires a corporation to indemnify its agent whenever the corporation sues the agent and the agent prevails. The jury found that an agency relationship existed between Kirton and Western. Kirton also prevailed in the suit. As such, Kirton should be awarded its costs and fees incurred in defending this action.

ARGUMENT

I.

THE BAILIE AFFIDAVIT WAS PROPERLY EXCLUDED FROM EVIDENCE.

Western claims that the trial judge committed prejudicial error by refusing admission of the affidavit of Robert Bailie into evidence. Western's argument fails, however, because (1) Robert Bailie was called by Western as a witness and Western had ample opportunity to ask questions about the substance of the affidavit; (2) Western failed to preserve the issue on appeal by making a proffer of evidence; and (3) Western offered no grounds to the trial judge for admitting this hearsay testimony into evidence.

A. Prejudicial Error Did Not Occur Because Western Had the Opportunity to Examine the Affiant About the Substance of His Affidavit.

Rule 103(a) of the Utah Rules of Evidence states that an error may not be predicated upon a ruling that excludes evidence unless a substantial right of the party is affected. At the time Western attempted to introduce the affidavit of Robert Bailie into evidence, Mr. Bailie was sitting on the witness stand, having been called by Western in its case. Although the Court refused to permit the affidavit into evidence, nothing prevented Western from questioning Mr. Bailie about the subject matter of the affidavit. Vol. 509 at 63-65.

The law is clear that prejudicial error does not occur when the offering party has an opportunity to have the same

evidence admitted through other means. Dahnken, Inc., of Salt Lake City v. Wilmarth, 726 P.2d 420 (Utah 1986). See also, First Realty & Inv. Company, Inc., vs. Rubert, 100 Idaho 493, 600 P.2d 1149 (1979). There was no objection to Western questioning Mr. Bailie about the subject of his affidavit. Western cannot now complain because it did not take advantage of an opportunity available to it.

B. Western's Failure to Make an Offer of Proof Precludes an Appeal.

Rule 103(a)(2) of the Utah Rules of Evidence requires a party to make an offer of proof to the Court, or make the character of the evidence apparent from the context of the questions asked, in order to preserve for appeal the question of whether exclusion of the evidence was proper. This Court has enforced this rule literally. See, e.g., State v. Rammel, 721 P.2d 498 (Utah 1986); Hill v. Hartog, 658 P.2d 1206 (Utah 1983); Bradford v. Alvey & Sons, 621 P.2d 1240 (Utah 1980).

Western failed to preserve for appeal its contention that the trial court improperly excluded the affidavit of Mr. Bailie. Attached as Addendum 1 is a copy of that portion of the transcript from the attempted introduction of the affidavit to the point where Western rested its case (three pages). Western made no offer of proof regarding the purpose of introducing the affidavit into evidence. Vol. 509 at 63-65 (Addendum 1). Further, Western failed to ask additional questions that would have indicated the purpose of introducing the affidavit as evidence. Id.

C. Western Offered the Trial Court No Exception to the Hearsay Rule, And As Such the Exclusion Was Proper.

The Utah Rules of Evidence require the exclusion of hearsay evidence unless it fits within one of the listed exceptions. Utah R. Evid. 802. Mr. Bailie's affidavit clearly constitutes hearsay because it concerned a statement made by him other than while testifying at trial. Id., Rule 801(c). Western has offered no basis for admission of this hearsay, either to the trial judge or to this Court. Vol. 509 at 63-65 (Addendum 1). Western has the burden of showing that the hearsay is admissible, and it cannot now complain that it failed to give any basis to the trial court for admitting the hearsay.

II.

THE EXCLUSION OF THE RADMAN TESTIMONY WAS AT BEST HARMLESS ERROR, AND IN ANY EVENT WAS NOT PRESERVED FOR APPEAL.

Western claims that it was prohibited from introducing the testimony of Mr. Radman, as president of Western, with respect to how Western would have changed the sales contract had Western known that it could not repossess the equipment free of other liens. Western claims that the testimony was essential in proving one of the elements of its case, namely, the element of causation.

A. The Issue of Whether the Testimony Should Have Been Excluded Is Moot Because the Jury Found That Kirton Did Not Breach Its Duty.

By way of background, the plaintiff in a legal malpractice case must prove each and every one of the following elements in order to establish the cause of action:

- (1) That an attorney-client relationship existed;
- (2) That the attorney had a duty to the client;
- (3) That the attorney failed to perform the duty;
- (4) That the client suffered damages; and
- (5) That the attorney's negligence proximately caused the damage to the client.

Stanaland v. Brock, 109 Wash. 2d 675, 747 P.2d 464 (1987);
Phillips v. Clancy, 152 Ariz. 415, 733 P.2d 300 (Ct. App. 1986);
Chocktoot v. Smith, 280 Or. 567, 571 P.2d 1255 (1977); R. Mallen
and V. Levit, Legal Malpractice § 657 (2d Ed. 1981) (hereinafter
referred to as "Legal Malpractice").

Western claims that it needed the testimony of Mr. Radman in order to establish what its position would have been had Kirton performed properly. While it is true that the element of causation requires the plaintiff to show that it would have benefited had the attorney performed properly,² that inquiry is moot in this appeal because the jury found that Kirton did perform properly. Vol. 510 at 81-82. In other words, Western appeals on the ground that it was precluded from introducing evidence that damages were proximately caused by the alleged breach of

²Dunn v. McKay, Burton, McMurray & Thurman, 584 P.2d 894 (Utah 1978)(appropriate to inquire as to what the plaintiff's position would have been if the attorney had performed the act properly; Young v. Bridwell, 20 Utah 2d 332, 437 P.2d 686, 689 (1968)(in order to establish a cause of action against an attorney for failing to advise the plaintiff of the right to appeal, plaintiff would have to show that there was a reasonable likelihood of reversing the judgment and that it would have benefited the plaintiff).

duty. But in fact no breach of duty ever occurred. Western failed to prove a critical element of its case (i.e., a breach of duty), and any error of the trial judge relating to the exclusion of Mr. Radman's testimony -- which would have gone to the proof of a different element of the cause of action -- constitutes harmless error.

