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BEFORE THE UTAH COURT OF APPEALS

VOLVO COMMERCIAL FINANCE, LLC THE AMERICAS, a Delaware limited liability company, Plaintiff-Appellant, vs. **WELLS FARGO BANK, N.A., a national banking association,** Defendant-Appellee.	**Case No. 20051127-CA**

APPELLANT'S OPENING BRIEF

APPEAL FROM THE THIRD DISTRICT COURT
SALT LAKE COUNTY, STATE OF UTAH,
THE HONORABLE L.A. DEVER
CIVIL NO. 020905207

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APR 1

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STATEMENT OF JURISDICTION

This Court has jurisdiction pursuant to Utah Code Ann. § 78-2a-3(2)(j), as this matter was appealed to the Utah Supreme Court from a final judgment of the Third District Court. (R. 2216-25.) The appeal was transferred by the Utah Supreme Court to this Court. (See R. 2237.)

STATEMENT OF ISSUES AND STANDARD OF REVIEW

Issues

Whether the trial court erred in dismissing, on summary judgment, the claims of Plaintiff Volvo Commercial Finance LLC, The Americas ("Volvo Finance") against Defendant Wells Fargo Bank, N.A. ("Wells Fargo"), for conversion, unjust enrichment, and constructive trust. Volvo Finance asserted that Wells Fargo wrongfully received nearly $700,000 in proceeds generated by the sale of 53 commercial trucks, when Volvo Finance had a perfected purchase money security interest in the trucks and all proceeds thereof. The seller of the trucks transferred the funds into its account with Wells Fargo, and Wells Fargo seized those funds in repayment of an overdraft advance. This issue will require the consideration of the following legal question:

a. How do the governing tracing rules apply when a debtor transfers funds from a commingled account to a new account and then dissipates the funds remaining in the first account; may a creditor with a claim to the funds trace them to the second account, or does the transfer defeat the creditor's interest in those funds?

Additionally, Volvo Finance anticipates that Wells Fargo may raise one or both of the following issues in its opposing brief:

b. Whether Volvo Finance's claim is barred under Revised Article 9 of the Utah Uniform Commercial Code, even though Revised Article 9 was not in effect when the events giving rise to this litigation occurred.

c. Whether Volvo Finance's claim is barred under the purported "ordinary course" defense discussed in a comment to Section 9-306 of former Article 9.

Volvo Finance addressed these issues in its memorandum opposing Wells Fargo's summary judgment motion, R.1451-81.

Standard of Review

In reviewing a grant of summary judgment, all facts and inferences are viewed in a light most favorable to the nonmoving party, and no deference is given to the trial court's ruling. E.g., Coulter & Smith, Ltd. v. Russell, 966 P.2d 852, 855-56 (Utah 1998); Badger v. Brooklyn Canal Co., 922 P.2d 745, 748 (Utah 1996).

DETERMINATIVE PROVISIONS

Former Utah Code Ann. § 70A-9-306:

> **"Proceeds" -- Secured party's rights on disposition of collateral or debtor's insolvency [Repealed effective July 1, 2001].**
>
> (1) "Proceeds" includes whatever is received upon the sale, lease, exchange, collection, or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Any payments or distributions made with respect to investment property collateral are proceeds. Money, checks, deposit accounts, and the like are "cash proceeds." All other proceeds are "noncash proceeds."
>
> (2) Except where this chapter or Chapter 2a, Leases, otherwise provides, a security interest continues in collateral notwithstanding sale, exchange, or other disposition thereof unless the disposition was authorized by the

secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

. . . .

Utah Code Ann. § 70A-9a-709(1):

Priority.

(1) This act [Revised Article 9] determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before this act takes effect, former Chapter 9 determines priority.

STATEMENT OF THE CASE

Nature of the Case

This lawsuit arises out of the collapse of the "Great Basin" chain of commercial truck dealerships in Salt Lake City and throughout the Intermountain West. Four of the dealerships had identical "floor plan" financing agreements with Plaintiff Volvo Finance, under which Volvo Finance advanced funds to enable Great Basin to purchase truck inventory. The floor plan agreements granted Volvo Finance a purchase money security interest in the trucks financed and all proceeds thereof. To perfect its security interest, Volvo Finance filed UCC-1 Financing Statements in each state in which the dealerships operated.

