

1983

## **Claron D. Bailey v. Deseret Federal Savings And Loan Association : Brief of Respondent**

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IN THE SUPREME COURT  
OF THE STATE OF UTAH

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CLARON D. BAILEY, )

Plaintiff-Respondent, )

vs. )

Case No. 18961

DESERET FEDERAL SAVINGS AND )

LOAN ASSOCIATION, )

Defendant-Appellant. )

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BRIEF OF RESPONDENT

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STATEMENT OF CASE

Mr. Bailey, Assignee of a second position Trust Deed sued defendant, Trustee on the first position Trust Deed, for an accounting and for distribution of the excess proceeds of a Trustee's Sale. The court below found that the amount bid exceeded the amount due to Beneficiary of the Trust Deed and awarded the excess to plaintiff. Defendant appeals, claiming the lower court had no jurisdiction and/or that the case was barred by res judicata.

DISPOSITION IN LOWER COURT

This matter was tried, without a jury, before the Honorable Homer F. Wilkinson of the Third Judicial District Court, on the 1st and 2nd days of July, 1982. After the close of the evidence and the submitting of legal memoranda by both parties, the Court entered its Memorandum Decision on July 30, 1982. On January 7, 1982, the Court entered its Findings of Fact, Conclusions of Law, and Judgment awarding to Plaintiff and against Defendant the total

sum of Two Thousand Thirty Two Dollars and Fifty-Eight Cents (\$2,032.58) together with interest and costs of court.

RELIEF SOUGHT ON APPEAL

Respondent seeks affirmance of the judgment of the court below.

STATEMENT OF FACTS

Respondent agrees with Appellant's statement of facts where not inconsistent with the statement below.

Deseret Federal Savings and Loan Association hereinafter referred to as "the bank", without notice to the junior lien claimant's, petitioned the bankruptcy court to order the bankruptcy trustee to surrender possession of Lot 46 HIDDEN VALLEY HILLS No. 1 Subdivision praying as follows:

WHEREFORE, plaintiff prays that JOHN C. GREEN, Trustee, be directed to surrender possession of Lots 19, 44, 46 and 21, and that plaintiff be allowed to complete the sale of said real property at Trustee's Sale. (R. 39)

The bankruptcy court ruled "that the relief sought in the complaint by Deseret Federal Savings and Loan is granted . . ." (R. 42)

The bank, acting as Trustee, then noticed the sale of Lot 46. Upon learning of the pending sale, Mr. Bailey filed a complaint in bankruptcy court as a third position mechanic's lien holder and as a sixth position purchaser on a Uniform Real Estate Contract from the bankrupts to prevent the Trustee's Sale of the property and to invalidate the banks first position. (R. 43)

Mr. Bailey's Complaint prayed basically as follows:

1. That defendant's Trust Deed be voided.
2. That plaintiff be allowed to bring the loan current.
3. That the bankruptcy Trustee abandon and disclaim any

interest in and to the subject property as a burdensome asset.

4. That the court enjoin the Trustee's Sale.

5. That the court award damages to plaintiff against defendant for wrongful dispersal of loan funds. (R. 48)

Though Mr. Bailey obtained an Order staying the Trustee's Sale, it was not timely served, and the Sale proceeded. (R. 63) At sale the bank bid Forty Eight Thousand Nine Hundred and Seventy Four Dollars and Fourteen Cents (\$48,974.14) which bid exceeded the amount actually due the bank by \$2,032.58 according to the findings of the court (R. 122-125). After sale the bank moved to have Mr. Bailey's complaint dismissed. The court dismissed the complaint.