The record is replete with evidence to support the jury's finding that Kirton did not breach its duty of care as it applies to the equipment claim. See, e.g., Vol. 508 at 162 (Dan McCormack); Vol. 509 at 162 (Robert Bailie); Vol. 508 at 101 (Mr. Williams). Furthermore, Western has not challenged the jury's finding on this point in its appeal.

B. Western Has Not Preserved the Issue for Appeal Because It Failed to Make an Offer of Proof.

As noted earlier in this brief, Rule 103 of the Utah Rules of Evidence requires a party to make a proffer of evidence in order to preserve for appeal a question regarding the propriety of a judge's decision to exclude evidence. See pages 13 to 14, supra, for a discussion of Rule 103. Kirton objected to the Radman testimony on the grounds that the question called for speculation on the part of the witness. The court sustained the objection. In order to preserve the issue for appeal, Rule 103 required Western to make an offer of the evidence so that the court could review the evidence and determine whether the basis for the objection was well founded. Western's failure to do so

means that it is now precluded from appealing the ruling because there is no evidence in the record to support its claim that a substantial right of the party was affected. Addendum 2 is that portion of the transcript wherein Western attempted to introduce the testimony of Mr. Radman on this issue. Vol. 510 at 27-28.

III.

THE RECORD SUPPORTS THE JURY'S FINDING THAT WESTERN WAS 50 PERCENT NEGLIGENT ON ITS ACCOUNTS-RECEIVABLE CLAIM.

The jury found that Kirton had a duty to file a financing statement in order to perfect a security interest in United's accounts receivable, and that Kirton breached that duty. The jury also found that Western was 50 percent negligent in any loss resulting from the failure to perfect. Western has appealed the jury's finding of contributory negligence on the grounds that the evidence does not support the finding.

There can be no doubt that contributory negligence is a defense in a legal malpractice claim. Helmbrecht v. St. Paul Insurance Co., 122 Wis. 2d 94, 362 N.W.2d 118 (1985); Hansen vs. Wightman, 14 Wash. App. 78, 538 P.2d 1238 (Ct. App. 1978); Ishmael v. Millington, 241 Cal. App. 2d 520, 50 Cal. Rptr. 592 (Ct. App. 1966); Legal Malpractice, § 351. Indeed, Western does not dispute this principle of law, as is evidenced by its failure to object to the jury instructions on contributory negligence. What Western apparently argues is that the nature of Kirton's breach was such

that Western could not be contributorily negligent as a matter of law. However, none of the cases cited by Western stand for that proposition. For example, in Theobald v. Byers, 193 Cal. App.2d 147, 13 Cal. Rptr. 864, 866 (Ct. App. 1961), the court held that "the trial court was correct in holding that contributory negligence could properly be considered a defense. . . ." The court ruled for the plaintiff in this case only because the facts did not support a finding of contributory negligence.

Similarly, Practical Offset, Inc. v. Davis, 83 Ill. App. 3d 566, 404 N.E.2d 516 (1980), another case cited by Western, addresses only the issue of whether sufficient evidence existed to support the trial court's granting of summary judgment. The issue of contributory negligence was not addressed by the court. The only apparent relevance of Practical Offset to the case at hand is that both involved the failure to file a financing statement and in both cases the trier of fact found that the attorneys had acted negligently. The difference, however, is that in the case at hand the defendant was able to prove contributory negligence, and in Practical Offset there is no indication that contributory negligence was even raised as a defense.

In summary, Western has offered no authority or reason for the proposition that the doctrine of contributory negligence should not apply in the current case. Furthermore, if Western seriously asserts this theory, it should have objected to the jury instructions on contributory negligence. Rule 51 of the Utah

Rules of Civil Procedure prohibits a party from assigning as error the giving of a jury instruction unless the party objects and states the grounds for objection. While an appeals court is not precluded from examining the question, this Court has held that it will not entertain a review absent unusual circumstances and a compelling reason. E. A. Strout W. Realty Agency, Inc. v. W. C. Foy & Sons, 665 P.2d 1320 (Utah 1983); State vs. Bell, 563 P.2d 186 (Utah 1977); Williams v. Lloyd, 16 Utah 2d 427, 403 P.2d 166 (1965). Western has given no such reason.

With respect to Western's claim that the record does not support the jury's finding, the standard rule of appellate review of a jury's verdict is that the verdict will not be disturbed if there is any reasonable support in the evidence. Uintah Pipeline Corp. v. White Superior, 546 P.2d 885 (Utah 1976); Barlow Upholstery & Furniture v. Emmel, 533 P.2d 900 (Utah 1975). In this case, the record contains more than reasonable support for the jury's finding of contributory negligence. For example, Western complains that it was damaged because it did not have a perfected security interest in the accounts receivable. The evidence is clear, however, that Western had specifically subordinated to Sovran Bank, the only other entity with a security interest in the accounts receivable. When Sovran finally foreclosed, there was not enough money to discharge the debt owed to it. Vol. 509 at 10-13. The fact Western had not perfected its security interest did not mean that Western could not foreclose on

the collateral. Vol. 508 at 41-42, 131-132, 172. Perfection only establishes the relative priorities among the parties claiming an interest in the collateral. Vol. 508 at 76-77, 91. For some reason, however, Western did not foreclose. Western's subordination of its security interest and its failure to exercise its remedy against the collateral can be found by a jury as negligence and as contributing to the damages Western suffered. See, e.g., Fisk v. Newsum, 9 Wash. App. 650, 513 P.2d 1035 (Ct. App. 1973).

