

1982

# The Citizens Bank v. The Elks Building : Brief of Respondent

Utah Supreme Court

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Theodore E. Kanell; Ronald L. Poulton; Attorneys for Plaintiff-Respondent;  
Joseph C. Rust; Antje F. Curry; Tanner, Kesler, Rust & Williams; Attorneys for Defendant-Appellant;

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IN THE SUPREME COURT OF THE STATE OF UTAH

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THE CITIZENS BANK, a state :  
chartered bank corporation, :  
  
Plaintiff and :  
Respondent : Case No. 18185  
:  
v. :  
  
THE ELKS BUILDING, N.V. a :  
Netherlands Antilles :  
Corporation, :  
  
Defendant and :  
Appellant :

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RESPONDENT'S BRIEF

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Appeal from order granting plaintiff's Motion for  
Summary Judgment from the  
Third Judicial District Court for  
Salt Lake County, State of Utah  
The Honorable G. Hal Taylor, Judge

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RONALD L. POULTON  
THEODORE E. KANELL  
Attorneys for the Plaintiff-  
Respondent  
9 Exchange Place Suite 520  
Salt Lake City, UT 84111

JOSEPH C. RUST  
ANTJE F. CURRY  
TANNER, KESLER, RUST & WILLIAMS  
Attorneys for the Defendant-Appellant  
2000 Beneficial Life Tower  
36 State Street  
Salt Lake City, UT 84111

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IN THE SUPREME COURT OF THE STATE OF UTAH

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THE CITIZENS BANK, a State  
chartered bank corporation,

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Plaintiff -  
Respondent,

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v.

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Case No. 18185

THE ELKS BUILDING, N.V., a  
Netherlands Antilles  
Corporation,

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:  
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:

Defendant -  
Appellant.

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:

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RESPONDENT'S BRIEF

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STATEMENT OF THE CASE

This is an action for declaratory relief brought by the Plaintiff-Respondent, The Citizens Bank, as a secured party lender against the Defendant-Appellant, as Lessor, to determine the priority of the parties to certain personal property of a tenant upon premises of the Defendant-Appellant which was pledged as security for a loan from the Plaintiff-Respondent.

## DISPOSITION IN LOWER COURT

Upon a Stipulation of Facts the parties brought cross motions for summary judgment. Based upon the Stipulation of Facts and arguments of counsel, the lower court granted Plaintiff-Respondent's motion for summary judgment and denied Defendant-Appellant's motion for summary judgment.

## RELIEF SOUGHT ON APPEAL

Plaintiff-Respondent seeks to have the judgment of the lower court affirmed.

## STATEMENT OF FACTS

Food Innovations Systems, Inc. is a Utah Corporation doing business under the assumed name of Pouches, Inc. As Pouches, Inc., the Corporation operated two restaurants in Salt Lake City. One of the restaurants was located in the Elks Building, in Salt Lake City, Utah.

Pouches, Inc. defaulted in its lease agreement with the Elks Building by failing to make payment for rent due November 15, 1980. (R.23) On December 8, 1980, Pouches, Inc. was served with a Notice from the Defendant-Appellant that if payment of the delinquent rent was not made by January 8, 1981, the Defendant-Appellant would commence legal proceedings to recover the delinquent rent. (R.23)

Pouches, Inc. failed to make the payment on January 8, 1981, as demanded, but the Defendant-Appellant did not commence legal proceedings as threatened in the Notice until April 9, 1981. At no time during the lease

period did the Defendant-Appellant terminate the lease with Pouches, Inc. nor did the Defendant-Appellant attempt to relet the premises to another tenant. (R.9) On or about March 18, 1981, Pouches, Inc. made application for an SBA loan from The Citizens Bank in the amount of seventy thousand dollars (\$70,000.00).

