1966

M & S Construction & Engineering Company v. Clearfield State Bank and Vern M. Smith, et al.. : Brief of Appellants

IN THE SUPREME
OF THE STATE

M & S CONSTRUCTION
ENGINEERING CO.

vs.

ELMARFIELD, INC.

STERN M. SMITH

BRIEF

Appeal from

Hon.

FILED

OCT 2 2 1966

Supreme Court, Utah

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Ogden, Utah
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TABLE OF CONTENTS

AUTHORITIES CITED

Cases

TABLE OF CONTENTS — (Continued)

Texts and Statutes

IN THE SUPREME COURT OF THE STATE OF UTAH

M & S CONSTRUCTION & ENGINEERING COMPANY,
Plaintiff,

-vs-

CLEARFIELD STATE BANK,
Defendant,

VERN M. SMITH, et al.,
Additional Defendants.

Case No. 10708

BRIEF OF APPELLANTS

NATURE OF THE CASE

Plaintiff's action was for damages against the Bank at Clearfield upon two grounds: (a) breach of agreement to extend financing assistance to the extent of $50,000 on a continuing or revolving line of credit basis, as required by plaintiff, to take care of payrolls and operating costs pending receipt of payments from the prime contractor on the basis of monthly estimates; and (b) damages for improper appropriation by the Bank of funds belonging to plaintiff, received by the Bank in trust subject to prior payment of all debts for labor and lienable obligations of plaintiff.

DISPOSITION IN LOWER COURT

The case was submitted to the jury on the first cause of action on special interrogatories (R. 87) as to (a) whether such an agreement was made by the Bank; and (b) whether the Bank breached the agreement. Both interrogatories were answered by the jury in the affirmative.

Thereafter, the jury was requested to assess the damages suffered by plaintiff on the basis of instructions given by the Court as to the elements to be considered in fixing damages for breach of contract. (R. 88-91). The jury then rendered its verdict fixing plaintiff's damages in the sum of $156,000.00. (R. 95)

Issues pertaining to the second cause of action were not submitted to the jury, but were reserved for determination by the Court as a matter of law on the basis of the uncontradicted evidence; the Trial Court having theretofore determined that the measure of damages would be the same in the second cause of action as in the first, since the result to plaintiff was the same, namely forfeiture of its contract rights under the Steenberg contract.

Thereafter, defendant Bank filed its motion for judgment notwithstanding the verdict (R. 97-99) which was granted by the Trial Court upon two grounds: that the contract for financing was unenforcable because it was in violation of the Statute of Frauds, as one which was not to be performed within one year; and that the fund represented by the $38,862.54 check from Steenberg

was not received by the Bank in trust as a special deposit or deposit for a special purpose, and hence that is was available to the Bank for its appropriation and application as it saw fit. (R. 108-112).

RELIEF SOUGHT ON APPEAL

Plaintiff seeks to have the verdict of the jury reinstated and the final judgment entered thereon, or in the alternative that the judgment be entered as a matter of law on the second cause of action on the basis of the uncontradicted evidence. Plaintiff and Additional Defendant Vern M. Smith seek to be relieved from affirmative judgments entered against them on several notes.

STATEMENT OF FACTS

Steenberg Construction Company had a general contract to construct the Lost Creek Dam for the Bureau of Reclamation on the Weber Basin Project. Steenberg, in turn, made a subcontract dated June 17, 1963, with plaintiff M & S Construction Company for digging the core trench portion of the job (Exhibits A and I) with the usual provisions for monthly payments to be made by Steenberg to M & S on the basis of monthly estimates as to value of labor performed and materials furnished, remittance to be made to M & S by Steenberg from money received from the Bureau, less 10% to be retained by Steenberg until final completion of the subcontract.

The subcontract also contained provisions requiring M & S to pay all costs of labor and materials as the same

became due and to save Steenberg harmless for all claims and mechanics' liens on account thereof, and to furnish Steenberg *as and when requested satisfactory evidence that M & S had complied with such payment obligations.* The subcontract further provided that if M & S shall default in performance of the contract, Steenberg shall have the right to take over the job, have full access to and use of all equipment in the care, custody and control of M & S, and to take over and complete the contract itself (see paragraphs I (a), V, XII, and paragraphs 1 (d) of the agreement of the contractor on page 2 of Exhibits A and I.)