Mr. Bailey, taking the position of second lien holder which he had obtained by assignment from Ivory and Company, then brought an action in the Third Judicial District Court. Mr. Bailey's state court action for the first time raised the statutory claim under U.C.A. 57-1-29\* requesting distribution of the proceeds of the Trustee's Sale against the bank as trustee. Though Mr. Bailey's complaint contained other claims against the bank, only the claim under U.C.A. 57-1-29 for distribution of excess proceeds at Trustee's Sale was considered by the court as a basis for its award. (R. 122-123)

The bank, prior to trial, brought a Motion for Summary Judgment claiming that the bankruptcy court's dismissal of plaintiff's complaint was res judicata as to Mr. Bailey's state court claims. In response to defendant's Motion for Summary Judgment, Mr. Bailey's counsel provided an Affidavit to the court, which Affidavit was uncontested by defendant. It provides in pertinent part as follows:

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\* For full text of U.C.A. 57-1-29, see Appendix 1

[Referring to the statements of Judge Ralph R. Mabey at the hearing defendant's Motion to Dismiss on November 13, 1979]

The Judge stated that because of the secured claims on the subject property, and the amount of the proceeds at the Trust Deed Trustee's Sale, the bankruptcy trustee, John Green, would have no claim on those proceeds, and the Bankruptcy Court would not be interested in adjudicating the claims to those funds. Therefore, the bankruptcy Judge suggested that the Bankruptcy Court should not be involved in this aspect of this matter, i.e. the adjudication of priority in the funds received by the trustee, Edward M. Garrett, acting on behalf of the defendant.

That he, the affiant, has on several occasions had telephone conversations with the bankruptcy trustee, John Green. That John Green, as trustee, has made the following representations:

(a) That he, as trustee, has no claim on the proceeds of the Trust Deed Trustee's Sale, conducted on behalf of the defendant on November 9, 1979.

(b) That the order of the bankruptcy court (Exhibit "C") was drafted for the purpose of extinguishing the rights of the junior lien claimants to the subject property such that if the property were thereafter sold by the defendant, Deseret Federal, Deseret would be required to account to the bankruptcy court for the funds received from such subsequent sale in excess of those paid at the original trustee's sale on November 9, 1979.

(c) That as far as he is concerned as trustee for the bankrupts' estate, the claims of the secured lien creditors attached to the proceeds received by Deseret at their trustee's sale in the same priority as they were previously attached to the subject real estate, and that he, as trustee for the unsecured creditors, would only claim an interest in the proceeds received from a subsequent sale by Deseret in excess over those received by Deseret's trustee's sale on November 9, 1979. (R. 64-65)

Judge Sawaya ruled that the previous dismissal by the bankruptcy court was not res judicata to the state court action. (R. 69)

At trial the court found that Mr. Bailey was Assignee of the Ivory & Company second Trust Deed (R. 113) and entitled to the excess proceeds at Trustee's Sale. (R. 113, 122-125). The court further found that the proceeds of sale exceeded by \$2,032.58 that

which the bank was entitled under the Trust deed pursuant to 457-1-29 (R. 113, 122-125). The bank does not here dispute these findings of the trial court.

ARGUMENT

POINT I: THE BANKRUPTCY COURT'S DISMISSAL OF MR. BAILEY'S COMPLAINT WAS NOT RES JUDICATA AS TO THE ISSUES TRIED SINCE BOTH THE POSITIONS OF THE PARTIES AND THE ISSUES WERE DIFFERENT IN STATE COURT.

The essence of the bank's first point on appeal is that the nature and gist of Mr. Bailey's bankruptcy complaint and Mr. Bailey's state court complaint were identical, making dismissal of the bankruptcy court complaint a bar to the action filed in the state court. Even a superficial examination of the complaints demonstrates rudimentary differences.

Bankruptcy Court Complaint

State Court Claims Upon Which Court Granted Judgment

Position of Plaintiff

Position of Plaintiff

Third Position Mechanics Lien Holder and/or Purchaser under Uniform Real Estate Contract from Bankrupts.

Assignee of Ivory and Company's Second Position Trust Deed. (R. 003, Paragraph 10.a.)

Relief Sought Against Bank As Lender

Relief Granted Against Bank As Lender

1. For an Order declaring defendant(s) . . . Deed of Trust void and requiring said defendant to release the same from the subject property.