Great Basin did much of its banking through Defendant Wells Fargo. Each of the Great Basin dealerships made deposits into its local Wells Fargo branch, and the funds were automatically swept into a central "concentration account" at the end of each day.

In late December 2000, Wells Fargo paid several items out of the Concentration Account, even though the Account had insufficient funds to cover them, creating an

$800,000+ overdraft in the account. On December 29, 2000, Great Basin transferred $900,000 from an account at First Security Bank (the "First Security Account") to the Concentration Account. Wells Fargo used the funds transferred on December 29 to repay itself for the advances Wells Fargo had made to cover the overdrafts. A significant portion of the funds that Great Basin transferred into the Concentration Account, however, were proceeds subject to Volvo Finance's security interest. About a week later, Great Basin filed for bankruptcy, owing Volvo Finance millions of dollars.

Volvo Finance has determined that under the applicable tracing rules, including the lowest intermediate balance rule, approximately $693,000 of the $900,000 transferred to Wells Fargo on December 29, 2000, was traceable to the sales of 53 trucks which Volvo Finance had financed under the Floor Plan Agreements (these 53 trucks are referred to as the "Volvo-Financed Vehicles"). After its demand for payment was rejected, Volvo Finance initiated this lawsuit.

A key issue during the litigation was the proper treatment of two transfers Great Basin had made on December 21 and 22. On those days, Great Basin transferred a total of $2 million from the Concentration Account to the First Security Account. The funds remaining in the Concentration Account were soon dissipated, but the funds going to the First Security Account were fully preserved until the December 29 transfer back to Wells Fargo. Volvo Finance's tracing analysis concluded that under the lowest intermediate balance rule, the $2 million transferred on December 21 and 22 included all sales proceeds that were then in the Concentration Account. Wells Fargo disagrees.

The trial court granted summary judgment for Wells Fargo, ruling that, as a matter of law, Wells Fargo did not receive any proceeds traceable to the Volvo-Financed Vehicles. The trial court adopted Wells Fargo's treatment of the $2 million transferred on December 21 and 22, concluding that the proceeds from the Vehicles remained in the Concentration Account to the greatest extent possible, and as such Volvo Finance lost its claim to those funds when the Concentration Account was dissipated.

Volvo Finance now appeals. There is no authority supporting the trial court's application of the tracing rules. To the contrary, courts have long held that when a debtor or trustee transfers funds from one account to another and then depletes the first account, the creditor or beneficiary may follow the funds into the new account. That is exactly what Volvo Finance asked the trial court to do.

Course of Proceedings

Volvo Finance filed its complaint on June 13, 2002, stating claims for conversion, unjust enrichment, and constructive trust. (R. 1-15.) On March 19, 2003, Wells Fargo filed its amended answer, denying liability and raising several affirmative defenses. (R. 71-81.)

On September 10, 2003, Volvo Finance moved for partial summary judgment, seeking a determination of liability only. (R. 761-63.) On November 12, 2004, Wells Fargo moved for summary judgment on all claims. (R. 813-15.) A hearing took place on the motions on May 17, 2005. (R. 2209.) On November 14, 2005, the trial court issued a written order granting Wells Fargo's motion. (R. 2210-15, Add. Ex. 1.)

On December 5, 2005, the trial court entered Judgment dismissing all claims with prejudice. (R. 2216-25.) Volvo Finance filed its notice of appeal on December 7. (R. 2226-28.)

Statement of Facts

A. Background: Volvo Finance's Financing Arrangements with Great Basin and Security Interest in Great Basin's Collateral.

As of December 2000, Volvo Finance had entered into Floor Plan Financing Agreements and Security Agreements with four of the Great Basin Dealerships: (a) Great Basin GMC Trucks, Inc. (based in Salt Lake City); (b) Arizona Great Basin Trucks, Inc. (Phoenix); (c) Great Basin Southwest Trucks, Inc. (Albuquerque); and (d) Idaho Great Basin Trucks, Inc. (Boise). (See R. 181-266, 536-56.) The Financing and Security Agreements, identical in their relevant parts, granted Volvo Finance a security interest in "*all new and used trucks, motor vehicles, tractors, trailers and similar equipment of Debtor* [Great Basin] . . . *and all proceeds of the foregoing.*" (R. 539, 551 (emphasis added).)

