1970

National American Life Insurance Company v. East Lawn Memorial Hills, Inc., A Corporation; Western S Tates Title Insurance Company, Trustee, Utah State Tax Commission, And W. Smoot Brimhall, Commissioner Of Financial Institutions of the State of Utah : Brief of Respondent

In The Supreme Court of the State of Utah

NATIONAL AMERICAN LIFE INSURANCE COMPANY, a corporation,
Plaintiff,

vs.

EAST LAWN MEMORIAL HILLS, INC., a corporation; WESTERN STATES TITLE INSURANCE COMPANY, TRUSTEE, UTAH STATE TAX COMMISSION, and W. SMOOT BRIMHALL, COMMISSIONER OF FINANCIAL INSTITUTIONS OF THE STATE OF UTAH,
Defendants.

Case No. 12[illegible]

BRIEF OF APPELL[illegible]

Appeal from decision granting S[illegible] favor of Plaintiff, National American L[illegible] and against Defendant, East Lawn M[illegible] the Fourth District Court, Utah County, [illegible] B. Sorensen.

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Defendants.

Case No. 12179

BRIEF OF RESPONDENT

NATURE OF THE CASE

This is an appeal from a judgment made and entered on the 12th day of June, 1970, by the Honorable Allen B. Sorensen, one of the Judges of the District Court of Utah County, State of Utah, determining there was insufficient evidence presented by defendant to support a novation and that plaintiff, National American Life, have judgment authorizing the foreclosure of its Trust Deed as a Real

Estate Mortgage, and further authorizing the sale of defendants property to satisfy its judgment.

DISPOSITION IN LOWER COURT

The matter came before the lower court for pre-trial on the 22nd day of May, 1970. (R. 125). At the pre-trial conference, plaintiff renewed its previous motion for Summary Judgment. (R. 140). Defendant also moved for Summary Judgment (R. 140) and further moved for leave to amend the pleadings to assert a counterclaim. (R. 141). Counsel for plaintiff objected and the trial court sustained the objection. (R. 141). Both Summary Judgment motions were taken under advisement. (R. 140). The trial court entered its memorandum decision (R. 142) and found that there was insufficient evidence to support a novation and granted plaintiff's motion for Summary Judgment.

Findings of Fact, Conclusions of Law, Decree of Foreclosure and Order granting plaintiff's motion for Summary Judgment were entered accordingly. (R. 143, 147).

RELIEF SOUGHT ON APPEAL

Appellant seeks reversal of the trial court's Order granting plaintiff Summary Judgment and further that this Court vacate the Decree of Foreclosure entered pursuant thereto.

STATEMENT OF FACTS

On January 21, 1965, plaintiff, National American Life Insurance Company and defendant, East Lawn Memorial Hills, Inc. entered into an agreement evidenced by a note in the face amount of Sixty-Three Thousand Six Hundred ($63,600) Dollars. (R. 8). To secure said note, the parties entered into a "Deed of Trust: (R. 9 through 12). Guaranty Fund Certificate No. 128 in the face amount of One Hundred Thousand ($100,000) Dollars (R. 86) was pledged as security for the payment of the note and Deed of Trust. (R. 96).

On May 4, 1965, the parties mutually agreed upon Shirley Patterson White assuming and covenanting to pay the note and Deed of Trust (mortgage) sought to be foreclosed herein. (R. 87). As security for the payment by Shirley Patterson White, fifty (50%) percent of the stock of First Security Savings and Loan Association was pledged to insure payment of the note and Deed of Trust (mortgage). (R. 87, 88 and 89).

This substitution of security was the result of an agreement in which Shirley Patterson White, at the instance and request of plaintiff, National American Life Insurance Company, was to purchase the stock of First Security Savings and Loan Association, a Mississippi Corporation.

The payment for the First Security stock was to be made by Shirley Patterson White assuming and paying the note and Deed of Trust. The agreement

was entered into in lieu of and in substitution of the pledge of the Guaranty Fund Certificate No. 128 when the proceeds of said Guaranty Fund Certificate were not forthcoming as originally agreed upon. At the time of the substitution of said security the Guaranty Fund Certitficate No. 128 was released completely as security for the payment of the note and mortgage. On February 27, 1967, the plaintiff and Shirley Patterson White Stockett entered into a second pledge and Hypothecation Agreement. (R. 90-92). This pledge and Hypothecation Agreement was made without the knowledge or consent of East Lawn Memorial Hills, Inc. Defendant, East Lawn Memorial Hills, Inc., in its answer to plaintiff's complaint, asserted that the substituted security pledged on February 27, 1967 did not have the value to secure the payment of the note and mortgage as did the stock pledged under the previous Hypothecation Agreement of May 4, 1965. (R. 76).