In general business practice such contracts call for financial assistance by the contractor to carry payrolls and obligations and to pay installment payments on equipment and materials until the receipt of monthly estimate payments (T. 66, 81, 82), particularly in the early stages of the job. (T. 66, 81, 82) M & S and its principal stockholders were depositors with defendant Bank so the Bank, through its Executive Vice President, Mr. Jesse D. Barlow, solicited the business of furnishing this financial service to M & S. (T. 23, 24) At first, M & S did not feel that it would need such assistance, because it had practically completed two jobs, one at Dugway Proving Grounds and another at Cedar City Airport, from which it was about to receive final payment; but early in August, 1963, M & S accepted the invitation of Mr. Barlow for the Bank to furnish this assistance on the Bank's financial plan for a revolving or continuing line of credit (T. 80, 82, 113, 114). This arrangement was consummated on or about August 23, 1963. The limit of

credit was first set at $25,000.00, and then raised to $50,000.00, to be utilized as needed, and effectuated by the making and renewal of short-term notes to cover payroll checks and other lienable expenditures, in accordance with a pattern described by Mr. Barlow of the Bank, and as found by the Court and jury to be true as alleged by plaintiff (T. 87). Before making this agreement, however, the Bank requested and received a copy of the M & S contract with Steenberg, submitted the same to its counsel, and discussed the merits of the agreement with Mr. Walsh, Steenberg's vice president (T. 66).

To secure the defendant Bank against loss, the Bank had its counsel prepare an assignment of all funds due or to become due to M & S from Steenberg under the subcontract, *totaling an estimated $754,579.00, as collateral security* for all loans *made and to be made by* the Bank to M & S, (see Exhibit B) which assignment was executed by M & S, notarized by Mr. Barlow, and then transmitted by the Bank to Steenberg for acceptance, which was done on August 23, 1963.

The defendant Bank thereafter, as additional security, also took similar assignments of all funds due and to become due to M & S on the jobs at Cedar City ($30,000.00), and at Dugway ($5,000.00) (T. 15, 17, 183), in addition to chattel mortgages on the interest of M & S in various equipment then owned or being purchased by M & S.

The financing arrangement was performed according to agreement during September, 1963. Payroll checks were drawn and honored as presented, and short-term

loans were made and a note was renewed as agreed. The September estimate for work done during August was duly received by check made payable to the Bank and M & S, with an endorsement on the back of the check to be signed by both that all obligations for labor and materials had been paid (see the reverse side of Exhibit G) and during this period M & S continued to issue its payroll checks to its employees which were duly honored by the Bank. This was in accordance with the pattern established as a part of the financing agreement for the revolving or continuing credit between the Bank and M & S as described by Mr. Barlow, with the understanding that all such checks were to be countersigned by Mr. Claire A. Nielson, an accountant acceptable to the Bank. (T. 62, 63, 128).

The October payment from Steenberg for work done during September, 1963, was delayed in arrival for reasons that are not material to this appeal, so the defendant Bank, through its Executive Vice President, Mr. Jesse Barlow, personally undertook the job of obtaining the money from Steenberg; made long distance phone calls to Mr. Walsh of Steenberg to find out why the delay, and Mr. Walsh explained to him that the Government had not transmitted funds as promptly as usual because of a change in location of the accounting office (Exhibit H); but finally, on October 23, 1963, a check for $38,862.54 from Steenberg, made payable to M & S and the Bank, arrived, with an endorsement on the reverse side to be signed by both M & S and Mr. Barlow for the Bank, as set forth verbatim in our discussion under Point II. This check was accompanied by a letter of transmittal signed

by Steenberg addressed to the defendant Bank, also set forth verbatim in our discussion of Point II.

In the meantime, these payroll checks on the Lost Creek job had been given to laborers in accordance with the Agreement, and the same had been permitted to accumulate in the Bank. (T.128).

