

1967

Jaeger And Branch, Inc., A Corporation v. Jim Pappas dba Jim Pappas Construction Company : Brief of Appellant

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IN THE SUPREME COURT
OF THE STATE OF UTAH

JAEGER AND BRANCH, INC., a
corporation,

Plaintiff-Respondent

vs.

Case No.
10885

JIM PAPPAS dba JIM PAPPAS
CONSTRUCTION COMPANY,

Defendant-Appellant,

Appeal from a Judgment against the Defendant
granted by the Third District Court in and for
Salt Lake County, Honorable Leonard W. Eiton,
Judge, Presiding.

*Appellants
Brief*

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JIM PAPPAS dba JIM PAPPAS
CONSTRUCTION COMPANY,

Defendant-Respondent

Appeal from a Judgment against the Defendant
Granted by the Third District Court in and for
Salt Lake County, Honorable Leonard W. Elton,
Judge, Presiding.

STATEMENT OF THE KIND OF CASE

This is an action to collect \$6,500.00
by an alleged holder in due course of a check
which was tendered by appellant who stopped
payment for failure of consideration.

DISPOSITION OF THE LOWER COURT

The Third Judicial District Court,
Leonard W. Elton, Judge, after plaintiff pre-
sented a prima facia case and defendant
presented his evidence, granted judgment in

favor of plaintiff as a holder in due course and against the defendant in the sum of \$6,500.00 with interest thereon at the rate of 6% per annum from January 18, 1966 plus costs.

RELIEF SOUGHT ON APPEAL

Appellant seeks reversal of the judgment of the District Court and a decision that as a matter of law plaintiff is not a holder in due course of appellant's check and is not entitled to the legal shelter arising from that status due to the notice which plaintiff received of a valid defense against the original payee and respondent's failure to show that it took for value and in good faith as required by the Utah Commercial Code.

STATEMENT OF FACTS

The facts are undisputed other than the question of whether or not the notice given was adequate to foreclose the claim of holder as a holder in due course. Appellant purchased a great number of items from one Allo Distributing Company in his construction of a lodge in Park City, Utah, known as the C'est Bon'

Hotel. (Tr. 25-26) The last two deliveries were to be a large shipment of carpet (Tr. 34 and 41) and a truck load of interior furnishings. (Tr. 29, 34 and 43) On or about January 9, 1966, the shipment of carpeting from Allo had been forwarded and was being held in Ogden by United Freight Forwarding and appellant could not get delivery. (Tr. 41) On January 11 or 12, 1966, appellant talked with Allo and at Allo's request with respondent to determine why the shipment was being held. (Tr. 48, 49 and 73) The carpet was released and received on January 14, 1966. (Tr. 60) Appellant agreed to forward a check for the balance of the items which were supposed to have been shipped by Allo prior to receipt of the check as consideration for the amount paid. Appellant told Allo that unless the items were received, payment on the check would be stopped. (Tr. 51 and 74) On January 12, 1966, appellant spoke by telephone at Allo's request with respondent concerning the payment to Allo. (Tr. 55) The first conver-

sation was to determine why the carpet was being held and the second was to determine whether they were paid in full for the materials purchased by Allo for appellant. (Tr. 57) :

Taking the testimony of defendant and his witness most favorably to the defendant, together with reasonable inferences therefrom, the following testimony from conversations between defendant and Allo Distributing Company and between the defendant and Mrs. Voorhees and the plaintiff's Mr. Don Moreland, should receive careful consideration from the Court

"The reason for stopping payment on the check on January 18, 1966, was overpayment." (Tr. 22)

"The check reached the Walker Bank January 22," (Tr. 23) It was agreed at pre-trial that the check was negotiated to plaintiff January 14. (Tr. 32) The conversations to the plaintiff were made January 11, 1966. (Tr. 34 and Exhibit 8) Allo Distributing agreed to ship an additional truckload of merchandise, which truckload never arrived. (Tr. 43) As of January 10, 1966, assuming delivery of the carpets

being held up, defendant would have owed Allo \$1,000 to \$1,500. (Tr. 48)

Plaintiff's Don Moreland was surprised the carpeting was being held up and told defendant "We couldn't know the carpets was being held up. We thought you received it." and told defendant he couldn't give information about the account between Allo Distributing and Jaeger and Branch, but that "our business with Allo Distributing has been good" and when defendant said "I assume you have been paid in full and are real happy with the deal" Moreland answered "Yes, and that it was not necessary to put Jaeger and Branch's name on the check he was sending to Allo. (Tr. 50-51)

An earlier conversation between Defendant and Allen Sandler of Allo Distributing made plain that \$6,000.00 to be sent was for operating cash against future purchases and that Allo would release the carpet. (Tr. 50) In that and subsequent conversations Sandler assured defendant the truckload of merchandise would be shipped and defendant stated:

"If you don't send me everything you say you are going to do -- I have sent you a company check -- and I will stop payment on it" as to which Sandler said "Fine, go ahead." (Tr. 51)

On the second conversation between defendant and Moreland, Moreland reiterated that Jaeger and Branch was not holding up the carpeting and that he could not release information as to the account between Allo and Jaeger and Branch: "You are dealing with Allo. We have nothing to do with that." And Moreland told defendant he couldn't say whether Allo had paid in full because it was against their business ethics but "our relationship with Allo Distributing is very good." (Tr. 59)

Mrs. Voorhees told Don Moreland "negotiations was breaking down between Allo Distributing Company and Jim Pappas Construction, and we were having trouble getting our shipments and getting our releasements, and we were afraid that we were going to end up shoved out of our order * * *" that I would live up to my end of the bargain if they would live up to their end of the bargain -- is the way she

said it to me." (Tr. 64-65)

If the carpets had not been released the check for \$6,500.00 would have overpaid Allo Distributing "by \$10,000.00 to \$15,000.00 without the check." (Tr. 66)

On January 12th defendant told Allo Distributing he was sending them a check for \$6,000.00 expecting the carpet to be released and also the other truckload of furniture to come up. (Tr. 73)

Defendant verified what Allo Distributing told him about not owing their suppliers "except with Mr. Moreland, he didn't know whether they owed money or didn't owe them money." (Tr. 75)

Mrs. Voorhees talked to Don Moreland on January 11th in behalf of defendant and told him there was some question as to whether or not the wholesale distributors had been paid by Allo which she was attempting to ascertain and that other suppliers had been called with Mr. Sandler's permission. (Tr. 78) Moreland asked

if they were having difficulty with Allo and she said "No, not really difficult, but Allo Distributing asked for more money and we just wanted to be sure that they weren't (sic.) maintaining their end of the contract. In part paid some of the money to Jaeger and Branch". (Tr. 79) And again "Well, it seems as though relations have broken down between Mr. Pappas and Allo Distributing * * * Mr. Pappas has to this point paid somewhere in the vicinity of \$45,000.00 to these people, and we have received very little of the goods." (Tr. 81) and upon being informed that carpeting was being held up Mr. Moreland said "We have nothing to do with that". (Tr. 81)

Mrs. Voorhees further explained to Moreland "that Mr. Pappas was a little fearful that all the money that he was paying to them * * * wasn't going where they said it was going" and Moreland said if anything further came up along this line he would call Mrs. Voorhees. (Tr. 81) She told Moreland that Pappas was going to be sending money down and before doing

so "he wanted to be sure that the moneys were going in the proper places". (Tr. 82-83)

The final shipment was not received. Payment on the check was stopped. Allo had transferred the check over to respondents who did not call appellant but called the drawee bank to see if there were funds to cover the check. The check was processed for payment by respondent. Prior to receipt by the bank, payment was stopped. (Tr. 21-24)

POINTS TO BE ARGUED

1. Legal notice was given to respondent of a valid defense.

2. Respondent was put on notice as to the validity of the check and the defense to its payment.

3. Respondent is not a holder in due course under the terms of the Utah Commercial Code.

ARGUMENT

This is the Court's first opportunity to review the provisions of the Utah Commercial Code relating to the legal shelter created

by the concept of holder in due course and the requirements of the code as to value, good faith and notice of defense which would overcome that legal presumption.

The trial court disposed of this case on plaintiff's Motion for Judgment at the close of defendant's evidence, plaintiff having presented only a prima facia case. On this motion and this appeal the evidence is to be construed in favor of the defendant and all reasonable implications arising from the evidence are to be resolved in favor of the defendant-appellant similar to granting of Summary Judgment, Bridge v. Backman, 10 Ut. 2d 366, 353 P 2d 909 (1960) and Condas v. Adams, 15 Ut. 2d 132, 388 P 2d 803 (1964)

The conversations between Mr. Pappas, Mrs. Voorhees and Mr. Moreland charged the respondent with notice thereof and the implication therefrom are also charged to the respondent. The purpose of the first inquiry was to learn whether Jaeger and Branch had been paid. At this point the carpets were being held up and the respondent is charged with

notice of the fact of the inquiry, the nature of the inquiry and the reason for the inquiry. Obviously, the situation between appellant and Allo was not satisfactory and appellant was raising a question both as to use of the money paid to Allo and whether there was a claim assertable against merchandise ordered by appellant and still undelivered.

Respondent took the position on the telephone that it had been paid, and when pressed as to that took the position that it was none of the appellant's business to know of the relationship between respondent and Allo and that appellant need not concern itself with that fact, despite appellant's offer to put the name of Jaeger and Branch on the check it was sending as payment.