Western also contributed to its own damages by unreasonably restricting its attorneys and by ignoring their advice. The record shows that Kirton was not asked to handle the transaction, but instead only to render advice on specific questions. Vol. 507 at 51-53, 58, 61-62; Vol. 508 at 63-64; Vol. 509 at 30-31, 34-35, 128-130, 153-157, 164-165. Western did not have Kirton involved in negotiating the transaction. Id. Indeed, Western had numerous telephone calls, meetings, and correspondence directly with United's counsel. Vol. 507 at 61-79; Exhs. 2-P, 3-P, 8-D, 52-D, 102-D, and 123-D. Western refused to follow its attorneys' advice to have a lawyer attend the closing to make certain that the details were properly handled. Vol. 508 at 88-89, 118-119. Western preferred instead to let United's counsel handle the details, including the filing of a financing statement. Vol. 508 at 88. All of these restrictions and limitations occurred because Western was extremely sensitive to legal fees. Vol. 508 at

130-131; Exhs. 111-P, 123-D. Such sensitivity has a risk, however, and the jury could reasonably find that Western's actions in limiting its attorneys and its own involvement in the transaction was negligent and contributed to the loss suffered by Western.

The courts have held that such actions on the part of a client can constitute contributory negligence. For example, the Washington Court of Appeals stated in Hansen v. Wightman, 14 Wash. App. 78, 538 P.2d 1238 (Ct. App. 1975) that a client can be contributorily negligent by failing to provide information to the attorney or by undertaking a matter and not handling it correctly. See also, Fisk v. Newsum, 9 Wash. App. 650, 513 P.2d 1035 (Ct. App. 1973). And in California, the Court of Appeals ruled in Theobald v. Byers, 193 Cal. App.2d 147, 13 Cal. Rptr. 864, 866 (Ct. App. 1961), that a client can be contributorily negligent if the client fails to follow the attorney's advice. In the words of the court:

A patient will thus be barred from recovery for medical malpractice where the patient has disobeyed medical instructions given by a doctor or dentist or has administered home remedies to an injury without the aid of medical advice. There would seem to be no reason whatever why the same rule should not be applicable in a legal malpractice action where there is evidence that a client chose to disregard the legal advice of his attorney. In our opinion, any other rule would be grossly unfair.

The evidence must be construed in the light most favorable to the verdict. Bezner v. Continental Dry Cleaners,

Inc., 548 P.2d 898 (Utah 1976). The record shows that the jury had ample basis for finding Western contributorily negligent, and this Court should affirm its verdict.

IV.

THE JURY VERDICT ON THE AMOUNT OF DAMAGES SHOULD BE OVERTURNED BECAUSE WESTERN FAILED TO PROVE THE AMOUNT OF ITS DAMAGES.

Western has appealed the jury's finding as to the amount of damages. In light of the jury's verdict finding Western 50% negligent, this Court does not need to address the issue of damages. If this Court does address damages, then Kirton agrees with Western that no evidence exists in the record to support the jury's damage award of \$84,000.00. However, unlike Western, Kirton claims that the record shows no competent evidence of damages.

As noted earlier in this brief,³ a plaintiff must prove all of the elements of a legal malpractice cause of action in order to prevail. One of those elements is the existence of damages. The amount of damages must be proven with reasonable certainty, or the plaintiff cannot prevail. Dunn v. McKay, Burton, McMurray & Thurman, 584 P.2d 894, 896 (Utah 1978). This Court has the power to overturn a jury finding if it believes the award is based on conjecture or speculation. Bodon v. Suhrmann, 8 Utah 2d 42, 327 P.2d 826 (1958).

³See pages 15-16, supra.

The sole evidence Western introduced to prove damages was a balance sheet showing the dollar amount owed by debtors of United and the approximate amount of the loan to Sovran Bank (the entity to whom Western subordinated its interest in the accounts receivable). Western's argument is that the difference between the two is the amount of damages it suffered. Western's evidence of damages does not adequately prove its case. Western has not, for example, introduced any evidence to establish the accuracy or credibility of the balance sheet, such as evidence that an audit was performed. Vol. 509 at 21-29, 53-59. Western has not established that it could have completed a foreclosure action within the time period of the evidence introduced. Western introduced no evidence that the fair market value of the accounts receivable was equal to its book value. And Western introduced no evidence that the accounts receivable were collectible. In other words, Western has not shown the value of the security interest lost; it has only introduced evidence as to the face amount of the accounts receivable. The face amount of the accounts receivable is an improper measure of damages.

In the case of Tilly v. Doe, 49 Wash. App. 727, 746 P.2d 323 (Ct. App. 1987), the court discussed the measure of damages in a legal malpractice case where the attorney was liable for failing to perfect a security interest. The plaintiff in the case argued that the proper measure of damages was the fair market value of the collateral. The court disagreed. It said that the plaintiff

was required to prove "the value of the loss of the security interest, not the value of the personal property." Id. at 325. The court defined a number of factors that the plaintiff must show in proving the determination of the value of a lost security interest, including evidence of collectability. The court specifically noted that the burden of proving collectability rests with the plaintiff. Id. at 326, See also, Taylor Oil Company v. Weisensee, 334 N.W.2d 27, 29 (S.D. 1983).

Like the plaintiff in Tilly, Western failed to put on any evidence of collectability. Western has only introduced evidence as to the book value of the accounts receivable, and this is insufficient as a matter of law to prove damages.

V

UNDER SECTION 16-10-4(2)(c) OF THE UTAH CODE, KIRTON, AS THE AGENT OF WESTERN, IS ENTITLED TO INDEMNIFICATION FOR ITS COSTS, EXPENSES AND ATTORNEYS' FEES INCURRED IN DEFENDING THIS ACTION.

