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First Federal Savings and Loan Association of Salt Lake City v. Gump and Ayers Real Estate, Inc. and Air Terminal Gifts, Inc. : Brief in Opposition to Certiorari

Utah Supreme Court

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UTAH SUPREME COURT
BRIEF

890166

IN THE SUPREME COURT
STATE OF UTAH

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FIRST FEDERAL SAVINGS & LOAN
ASSOCIATION OF SALT LAKE CITY,

Respondent,

vs.

GUMP & AYERS REAL ESTATE, INC.
and AIR TERMINAL GIFTS, INC.,

Petitioner.

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Cert No. 890166
:
Category No. 13
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Court of Appeals No.
88-0331-CA
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BRIEF IN OPPOSITION TO ISSUANCE
OF WRIT OF CERTIORARI

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IN THE SUPREME COURT

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* * * * *

STATEMENT OF FACTS

Respondent First Federal Savings & Loan Association of Salt Lake City (First Federal) disagrees with several statements of fact set forth by Petitioner Air Terminal Gifts, Inc. (Air Terminal). References are to the paragraph numbers in Air Terminal's Statement of Facts.

1 and 4. Air Terminal asserts that the note and purchase agreement were an "integrated, package transaction", citing a conclusion of law by the District Court. The Court of Appeals was not bound by any conclusion of law by the District Court nor is the Supreme Court bound. There is no finding of fact that there was any integration. The only incorporation was contained in the security agreement which, in paragraph 2, stated in reference to the promissory note that it was "incorporated" within the security agreement. The note has no such incorporation.

8. Air Terminal states that the written list showing the purpose of the loan by First Federal was "in part to pay Gump & Ayers \$18,500 and to cover the Morse shortfall" (emphasis added). The \$18,500 was not in addition to the Morse shortfall but was a part of the Morse shortfall as shown by Exhibit G in Air Terminal's petition which lists Gump & Ayers' \$18,500 under the heading ITEMS DUE TO MORSE SHORTFALL.

12. Air Terminal asserts that the Court of Appeals' opinion concludes that "Gump & Ayers received no 'benefit' from the First Federal loan". That is not a correct interpretation of the Court of Appeals' opinion which stated:

There is no question that Gump & Ayers, as general partner of Sunayers, was a fiduciary to Air Terminal and that proceeds of the loan were used to satisfy debts of the Sunayers development project for which Air Terminal had given its note. However, Air Terminal cites no authority for the proposition that these facts alone establish that its note was negotiated "for the benefit" of Gump & Ayers. Furthermore, the case law interpreting provisions identical to §70A-3-304(2) require a more substantial link to the fiduciary's personal interests than exists here.

ARGUMENT

QUESTION I. Air Terminal asserts that the terms of the security agreement are incorporated within the note because of the provision in the note that

reference is made to the purchase and security agreement for additional rights of the holder hereof.

The reference is not an incorporation. The note does not "contain" the provisions of the security agreement. Consequently, there is no additional promise which would destroy negotiability.

In 5 Anderson Uniform Commercial Code, § 3-105.12 it is stated:

A contemporaneous agreement is not necessarily read together with an instrument for purposes of determining its negotiability, although the agreement and instrument may be read together for other purposes.

In Section 3-119.3, Anderson states:

The fact that a note is given in connection with a conditional sale does not affect the negotiability of the note because the condition of the sales contract is not to be incorporated into the note.

We concede that as between the original parties, the seller and the purchaser, the documents could be construed together. That is not true, however, in determining the negotiability of the note in the hands of a third party, and in determining whether or not the third party is a holder in due course. In the latter situation, the note is negotiable despite the reference to the security agreement and the third party is a holder in due course.

There are various provisions in mortgages and other security instruments which, although if contained in the note itself would make the note conditional, do not make the note conditional when they are contained only in the security agreement. Examples are provisions for the protection of security and provisions for payment of taxes, both of which are indefinite in amount (5 Anderson 3-106.15)

A negotiable promissory note and contemporaneously executed mortgage will not be construed as one instrument where to do so renders the note non-negotiable. Bradley v. Buffington, 500 S.W.2d

314, (Mo.App. 1973).

General rules of construction respecting contemporaneously executed instruments are inapplicable where negotiability of an instrument is involved, i.e., where it is in the hands of a holder in due course. McLean v. Paddock, 78 N.M. 234, 430 P.2d 392, (1967).

A note's negotiability must be determined by the terms on its face. In holding that a non-negotiable note could not be made negotiable by the terms of a separate document, the New Mexico Court stated:

The whole purpose of the concept of a negotiable instrument under Article 3 is to declare that transferees in the ordinary course of business are only to be held liable for information appearing in the instrument itself and will not be expected to know of any limitations on negotiability or changes in terms, etc., contained in any separate documents. The whole idea of the facilitation of easy transfer of notes and instruments requires that a transferee be able to trust what the instrument says, and be able to determine the validity of the note and its negotiability from the language in the note itself. First State Bank at Gallup v. Clark, 91 N.M. 117, 570 P.2d 1144, 1147 (1977).

Negotiability is determined from the face of the instrument without reference to extrinsic facts and "the conditional or unconditional character of the promise or order is to be determined by what is expressed in the instrument itself". Holsonback v. First State Bank of Albertville, 30 UCC Rep Serv 222, 224; 394 So2d 381 (Ala App, 1980).

evidence that Morse has made any claim. Therefore, there is no basis for any indemnification.