The Citizens Bank approved the loan application, and in turn, submitted the loan application to the SBA for approval. (R. 9) The SBA approval was received March 24, 1981. (R.9) On April 7, the loan was made to Pouches, Inc. and proceeds disbursed on April 7, 1981. (R.9) The obligation of Pouches, Inc. was evidenced by a promissory note in the amount of \$70,000.00 and was secured by a security interest in all machinery, equipment, furniture and fixtures owned or thereafter acquired and in proceeds thereof owned by Food Inovations Systems, dba Pouches, Inc. (R.35) The Plaintiff-Respondent perfected it's security interest by filing a financing statement on April 7, 1981. (R.36) As of that date, the Plaintiff-Respondent held a perfected security interest in all of the personal property of Pouches, Inc. located at the Elks Building. (R.35,36)

Two days after the Plaintiff-Respondent obtained its perfected security interest in the equipment at the Elks Building, the Defendant-Appellant filed a complaint against Pouches, Inc., under which the Defendant-Appellant elected to pursue it's statutory lessor's lien right. (R.10) Service of Process was not obtained until some time during the summer of 1981 and on August 28, 1981 a judgment by default was obtained upon Defendant-Appellant's statutory lessor's lien right.

Thereafter, because of the small sums involved, the parties agreed to have their competing claims determined by summary judgment based upon a Stipulation of Facts prepared by the parties jointly, and the parties stipulated that all documents attached to the Stipulation and Exhibits be admissable to



determine the issues raised in the pleadings, and further stipulated that the court should interpret all exhibits according to their terms, and should enter judgment on all issues raised in the pleadings based upon the facts of the case as set forth in the Stipulation and Exhibits. (R.6,7)

## ARGUMENT

### POINT 1

#### **THE LOWER COURT DID NOT ERR IN FOLLOWING THE UTAH STATUTE WHICH PROVIDES THAT ALL LESSOR'S LIEN RIGHTS ARE SUBORDINATE TO PERFECTED SECURITY INTERESTS.**

The Defendant-Appellant argues that it's lessor's lien right attached prior in time to perfection of the Plaintiff-Respondent's security interest and therefore Defendant-Appellant claims that its statutory lessor's lien is prior in right to Plaintiff-Respondent's perfected security interest. The trial court rejected Defendant-Appellant's argument because the argument is contrary to the express priority provisions set forth in the Utah Code Annotated.

The priority to be given lessor's liens, as a class, is set forth in Utah Code Annotated, Section 38-3-2 (1953) (amended 1977). This Section provides:

The lien provided for in this chapter shall be preferred to all other liens or claims except claims for taxes and liens of mechanics under chapter 1 of this title, perfected security interests, and claims of employees for wages which are preferred by law; provided, that when a lessee shall be adjudicated a bankrupt, or shall make an assignment for the benefit of creditors, or when his property shall be put into the possession of a receiver, the lien herein provided for shall be limited to the rent for ninety (90) days prior thereto (emphasis added)

This section establishes priority on the basis of the type of lien held rather than the time when a particular lien is acquired. Issues between competing

liens as to which lien was acquired first in time would only be relevant in determining competing claims between liens of the same class. The issue of first in time is irrelevant when all liens of one class are subordinated to all liens of another class. Annot., 99 A.L.R. 3d 1006 (1980).

Ignoring the Utah Statute, the Defendant-Appellant relies on two decisions from the Supreme Court of New Mexico interpreting New Mexico law i.e., Chessport Newark, Inc. v. Solie, 522 P.2d 812 (N.M. 1974) and National Investment Trust v. Thrift National Bank, 543 P.2d 482 (N.M. 1975). The Defendant-Appellant failed to acknowledge that New Mexico has no statutory provision which covers priorities between the lessor's lien and a perfected security interest as does Utah. In the absence of an absolute rule of perfection such as that set forth in the Utah Code, the New Mexico court ruled that priority was based on the first interest to be perfected.

In addition, the Defendant-Appellant failed to make the distinction between attachment of the landlord's lien and the method and time in which that lien must be perfected. The Code provides that a lessor shall have a lien for rent due upon all non-exempt property of the tenant, brought or kept upon the leased premises only so long as the tenant shall occupy the premises and for 30 days thereafter. U.C.A. Section 38-3-1 (1953). This provision provides for attachment of the lessor's lien when property of the tenant is brought on the premises, but the lien will not be perfected and will be lost if the lessor does not take the required actions to perfect the lien within 30 days after the tenant leaves the premises. The Code provides that before the lessor may take the property of the tenant, the lessor is required to file a complaint and only after the filing of a complaint may a writ of attachment issue in aid of the lessor's lien. U.C.A. 38-3-3,-4 (1953). Upon the filing of the complaint by the lessor, with a supporting affidavit and bond, it is the duty of the court

to issue a writ of attachment and to make a determination of the priorities of the claims, liens and security interests in the property of the tenant. U.C.A. 38-3-5 (1953) (amended 1977); Freeway Park Building, Inc. v. Western States Wholesale Supply, 22 Utah.2d 266, 451 P.2d 778 (1969).