Shirley Patterson White made payments on the mortgage from May, 1965 until March 15, 1967. (Deposition of Harold Webb, Exhibit VII.) Defendant, East Lawn Memorial Hills, was not notified of the default of Shirley Patterson White until February 18, 1969. (Deposition of Harold Webb, Ex. XII.) This was nearly 2 years after the date of last payment by Mrs. White. Yet White was allowed by plaintiff to substitute the initial security pledged with plaintff. (R. 90-92). On Aprl 11, 1969, plaintiff, National American, filed a complaint seeking to foreclose upon the real property owned by defendant, East Lawn

Memorial Hills, Inc. (R. 3). Defendant filed an answer and counterclaim. (R. 22). Defendant later filed an amended answer and asserted as an affirmative defense that the plaintiff was estopped from foreclosing. Defendant claimed that plaintiff had sufficient security for the indebtedness in the form of the Fifty (50%) percent stock in First Security Savings and Loan Association; that the later substitution was done without defendant's knowledge, consent or approval all to defendants damage. And asked that plaintiff be required to account to defendant and that the court award and assess the damages to defendants as a result of plaintiff's wrongful release of the security pledged for the payment of the note. (R. 76).

ARGUMENT

POINT I.

THE COURT ERRED AS A MATTER OF LAW IN RULING THAT THERE WAS NO NOVATION.

A novation arises when a creditor accepts the obligations of a third person as a substitute in the place of the original debtor. *Andrews v. St. Louis Joint Stock Land Bank,* 127 F.2d 799 (C.A. 8th 1942) *Associates Discount Corp v. Greisinger,* 103 F. Supp 705 (D.C. Pa. 1952).

The essential legal elements to establish a novation are:

1. Parties capable of contracting;

2. A valid prior obligation to be displaced;

3. The consent of all the parties to the substitution; and

4. Lastly, the extinction of the old obligation and the creation of a valid new one. Vol. 2, *Williston*, Contracts 3rd Ed. Section 353 P. 816.

There is no factual dispute concerning the contractual capacity of the parties in the instant case. Nor is there any factual dispute concerning the legal validity of the prior obligation to be discharged, (herein the note secured by a deed of trust).

What is in dispute is:

1. Whether there was consent of all of the parties to the substitution of Shirley Patterson White for East Lawn, and If so,

2. Did the parties intend that the East Lawn obligation to be extinguished by the substitution.

These latter two requirements necessarily depend upon the intentions of the parties. *City National Bank v. Fuller,* 52 F 2d 870 (C.A. 8th 1931); *Engineering Service Corp. v. Longridge Investment Co.,* 153 Cal App. 2d 404, 314 P2d 563 (1957). Which intentions are determined from the facts and circumstances involved. *Buerger Bros. Supply Co. v. El Rey Furniture Co.,* 43 Ariz. 472, 32 P2d 1029 (1934). And which intentions need not be expressed or evidenced in any particular manner but can be implied or inferred from the at-

tendant factual circumstances. *Alexander v. Angel*, 37 Cal. 2d 856, 236 P2d 561 (1951).

The parties in the instant case mutually agreed that Shirley Patterson White would assume and covenant to pay the note secured by the deed of trust. These intentions became manifest when she signed the assumption agreement dated May 4, 1965. The agreement was prepared by National American Life. It was notarized by its officer. As part of the transaction, and to further insure that Shirley Patterson White would pay the obligation, the fifty (50%) percent of the capital stock of First Security Savings and Loan Association that she had agreed to purchase from defendants herein was to be held by plaintiff until she paid off the note secured by the deed of trust. Pursuant to this arrangement, plaintiff held the stock. Shirley Patterson White commenced payments on the note in May, 1965. The payment was accepted by plaintiff in May, 1965. She continued to make regular payments to plaintiff for each month thereafter for approximately 22 consecutive months. Plaintiff accepted each and every payment made during this entire period of time. Plaintiff held its security in the form of First Security Savings and Loan for approximately 21 months. Plaintiff's participation in this subsequent agreement is obvious from the record. During this entire period of time, plaintiff looked solely to Shirley Patterson White for payment. No statements of account were sent to defendant, East Lawn. No notice of delinquency was sent to de-