NONE

2. For an Order requiring defendant Deseret to accept payment from plaintiff. . . and reinstating said note and Trust Deed . . .

Bankruptcy Court Complaint

State Court Claims Upon Which  
Court Granted Judgment

5. For damages against the defendant Deseret for its breach of its fiduciary duty to the plaintiff in wrongfully disbursing funds on the loan . . . and for an Order requiring Deseret to account for all transactions with regard to the subject loan . . .

NONE

Relief Sought Against Bank  
In Its Position as Trustee

Relief Granted Against Bank  
In Its Position as Trustee

4. For an Order enjoining the sale by the defendant and its attorney scheduled for November 9, 1979 at 10:00 a.m.

[For an Order] to pay to the plaintiff and the other party entitled to the proceeds of Trustee's Sale such amounts and in such priority as the court shall determine.

It is clear from the comparison above, that the court based its award only upon that which was new and unique to the state court complaint. The court's memorandum decision provides in pertinent as follows:

The Court further finds that when the Bankruptcy Court refused to take jurisdiction over the excess funds, if there be any, then the State Court could proceed pursuant to §57-1-29 to adjudicate the priority and the rights to the proceeds of the trustee's sale.

That the plaintiff did take an assignment of a trust deed from Ellis R. Ivory, successor in interest to Ivory, Inc. formerly known as Ivory Company, a Utah corporation and stands in their position as far a priority is concerned. That the note and trust deed provides for 9% interest and that the defendant in the foreclosure proceedings did charge interest at the rate of 10% from the date the note was declared due and payable. This was agreed to in the construction agreement but was not in the security agreements and the Court finds it was an improper charge at the trustee sale. The Court also finds that the attorney's fees were excessive, that a proper attorney fee would be the amount of \$3,000.00 and \$200.00 costs.

Based on the foregoing, the Court awards judgment to the plaintiff in the sum of \$650.67 and \$300.00 as amounts received at the trustee sale over and above what the beneficiary is entitled to. (R. 113-114)

Later the court amended its decision, and awarded Mr. Bailey an additional \$1,081.91 for foreclosure attorney's fees bid at sale but not actually paid by the bank. (R. 125, paragraph 10)

The case cited by the Bank, Krofcheck v. Downey State Bank, 580 P.2d 243 (Utah, 1978) lists three criteria which must be met before a cause of action is barred by the doctrine of res judicata: Identity of parties, identity of claims and disposal of those claims on the merits. Let us examine these points separately.

(1) The two cases must be between the same parties or their privies.

Though one of the named plaintiffs and one of the named defendants in the bankruptcy suit are the plaintiff and defendant in this case, their positions and capacities are different.

Mr. Bailey sued in bankruptcy court as a third position mechanic's lien holder and as a sixth position purchaser of the bankrupts' equity in the property. (R. 003) In the state court action, Mr. Bailey was granted relief as the assignee of the position of Ivory and Co. (R. 122) In Conway v. Mosher 103 P.2d 456 (Ariz., 1940) the Arizona Supreme Court held that where the Assignor (State of Arizona) had not been a party to a quiet title action its grantee or assignee was not bound by the quiet title action even though the grantee had been a party to the action in a different capacity.

. . . [I]f the state was not foreclosed by the action to quiet title, neither was its assignee or grantee. (P. 467)

Likewise, if Ivory and Company's interest against the bank was not foreclosed by the bankruptcy dismissal, then neither was its assignee (Mr. Bailey) even though he was a party to the bankruptcy complaint.

The Bank was sued in the first action primarily as a first position lien holder and as a lender. Mr. Bailey challenged the bank's right to be in first position, claiming that as a lender the bank had failed to properly distribute the construction loan funds to Bailey who had provided materials to the property. In the state court action, Mr. Bailey was granted judgment against the Trustee who happened to be the bank but could just as well have been a title company or an attorney. The different capacities of the bank in the two actions should be considered by the court.