A. Agents Are Entitled to Indemnification as a Matter of Law When They Prevail.

Section 16-10-4(2) of the Utah Business Corporation Act, which is based upon section 5 of the 1967 Model Business Corporation Act, sets out a statutory scheme whereby a person may obtain indemnification for the costs of defending an action brought against the person and arising out of the performance of his/her duties as a director, officer, employee or agent. Subsection (a) of Section 16-10-4(2) authorizes a Utah corporation

to indemnify any such person for the costs in defending against an action brought by a third party. Utah Code Ann. § 16-10-4(2)(a) (1987). Subsection (b) authorizes indemnification for costs incurred if the claim was made by or in the right of the corporation (as opposed to a third-party claim). Id.

§ 16-10-4(2)(b). These subsections are voluntary; corporations are authorized, but not required, to provide the indemnification discussed therein, and they do not necessarily require the person to be successful on the merits.

Subsection (c) of Section 16-10-4(2), on the other hand, places upon corporations an affirmative obligation to provide indemnification. It states that to the extent a person "has been successful on the merits or otherwise in defense of any action, suit or proceeding" of either of the types referred to above (i.e., a third party suit or a suit by or in the right of the corporation), "he shall be indemnified against expenses (including attorney's fees) actually and reasonably incurred by him in connection therewith." Id. § 16-10-4(2)(c).

Although the Utah courts have not addressed the interpretation of subsection (c), courts and commentators in other jurisdictions with the same or similar provisions have uniformly agreed that the language used in subsection (c) requires a corporation to provide indemnification to directors, officers, agents and employees who prevail. See e.g., McClean v. International Harvester Co., 817 F.2d 1214, 1221 (5th Cir. 1987);

Galdi v. Berg, 359 F. Supp. 698, 699-700 (D. Del. 1973); Katayama v. Interpacific Properties, Inc., 190 Cal. App. 3d 1604, 236 Cal. Rptr. 108 (Ct. App. 1987) (ordered not published, Rule 976, Cal. Rules of Ct.); Green v. Westcap Corp. of Delaware, 492 A.2d 260 (Del. Super. 1985); Model Business Corp. Act Anno. § 5 (Supp. 1977) (official comment); Heyler, Indemnification of Corporate Agents, 23 UCLA L. Rev. 1255 (1976). Given the plain language of subsection (c) and the uniformity of decisions of courts and interpretations of commentators, indemnification of a director, officer, agent or employee is mandatory when such person prevails.

The trial judge denied Kirton's motion primarily because the jury found that Kirton had acted negligently, and as such he did not believe that the statute mandated indemnification. Vol. 492 at 19-20. The trial judge reasoned that the finding of negligence meant that the lawyers had not acted in good faith, which he read as a prerequisite to mandatory indemnification. Id.

Subsection (c) mandates indemnification if the agent has been successful in defense of any suit referred to in subsections (a) or (b) of the statute. As noted above, subsection (a) describes lawsuits brought by a third party against the agent, and subsection (b) describes lawsuit brought by the corporation or brought in the right of the corporation (i.e. a derivative lawsuit). Those are the lawsuits referred to in subsection (c). The only time a finding of good faith is necessary is if the corporation voluntarily elects to indemnify the agent. The reason

such a finding is required for voluntary payments is that the corporation can indemnify the agent even if he is found liable. Utah Code Ann. § 16-10-4(2)(a)-(b).

This interpretation of the statute is consistent with the legislative history and court decisions of other jurisdictions that have adopted similar indemnification statutes. In Delaware, the Reporter to the Delaware Corporation Law Revision Commission originally suggested that the good-faith requirement contained in subsections (a) and (b) be incorporated into the mandatory indemnification provisions of subsection (c). This suggestion was rejected, however. The legislature instead decided to indemnify any person who was successful, whether on a technical defense or otherwise, and even if that person could not meet the standard of conduct described in subsections (a) and (b). The underlying policy reason was that the legislature wanted to attract incorporators to Delaware. Barrett, Mandatory Indemnification of Corporate Officers and Directors, 29 S.W.L.J. 727, 733 (1975).

In Merritt-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138 (Del. Super. 1974), one of the plaintiffs had been charged with criminal indictments. He was subsequently found guilty on one count and the balance of the charges were dropped. The plaintiff requested indemnification under the Delaware indemnification statute (which is substantively identical to the Utah statute). The corporation argued that the statute should mandate indemnification only where there has been vindication by a finding

or concession of innocence. The court disagreed. It said that as to the matter upon which guilt had been found the plaintiff could not recover, but as to all other matters, the statute required only that the plaintiff be successful, on the merits or otherwise. The court never examined the good faith of the plaintiffs.

In this case, Judge Russon misinterpreted the statute. The Utah indemnification statute has been written as broadly as possible. It mandates indemnification to successful parties and it does not care how they arrive at their success.

B. Kirton Was an Agent of Western and is Entitled to Indemnification.

The Restatement (Second) of Agency defines "agency" as follows:

(1) Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.

Restatement (Second) of Agency § 1 (1958). Western retained Kirton to act on its behalf, and Kirton was subject to Western's control. The act of retaining Kirton was a manifestation of consent to Kirton so acting. Further, Kirton's agreeing to act as counsel constituted its consent to the relationship. This principal-agent relationship is created between every client and attorney when the attorney is retained to accomplish some act on behalf of the client or otherwise to assist the client in

accomplishing an act. This fact is recognized by the Restatement itself, where in the official comment it states "the attorney-at-law . . . and other similar persons employed either for a single transaction or for a series of transactions, are agents. . . ." Id. § 1, comment on subsection (3).

That attorneys are agents for purposes of indemnification has been recognized in at least one other jurisdiction. In Katayama v. Interpacific Properties, a defendant-attorney in a legal malpractice action was specifically found to be an agent of his client for purposes of the indemnification provisions of the California Corporations Code.⁴

The fact Kirton was sued for alleged malpractice does not mean that Western can avoid the statutory obligation of indemnification. Kirton is entitled to indemnification from Western for Kirton's costs and expenses, including, without limitation, attorneys' fees and court costs. All of the requirements for mandatory indemnification under Section 16-10-4(2)(c) have been met. Kirton was an agent of Western, was sued by reason of undertaking to act as agent, and has prevailed in the lawsuit.