fendant. In fact, the record indicates that Shirley Patterson White was in default nearly 2 years after the March 15, 1967 monthly payment was made before defendants were so notified. Plaintiff, in its acceptance of Shirley Patterson White as a substitute obligor, allowed her to substitute the security held by them to insure her payment. No notification of this substitution was sent to defendant. All of the above factors clearly indicate that the intention of the parties was to substitute Shirley Patterson White as the obligor on the East Lawn note. If plaintiff were still looking to defendant, why were no statements sent? If plaintiff were looking to defendant for payment, why didn't they notify defendant of Shirley Patterson White's defalcations? If plaintiff were looking to defendant, why did plaintiff fail to notify defendant of the agreement to substitute the security held by plaintiff to insure payment by Shirley Patterson White? If plaintiff were looking to defendant for payment, why did plaintiff allow nearly 2 years of defaults to occur by White before notifying defendant of her nonpayment?

These facts would clearly indicate that the intentions of the parties were that Shirley Patterson White would be substituted for East Lawn and that National American would henceforth look to and deal with White for payment. National American did in fact look to White. They should now be estopped from changing their position after nearly 4 years of dealing with White. Particularly where East Lawn, in reliance thereon, has materially

altered its position. Viewing these facts in a light most favorable to the party moved against, as the Court is required to do, the trial Court's ruling that there was no novation as a matter of law, was erroneous and contrary to the evidence presented in behalf of defendant, the inferences to be drawn therefrom and contrary to the legal precedents and authorities above cited.

POINT 2.

THE TRIAL COURT ERRED AS A MATTER OF LAW IN FAILING TO RULE THAT THE RELATIONSHIP OF THE PARTIES WAS ONE OF SURETY AND THAT THE ACTS OF NATIONAL AMERICAN EFFECTED A RELEASE OF THE EAST LAWN.

Section 83 (c), Restatement Law of Security indicates that a suretyship relationship is established where the surety:

(c) "having been a principal obligor, his obligation, without a novation, has been assumed or his property has been transferred under such circumstances as to place the property under the primary burden of the obligation."

Paragraph third of the assumption agreement (R. 87) prepared by National American Life Insurance Company, reads as follows:

> "For valuable consideration, receipt of which is hereby acknowledged, and full discharge and acquitance granted therefore, appearer (Shirley Patterson White) does hereby assume to the full release, discharge and

> acquitance of East Lawn Memorial Hills, Inc., all of the payments in and under a certain deed of trust made and executed in the County of Utah, State of Utah, on the 26th day of January, 1965, which deed of trust was duly filed of record as Act No. 1251, Book 998, pages 632-635 on January 26, 1965; appearer acknowledges that there is a balance due in the principal and interest as of May 15, 1965, the sum of sixty-three thousand three hundred seven and 19/100 ($63,307.19), which said sum appeared as specifically and unconditionally bind and obligate herself to pay to National American Life Insurance Company of Baton Rouge, Louisiana, all in accordance with the amortization schedule and other stipulations and provisions contained in said deed of trust."

As part of the consideration for the assumption by White, the agreement further provided that ten thousand (10,000) shares of the capital stock of First Security Savings and Loan Association be pledged to the plaintiff, National American Life Insurance Company, and further in paragraph 3 of said document, National American Life was granted "The full right to vote the shares of stock represented by Stock Certificate Number Ten above referred to." These ten thousand (10,000) shares represented control of First Security Savings and Loan. To maintain the control of the corporation and thus the value of the security, paragraph 4 of the document drafted by National American Life, further provided that no additional stock would be issued in First Security Savings and Loan Association without Shirley Patterson White pledging fifty (50%) percent of any

additional stock so issued. And finally, paragraph two of the document grants National American Life Insurance Company the power to sell the First Security Savings and Loan Association stock in the event of a defualt by Shirley Patterson White.