The letter of transmittal from Steenberg, with the check, arrived at the post office at Clearfield, Utah, in the evening, after the close of business, but Mr. Barlow, not content to wait until the morrow, got the postmaster to go down to the post office to get it out, called Mr. Mendenhall of M & S to come over and endorse the check, and then had an officer of an Ogden bank, its correspondent, put its stamp on the check following an endorsement by Mr. Mendenhall of M & S and the endorsement by defendant Bank; and then the Ogden bank officer personally took the check to the airport in Salt Lake that same night for mailing to St. Paul, Minn., for payment. It was during this time, while the Bank was waiting for the check to clear that M & S became fearful that the Bank might not honor its financing agreement, so it had its attorney, Mr. Pritchett, call on Mr. Barlow at the Bank to urge the Bank to adhere to its financing agreement. (T. 89, 90) Mr. Barlow requested Mr. Pritchett not to communicate to Steenberg any intimation of trouble between the Bank and M & S until after the check had cleared. Then, when Mr. Barlow had been advised personally by Mr. Walsh of Steenberg over long distance phone that the check had cleared, he called Mr. Stoker of M & S into the Bank and then for the first and final

time directed that all payroll checks of M & S on the Lost Creek job were to be dishonored, payment refused, (T. 127, 131), and directed that the amount of the check be credited to obligations of M & S to the Bank and its officers excepting only a small amount, one of which obligations so paid was not yet due, including also a $2,000.00 note owned by Mr. Barlow and Mr. Steed personally, and one note subject to the renewal agreement.

The result was of course that Steenberg immediately defaulted M & S on the job, made arrangements to pick up the outstanding payroll checks, took over all equipment, and M & S lost not only its investment in the job amounting to $100,129.91 (Exhibit N), but also its anticipated profit; all as found by the verdict of the jury to be in the sum of $156,000.00. (T. 129, 134)

The jury found for M & S on all issues on the basis of the Trial Court's instructions as to the issues on the first cause of action and as to the measure of damages.

The Trial Court then, upon motion of the defendant bank, considered the Bank's motion for judgment notwithstanding the verdict, which was thereafter granted on July 12, 1966 upon the following grounds:

1. That the financing contract for revolving credit between M & S and the Bank was invalid because it was barred by the Statute of Frauds as contemplating action not to be performed within one year; and

2. That the evidence did not show that the deposit of $38,862.54 received by the Bank from Steenberg on October 23, 1963, was received in trust as a deposit for

special purpose, namely to pay for labor and materials on the job; and hence was available to the Bank for its appropriation.

This appeal is from the order and judgment of the Trial Court in making and entering that judgment notwithstanding the verdict of the jury.

POINT I

THE DISTRICT COURT ERRED IN HOLDING THAT THE AGREEMENT UPON WHICH APPELLANT BASED ITS CAUSE OF ACTION AND WHICH AGREEMENT WAS FOUND BY THE JURY IN ANSWER TO SPECIAL INTERROGATORY TO HAVE EXISTED IN FACT, WAS BARRED BY THE PROVISIONS OF 25-5-4 (1) UTAH CODE ANNOTATED, 1953, IN THAT SAID AGREEMENT BY ITS TERMS WAS NOT TO BE PERFORMED WITHIN ONE YEAR FROM THE MAKING THEREOF.

During the course of this lawsuit there has been mention of several contracts, subcontracts and agreements. We are presently concerned with one and only one of these, namely the Bank's agreement to finance M & S on the Lost Creek Dam Project, as alleged in appellant's second cause of action. There is no question as to whether or not such Agreement did in fact exist for such was resolved in the affirmative by the jury's answer to Special Interrogatories. The question remains to be resolved by this Court as to whether or not such Agreement is enforcible under the provisions of the Utah Statute of Frauds found at 25-5-4 (1) Utah Code Annotated, 1953, which reads as follows:

> In the following cases every agreement shall be void unless such agreement or some note or

memorandum thereof is in writing subscribed by the party to be charged therewith:

(1) Every agreement that by its terms is not to be performed within one year from the making thereof.