Professor James Wm. Moore's Treatise on Federal Practice at Res Judicata Paragraph 0.411 [3.-2] Volume 1B Page 427 states as follows:

As we have seen, the practical view of parties for purposes of res judicata centers on the interest that is litigated rather than the names that appear in the pleadings . . . The capacities rule is but the other side of the coin; where the names are the same but the interests put into the litigation belong to others, res judicata follows the interest and not the name.

Since Mr. Bailey asked the bankruptcy court to order the bank as trustee to stay the Trustee's Sale, Respondent unfortunately cannot claim complete lack of identity of the parties, but the different capacities in which the bank serves relative to the claims in the two actions is at least illustrative of the differences in the transactional facts of the two actions.

(2) There must have been a final judgment on the merits of the prior case.

Rule 41(b) of the Federal Rules of Civil Procedure, provides that an involuntary dismissal is a dismissal on the merits. The record indicates that the dismissal was in fact voluntary and therefore not with prejudice. Counsel for Mr. Bailey submitted his Affidavit to the court which provides in part as follows:

8. Judge Ralph R. Mabe granted a temporary restraining order on November 9, 1979, at 10:00 a.m. However, the order was not timely served on the defendant's trustee until after the trustee's sale had been accomplished. In connection with the issuance of the temporary order, the Court set a hearing date in this matter for November 13, 1979. Both the undersigned affiant and counsel for the defendant were present at the hearing.

9. At the hearing referred to above, the issues raised by the plaintiff in its complaint in the Bankruptcy Court were not tried, and the matter was not dismissed with prejudice. The matter was dismissed after discussion between counsel and the Court because the issue of whether the sale should be delayed and whether the plaintiff should be allowed to cure the loan with the defendant were moot. It was understood by the Judge and counsel, that the funds received at the trustee's sale did not exceed, by far, the amount of the secured claims on the property. The Judge stated that because of the secured claims on the subject property, and the amount of the proceeds at the Trust Deed Trustee's Sale, the bankruptcy trustee, John Green, would have no claim on those proceeds, and the Bankruptcy Court would not be interested in adjudicating the claims to those funds. Therefore, the bankruptcy Judge suggested that the Bankruptcy Court should not be involved in this aspect of this matter, i.e. the adjudication of priority in the funds received by the trustee, Edward M. Garrett, acting on behalf of the defendant.

This court should find that the plaintiff's undisputed agreement to the dismissal limited the res judicata effect of the dismissal to only those items specifically raised in the bankruptcy complaint.

(3) The prior adjudication must have involved the same issue or an issue that could or should have been raised therein.

The court below gave judgment to Mr. Bailey ordering the bank to distribute the excess proceeds of sale to plaintiff pursuant to

Utah Code Annotated §57-1-29. No claim for distribution of excess proceeds of sale was raised in the bankruptcy court complaint. In fact, no claim could have been made in the complaint since the sale had not yet taken place. On the contrary, the fervent intent of Bailey's complaint in bankruptcy court was to prevent the sale from taking place. It was only after the essence of his complaint had been mooted by sale of the property and after the bankruptcy court had indicated that it did not care to be involved in the dispute over the proceeds of the Trustee's Sale (R. 63, 64) that the state court action was brought.

It is clear that the state court cause was not actually brought in the earlier case. "Could or Should" the claim have been raised in the bankruptcy court? The could or should language of Utah and many other state cases is not very helpful. No court, including Utah's, has interpreted "should or could" to mean "was it possible to". Any permissible counterclaim, for instance, could be brought in an action by defendant, but only compulsory counterclaims are barred by res judicata if the defendant fails to raise them.

Arizona interprets "could or should" to mean "could have been brought based upon the points in the record." Vance v. Vance 601 P.2d 605 (Ariz. 1979). Kansas used a different test. "Could the claim have been litigated under the facts which gave rise to the cause of action?" Jay Hawk Equipment Company vs. Mentzer 379 P.2d 342 (Kan., 1973). Any specific Utah test has escaped Respondent's research. If this court has not adopted a specific test, Respondent respectfully submits that the Rule proposed in the restatement (second) and argued for by Professor Moore is the preferable rule.