National American Life Insurance Company accepted the document referred to above together with the terms thereof as above outlined. It accepted payments from Shirley Patterson White and pursuant thereto accepted the First Security Savings and Loan stock together with additional powers and authorities and did in fact exercise the powers and authority granted under said pledge and hypothecation agreement. In the case of *Kennedy v. Griffith,* 95 P2d 752 (1939) the Utah Supreme Court made the following signifcant observations:

> "Here was a case where a third party agreed to pay the obligations of one party to another. The resulting relationship was akin to suretyship which appellants as the principal debtor and the respondents as sort of surety *because not released by Johnson.* (Emphasis supplied) In fact, it was a simple agreement to pay the debt of another, which, when breached, gave use to a right of action against the other. *So far as the relationship between the original debtor and the one who assumed the debt is concerned, the original debtor became surety and the one who assumed, the principal.*" (emphasis supplied)

In the instant case, Shirley Patterson White agreed to pay the obligation of East Lawn to National Amer-

ican. In fact, she paid the obligation for approximately 2 years. Based upon the foregoing undisputed facts, and the position of the Utah court in the *Kennedy* case, supra, the relationship thus established between the original debtor, East Lawn, and the assuming debtor, Shirley Patterson White, was one of surety. East Lawn became surety for the payment of the obligation of National American which was assumed by White who became the primary obligor. The trial court erred as a matter of law in not concluding that East Lawn, under the terms of the pledge and Hypothecate Agreement, became a surety for the payment of the obligation assumed by White who was accepted by National American as the primary obligor.

B. THE ACTS OF NATIONAL AMERICAN EFFECTED A RELEASE OF EAST LAWN.

On February 27th, 1967, a second pledge and Hypothecation Agreement was prepared by plaintiff, National American, by and through Rufus D. Hayes, an officer of the plaintiff corporation. Under the terms of said agreement, Shirley Patterson White Stockett formerly Shirley Patterson White and National American Life Insurance Company agreed that:

> ". . . in consideration of National American Life Insurance Company of Baton Rouge, Louisiana, releasing unto appearor Stock Certificate No. 10, dated May 4, 1965, for ten thousand (10,000) shares of the capital stock

in First Security Savings and Loan Association, appearor does hereby pledge, assign and hypothecate to National American Life Insurance Company, of Baton Rouge, Louisiana, additional security for the above-referenced deed of trust the following: pledge of stock of American Public Life Insurance Company."

"Five. Appearor does hereby specifically acknowledge and agree that the amount of principal due and owing to National American Life Insurance Company under said deed of trust is the sum of Fifty-Nine Thousand Seven Hundred Forty and 16/100 ($59,740.16) Dollars which said sum, plus interest, appearor does specifically and unconditionally *reaffirm, and obligate herself to pay to National American Life Insurance Company,* of Baton Rouge, Louisiana, all in accordance of the amortization schedule and the other stipulations and provisions contained in said deed of trust." (emphasis supplied)

In the depositions of Mr. Rufus D. Hayes and Mr. Harold Webb, said witnesses verified that the two pledge agreements, that of May 4, 1965 and February 27, 1967, were acknowledged and accepted by the plaintiff, National American Life Insurance Company. National American did in fact act upon and receive the respective securities under the hypothecation agreements. Hayes and Webb both testified that National American did not contact East Lawn or consult with East Lawn concerning the change in the security originally pledged. This substitution was done without defendant's knowl-

edge, consent or approval. Plaintiff's actions not only damaged defendant, but was also a breach of the duties owed by one in plaintiff's position.

As a general proposition, "a creditor owes one who is a surety for a debt or undertaking the duty of continuous good faith in dealing with the debt or undertaking, or with security received to assure the payment of the debt or the performan of the undertaking. He is bound to a faithful observance of the rights of the surety and to the performance of every duty necessary for the protection of those rights. The duty arises not from any contract of the creditor with the surety, but from the equities of the situation." 50 Am. Jur., Suretyship § 40. See also, *Sumitomo Bank of Cal. v. Iwasaki,* 447 P 2d 956, 73 Cal. Rptr. 564 (1968).