The Financing Agreements provided that upon the sale of a vehicle, Great Basin was to "immediately pay to Company [Volvo Finance] an amount equal to the unpaid balance of the amount advanced with respect to the item of inventory sold." (See R. 540.) All funds due to Volvo Finance were to be sent immediately by wire transfer, "on the same business day if possible, and if not, then on the next business day." (Id.) Volvo Finance filed UCC-1 Financing Statements describing its security interest in the vehicles and proceeds in the pertinent jurisdictions. (See R. 299-322, 567-69.) Between July

1999 and December 2000, Volvo Finance financed Great Basin's purchase of the 53 vehicles at issue in this lawsuit (the "Volvo-Financed Vehicles"). (See R. 571-90.)

This arrangement was successful for a number of years, but a routine audit conducted in September 2000 revealed that Great Basin was not timely remitting funds to Volvo Finance. On December 8, 2000, after several rounds of follow-up correspondence and audits, Volvo Finance formally notified Great Basin that it was in default under their agreements, and that Volvo Finance would not release the title certificates or "MSOs" for any sold vehicles unless Volvo Finance received payment for those vehicles. (See R. 592-96.) Unfortunately, Great Basin continued to breach its obligations under the Floor Plan Agreements: From December 7 through December 29, 2000, Great Basin sold the 53 vehicles, receiving proceeds in excess of $5 million, and failed to pay *any* of that money to Volvo Finance. (See R. 604-06.) By the end of December 2000, the Great Basin Entities owed Volvo Finance approximately $30 million. (See R. 706, ¶ 9.)

B. The Bank Transactions.

As of December 2000, Great Basin held a number of "Dealership Accounts" with Wells Fargo, one for each of its individual dealerships. (See R. 598-606.) Great Basin also held a "Concentration Account" with Wells Fargo. (See R. 598, 604.) Each dealership would deposit funds, including sales proceeds, into the Dealership Accounts, and each night the funds in those accounts were automatically swept into the Concentration Account. (See R. 824.)

At the close of business on December 20, 2000, the Concentration Account held just under $3 million, including approximately $1.7 million in proceeds attributable to the

sale of the Volvo-Financed Vehicles. (See Tracing Analysis, R. 1484, Add. Ex. 2.[1]) Over the next two days, Great Basin transferred exactly $2 million from the Concentration Account to a newly opened account at First Security (the "First Security Account"). (See id.) All funds remaining in the Concentration Account after the transfer were dissipated by December 26. (Id.)

On December 27, over $1 million worth of items were presented to Wells Fargo for payment out of the Concentration Account. (See R. 614.) Wells Fargo paid those items, even though the Concentration Account lacked sufficient funds to cover them. (Concentration Account Statement, R. 614, Add. Ex. 3; R. 662-63, 682-86.) As of the close of business on December 27, the Concentration Account was overdrawn by $790,160.73. (See Statement at R. 615.)

The following day, additional items were presented to Wells Fargo for payment out of the Concentration Account. (See id. at R. 614.) Wells Fargo paid those as well, even though, once again, the account lacked sufficient funds. (See id. at R. 614-15; R. 664-65, 687-92.) Thus, as of the close of business on December 28, 2000, the overdraft had reached $828,951.36. (See Statement at R. 615.)

On December 29, 2000, Great Basin transferred $900,000 from the First Security Account to the Concentration Account. (See id. at R. 612; R, 657, 692.) Wells Fargo's system automatically subtracted the amount of the previously existing overdrafts (or

[1] In addition to being included as Addendum Exhibit 2, a separate removable color copy of the Analysis has been placed in the pocket on the inside back cover of each copy of this brief. Counsel would be happy to provide additional copies if requested.