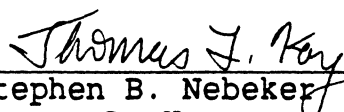
⁴Cal.Corp. Code § 317(d). This subsection is substantively identical to Utah Code Ann. § 16-10-4(2)(c) (1987). 236 Cal. Rptr. at 108. As such, the court ruled that the attorney was entitled to indemnification.

CONCLUSION

For the reasons stated, the jury's verdict that Kirton, McConkie & Bushnell has no liability to Western Fiberglass, Inc. should be affirmed. This Court should also reverse the ruling of the trial judge denying Kirton's motion for indemnity and award Kirton, McConkie & Bushnell its' costs, expenses, and attorney's fees incurred by it in this action.

DATED this 19th day of August, 1988.

RAY, QUINNEY & NEBEKER



Stephen B. Nebeker
Thomas L. Kay

Attorneys for Defendant Kirton,
McConkie & Bushnell

1484k

CERTIFICATE OF SERVICE

I hereby certify that on the 19th day of August, 1988,
four (4) true and correct copies of the foregoing Brief of
Respondent and Cross-Appellant were mailed, postage prepaid, to
the following:

Joseph R. Fox
9160 South 300 West
Sandy, Utah 84070

Thomas J. Kay

1484k

ADDENDUM 1

1 IN THE DISTRICT COURT OF THE THIRD JUDICIAL DISTRICT
2 IN AND FOR SALT LAKE COUNTY, STATE OF UTAH

3 * * * * *

FILMED

4 WESTERN FIBERGLASS)

5 Plaintiff)

Transcript of:

6 TRIAL)

7 vs.)

(5 of 6 days)

8 KIRTON, MC CONKIE & BUSHNELL)

9 Defendants)

Case C86-5552

10 * * * * *

11
12 The above-entitled cause of action came on
13 regularly for hearing before the Honorable Leonard H.
14 Russon, a Judge of the Third Judicial District Court of
15 the State of Utah, at Salt Lake County, Utah, on Tuesday,
16 December 8, 1987, at 9:00 a.m.

17
18 APPEARANCES

19 For the Plaintiff: JOSEPH F. FOX
20 Attorney at Law
9160 South 300 West
Sandy, Utah

21
22 For the Defendants: THOMAS L. KAY
STEPHEN B. NEBEKER
Attorneys at Law
23 79 South Main
24 Salt Lake City, Utah

FILED IN CLERK'S OFFICE
Salt Lake County Utah

25 MAY 6 1988

H. Dixon Hindley, Clerk 3rd Dist. Court
By William Patrick
Deputy Clerk

1 Your Honor.

2 THE COURT: Sustained.

3 Q (By Mr. Fox) Did you have any conversations with
4 Mr. Kay prior to testifying at the deposition?

5 MR. KAY: That calls for hearsay, Your Honor.

6 THE COURT: Overruled, he can answer that yes or
7 no.

8 THE WITNESS: Yes.

9 Q (By Mr. Fox) Did Mr. Kay tell you anything about
10 the significance between the terms "release -- "

11 THE COURT: Hold on. Let's come up to the bench.
12 (Off the record discussion between Court and
13 counsel.)

14 THE COURT: Let me see the exhibit.

15 MR. FOX: 82-P and 56-P.

16 THE COURT: (Pause) I don't have time to look at
17 all of these. Go ahead with your question. I will come
18 back to those. If the question is posed for me to deal with
19 those documents, you may ask your next question.

20 Q (By Mr. Fox) Mr. Bailie, subsequent to your
21 having had your deposition taken, did you sign an affidavit
22 relative to a portion of that deposition?

23 A I did.

24 Q Did you say in your affidavit --

25 MR. KAY: Objection, Your Honor.

1 THE COURT: Sustained.

2 Q (By Mr. Fox) Subsequent to your having your
3 deposition taken, did you talk with Mr. Radman regarding
4 the deposition?

5 A I did.

6 Q And do you recall that conversation?

7 MR. KAY: Objection, calls for hearsay.

8 THE COURT: Sustained.

9 MR. FOX: With Mr. Radman?

10 (Off the record discussion between Court and
11 counsel.)

12 Q (By Mr. Fox) Do you recall a conversation you had
13 with Mr. Radman after your deposition?

14 A I do.

15 Q Do you remember when that conversation was?

16 A The specific date?

17 Q Do you recall the date?

18 A I do not.

19 Q Do you recall what you said to Mr. Radman?

20 A We discussed a number of things in the conversation

21 Q Your testimony a little while ago was that you had
22 told Mr. Radman, or you were present in conversations with
23 Mr. Radman where he was told that his right to retake the
24 possession of the equipment was subject to senior liens.
25 Do you recall his comments after the deposition regarding that?

1 A Yes.

2 Q What did you tell him?

3 A I reaffirmed that was my recollection of the
4 conversations.

5 MR. FOX: I don't have further questions.

6 MR. KAY: We have nothing further, Your Honor.

7 THE COURT: You may step down.

8 MR. KAY: Your Honor, may this witness be excused?
9 He has to catch a plane back to Virginia.

10 THE COURT: Mr. Fox, you want this witness excused?

11 MR. FOX: Yes.

12 THE COURT: You are also free to leave. You may
13 call your next witness.

14 MR. FOX: Your Honor, I don't think we have anymore
15 witnesses. I need to check and make sure our exhibits are
16 admitted and a couple of matters are cleaned up.

17 MR. NEBEKER: Your Honor, we will have a motion
18 to make. I am just wondering in view of time if it would
19 be appropriate for us to have some time to discuss that
20 matter with the Court since it is now about 20 to 12.