The original security pledged in behalf of East Lawn to insure payment of East Lawn's obligation by White consisted of the controlling shares of First Security Savings and Loan Association. When White agreed to purchase these shares, they were pledged to National American as security for the payment of the East Lawn obligation, which White agreed to pay. The subsequent security consisting of a minority stock interest in American Public Life Insuarnce Company, according to defendant's amended answer, was less valuable than the First Security Savings and Loan Shares. East Lawn was not notified of the substitution. In *Wallin v. Young,* 180 P 2d 535, 181 Or. 185 (1947) the court indicated that a surety will be discharged where a valid contract

is made between the creditor and the principal debtor extends the time of payment, or where securities held by the creditor are *voluntarly surrendered without the consent of the surety, at least to the value of such securities.* (emphasis supplied). The acts of plaintiff were sufficient in law to effect a release of defendant, at least to the value of the security released by plaintiff, which value would necessarily be a factual issue.

POINT 3.

THE TRIAL COURT ABUSED ITS DISCRETION BY REFUSING TO GRANT DEFENDANT LEAVE TO AMEND ITS PLEADINGS TO ASSERT A COUNTERCLAIM AND O B T A I N AFFIRMATIVE RELIEF AGAINST PLAINTIFF.

In defendant's original answer, defendant asserted a Counterclaim seeking affirmative relief. (R. 24). Defendant later amended his answer and asserted an affirmative defense asserting matter similar to those matters raised in the original Counterclaim. (R. 73). At the pre-trial hearing, the following exchange took place: (See Partial Transcript of Pre-trial Proceedings pages 33 and 34.)

THE COURT: Do either of you have any objections to the pre-trial order?

MR. BALLIF: I have none.

MR. TAYLOR: Your Honor, we have in our pleadings, and I apologize for my pleadings on this, because—

THE COURT: Don't make speeches. Do you have any objection to the pre-trial order?

MR. TAYLOR: Only in that we have asked relief for damages, but those damages would be applied—

THE COURT: What would the damages be?

MR. TAYLOR: The loss of the value of the corporation known as First Security Savings and Loan Association.

THE COURT: On the present state of the pleadings, *if that figure should exceed the balance payable on the note, I am not going to give you credit for it. I will rule on it right now. You haven't asked for it and he objects. There is no Counterclaim.* (emphasis supplied)

MR. TAYLOR: I had it in the form of an affirmative defense.

THE COURT: You don't assert Counterclaims as affirmative defenses.

This is on the record now. Let's be sure we have the record.

The defendant—you wish to move to amend your pleadings to assert a Counterclaim?

MR. TAYLOR: I would request permission to assert that Counterclaim.

THE COURT: Do you object to it?

MR. BALLIF: Yes.

THE COURT: Objection sustained.

Rule 8-c, Utah Rules of Civil Procedure reads, in part, as follows:

"When a party has mistakenly designated a defense as a Counterclaim or a Counterclaim as a defense, the court on terms, if justice so requires, *shall treat the pleading as if there had been a proper designation.*" (emphasis supplied)

In the instant case, the trial judge refused to allow defendant leave to assert a Countercailm. This refusal was contrary to the mandate of the above-quoted rule. Particularly in light of the fact that there was nothing of record to indicate that the plaintiff would be prejudiced by defendant's motion at such a late date. In fact, defendant's original answer placed plaintiff on notice of defendant's assertion for affirmative relief. This assertion was apparently denominated an affirmative defense in the amended answer. Although it is true that under Rule 15(a), Utah Rules of Civil Procedure, a party must obtain leave of Court to amend a pleading, it is also true that: ". . . *levae shall be freely given when justice so requires.*" (emphasis supplied) The effect of the trial judge's ruling prevented defendant from asserting a meritorious claim against plaintiff, which c,laim would otherwise be extinguished. Such refusal by the trial court constituted a sufficient abuse of discretion as to justify this court to return the matter for trial on all of the issues, not merely those raised by plaintiff.

CONCLUSION

For the reasons stated herein, appellant respectfully prays that this Court reverse the trial court's decision appealed from in the following particulars:

1. By determining that there was sufficient evidence of record to require the trial court to conclude as there was a novation as a matter of law.

2. Determining that the trial court erred in not finding that relationship between plaintiff and defendant was one of suretyship from which defendant became discharged when plaintiff allowed the substitution to take place.

3. Determining that the trial court's refusal to allow defendant leave to amend to assert a Counterclaim was an abuse of descretion and unduly prejudiced defendant.

4. Setting aside the summary judgment of the trial court.

Respectfully submitted,

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