"negative balance") of $828,951.36, thus making only $71,048.64 available for use by the Great Basin Entities. (See Statement at R. 615; R. 689-93, 698-99.)

Volvo Finance's expert has testified that the $900,000 transfer from the First Security Account to the Concentration Account included $693,132 of proceeds traceable to the sale of the Volvo-Financed Vehicles. (R. 629; Tracing Analysis, Add. Ex. 2.) Wells Fargo maintains that no proceeds were transferred.

C. Wells Fargo Ignores Volvo Finance's Security Interest in the Proceeds Despite Actual and Constructive Notice.

Wells Fargo admitted in depositions that it did essentially no investigation or analysis of Great Basin's financial status before deciding to pay the items for which insufficient funds existed in the Concentration Account. Wells Fargo failed to consider (a) whether Great Basin was in debt to others besides Wells Fargo, (b) how much Great Basin may have owed to those other creditors, (c) whether Great Basin was in default on any of its debt obligations to other creditors, (d) whether any of Great Basin's debt obligations were secured, or even (e) *whether any other creditor of Great Basin had an interest in the funds that Great Basin was going to transfer to cover the overdrafts*. (R. 694, 1004-05, 1106-07.) Wells Fargo did not search the UCC filings to determine whether any creditors had security interests in any of Great Basin's property. (R. 604, 700.) Wells Fargo knew, however, that Great Basin's floor plan financing was being provided by Volvo Finance, and that Great Basin's debt obligations to Volvo Finance were secured at least by Great Basin's inventory, i.e., commercial trucks. (R. 1004-05.)

Wells Fargo also knew that the funds Great Basin was going to use to cover the overdrafts were likely proceeds of the sale of commercial trucks. (See id.)

D. Great Basin's Collapse.

Great Basin's house of cards soon collapsed, and on January 5, 2001, Great Basin filed for bankruptcy. (R. 831.) At the time, Great Basin owed Volvo Finance more than $30 million for floor plan financing. (R. 1314.) Volvo Finance therefore retained the local accounting firm of Nielson Elggren to assist it in examining Great Basin's records and tracing the funds from the sales of Volvo-Financed Vehicles. (R. 618.) Using the lowest intermediate balance rule ("LIBR"), Nielson Elggren determined that approximately $693,000 of the $900,000 transferred to Wells Fargo on December 29, 2000, were proceeds traceable to the sales of the Vehicles. (Tracing Analysis, Add. Ex. 2.)

Nielson Elggren's tracing analysis also revealed that in addition to the proceeds that were transferred to the Wells Fargo Concentration Account on December 29, a significant sum of proceeds (roughly $3.5 million) ended up in the possession of Zions Bank, with whom Great Basin had other accounts and other obligations. (Id.; R. 605-06, 619-20.) Volvo Finance presented its tracing analysis to Zions Bank, and recognizing Volvo Finance's superior interest, Zions ultimately repaid a significant portion of these funds to Volvo Finance. (R. 488.)

After reaching its settlement with Zions concerning the proceeds that ended up with Zions, Volvo Finance sought payment from Wells Fargo for the proceeds that were transferred to Wells Fargo on December 29. (Id.) But instead of acknowledging Volvo

Finance's right to the proceeds of the Vehicles, as Zions had done, Wells Fargo denied liability. (Id.)

E. The Litigation.

Volvo Finance therefore initiated this lawsuit, stating claims for conversion, unjust enrichment, and a constructive trust. Wells Fargo did not seriously dispute Volvo Finance's security interest in the Vehicles or the facts regarding the sale of the Vehicles and the deposit and transfers of the funds. (See Stipulation of Facts, R. 2193-2208.) Wells Fargo's expert, however, disputed Nielson Elggren's application of the tracing rules. (See R. 1217-76.) Wells Fargo also raised a number of affirmative defenses, asserting that even if Wells Fargo received funds traceable to the Vehicles, Wells Fargo would not be liable. (R. 76-79.)

After discovery, Volvo Finance moved for partial summary judgment, seeking a ruling that Wells Fargo was liable for conversion to the extent it received funds traceable to the Vehicles. (R. 481-763.) Volvo Finance asked for a ruling that it had a superior right to any proceeds that were transferred to the Concentration Account on December 29, 2000, and that Wells Fargo's affirmative defenses lacked merit as a matter of law.