21 THE COURT: Am I to understand, Mr. Fox, that you
22 are now resting the plaintiff's case with the single
23 exception of checking exhibits to make sure all are in
24 that you want in?

25 MR. FOX: Yes.

ADDENDUM 2

1 IN THE DISTRICT COURT OF THE THIRD JUDICIAL DISTRICT
2 IN AND FOR SALT LAKE COUNTY, STATE OF UTAH

3 * * * * *

4 WESTERN FIBERGLASS)

5 Plaintiff)

7 vs.)

8 KIRTON, MC CONKIE & BUSHNELL)

9 Defendants)

FILMED

Transcript of:

TRIAL

(3 of 6 Days)

Case C86-5552

11 * * * * *

12 The above-entitled cause of action came on
13 regularly for hearing before the Honorable Leonard H.
14 Russon, a Judge of the Third Judicial District Court of
15 the State of Utah, at Salt Lake County, Utah, on Thursday,
16 December 3, 1987, at 9:30 a.m.

18 APPEARANCES

19 For the Plaintiff:

JOSEPH F. FOX
Attorney at Law
9160 South 300 West
Sandy, Utah

22 For the Defendants:

THOMAS L. KAY
STEPHEN B. NEBEKER
Attorneys at Law
79 South Main
Salt Lake City, Utah

23 FILED IN CLERK'S OFFICE
24 Salt Lake County Utah

25 MAY 6 1988

H. Dixon Hindley, Clerk 3rd Dist. Court
By [Signature]
Deputy Clerk

1 THE COURT: Sustained.

2 Q (By Mr. Fox) In the course of your negotiations
3 with the buyers did you ever attempt to negotiate a
4 secured interest in the proprietary equipment?

5 A No, I did not.

6 Q Why not?

7 A Mr. Williams and the Kirton, Mc Conkie were
8 going to take care of that.

9 Q Take care of it, how do you mean?

10 A They were going to secure us, whatever lawful
11 ways to be done. The only negotiation I made was how much
12 equipment I will supply, bolts and nuts, as such. The
13 legal part of it was going to be taken care of by the firm
14 of Kirton, Mc Conkie.

15 Q Did you discuss with anybody security over the
16 equipment?

17 A No, I did not, except that when the agreement
18 was written, it was discussed what kind of security we
19 can get and the security that was left over was the accounts
20 receivable.

21 Q Had you known you couldn't take your equipment
22 back, would your negotiations have been different?

23 MR. KAY: Objection, calls for speculation.

24 THE COURT: Sustained.

25 MR. FOX: May we approach the bench, Your Honor.

1 THE COURT: You may.

2 (Off the record discussion between Court and
3 counsel. The last question was read back by the reporter.)

4 MR. KAY: Your Honor, we objected on the ground
5 of speculation and that is still our objection.

6 THE COURT: Sustained.

7 MR. FOX: Your Honor, we don't have any other
8 questions of this witness.

9 THE COURT: You may cross examine.

10 CROSS EXAMINATION

11 BY MR. KAY:

12 Q Mr. Radman, yesterday or Tuesday, I believe you
13 testified you never borrowed money in Australia; is that
14 correct?

15 A No.

16 Q What did you testify?

17 A I testified we used overdraft.

18 Q Was that like borrowing money?

19 A I presume, if that is what you call it.

20 Q Will you explain to us what an overdraft is?

21 A An overdraft is when you are a good customer of
22 the bank, they don't ask you to do anything. They just
23 increase as they do here in Salt Lake, for that manner.
24 They just pay your checks as they come through.

25 Q Is that money that you necessarily don't have in

ADDENDUM 3

UTAH CODE ANNOTATED § 16-10-4(2)(a)-(c)

(a) A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, or investigative, (except not an action by or in the right of the corporation) by reason of the fact that he is or was a director, officer, employee, or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise against expenses, including attorney's fees, judgments, fines, and amounts paid in settlement actually and reasonably incurred by him in connection with the action, suit, or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and with respect to any criminal action or proceeding, had reasonable cause to believe his conduct was unlawful.

(b) A corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee, or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise against expenses, including attorney's fees actually and reasonably incurred by him in connection with the defense or settlement of the action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, except that no indemnification shall be made in respect of any claim, issue, or matter as to which the person shall have been adjudged to be liable to the corporation, unless and only to the extent that the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all circumstances of the case, the person is fairly and reasonably entitled to indemnity for such expenses as the court considers proper.

(c) To the extent that a director, officer, employee, or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Subsection 2(a) or (b), or in defense of any claim, issue, or matter therein, he shall be indemnified against expenses, including attorneys' fees, which he actually and reasonably incurred in connection therewith.

ADDENDUM 4

236 Cal. Rptr. 108 printed in FULL format.

ARTHUR S. KATAYAMA, Cross-complainant and Appellant, v.
INTERPACIFIC PROPERTIES, INC., Cross-defendant and
Respondent.

No. G002046.

Court of Appeal of California, Fourth Appellate District,
Division Three.

190 Cal. App. 3d 1604; 236 Cal. Rptr. 108

April 10, 1987; Respondent's petition for review DENIED June
25, 1987 and Reporter of Decisions Directed not to publish
this opn. in the Official Reports (Cal. Const., art. VI, §
14; rule 976, Cal. Rules of Ct.).

Superior Court of Orange County, No. 29-47-35, James Cook, Judge.

MacDonald, Halsted & Laybourne, Gordon E. Bosserman and Karen A. Pikulin for
Cross-complainant and Appellant.

Horvitz, Levy & Amerian, S. Thomas Todd and Frederic D. Cohen for
Cross-defendant and Respondent.

CROSBY

CROSBY, J.

Does the Corporations Code require a corporate plaintiff to indemnify its
former lawyer for his costs and attorneys fees after he prevailed in an action
brought against him for legal malpractice? We hold it does and that the
corporation may not limit its liability to the deductible amount of the
attorney's malpractice coverage.