Upon receipt of the check it is plain that respondent had some misgivings about it and placed a call to the bank upon which the check was drawn. This was not a reasonable thing to do. Jaeger and Branch had given nothing for the check, was not releasing anything, since it denied that it was holding

up the carpets and the purpose of the inquiry would seem to be that it was trying to make itself a holder in due course and get the money out of the bank before appellant could correct the situation between it and Allo Distributing. Since appellant had gone to the trouble of calling respondent four times on the telephone the only reasonable inquiry for respondent to make when it received the check from Allo Distributing, whom it knew to be in financial distress, was to clear the matter with the Appellant and make certain that the goods to be delivered by Allo had, in fact, been delivered and that no stop payment was to be outstanding on the check. The fact is, and respondent must have been apprehensive of that very situation, that had respondent called appellant it would have been told that the check was being held up until Allo performed in accordance with their agreement, which had been intimated in the earlier telephone conversations between these parties.

Respondent is charged with this inform-

ation. Appellant plainly had a defense against Allo Distributing, the payee of the check, and upon establishing that defense the burden shifted to the plaintiff-respondent to show that it was a holder in due course, which burden the respondent did not sustain.

POINT I. LEGAL NOTICE WAS GIVEN TO RESPONDENT OF A VALID DEFENSE.

70A-3-302 U.C.A., 1953 as amended:

"(1) A holder in due course is a holder who takes the instrument

- (a) for value; and
- (b) in good faith; and
- (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person."

70A-3-304 U.C.A., 1953 as amended:

"(1) The purchaser has notice of a claim or defense if. . .

- (b) The purchaser has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged. . .

(6) To be effective notice must be received at such time and in such manner as to give a reasonable opportunity to act on it."

The notice required is defined in 70A-1-201 U.C.A., 1953 as amended:

"(27) Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information."

This legal notice is such knowledge to the respondent that Allo had not fulfilled its contract. Both appellant and Mrs. Voorhees disclosed to respondent that the delivery of carpets was being held up and that the final truckload of items had not been received. Both indicated to respondent that payment was requested for these items prior to their being received. That same knowledge imported to respondent notice that the shipments must be received before the check was valid. By the telephone calls respondent was notified

that a check was being sent conditionally, that respondent could be a payee, and that Allo had not yet performed. It was also put on notice that Allo was not paying its bills and that appellant was trying to avoid paying for his merchandise twice. Notice of this legal defense is the notice required in 70A-3-302, which nullifies the concept that respondent is a holder in due course and which under 70A-3-304, gives notice of a voidable obligation in whole or in part for failure of the consideration upon which the check was tendered. Allo falsely represented that the final shipment had been made, (Tr. 51), and it was the notification to respondent that before the check was payable this shipment was to be received which made the check voidable at the election of the maker and constituted notice to the respondent that the legal shelter afforded a holder in due course would not become respondent's legal asylum.

POINT II. RESPONDENT WAS PUT ON NOTICE AS TO THE VALIDITY OF THE CHECK AND THE DEFENSE TO ITS PAYMENT

The "due diligence" required of the claimant in 70A-1-201 (27) as to the notice received required the respondent to determine that the check had not been cancelled because of Allo's failure to comply with shipment of promised items for which the check was payment and of which respondent had been notified. This same burden is expressed in 70A-3-307, U.C.A., 1953:

"(3) After it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course."

There is a duty to inquire of the appellant as to the validity of the check when notice has been given as to the condition upon which the check was tendered. Appellant has the burden of showing a failure of that condition and respondent must then show that after "due diligence" it could not know of a claim of avoidance, to present a valid defense.

Respondent waived right to further notice and waived any interest in the matter in refusing to become a payee thereon.

The principle carried in the requirement of 70A-3-302 that respondent must take in "good faith" is defined as "honesty in fact in the conduct or transaction concerned."

70A-1-201 (19) That honesty which would require that the informed respondent return to the maker, its informant, to determine the validity of the instrument to which it became a purchaser and to which it now claims to be a holder in due course. Respondent failed entirely to exercise good faith in performing under business standards to become a holder in due course. These reasonable commercial standards become the axis of the decision under the New York Commercial Code in Potter Bank & Trust Co. v. Massey, 11 Misc. 2d 523, 171 N. Y. S. 2d 27 (1958) The Court held that the claimant's failure to make further inquiry would indicate a deliberate desire on his part to evade knowledge being of a belief or fear that an investigation

would disclose a vice in the transaction and prevent the protection of a holder in due course. This principal of good faith broadens the prior law as to inquiry by the holder to not only the actual knowledge required by the previous Utah law but to include good faith in exercising sound commercial standards before respondent could claim to be a holder in due course. Respondent refrained from such inquiry and is attempting to trap appellant, relying only on the irrelevant inquiry of the bank whether there were funds in the account.