According to the facts before the Court, the tenant ceased to occupy the premises on December 8, 1980, and therefore the lessor's lien which had attached to the property had to be perfected or would be lost by January 8, 1981. The undisputed fact is that no complaint was filed by the Defendant-Appellant until more than four months after the tenant ceased to occupy the premises, and never did the lessor seek writ of attachment or determination of the priorities of competing claims in the property of the tenant.

Therefore, in view of the statute and the actions of the Defendant-Appellant, the lower court was correct in rejecting the argument that the lessor's statutory lien was prior in right to the Plaintiff-Respondent's perfected security interest.

## POINT II

### **THE LOWER COURT DID NOT ERR IN RULING THAT THE REAL PROPERTY LEASE AGREEMENT DID NOT CREATE A SECURITY INTEREST IN FAVOR OF THE DEFENDANT-APPELLANT.**

The Plaintiff-Respondent acknowledges that the lease default provision expressly authorized the landlord to re-enter the premises, preserve his statutory lien right by taking possession of the personal property on the premises and reletting the premises for the account of the tenant.

However the Plaintiff-Respondent and the lower court rejected the Defendant-Appellant's claim that the default provisions of the real property lease agreement should also be construed as a security agreement which granted

the Defendant-Appellant a security interest in the personal property of Pouches, Inc.

The Defendant-Appellant seeks to base its claim on the Default and Remedies section of the lease, Paragraph 25, which provides in part:

In the event of any such material default or breach by Tenant, Landlord may at any time thereafter, with or without notice or demand, without limiting Landlord in the exercise of any other right or remedy which Landlord may have by reason of such default or breach:

a. without terminating this lease, may re-enter the premises, with or without process of law, and take possession of the same and of all equipment and fixtures therein, and thereafter relet the premises or any part thereof for the account of Tenant for such terms and upon such conditions as Landlord may deem proper;... .  
(R.20)

The Plaintiff-Respondent does not contend that a landlord and tenant could not agree to have a real property lease also contain provisions of a security agreement, creating a security interest in personal property of the tenant. See e.g., Foster v. Hamblin 405 F.2d 1043 (6th Cir. 1969) (A security interest was intended by the parties where the agreement provided, "All of lessee's mining machinery and equipment upon said premises shall be subject to a lien to secure unto lessors payment of all rental... " and the landlord filed a financing statement in support of the security interest.); In re King Furniture City, Inc., 240 F. Supp. 453 (E.D. Ark. 1965) (A security interest was intended by the parties to an agreement providing, "to secure payment of all rent due...tenant gives a landlord an express contract lien..." and the landlord filed a financing statement in support of its security interest). In this case there is no express language creating a security interest in favor of the landlord at the time the lease agreement was executed and the conduct of the parties illustrates that the landlord did not assume it had a security interest until after learning of the secured party status of the Plaintiff-Respondent.

Rejection of the Defendant-Appellant's claim is justified by a review the



historical development of the tenant account default remedy relied upon by the Defendant-Appellant, the express language of the default remedy and the conduct of the Defendant-Appellant.

The tenant account default remedy was developed in response to a particular problem encountered by lessors in acting upon to the default of tenants. Historically, when a tenant defaulted under a lease agreement a lessor was exposed to the potential danger that his re-entry into or reletting of the premises, prior to the expiration of the term of the lease, could be construed as an acceptance of a surrender of the premises by the tenant. The legal effect of such surrender was to effect the termination of the lease and release the tenant from further obligations to pay rent. See generally, G. Thompson, Real Property 3A, Section 1342-48 (1959). In response to this problem lessors began inserting a provision which would permit them, without terminating the lease, to re-enter the premises and take control of the premises and property, and to relet the premises for the account of the tenant until the landlord had been made whole from the default of the tenant. See generally, C. Berger, Land Ownership and Use, 2ed. 433-40 (1975). The default provision in this lease is simply a statement of the tenant account theory which protects the lessor from the claim that he has accepted a surrender of the premises and forfeited his lessor's lien right.