Wells Fargo filed a cross-motion for summary judgment, asking the trial court to dismiss all of Volvo Finance's claims. (R. 813-1141.) Wells Fargo argued that under LIBR, the first funds taken out of an account must be considered non-proceeds, even if those funds are merely transferred between the debtor's own accounts. (R. 832-40.) As such, Wells Fargo argued, the $2 million Great Basin transferred from the Concentration Account to the First Security Account included primarily non-proceeds, and the funds

that were transferred back on December 29 did not include any traceable proceeds at all. (Id.)

Wells Fargo sought judgment on two additional grounds. First, Wells Fargo contended that even if funds were traceable to the Vehicles, Wells Fargo had a superior right to those funds under Revised UCC Article 9. (R. 840-42.) Second, Wells Fargo argued that under the purported "ordinary course" defense, based on a statement in a comment to pre-revision UCC 9-306, Wells Fargo had a superior right to the funds, notwithstanding Volvo Finance's perfected purchase money security interest, because Wells Fargo did not have actual knowledge of Volvo Finance's claim to those specific funds. (R. 842-49.) (Volvo Finance's motion had previously raised the "ordinary course" issue, asking the court to strike Wells Fargo's 13th and 14th affirmative defenses, which were based on that provision.)

Opposing the motion, Volvo Finance explained that under the lowest intermediate balance rule, funds do not lose their status as proceeds when they are transferred between a debtor's own accounts. (R. 1451-64.) Volvo Finance cited nine cases, plus treatises, a law review article, and two restatements, supporting this position. (R. 1456-60.)

Volvo Finance further pointed out that Revised Article 9 did not govern the present case since that revision was not effective until July 1, 2001. (R. 1464-67.) Volvo Finance also explained that in Insley Manufacturing Co. v. Draper Bank & Trust, 717 P.2d 1341 (Utah 1986), a case nearly identical to the present one, the Utah Supreme Court held, explicitly, that a secured party's right to trace proceeds prevails over the

rights of a setting-off bank even if the bank does not have actual knowledge of the secured party's interest. (R. 1467-80.)

The cross-motions were argued on May 17, 2005, after which the trial court took the matter under advisement. On November 14, the court granted Wells Fargo's motion on the ground that the December 21-22 transfers from the Concentration Account to the First Security Account defeated Volvo Finance's claim to the funds. (R. 2210-15, Add. Ex. 1.) Despite the case law and other sources Volvo Finance supplied, the trial court stated that there was "no authority" supporting Volvo Finance's treatment of the transfers. (See id. at R. 2213.) The trial court did not address the two additional grounds Wells Fargo had raised.

SUMMARY OF ARGUMENT

In granting summary judgment against Volvo Finance, the trial court disregarded over a century's worth of authority. Courts in several jurisdictions have held that when a trustee or debtor commingles trust funds and personal funds in an account, transfers some of those funds to a new account, and then dissipates the funds remaining in the original account, the transferred funds remain subject to the beneficiary's claim. These courts have expressly rejected the argument that Wells Fargo made below and the trial court adopted, i.e., that the first funds taken out of an account must be treated as the trustee's own funds, even if the trustee retains full possession and control over those funds. Notably, neither Wells Fargo nor the trial court was able to cite a single case extending LIBR to cover a transfer between accounts held by the trustee.

Further, the trial court's ruling frustrates the reasoning behind LIBR. The lowest intermediate balance rule presumes that a trustee acts honestly, and that when a trustee spends money from a commingled account, he or she is spending personal funds first. By this presumption, the rule preserves the trust account to the greatest extent possible. The trial court overturned this presumption by ruling that when Great Basin transferred funds to the First Security Account and then dissipated the Concentration Account, Great Basin was actually spending trust money and retaining its own funds. Further, by ruling that a transfer between accounts was enough to deprive Volvo Finance of its claim to the sales proceeds in Great Basin's accounts, the trial court exalted form over substance; the important question in tracing funds is whether the trustee kept the funds or dissipated them, but the trial court's ruling focused on the method the trustee used to keep the funds. The Court should therefore hold that the trial court erred in its interpretation of LIBR.