The Restatement of the Law Second Judgments 2d  
Vol. 1 §24 provides as follows:

(1) When a valid and final judgment rendered in an action extinguishes the plaintiff's claim pursuant to the rules of merger or bar, the claim extinguished includes all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of transactions, out of which the action arose.

(2) What factual grouping constitutes a "transaction" and what groupings constitute a "series", are to be determined pragmatically, giving weight to such considerations as whether the facts are related in time, space, origin or motivation, whether they form a convenient trial unit and whether their treatment as a unit conforms to the parties expectations or business understanding or usage.

The transactional facts of the two cases are disparate. The first cause dealt with allegations of a defective Trust Deed and wrongful pay out of construction loan funds to the damage of a materialman who supplied materials to the construction site. The complaint asked for damages as a result, for voiding of the first position Trust Deed and for injunction of Trustee's Sale or for reinstatement of the loan. The state court cause resulted in an order causing the Trustee on the Trust Deed to disperse excess proceeds of sale. No damages were awarded nor was the bank's first position Trust Deed invalidated. The transactions are separated in time, space and origin and could reasonably be expected from a business standpoint to be considered separate transactions. Defendant must argue that if a junior lien claimant unsuccessfully attacks a first position lender, that lien claimant automatically loses all position in the property and may not pursue excess proceeds at Trustee's Sale. The facts of this case require defendant to take this argument even further. Since Mr. Bailey's bankruptcy court complaint was based on a third and sixth position in the property where his state court

complaint was based on a second position in the property which was assigned to him, the bank would have the court rule that should a third position lien holder unsuccessfully challenge the rights of a first position lender that all junior lien holders lose all their rights to the property whether they are parties or not.

The bankruptcy court's order did not bar plaintiff's complaint in the state court.

POINT II: THE BANKRUPTCY COURT'S ORDER ON ITS FACE CLEARLY DOES NOT EXTEND THE JURISDICTION OF THE BANKRUPTCY COURT THROUGH TO THE PROCEEDS OF SALE

While it is true that 28 U.S.C. §1471 grants exclusive jurisdiction over the property of the bankrupt to the bankruptcy court. It is just as clear that the bankruptcy trustee may on his own motion or upon petition by other claimants, abandon jurisdiction of the property. 11 U.S.C. §554 provides in pertinent part as follows:

(a) After notice and a hearing, the Trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate.

(b) On request of a party in interest and after notice and a hearing, the court may order the Trustee to abandon any property of the estate that is burdensome to the estate and that is of inconsequential value to the estate.

\* \* \*

Though the banks complaint in reclamation to obtain abandonment of real property was an unorthodox if not incorrect procedure for a secured creditor, it nevertheless was effective and the bankruptcy court abandoned its jurisdiction as follows:

That the relief sought in the complaint by Deseret Federal Savings and Loan Association is granted and said Association may proceed to Trustee's Sale on the real property described in the complaint herein pursuant to the laws of the state of Utah. (R. 40-41)

Once the bankruptcy court has abandoned property, it is irrevocable. In re Polumbo 271 F. Supp 640 (DC Va., 1967). Though the court clearly abandoned the property, the bank to obtain such a ruling, stipulated and agreed that should it obtain the property at the Trustee's Sale, it would then offer this property for sale in a commercially reasonable manner and pay the excess to the court. The second part of the Order of the Court provided as follows:

In the event that Deseret Federal Savings and Loan Association should be the successful bidder at the Trustee's Sale and shall acquire title to part or all of the real property herein, free of other liens, then the property so acquired shall be offered for sale by the Association in a commercially reasonable manner and in the event that the sum in excess of that necessary to fully satisfy the note, Trust Deed, interest, costs and attorney's fees is realized upon the sale, such excess shall be paid over to the court for further disposition. (R. 40-41) (Emphasis added)

Though Deseret Federal acquired the property, the results of a commercially reasonable sale are not in evidence or issue in this action. It is clear that any amounts to be paid into bankruptcy court are amounts realized from a second sale, a commercially reasonable sale, not the Trustee's Sale.