70A-3-307 (3)

POINT III. RESPONDENT IS NOT A "HOLDER IN DUE COURSE."

The respondent made no effort to determine from the maker the validity of the check. Yet by telephone they had been notified that the condition as to payment was the receipt of the merchandise and assured appellant that no further notification was necessary for they had been paid in full. In First Pennsylvania Bank & Trust Co. v. DeLise, 168 Pa. Super 398 142 A. 2d 401, these same provisions

of the Commercial Code were considered. Defendants purchased a home improvement contract and signed a note. The note was discounted to the bank which claimed to be a holder in due course. The bank had received a telephone call from the defendants prior to the discounting of the note at the bank claiming that the work was not finished satisfactorily as of that time. The court held for defendants. The defendants contended that they notified plaintiff that they would not pay the note for failure to fulfill the contract or until the contract was fulfilled.

The court held that notice was sufficient to shift the burden upon persons claiming rights of holder in due course "where the makers of a negotiable instrument testify that it was fraudulently executed and used for a purpose not intended, a breach of faith is sufficiently established to require the endorsee to assume the burden of proving that he is a holder in due course." The telephone

conversation put the claimants on notice that a defense may exist and that notice took the plaintiff out of the protection of the legal holder in due course putting it on notice and shifting the burden to it to show that in fact it exercised due diligence in inquiry in order to be found a holder in due course.

Norman v. World Wide Distributors, Inc. 202 Pa. Super, 193 A. 3d 115 (1963) involves a "referral sales contract" and upon the principle of the Commercial Code required:

"He who seeks protection as a holder in due course must have dealt fairly and honestly in acquiring the instrument as to the rights of prior parties, and where circumstances are such as to justify the conclusion that the failure to make inquiry arose from a suspicion the inquiry would disclose a vice or default in the title, the person is not a holder in due course."

And further held, when a defense appears to be meritorious the burden of showing it was a holder in due course is on he one claiming to be such.

The holder and respondent herein had

knowledge of circumstances which should have caused it to inquire concerning the payee's method of obtaining the check. Respondent had no interest in notice of defense stating it was paid in full and did not want its name included on the check further stating that if any question arose it would call appellant. Again, there is basis to determine that respondent herein had reason to know that there existed circumstances which would have made the whole transaction with Allo voidable and the check without validity.

70A-1-201 (25) U.C.A., 1953

- (25) A person has 'notice' of a fact when
- (a) he has actual knowledge of it; or
 - (b) he has received a notice or notification of it; or
 - (c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists."

In Peoples Bank of Aurora Colorado

v. Haar, (Okla, 1966) 421 P 2d 817, plaintiff was presented two checks drawn by defendant to Western Aircraft Leasing.

The bank called drawee bank and then cashed them allowing immediate credit on the checks. Defendant became concerned that he would not get the interest in Western Aircraft Leasing which he purchased and so stopped payment. The bank claimed to be a holder in due course under the Oklahoma Commercial Code. The case was remanded upon the claimed defense that the bank had not taken in good faith in failing to ascertain the consideration for the checks.

"The evidence did not show clearly what his agreement was with the payees, but it did indicate the possibility of a defense as between the defendant and the payees. This is all that is required by the law to place upon the plaintiff the burden of proving that it was in good faith and had no knowledge of the defense."

Budget Charge Accounts v. Mullaney,

187 Pa. Super 190, 144 A. 2d 438 (1958). The Court found that negotiation of a note before installation of the appliance pursuant to the underlying contract "might well raise a jury question as to whether the negotiation was for

the purpose of cutting off the defense of fraud in the inception and so affecting the good faith of the holder". If so, the plaintiff could not prove that it is a holder in due course "without notice that [the note] is overdue or has been dishonored or of any defense against or claim to it on the part of any person." Therefore, the maker was permitted to open the judgment.

"The burden of proving that an instrument is taken in good faith and without knowledge of a defense is placed upon a party claiming to be a holder in due course after the adverse party introduces evidence indicating the possibility of a defense to the instrument as between the payor and payee." Peoples Bank of Aurora, Colorado v. Haar, 421 P 2d 817, supra.
(Syllabus of the Court)

What the respondent has shown is that it is a holder of the appellant's check. It has not carried its burden further to show that it is a holder "for value", "in good faith" or "without notice." 70A-3-302 U.C.A. 1953 Having failed to comply with either of these requirements respondent cannot be heard to claim the protection of a holder

in due course.

CONCLUSIONS

Appellant gave legal notice to respondent that the check was tendered on condition precedent to validity and thus "voidable" upon failure of that consideration. Respondent did not put forth "due diligence" to determine its rights as a holder nor did it desire further notice of defense but sought to avoid knowledge of it. Respondent failed to carry its burden that as a holder it took "for value", "in good faith" and "without notice". It was error to grant the Motion for Judgment and the judgment should be reversed.

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