The language of the lease agreement also indicates that the parties to the agreement did not intend to create a security interest in favor of the landlord. First, under the lease, the interest of the lessor in the personal property of the tenant arose only after the default of the tenant and existed only so long as the property remained on the premises, which is exactly the interest recognized by the statutory lessor's lien. However, if a security interest were to attach to the personal property of the tenant, that interest

would follow the property whether the property were located on the leased premises or located elsewhere. The lease provision only repeats the interest recognized by the statutory lessor's lien but does not expand the lessor's interest to that of a secured party under Article 9 of the Uniform Commercial Code. Second, the right of the lessor to take possession of the property is coupled with the landlord's obligation to relet the premises for the account of the tenant. Nowhere in the lease provision is the right granted the landlord to make a public or private sale without legal process, as he could do, if he were a secured party creditor. Finally, there is no representation that the personal property of the tenant was free of encumbrances nor is there a covenant that the property will remain unencumbered during the term of the lease. Both of these issues are fundamental concerns of parties to security agreements.

The strongest evidence that the claimed security interest was an after-the-fact creation of the Defendant-Appellant is the conduct of the Defendant-Appellant. First, upon the default of Pouches, Inc., the Defendant-Appellant did not avail itself of the remedy to re-enter the premises, take possession of the personal property and relet the premises for the account of the tenant. As the Defendant-Appellant admitted, at no time during the lease period did it terminate the lease or attempt to relet the premises to another tenant. The Defendant-Appellant did pursue its only avenue to acquire the property of the tenant which was the action on the statutory lessor's lien.

Second, if landlord had a security interest in the personal property of the tenant, the landlord would have taken immediate steps to perfect its security interest by filing a financing statement rather than wait to perfect after the tenant was in default. In this case the landlord did nothing which could be claimed as perfection of its alleged security interest until after default by

the tenant.

Third, if the lease agreement were also a security agreement creating a security interest in favor of the Defendant-Appellant, upon the default of Pouches, Inc. Defendant-Appellant would have had the right under Article 9 of the Uniform Commercial Code to make a public or private sale of the personal property without judicial proceedings. No such attempt was ever made by the Defendant-Appellant because the Defendant-Appellant knew it had no secured party status. After the default of Pouches, Inc., the Defendant-Appellant elected to file a complaint against the tenant on the theory of a statutory lessor's lien only. At no time prior to learning of the secured party status of the Plaintiff-Respondent was there a claim that the lease agreement operated as a security agreement creating a security interest in favor of the Defendant-Appellant. The only consistent explanation of the Defendant-Appellant's conduct is that the lease parties did not intend the lease agreement to create a security interest in favor of the landlord, and the lease was not drafted to provide a security interest in favor of the landlord.

### POINT III

**EVEN IF ALL FACTS OF THE CASE ARE VIEWED IN A LIGHT MOST FAVORABLE TO DEFENDANT-APPELLANT THE DEFENDANT-APPELLANT IS BOUND BY ITS ELECTION TO PURSUE THE STATUTORY LIEN.**

As noted previously, after Pouches, Inc. defaulted under the lease agreement, the Defendant-Appellant elected to pursue judgment against Pouches, Inc. on the basis of the statutory lessor's lien. (R.98,46-47) Such action on the part of the Defendant-Appellant constituted an election of its

remedy against Pouches, Inc. for default under the lease agreement. 25 Am. Jur. 2d, Election Of Remedies, Sections 7 and 19; Royal Resources, Inc. v. Gibraltar Financial Corp., 603 P.2d 793, 796 (Utah 1979); Cook v. Covey-Ballard Motor Co., 69 Utah 161, 253 P. 196 (Utah 1927).

Election of Remedies is an equitable doctrine established to do justice between the parties. Royal Resources, Inc. v. Gibraltar Financial Corp., *supra*. The defense of election of remedies must be raised by way of answer, motion or demand so as to put the issue before the trial court. *id.* at 796. The issue of the election of remedies was raised by the trial court during oral argument on the cross motions for summary judgment. (R.98) In relevant part the record states:

(Counsel for Defendant-Appellant Ms. Curry): "So whether or not this court finds that the (Defendant-Appellant) had a statutory lien or a contractual lien, we believe we have shown that the statutory lien attached upon the property getting onto the premises that was the latest point in time, and it is not subject to Article 9 because there was no perfected security interest at the time. If the court finds we have a contractual lien, then we do come within the ambit and we perfected our security interest by taking possession some three months before the (Plaintiff-Respondent) did."