The Third Judicial District Court was put into a position of having to interpret the meaning and import of a bankruptcy order. On its face and with the further clarification given by the affidavit of James R. Ivins, the court reasonably construed the order of the bankruptcy court to mean that the bankruptcy trustee had abandoned any claim to the proceeds of the Trustee's Sale and that the priority and distribution of the proceeds of the Trustee's Sale could be distributed as the state court directed pursuant U.C.A. 57-1-29. The lower court did not err in its interpretation that the bankruptcy court had abandoned its interest in the proceeds.

POINT III: DEFENDANT FAILED TO FOLLOW APPROPRIATE PROCEDURE FOR HAULTING THE ACTION IN STATE COURT

It was defendant's responsibility to get an Order from the bankruptcy court staying the proceeding and superceding the jurisdiction of the state court. The bank argues that the purpose and effect of the bankruptcy court orders have been thwarted by action in the state court. Substantially prior to trial, the bank brought a Motion for Summary Judgment. In its memorandum, the bank argued as follows:

It must be conceded that the bankruptcy court had full and complete jurisdiction of all matters relating to the said Lot 46 and acted thereon. That being the case, this court has no jurisdiction over the matters sought to be litigated by plaintiff. This jurisdiction continues over the property of the bankrupt until the bankruptcy court formally divests itself of jurisdiction by abandonment or in some other manner. (R. 19,20)

When the state court clearly rejected the bank's interpretation of the bankruptcy court rulings, the bank should have gone back to bankruptcy court to obtain an order clearly asserting the bankruptcy court's desire to maintain jurisdiction over the property. This would have been a relatively simple procedure and had that been the true intent of the bankruptcy court the trial and this appeal would have been avoided. Respondent submits that the bank should be estopped from asserting a contrary interpretation of the bankruptcy court's order.

CONCLUSION

The judgment by the court below was based upon the plaintiff's suit for an order directing the disposition of proceeds of the Trustee's Sale pursuant to §57-1-29 U.C.A. This issue was neither raised nor litigated in the bankruptcy court. The directed

distribution to Mr. Bailey was based on the rights of the Ivory second trust deed. The state action below arose only after the Bank as trustee conducted the sale while the bankruptcy court action was commenced prior to the trustee's sale and sought to prevent the trustee's sale and to adjudicate the validity of the first lien of the bank. Mr. Bailey's action in this matter was not, therefore, barred by res judicata. The lower court did not err in so holding nor did the court err in its findings that the bankruptcy court had abandoned the proceeds of the trustee's sale by its specific order. The judgment of the lower court should be affirmed.

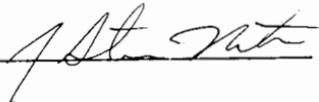
RESPECTFULLY SUBMITTED this 11th day of August, 1983.

NEWTON & IVINS

By   
J. STEVEN NEWTON

CERTIFICATE OF MAILING

I hereby certify that two correct copies of the foregoing RESPONDENT'S BRIEF were mailed to Edward M. Garrett, Joseph E. Hatch, GARRETT & STURDY, 311 South State Street, Suite 320, Salt Lake City, UT 84111 this 11th day of August, 1983.

  
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APPENDIX 1

57-1-29. Proceeds of trustee's sale—Disposition.—The trustee shall apply the proceeds of the trustee's sale, first, to the costs and expenses of exercising the power of sale and of the sale, including the payment of the trustee's and attorney's fees actually incurred not to exceed the amount which may be provided for in the trust deed, second, to payment of the obligation secured by the trust deed, and the balance, if any, to the person or persons legally entitled thereto, or the trustee, in his discretion, may deposit the balance of such proceeds with the county clerk of the county in which the sale took place. Upon depositing such balance, the trustee shall be discharged from all further responsibility therefor and the county clerk shall deposit the same with the county treasurer subject to the order of the district court of said county.

History: L. 1961, ch. 181, § 11.