(2) *****

(3) *****

(4) *****

(5) *****

The nature of the Agreement was such that the Bank agreed and promised to lend to M & S, as and when required by M & S, for the purpose of providing finances to carry on its work under the terms and provisions of the subcontract between M & S and Steenberg Construction Company, certain sums of money and to renew such loans from time to time to the date of final payment by Steenberg Construction Company (T. 87). M & S contends that there is nothing within the terms of the subcontract referred to which by the terms thereof negate the possibility of performance within one year from the making of the agreement to loan money. Such factor is extremely significant as will appear from an analysis of the authorities on this subject.

In discussing this point of law 2 Corbin on Contracts 534 states at Section 444:

> . . . In its actual application . . . the courts have been perhaps even less friendly to this provision than to the other provisions of the Statute. They have observed the exact words on this provision and have interpreted them literally and very narrowly. . . . In general the cases indicate that there

must not be the slightest possibility that it (the Agreement) can be fully performed within one year.

It makes no difference how long the agreed performance may be delayed, or over how long a period it may in fact be continued. It makes no difference how long the parties expect the performance to take or how reasonable and accurate those expectations are, if the agreed performance can possibly be completed within a year. Facts like these do not bring a contract within the Statute. A provision in the contract fixing a maximum period within which performance is to be completed, even though that period is much in excess of one year, does not make the Statute applicable. A building contract is frequently such that it can be fully performed within one year. If so, it is not within the one year clause however long the parties may expect to take or actually do take.

In the subcontract referred to above there was a fixed time limit within which such contract had to be performed, however, there was no provision which in any way could have been construed to negate the possibility of performance within one year.

In *Gronvold v. Whaley,* 39 Wash. 2d 710, 237 P.2d 1026, the Supreme Court of Washington held that where a performance of a certain agreement was not possible until a certain dam was completed, that the fact that the dam could have been completed within one year, but was not expected to be and was not in fact completed for three years, did not place the agreement within the purview of the Statute. In reaching this conclusion, the

Court referred to 2 Corbin on Contracts 541, Section 445 as follows:

> A certain performance that would not in itself take a year to complete may be promised at a definite future date more than one year from the time of making the Contract. Such a Contract is within the Statute. But if such a performance is promised at an uncertain time to be determined by the happening of a condition that may possibly occur within one year, the promise cannot be said to be one that is not to be performed within one year and it is not within the one year clause of the Statute. It makes no difference how improbable it is that the condition will occur within a year; if there is any possibility that it may so happen, the statutory provision is not applicable. Nor does it make any difference that the condition is one that may never happen at all.

A like result was reached in *McClanahan v. Otto-Marmet Co.*, 74 W. Va. 543, 82 S.E. 752 wherein the Court held that a contract to cut the timber on certain tracts of land and deliver it as ties and posts was not within the Statute, even though the employee expected when he undertook the work that it would require six years to complete. The court said: "It can only be said that it was not likely to be performed, nor expected by plaintiff to be performed within a year. This was held in *Kimmins v. Oldham,* 27 W. Va. 259, not to bring an agreement within the Statute."

The Supreme Court of the United States considered this section of the Statute of Frauds in the leading case of *Warner v. Texas and Pacific R. Co.,* 164 U.S. 418, 41 L.Ed. 495, 17 S.Ct. 147. In an exhaustive opinion, the

Court stated that "the question is not what the probable or expected or actual performance of the contract was, but whether the contract according to the reasonable interpretation of its terms *required that it should not be performed within a year.*" (Emphasis added). As stated above, there is no indication that performance by the parties was required not to be performed within one year.

3 Williston on Contracts, 3rd Ed. 575 is in accord with the views expressed above and states at Section 495:

> It is well settled that oral contracts invalidated by the Statute because not to be performed within a year include those only which cannot be performed within that period.