The trial court's ruling cannot be justified on the basis of the two other grounds Wells Fargo raised below, either. Wells Fargo's reliance on revised Article 9 is clearly improper, as that Article did not go into effect until July 2001, and the Revised Article itself states that it does not apply where relative priorities were established prior to the Act's effective date. When Wells Fargo's conversion took place in December 2000, the parties' relative priorities were established, as Volvo Finance already had a perfected purchase money security interest in Great Basin's inventory and the proceeds thereof. When Revised Article 9 was enacted, creditors in Volvo Finance's position were given until July 2001 to take the additional steps required to protect their interest in a debtor's

proceeds, and it would be unfair and illogical to hold that Volvo Finance's claim is barred because it had not taken those steps by December 2000.

Finally, Wells Fargo's "ordinary course" defense should be rejected as a matter of law. The ordinary course defense is not even part of the UCC; it appears only in a comment to one of the sections in Article 9. Moreover, Utah law precludes application of the ordinary course defense, as the reasoning behind the defense flatly contradicts the reasoning of Insley. Even apart from Insley, cases from other jurisdictions establish that in situations like the one at present, i.e., where a bank lends money to a customer after the customer is already in debt to secured creditors, a bank may not rely on the ordinary course defense to claim proceeds from inventory covered by a senior security interest. At the very least, even if the ordinary course defense were viable in Utah, Wells Fargo did not establish that the defense applies as a matter of law. As such, summary judgment was simply not appropriate.

ARGUMENT

THE TRIAL COURT ERRED IN GRANTING SUMMARY JUDGMENT AGAINST VOLVO FINANCE

A. Under the Lowest Intermediate Balance Rule, Volvo Finance's claim is not defeated by Great Basin's transfer of $2 million from the Concentration Account to the First Security Account on December 21 and 22, 2000.

The trial court erred in granting summary judgment on the basis that the lowest intermediate balance rule bars Volvo Finance's claim for conversion.

1. Preliminary Point: Wells Fargo is liable for conversion to the extent Wells Fargo received proceeds of Great Basin's sale of the Volvo-Financed Vehicles.

Under Utah law, conversion is an "act of interference with a chattel, done without lawful justification by which the person entitled thereto is deprived of its use and possession." Phillips v. Utah State Credit Union, 811 P.2d 174, 179 (Utah 1991). While conversion involves intentional conduct, it does not require a conscious wrongdoing, but "only an intent to exercise dominion and control over the goods inconsistent with the owner's right." Id. In the context of secured transactions, if one creditor exercises control over certain collateral in the face of a second creditor's superior security interest, the first creditor is liable to the second for conversion. See, e.g., Insley, 717 P.2d at 1344-47.

a. Volvo Finance had a security interest in all proceeds of the Volvo-Financed Vehicles.

A valid security interest is created when a written security agreement is signed by the debtor describing the collateral, value is given by the creditor, and the debtor has rights in the collateral. Valley Bank & Trust Co. v. Gerber, 526 P.2d 1121, 1125 (Utah

1974). See Utah Code Ann. § 70A-9-203 (2000).[2] Volvo Finance clearly obtained a security interest in all inventory owned and acquired by Great Basin when it entered into the Security Agreements with each of the Great Basin entities. (See R. 551-56.) The inventory is described in the Security Agreements, Volvo Finance gave value by advancing funds to purchase the inventory, and Great Basin held the rights to the inventory.

Volvo Finance's security interest also extended to the *proceeds* generated by Great Basin's sale of commercial trucks financed by Volvo Finance. Indeed, the UCC provisions then in effect explicitly stated that a security interest "continues in any identifiable proceeds including collections received by the debtor." Utah Code Ann. § 70A-9-306(2) (2000). Further, the Security Agreements specifically stated that Volvo Finance held a security interest in all proceeds received from the disposition of Great Basin's inventory. (R. 551.) Accordingly, Volvo Finance holds a security interest in Great Basin's collateral as described in the Security Agreements, including all proceeds obtained from the disposition of that collateral.