Interpacific Properties, Inc. sued Arthur S. Katayama for legal malpractice,
claiming he entered into an unauthorized settlement of a multimillion dollar
lawsuit on behalf of the corporation. Katayama cross-complained for
approximately \$12,000 in attorneys fees for his representation of Interpacific
in the underlying litigation and for indemnity for the expenses, including legal
fees, he would incur in defense of the malpractice suit. The latter claim was
made under Corporations Code section 317, subdivisions (c) and (d).

The malpractice action was tried first and Interpacific lost. n1 Trial on the
cross-complaint followed, and the court awarded Katayama \$12,637.76 on his cause
of action for fees earned while serving as Interpacific's counsel. The court
further found Katayama was an agent of the corporation within the meaning of
Corporations Code section 317, subdivision (a), that he was successful in his
defense of the action brought by the corporation, and that he reasonably
incurred expenses, including attorneys fees, in the sum of \$137,041.21 to defend
the malpractice action.

n1 Interpacific may have a decent malpractice action now . It noticed an
appeal from the judgment in the main action, but it was twice dismissed for

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its counsel's failure to follow required procedures and twice reinstated upon his application. The appeal was finally dismissed on March 28, 1985, for failure to deposit costs for the preparation of the appellate record. (Cal. Rules of Court, rule 10(c).) We rejected a third motion to revive the appeal many months later brought by Interpacific's current attorneys who were not involved in the matter previously.

Nevertheless, the court concluded that Corporations Code section 317, subdivision (d) 'was intended and applies to the situation where an agent of a corporation successfully defends against an action by a third party or against a derivative action by the corporation, and that it does not apply to the situation where, as in the present case, the corporation in a non-derivative type proceeding sues its agent, even if the agent prevails in the action.' Judgment was entered for Interpacific on Katayama's cause of action for indemnification under the Corporations Code. Katayama appeals from that portion of the judgment.

I

The Legislature added section 317 to the Corporations Code in 1975, effective January 1, 1977. (Stats. 1975, ch. 682, § 7, p. 1541.) It was based on language in the American Bar Association Model Business Corporations Act, section 5, and is virtually identical to corresponding legislation in New York, Delaware, Ohio, and other states. Subdivision (a) of section 317 furnishes definitions for various terms. For example, 'agent' is defined as anyone who has served a corporation in the capacity of 'director, officer, employee or other agent'. And "'proceeding' means any threatened, pending or completed action or proceeding, whether civil, criminal, administrative or investigative'. Expenses' include attorneys fees and all costs reasonably incurred to establish the right to indemnification. Subdivision (b) provides for indemnification of any agent who is or is threatened to be a party to any proceeding other than the 'by or in the right of the corporation'. Traditionally, this has meant corporate agents may seek indemnification for third party civil actions and criminal prosecutions.

Subdivision (c) provides, 'A corporation shall have power to indemnify any person who was or is a party . . . to any [] pending or completed action by or in the right of the corporation to procure a judgment in its favor by reason of the fact that such person is or was an agent of the corporation, against expenses actually and reasonably incurred by such person in connection with the defense or settlement of such action if such person acted in good faith' (Italics added.) Subdivision (d) mandates indemnification of the agent '[t]o the extent [he] has been successful on the merits in defense of any proceeding referred to in subdivision (b) or (c)'.

The language in section 317, subdivisions (c) and (d) is straightforward and unambiguous; and its literal terms require indemnification of an attorney who successfully defends a legal malpractice action brought by a former corporate agent. Nevertheless, we recognize that commentators invariably discuss subdivision (c) only as it relates to derivative actions, as that term is used in the corporate context, i.e., a lawsuit by one or more shareholders on behalf of the corporation. (See, e.g., 1 Marsh, Marsh's Cal. Corporation Law (2d ed. 1985 supp.) Executive Compensation and Indemnification, § 9.36, pp. 536-537; 1 Blount & Sterling, Cal. Corporation Laws (4th ed. 1985) Indemnification and Insurance, § 109.01, p. 6-39; Heyler, Indemnification of Corporate Agents

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(1976) 23 U.C.L.A. L.Rev. 1255, 1257, 1259-1261.) Interpacific attempts to put its own lyrics to the melody of these articles. It argues subdivision (c) must only apply when the corporation and agent are on the 'same side of the litigation,' e.g., when disgruntled minority shareholders sue, or when the corporation sues a third party who in turn cross-complains against the agent. *Fed-Mart Corp. v. Pell Enterprises, Inc.* (1980) 111 Cal.App.3d 215, 218-219 [168 Cal.Rptr. 525].)

In support of its contention Interpacific suggests there is nothing in the predecessor statute, former Corporations Code section 830, to lend support to Katayama's 'distort[ed]' interpretation of section 317. Not so. Former section 830 provided in part, '(a) When a person is sued, either alone or with others, because he is or was a director, officer, or employee of a corporation, [] in any proceeding arising out of his alleged misfeasance or nonfeasance in the performance of his duties or out of any alleged wrongful act against the corporation or by the corporation, indemnity for his reasonable expenses, including attorneys' fees incurred in the defense of the proceeding, may be assessed against the corporation, [] by the court in the same or a separate proceeding, if both of the following conditions exist: [P] (1) The person sued is successful in whole or in part, or the proceeding against him is settled with the approval of the court. [P] (2) The court finds that his conduct fairly and equitably merits such indemnity.

"[Text omitted.]

'(d) This section applies to all proceedings specified in subdivision (a), whether brought by the corporation, its receiver, its trustee, one or more of its shareholders or creditors, any governmental body, any public official, or any private person or corporation, domestic or foreign. . . .' (Italics added.)