In the second place, even if there were a right of indemnification, that would not make the note voidable. Here, the Court of Appeals' reasoning was that any obligation to indemnify did not make the note "voidable" and that although there may be a claim by Air Terminal against Sunayers or Gump & Ayers because of this indemnification provision in the security agreement that is not something that makes the note voidable. The Court stated:

In support of its holding, the court stated "[the]...inclusion of the word 'voidable' [in U.C.C. §3-304(1)(b)]¹ is meant to restrict the provision to notice of a defense which will permit any party to avoid his original obligation on the instrument as distinguished from a setoff or counterclaim." Id. (referring to the Official Comments to the Uniform Commercial Code).

Similarly, The Purchase and Security Agreement gives Air Terminal the right to indemnification from Sunayers for any reduction in capital of the Sunayers Limited Partnership resulting from the Morse Shortfall, but it does not render Air Terminal's obligation on the note voidable under §70A-3-304(1)(b). Instead, Air Terminal's right to partial indemnification from Sunayers is independent of its obligation to pay on the air Terminal note. Air Terminal may have a separate claim for indemnification against Sunayers or Gump & Ayers, but it cannot use this claim as a defense to its obligations to First Federal on the note.

Air Terminal argues that the Appellate Court's decision is in conflict with Calfo v. D. C. Stewart Company, et al., 30 Utah Adv. Rep. 8, 717 P.2d 697 (Utah 1986) concerning what constitutes notice

1

The negotiability of an instrument which contained all the elements of negotiability specified in the UCC was not affected by reference in the instrument to the transaction giving rise to the instrument. Federal Factors, Inc. v. Wellbanke, 3 UCC Rep Serv 813; 241 Ark 44, 406 SW2d 712 (1966).

The court in Northwestern Bank v. Neal, 25 UCC Rep Serv 487; 248 SE2d 585 (S.C. 1978) quoted and relied upon the official comment to UCC § 3-119(2):

If the instrument itself states that it is subject to, or governed by, any other agreement, it is not negotiable under this Article; but if it merely refers to a separate agreement or states that it arises out of such an agreement, it is negotiable.

QUESTION II. Air Terminal argues that because of an indemnification in the security agreement that the note is voidable.

In the first place, there are no facts creating any right of indemnification. The indemnification agreement in paragraph 11 excepts any losses "caused by specific acts or omissions of the purchaser" (Exhibit D to Air Terminal's brief). The purchaser is Air Terminal. Air Terminal performed a specific act in executing the note. It cannot now claim that it is being indemnified against liability on its own note. The other indemnification is contained in paragraph 12 of the security agreement which provides that Sunayers and Gump & Ayers will reimburse Air Terminal "for the reduction of the purchaser's portion of any distribution...based upon any claims...by...Morse". There is no evidence that there is any reduction of any distribution to Air Terminal nor is there any

of potential infirmity. Calfo was cited for the proposition "when determining the negotiability, only the instrument in question should be examined", which is a correct interpretation of Calfo. This court in Calfo held that the note on its face contained language which made it payable upon final closing "when Buyers exercise their option to purchase". The court there correctly held that the note was conditional upon its face and was payable at an indefinite time and therefore, was not negotiable. The decision here is not in conflict with Calfo.

QUESTION III. Air Terminal argues that knowledge that a fiduciary received \$18,500 of the Morse shortfall prohibited First Federal from being a holder in due course because of § 70A-3-304 relating to a fiduciary's acting in breach of a fiduciary duty. Air Terminal eliminates the crucial phrase in quoting that section of the code which provides:

- (2) The purchaser has notice of a claim against the instrument when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty. (emphasis added)

Air Terminal omitted the last phrase "or otherwise in breach of duty". There was no breach of duty by Gump & Ayers in its borrowing for and on behalf of the partnership Sunayers the \$100,000 merely because part of the Morse shortfall included money owed by Morse to Gump & Ayers.

Also, subsection (2) relates to a transaction for the benefit of the fiduciary. This transaction was for the benefit of the

partnership to raise funds that the partnership needed to pay obligations of the partnership incurred on the Sunflower project. There was therefore no breach of duty such as there would have been had the proceeds of the loan been intended for the personal use of the partner Gump & Ayers.

Subsection (2) applies when the taker knows that notes held by a partnership are negotiated to it for a non-partnership purpose. As stated in 5 Anderson Uniform Commercial Code § 3-304.29:

When the taker knows that notes held by the partnership are negotiated to it for a non-partnership purpose, the taker cannot be a holder in due course.

Here the loan was for a partnership purpose of paying off the debts of the partnership.

QUESTION IV. For the first time the argument is asserted by Air Terminal that, since the assignment was made as security for Gump & Ayers own \$100,000 debt, that caused it to be for the benefit of Gump & Ayers and made the note voidable. This was neither raised in the lower court nor in the Court of Appeals. However, the evidence in this case shows that Gump & Ayers, the fiduciary, was borrowing not for its own benefit but to raise funds for the partnership Sunayers. Exhibit G in Air Terminal's brief is captioned "Monies needed for Sunflower" and showed Gump & Ayers, the fiduciary, was borrowing to raise funds for Sunflower. No logical contention can be made that Gump & Ayers, by putting its own credit on the line for the partnership, was doing something that would make the note voidable.

CONCLUSION

There is no error in the decision of the Court of Appeals.

Furthermore, Rule 43 of the Rules of the Utah Supreme Court in setting forth what considerations govern review of certiorari sets forth four criteria. Only the fourth one appears to be relevant which is "when the Court of Appeals has decided an important question of municipal, state or federal law which has not been but should be settled by this Court". The Court of Appeals decision applies provisions of the Uniform Commercial Code to the peculiar facts of this case and relies upon the many decisions construing same. There is no need for settlement by this Court.

The petition for writ of certiorari should be denied.

Respectfully submitted this 10th day of May, 1989.

John W. Lowe
Attorney for Respondent
First Federal Savings & Loan
Association of Salt Lake City

/s/ John W. Lowe

John W. Lowe