Additionally, Volvo Finance *perfected* its security interest in Great Basin's collateral and proceeds by filing UCC-1 Financing Statements in the pertinent jurisdictions. (See R. 567-69.) Utah Code Ann. §§ 70A-9-203, -302, -304 (2000). A security interest in proceeds "is a *continuously perfected security interest* if the interest in

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[2] Except as otherwise noted, all statutory references are to the version of the UCC that was in effect in December 2000, when the relevant actions took place. Copies of the pertinent sections of the 2000 version of Utah's UCC Article 9 are included in Addendum Exhibit 4.

the *original* collateral was perfected . . . ." Utah Code Ann. § 70A-9-306(3) (2000) (emphasis added). As Volvo Finance's security interest in the trucks was perfected by filing the UCC-1 Financing Statements, Volvo Finance's security interest in the proceeds of those trucks was also perfected. Therefore, Volvo Finance had a perfected purchase money security interest in the proceeds received from Great Basin's sale of the Volvo-Financed Vehicles.

The basic dispute in this case is whether Volvo Finance or Wells Fargo had superior rights to the funds that Great Basin transferred into the Concentration Account on December 29, 2000. Regarding the portion of those funds that were traceable to the sale of the Volvo-Financed Vehicles, the law clearly favors Volvo Finance.

b. Volvo Finance's interest in traceable proceeds was superior to any interest Wells Fargo claimed.

Because Volvo Finance had a perfected purchase money security interest in both the Volvo-Financed Vehicles and the proceeds thereof, Volvo Finance's interest takes precedence over any interest Wells Fargo could possibly claim. The seminal case on this issue is Insley Manufacturing Corp. v. Draper Bank & Trust, 717 P.2d 1341 (Utah 1986) (copy included as Addendum Exhibit 5). In Insley, the plaintiff manufacturer sold, on credit, a $100,000+ backhoe to one of its retail dealers, Schneider, taking a security interest in the backhoe and all proceeds thereof. Schneider sold the backhoe and deposited the proceeds into its checking account with Draper Bank. The bank, however, had previously advanced funds to Schneider to cover several overdraft checks on that account, creating a negative balance. When Schneider deposited the proceeds from the

backhoe sale, the bank credited the deposit to the account and then took those funds to repay itself for the overdrafts. Schneider was thus unable to repay Insley the money it owed on the backhoe and filed bankruptcy a few months later.

Insley sued the Bank for conversion of the proceeds of the backhoe. The trial court granted summary judgment in Insley's favor, and the Utah Supreme Court affirmed. First, the court explained that because Insley entered into a security agreement to secure the purchase price of the backhoe, filed a UCC-1 financing statement, and delivered the backhoe, Insley had a perfected purchase money security interest under Article 9. See id. at 1343. The court further pointed out that when the backhoe was sold, Insley lost its security interest in the backhoe, but "its interest remained in the identifiable cash proceeds," and that when the funds were deposited into Schneider's checking account, that account "contained, in part, identifiable cash proceeds from the [backhoe] sale." Id.

The court then concluded that Insley's security interest in the funds took priority over the Bank's right to use those funds to repay its advances, reasoning that "Insley's purchase money security interest in the proceeds was perfected," while the Bank was simply an unsecured creditor. Id. at 1347. The court therefore determined that "the Code's priority rules require that Insley's interest must prevail over Draper's right of setoff." Id. The court noted that under the UCC, "*a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors*," and that "'[t]he effect of [Section 9-201] is to give the Article Nine secured party, upon a debtor's default, *priority over "anyone, anywhere, anyhow*" except as otherwise provided by the remaining Code priority rules.'" Id. (emphasis added,

citation omitted). Accord GMAC v. Lincoln Nat'l Bank, 18 S.W.3d 337 (Ky. 2000); C & H Farm Serv. Co. v. Farmers Sav. Bank, 449 N.W.2d 866 (Iowa 1989).