The interpretation of this provision of the Statute of Frauds is summed up in 49 Am. Jur. 383, Statute of Frauds, Section 23 wherein it is stated that "to bring a case within the Statute *there must be a negation of the right to perform within one year.*" "In other words, that a contract cannot be performed within a year means not a natural or physical impossibility, but *an impossibility by the terms of the contract itself . . .*" (Emphasis added)

The foregoing has been intended as a general survey of the law on this subject, which survey supports the proposition that enforcement of the Agreement found by the jury is not barred by the Statute of Frauds, in that there was nothing in the terms of said Agreement or within the terms of the subcontract upon which such Agreement is in part dependent, which in any way negate the possibility of performance or the right to

perform within one year. In the absence of such restriction within the terms of the Agreement or Subcontract, the Statute is not applicable and the enforcement thereof must not be hampered by the Statute.

The Supreme Court of Utah, chose to place itself within the main stream of judicial thought on this point in *Zion's Service Corporation v. Danielson,* 12 U. 2d 369, 366 P.2d 982, wherein the Court stated at column 1, page 985:

> "Where the agreement can be performed within one year, *though this be done by election of one of the parties to terminate, there can be no doubt but that the Statute of Frauds is not applicable.* We agree with the following statement from the Restatement of Contracts and believe it determinative of this question:
>
> > 'The words "cannot be fully performed" must be taken literally. The fact that performance within a year is entirely improbable or not expected by the parties, does not bring the contract within this Statute.' (Sec. 198, Comment b.)
>
> "In Johnson vs. Johnson, 31 Utah 408, 88 P. 230, we ruled that a contract by a purchaser of land to pay the seller 'for life, one-half of the crops produced on the lands' was not within the above provision since death might occur within one year.*The right to terminate a contract at any time is likewise such an event as may occur within a year and hence the statute does not apply.*" (All emphasis added.)

The position that the Bank urged upon the trial court has been clearly rejected by this Court in a recent

decision involving an identical financial arrangement and an identical factual situation to the case at bar. This Court has clearly held that under these circumstances the Statute of Frauds provision as to performance within one year is not applicable.

In that case, *Commercial Security Bank v. Hodson,* 15 U.2d 388, 393 P.2d 482, this Court stated:

> "The exact length of time that this loan should last is not specified, but there is nothing in the evidence which indicates that the loan should not terminate in less than a year."

In the case before the Court it was not stated exactly how long the revolving credit agreement would last, except that the loans would be made as and when required by M & S to date of final payment from Steenberg.

It is significant to note that pursuant to the terms of the Agreement loans were to be made "as and when required" by M & S and under such arrangement the Agreement could have been terminated at any time by M & S upon finding that it had no need for further loans. It is not uncommon for construction companies to require financing during the initial stages of a contract and then become able to function without financing during the final stages of construction when the heavy and expensive work has been completed. (T. 66, 82, 114) Under these circumstances and in light of this Court's holding in *Zion's Service Corporation v. Danielson,* supra, and *Commercial Security Bank v. Hodson,* supra, the Statute of Frauds is not applicable here since M & S could have terminated the Agreement at any time within one year.

As previously stated, there is nothing in the evidence, Agreement or Subcontract which precludes the possibility of performance and hence, the final payment from Steenberg all within one year and although performance within that time may have been deemed improbable, such was not sufficient reason to bring the transaction within the purview of the Statute.

In view of the facts as disclosed by the record and the eminent authorities cited herein, the District Court erred in applying the Statute of Frauds in such a manner as to preclude the enforcement of the Agreement found by the jury to have existed as alleged in appellant's second cause of action.

POINT II

THE COURT ERRONEOUSLY HELD THAT, AS A MATTER OF LAW, THE $38,852.54 CHECK WAS SUBJECT TO SET OFF AND APPROPRIATION BY THE BANK. THE UNCONTRADICTED EVIDENCE SHOWED IT TO BE HELD BY THE BANK IN TRUST AS A SPECIAL DEPOSIT ON DEPOSIT FOR SPECIAL PURPOSES, OF WHICH THE BANK HAD ACTUAL KNOWLEDGE. THE JUDGMENT SHOULD HAVE BEEN ENTERED FOR M & S ON THIS BASIS, REGARDLESS OF THE RESULT AS TO THE FIRST CAUSE OF ACTION.

The facts with reference to this phase of the case are relatively simple, almost entirely in writing, and leave no doubt as to the liability of the Bank for the natural results of its ~~contract~~ CONDUCT.