We have located only one California appellate opinion discussing an agent's right to indemnification for successfully defending a direct action by the corporation under former section 830, and it is of no assistance to Interpacific. In *New Capital for Small Businesses, Inc. v. Saunders* (1963) 215 Cal.App.2d 728 [30 Cal.Rptr. 563], a corporation obtained a judgment against its attorney, who was also a director, on a common count for money had and received based on unauthorized payments to himself of commissions from the sale of corporate stock. Notwithstanding the corporation's success, the attorney sought indemnification under section 830. The court dismissed his contention because he was not the successful party, but the opinion never suggests an agent who prevails in a direct action by the corporation could not recover his fees.

Case law interpreting the current statute and its out-of-state cousins is sparse, and there is none to our knowledge from California courts. But we have located two opinions from other jurisdictions, and they support Katayama's position. In *Professional Ins. Co. v. Barry* (1969) 60 Misc.2d 424 [303 N.Y.S.2d 6], a corporation sued a former director for breach of fiduciary duty. He cross-complained for indemnity under the applicable New York statute, Business Corporation Law section 722, which is similar to our section 317. The opinion is not clear on the point, but the director apparently undertook his relationship with Professional at the request of another corporation, Schapiro & Co., Inc. The court conceded he was entitled to indemnification from Professional if he prevailed and met the other requisites of the statute (*id.*, 303 N.Y.S.2d at p. 11.) and concluded he might be entitled to indemnification from Schapiro as

In *Lawson v. Young* (1984) 21 Ohio App.3d 190 [486 N.E.2d 1177] the receiver for an insolvent corporation sued the directors for fraud. The directors prevailed; but the trial court refused to award attorneys fees under Revised Code 1701.13(E)(3), which is identical to our statute. The appellate court reversed, observing, 'Clearly, had [the corporation] brought the action against [the directors] alleging fraud and mismanagement . . . and had [the directors] successfully defended such an action, [the corporation] would have been obligated pursuant to R.C. 1701.13(E)(3) to indemnify [the directors] for their expenses incurred in the successful defense of such an action.' (*Id.*, 486 N.E.2d at p. 1179.)

We see no logical reason to view Katayama's position any differently. Corporations may be treated as persons under the law in general, but they are creatures of statute and subject to a wide range of rules and obligations not imposed on individuals. In the context of litigation expenses, a rationale for disparate treatment is not difficult to divine. Corporations may only operate through agents by their very nature, and they are frequently wealthy and able to pursue prolonged and complex litigation that few individuals could afford to defend. And a direct suit by a corporation is no less costly to defend than the same claim brought as a derivative action by minority shareholders. In the latter situation, of course, the successful agent is unquestionably entitled to indemnification. Thus, we see nothing in the statute itself, or the apparent policy behind it, supportive of Interpacific's argument.

III

Katayama's legal malpractice insurer retained an attorney who represented him both in his capacity as a defendant and cross-complainant. The reasonable expenses for the defense of the main action alone totaled \$137,041.21, according to the trial court's findings. Of this sum, however, Katayama's out-of-pocket expenses were only \$1,000, his deductible under the malpractice policy. Interpacific's final contention is that if it must indemnify Katayama, it is responsible only for that \$1,000. Again we disagree.

A similar argument was rejected by Division One of this court in *Fed-Mart Corp. v. Pell Enterprises, Inc.*, *supra*, 111 Cal.App.3d 215. There, the trial judge determined the corporation's former president, Sol Price, was entitled to indemnification from Fed-Mart and ordered the corporation to pay him \$73,500. Price had 'an informal' fee arrangement with his counsel: '[T]he attorney would be entitled to receive fees only after Price's right to indemnification had been established by the court. The amount of attorney fees was to be whatever the trial court determined to be 'reasonable'' (*Id.*, at p. 228.) Based on this understanding, Price actually paid \$50,000 to his lawyers during the course of the litigation. On appeal Fed-Mart launched a two-pronged attack on the award: First, it argued its obligation to indemnify should be limited to Price's out-of-pocket expenses. Second, Fed-Mart contended the arrangement constituted a contingent fee agreement which was 'not subject to indemnification under section 317 because the fees were not 'actually incurred.'" (*Id.*, at p. 229.)

The Court of Appeal disagreed: 'Fed-Mart's argument assaults a straw man. The trial court determined . . . what legal expenses were actually incurred and their reasonableness. The court's assessment was based upon statutory duties imposed on Fed-Mart and the court, not upon any arrangement, contingent or otherwise, existing between Price and his attorney .' (*Ibid.*., *italics added.*) The same logic applies in this situation as well.

Under section 317, subdivision (d) the successful agent is entitled to 'be indemnified against expenses actually and reasonably incurred by the agent' Actual payment by the agent is not a prerequisite to the right to indemnification. Katayama reasonably incurred legal expenses of \$137,041.21 in order to defend Interpacific's complaint. That his legal malpractice insurer was obligated, pursuant to a wholly unrelated contract, to assume the financial burden of providing his defense does not alter the fact that the expenses were actually incurred or that Interpacific had a statutory obligation to pay them. n2 In other words, having lost on the merits, Interpacific is not entitled to be treated as a third party beneficiary of Katayama's policy. (See also Staples v. Hoefke (1987) 189 Cal.App.3d 1397, 1410 [235 Cal.Rptr. 165], where the Court of Appeal affirmed an award of attorneys fees under Civ. Code, § 1717: 'Plaintiffs were not entitled to avoid their contractual obligation to pay reasonable attorney fees based on the fortuitous circumstance that they sued a defendant who obtained insurance coverage providing a defense.')

n2 We note that Katayama does not stand to enjoy a windfall. Any reimbursement he receives, according to his counsel's undisputed representations, is payable to his insurer. The expenses were incurred because of Interpacific's conduct and were entirely beyond the carrier's control. Thus, as between Interpacific and the insurer, it makes perfect sense that Interpacific bear the cost.

Judgment reversed. Appellant is entitled to costs on appeal, including attorneys fees, to be determined on remand by the trial court.

Trotter, P. J., and Sonenshine, J., concurred.