Now, the (Plaintiff-Respondent) has argued—

THE COURT: Now, you read to me you could take possession of it. Then what does the lease provide?

MS. CURRY: Well, it says that the landlord may pursue any and all remedies it has at law.

THE COURT: Tell me what remedy you pursue.

MS. CURRY: We pursue the statutory lien eventually.

THE COURT: All right.

The Defendant-Appellant is bound by the election made in the proceedings against Pouches, Inc. under the holding in Brigham City Sand and Gravel v. Machinery Center, Inc., 613 P.2d 510 (Utah 1980). In that case the Plaintiff stored equipment with the first Defendant. The first Defendant in turn sold



the equipment to the second Defendant. The Plaintiff brought an action against both Defendants for money damages or return of the property. Prior to trial the Plaintiff and the first Defendant entered into a settlement, but the Plaintiff expressly reserved all rights against the second Defendant. In affirming the ruling of the trial court, this Court noted that it was the failure of the Plaintiff to use reasonable diligence to protect its interest in the property that provided the foundation for the events which resulted in the second Defendant's intervening interest. Since the second Defendant derived its interest in the property from the first Defendant this Court held that the second Defendant could claim the benefit of the election made by the Plaintiff with the first Defendant. id. at 512.

The controlling facts of Brigham City Sand and Gravel v. Machinery Center, Inc., supra, are present in this case. Here the Defendant-Appellant failed to use reasonable diligence to pursue its remedy against Pouches, Inc., and during that delay Plaintiff-Respondent acquired its security interest in the property. Also, the Plaintiff-Respondent acquired its interest in the property from Pouches, Inc., the party against whom the Defendant-Appellant made a binding election. Therefore, the Plaintiff-Respondent is entitled to the benefit of the election made, and the Defendant-Appellant is precluded from asserting a claim for a new remedy in the present case.

## POINT IV

### **THE PLAINTIFF-RESPONDENT HOLDS A PERFECTED SECURITY INTEREST IN THE PROPERTY OF POUCHES, INC.**

The Defendant-Appellant raises an issue as to whether or not the Plaintiff-Respondent has a purchase money security interest or just a perfected security interest in the property of Pouches, Inc. Pouches, Inc. represented to Plaintiff-Respondent that the security interest granted in the property would be a purchase money security interest. (R.35) The parties in this action did not stipulate to the conclusiveness of the representation of Pouches, Inc. and therefore Plaintiff-Respondent only claimed to have a perfected security interest in the property of Pouches, Inc. (R.90-91) On appeal, Plaintiff-Respondent again makes no greater claim than being a secured party lender and not a purchase money lender. In light of the points discussed previously in this brief there is no need for the Court to make a determination as to whether the Plaintiff-Respondent was a purchase money lender.

## **CONCLUSION**

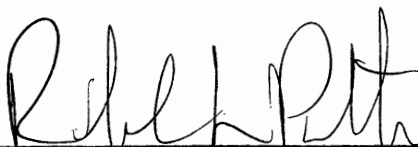
The trial court did not err in finding the perfected security interest of the Plaintiff-Respondent prior to the Defendant-Appellant's statutory lessor's lien because the priority was established by the lessor's lien statute.

The trial court did not err in rejecting Defendant-Appellant's efforts to construct, after-the-fact, a security interest in the personal property of Pouches, Inc. because the Defendant-Appellant's claim was not supported by the language of the lease agreement or the conduct of the Defendant-Appellant.

Even if the Defendant-Appellant were allowed to claim a security interest

in the property of Pouches, Inc. its claim to priority is barred by its election  
to obtain judgment against Pouches, Inc. on the statutory lessor's lien.

Respectfully submitted this 18th day of March, 1982.

By   
Ronald L. Poulton  
Attorney for Plaintiff-Respondent  
Citizens Bank

#### CERTIFICATE OF DELIVERY

I hereby declare that I hand-delivered two true and correct copies of the  
foregoing Respondent's brief to Joseph C. Rust, attorney for Appellant, this  
18th day of March, 1982, at 2000 Beneficial Life Tower, 36 South State Street  
Salt Lake City, Utah 84111.

  
Annette Ward