The assignment (Exhibit B) by which defendant acquired its right to receive these monthly payments, clear-

ly and plainly states the relationship of the Bank to the fund, viz: *as the agent of M & S , with authority to endorse the checks on their behalf;* and that it (the Bank) receives the same *as collateral security* for loans *made and to be made by the Bank to M & S and as collateral security* for any and all liabilities *due or to become due* from M & S to the Bank.

Payment for the September estimate was made by check dated October 22, 1963, and received by the Bank under the circumstances in the most unusual manner described in the statement of facts. The letter of transmittal from Steenberg and the endorsement on the check to be signed by the Bank and M & S are as follows:

"October 22, 1963

AIR MAIL—SPECIAL DELIVERY
Clearfield State Bank
Clearfield, Utah

Attn: Mr. Jesse Barlow, Executive Vice President

Re: M & S Construction & Engineering Co.
Lost Creek Dam, Weber Basin Project
Utah, Spec. No. DC-5935

Gentlemen:

In line with our conversation of this date, we are enclosing herewith our check in the amount of $38,862.54 in payment of the September Estimate due M & S Construction & Engineering Co. on the above project.

Inasmuch as we will have to depend upon one another on this deal, we are looking to you to ascertain from Mr. Claire Nielson, Auditor for M & S, that these funds are being used to keep their accounts current on this project.

We greatly appreciate your help on keeping us advised with any new information or developments around our sub-contractor, M & S, and we ask that you keep any conversations or correspondence confidential on this matter.

With kindest personal regards,

Sincerely,

STEENBERG CONSTRUCTION COMPANY

By /s/ Emil E. Walsh

Emil E. Walsh, Vice President

EEW/het

enclosure—check"

Endorsement on check:

"In consideration of this check and the endorsement thereof, we hereby certify that we have paid all labor, material, equipment, etc., used on the Weber Basin Project, and do hereby waive all rights to assert claims against Steenberg Construction Co., its surety and the owner up to and including Sep. 1963, except for the retained percentage, if any, as set forth in our contract."

M & S Const. Engr. Co.

By /s/ James H. Mendenhall

Vice-President & Treasurer

Clearfield State Bank

By /s/ Jesse D. Barlow

Exect. V. P.

Clearfied State Bank

Clearfield, Utah

Under these undisputed facts, regardless of whether there was or was not an agreement with the Bank to extend to M & S this revolving or continuing line of credit under the pattern described by Mr. Barlow (R. 221, 222) the Bank never had such a relationship to the proceeds of this $38,862.54 check as to give it (the Bank) the right to appropriate it to the payment of its obligations and to payment of notes held by its officers when it then had in its possession payroll checks issued by M & S as referred to in the letter and endorsement; and with the full knowledge of the fact that by so doing it would not only violate the trust relationship as to the fund set forth in the letter and on the check itself, but also would cause an irreparable breach in the Steenberg contract with M & S, and give Steenberg the right to declare default and take over the job.

In the first place, neither the Bank nor M & S, under the Steenberg contract, had the right to demand or receive the fund, unless payrolls had been paid and lienable obligations discharged. The Bank, as assignee of the fund, had no better right to the money than M & S. The Steenberg contract expressly so states. It even goes further, and gives Steenberg the right to demand proof of such fact before payment is made, which is exactly what it did. The requirements set forth in the Steenberg letter (Exhibit I), and on the reverse side of both checks (Exhibits G and H) were within the contract right of Steenberg.

The fund belonged to M & S, subject only to the prior right of Steenberg to require proof of payment of

payrolls and prior application as above set forth; and subject also to the right of the Bank, *as agent* of M & S to receive it and hold for M & S *as collateral security* for loans made *and to be made.*

From these undisputed facts, the law clearly imposes upon this fund the status of a trust relationship, a special deposit or a deposit for a special purpose, well-known in the law, not a general one which may be subject to offset or appropriation by the Bank. It surely requires no citation of authorities to this Court to establish the fact that funds received as *agent* and held as *collateral,* as recited in the assignment itself are received and held under a *trust* relationship as to those funds, regardless of what other relationship may exist between the parties as to other funds. But the letter transmitting the fund and the endorsement on the reverse side of the check leave no doubt as to its being a special deposit, or deposit for a special purpose relationship between the parties as to this particular fund.

A bank has the right of appropriation and set-off as to funds held in a general account where the relationship is that of debtor and creditor—not that of trustee and cestui que trust.

This would be true regardless of the presence or absence of the continuing or revolving line of credit agreement. It would be doubly true if, as stated in the assignment itself, the funds to be received under the assignment are to be received by the Bank as *agent* and held as *collateral* for loans *to be made* in the future, as clearly set forth in the assignment and, as established by the evi-

dence, to consist of a continuing relationship as needed under the subcontract with Steenberg.

The authorities are overwhelmingly and almost uniformly against the right of the Bank to do what it did in disregarding and violating its agreement with M & S, and in appropriating to itself funds entrusted to it under this condition of trust. The Bank had the right to refuse to receive the deposit under the conditions imposed by the assignment as drawn by its own counsel, and as imposed under the terms of the letter of transmittal and under the terms of the endorsement which it was required to accept, but it had no right whatsoever to receive the deposit under those conditions and then, under highly questionable conduct, take the money, and leave M & S and Steenberg to pick up the wreck.

The fact that a part of the money was applied on a note that wasn't even due, part of it applied to payment of notes held by Mr. Barlow and Mr. Steed personally, and a large part on the payment of a note that was agreed to be renewed under the revolving line of credit agreement, simply paints the picture in the true colors as to how far some people are willing to go in violating their word and in breaching a relationship of trust and confidence.

Nor can they be heard to say that they did not know or fully appreciate the dire consequences of their conduct. Their counsel had studied the Steenberg contract, and was present at the final decision to dishonor the checks, and the Bank was fully informed as to what would occur if they did as they said. The Bank had drawn the assign-

ments and chattel mortgages under which the Bank had gathered in every vestige of resources M & S had. M & S had nothing else to offer to any other financing agency. When they dishonored those payroll checks, they pulled the whole structure down and the jury was most considerate in assessing the damages as low as it did.

We submit the following authorities that deny the right of the bank to do that:

> 7 Am. Jur. 298, Banks, Sec. 424 — "Deposits for Special Purposes — Deposits of funds for a special purpose, such as for the purpose of paying such funds to a third perion upon the presentation of certain papers or instruments of title; paying bonds or the interest thereon as such obligation matures; paying a mortgage indebtedness; meeting certain checks or classes of checks; taking up the depositor's note that has been indorsed to another bank; transmitting such funds to another at a distant place; paying a contractor for work being performed by him; holding such money in escrow, to be returned to the vendee if title is found defective, and to be paid to the vendor if title is approved; furnishing collateral security to the bank, etc., have all the attributes of special deposits and are generally termed and constructed as such. The bank becomes a bailee of the deposit, as in the ordinary case of a special deposit, in so far as the retention of the deposit is concerned; beyond such function, and in addition thereto, the bank has also the fiduciary duty of an agent to apply the deposit to the particular purpose for which it was delivered to the bank, and in case of the misapplication of the deposit, it may be followed on the trust fund theory."
>
> *Sindlinger v. Department*, 210 Ind. 83, 199 N.E. 715. See annotation 105 A.L.R. 516.

Where there is a deposit in a bank for the purpose of meeting certain checks or classes of checks, it is generally held that the money thus deposited must be applied to the purpose for which it was deposited. It cannot be diverted by the bank therefrom. *Morton v. Woolery* 48 N.D. 1132, 189 N.W. 232. Seen annotation 24 A.L.R. 1111; *Payne v. Burnett,* 151 Tn. 496, 269 S.W. 27. See annotation 39 A.L.R. 1138; *Re Warren's Bank,* 209 Wis. 121, 244 N.W. 594, 86 A.L.R. 371. See annotation at page 375.

Zions Savings Bank v. Rouse, 86 Ut. 574, 47 P.2d 617:

> "The right of a bank to apply a depositor's funds, held by it, to payment of his indebtedness, can exist only where each occupies the position of debtor and creditor, and where there exists mutual demands. 5 Michie, Banks and Banking, 218. The debt owing by the depositor must have matured. 5 Michie, Banks and Banking, 216. Both maturity and mutuality are essential to the validity of a setoff."

The relationship of debtor and creditor is entirely different from the trust relationship existing here as to the nature of the fund as a deposit for a special purpose and also as to its status as collateral under the assignment.

The doctrine was reaffirmed by our Supreme Court in *Seaboard Finance v. Shire,* 117 Ut. 546, 218 P.2d 282.

The most recent consideration of the subject is contained in *National Indemnity Co. v. Spring Branch State Bank,* 162 Tex. 521, 348 S.W. 2d 528; as annotated in 8

A.L.R. 3rd 229, with the following heading listing cases from almost every state in the Union at p. 339:

> "It has universally been held that knowledge upon the part of a bank that deposits made by a debtor in his own name belong to a third person absolutely precludes the bank from applying such funds to the individual indebtedness of the depositor to it."

See also *Moore Mill & Lumber Co. v. Curry County Bank*, 200 Ore. 558, 267 P.2d 202, quoting with approval 9 C.J.S., Banks and Banking, Sec. 275, page 570, as follows:

> "* * * A specific deposit, or deposit for a specific purpose, consists in the delivery of money or property to a bank for application to a designated object or a defined purpose, as in the case of money deposited to meet a maturing obligation or a note delivered for collection. While such a deposit has been referred to as 'special,' and by other authority has been termed general in character, strictly speaking it is neither general nor wholly special, but constitutes a distinct class of deposits.
>
> "A 'specific' deposit partakes of the nature of a 'special' deposit to the extent that title to the thing deposited remains in the depositor and does not pass to the bank, unless and until applied to the specified purpose, that no relation of debtor and creditor is created between bank and depositor, and that the bank becomes the depositor's agent, bailee, or trustee. * * *"

POINT III

THE COURT ERRONEOUSLY ENTERED JUDGMENT IN FAVOR OF THE BANK ON ITS COUNTERCLAIMS AND CROSS COMPLAINT WHEN THE EVIDENCE SHOWED THAT THE NOTES WERE SECURED AND THE BANK HAD DESTROYED ITS SECURITY IN AN AMOUNT IN EXCESS OF THE AMOUNT OF THE NOTES.

Additional defendant Vern M. Smith has appealed, along with Plaintiff, from the judgment entered by the Court in the first and second causes of action of its counterclaims, and against plaintiff on its third and fourth causes of action; and against additional defendant Vern M. Smith on its first cause of action in its cross complaint.

The uncontradicted evidence shows that these alleged causes of action were secured by the assignment, Exhibit "B," and that pursuant to that assignment defendant held as security all of the right of plaintiff to receive from Steenberg payment for its October, 1963 estimate, plus the 10% retained on prior estimates, plus the additional claim for additional work on the core trench, in addition to its estimated profits on the job, all as referred to by Mr. Pritchett (R. 87). This security was placed by the assignment in the name of the Bank to be held by it as collateral security, and it had the exclusive right to have and receive the same. It stands before this Court as having either intentionally or negligently destroyed that security by its improper action.

The jury found the lost security to have been worth $156,000 for loss of profits alone. The defendant was not

entitled to recover a personal judgment against any of the parties on this phase of the record regardless of either of the other questions presented.

A pledgee of property or property rights, to be held as collateral security must use reasonable care to protect the property or property right pledged and is liable for either intentional or negligent loss or damage to the security. See 41 Am. Jur. 619, Sec. 49 of Pledge and Collateral Security and Restatement of the Law, "Security," Sec. 17, as to duty of pledgee with reference to pledged security. See note on liability of Bank for loss or damage to pledgee's property. 68 A.L.R. 2d, 1262, Sec. 4; 72 C.J.S. 5, Sec. 2, under "Pledges."

CONCLUSION

The jury was right in its verdict; the Trial Judge erroneously granted the motion for judgment notwithstanding the verdict; and erroneously granted judgment to defendant Bank on the counterclaim and cross complaint for amounts represented by notes secured by the assignment of funds to be received from Steenberg.

Respectfully submitted,

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