The present case is functionally identical to Insley. Just as the manufacturer did in Insley, Volvo Finance loaned funds to a dealer, Great Basin, to enable the dealer to buy inventory, pursuant to a security agreement that gave Volvo Finance a security interest in the inventory and all proceeds thereof. Just as in Insley, the dealer issued checks for which there were insufficient funds in its account, and the bank (in this case Wells Fargo) decided to advance funds to the dealer to cover those checks. Finally, just as in Insley, the bank decided to take proceeds from the collateral and use those funds to repay the dealer's overdraft debt to the bank, notwithstanding that Volvo Finance had a prior perfected security interest in those funds. Therefore, just as in Insley, Wells Fargo is liable for conversion.

c. Volvo Finance's Tracing Analysis.

The extent of Volvo Finance's claim depends on its ability to trace proceeds of Great Basin's sales of the 53 Volvo-Financed Vehicles into the $900,000 Great Basin transferred to Wells Fargo on December 29, 2000. Volvo Finance's tracing analysis (Add. Ex. 2; also inserted in the pocket inside the back cover) shows that the December 29 transfer included roughly $693,000 in traceable proceeds. As shown on the Analysis (in the "Total Beginning Balance" line across the top of the page), the Concentration Account (Account 409-8328487) held $2,989,075 at the start of business on December 21, 2000. Of these funds, $1,691,585 were proceeds traceable to the sale of 25 of the

Volvo-Financed Vehicles (printed in red ink and identified as "Trust Money").[3] The remaining $1,297,489 constituted non-proceeds (black ink). On December 21, Great Basin transferred $1.5 million from the Concentration Account to the newly created First Security Account. (These funds were not received into the First Security Account until the next day.) On December 22, Great Basin deposited $100,334 in proceeds into the Concentration Account (from the sale of another Vehicle) and transferred another $500,000 from the Concentration Account to the First Security Account.[4] When those transfers were complete, $661,274 was left in the Concentration Account (as shown by the "Ending Balance" line for December 22). By December 26, Great Basin had fully depleted the funds left in the Concentration Account.

Because Great Basin kept control over the funds transferred to the First Security Account, Mr. Judd concluded that all sales proceeds in the Concentration Account on December 21 and 22 were included in the $2 million transferred to the First Security Account. (When some funds are spent and some retained, LIBR presumes that trust funds were retained.) Therefore, the $2 million transfer included $1,791,919 in proceeds

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[3] Wells Fargo disputes Volvo Finance's conclusions as to what portion of the account balance constituted proceeds. That dispute is not material to the present discussion, however, because the discussion is for illustrative and background purposes only.

[4] These transfers are somewhat difficult to follow on the Tracing Analysis. The table on the top of the Tracing Analysis addresses the Wells Fargo Concentration Account. The first $1.5 million transferred out appears as a negative entry in the 12/21/00 column. Because the Tracing Analysis concludes that these funds were comprised entirely of sales proceeds, the "(1,500,000)" is in red ink. The second $500,000 is shown as two negative entries in the 12/22 column: "(291,919)" in red, i.e., proceeds, and "(208,081)" in black.

The bottom table shows the First Security Account. Because the entire $2 million arrived in the First Security Account on December 22, the combined transfer is shown as two positive entries on the 12/22 column: "1,791,919" in red, and "208,081" in black.

(the $1,691,585 in proceeds that were already in the Concentration Account on December 21, plus the additional $100,334 deposited into that account on December 22). Thus, as of the end of the day on December 22, the First Security Account held $1,791,919 in proceeds.

On December 27, Great Basin deposited $32,630 from the sale of one more truck directly into the First Security Account, bringing the total proceeds in the First Security Account to $1,824,549 ($1,791,919 + $32,630).

As of the start of business on December 29, the First Security Account had a balance of $2,230,002, including that $1,824,549 in proceeds and $405,453 in non-proceeds. That day, Great Basin deposited another $1,882,967 in proceeds (from the sale of 26 Volvo-Financed Vehicles) directly into the First Security Account, bringing the total proceeds in the account to $3,707,516 ($1,824,549 + $1,882,967). Additional non-proceeds went in and out of the account that day, so that prior to the $900,000 transfer back to the Concentration Account, the First Security Account held $3,914,385, including $3,707,516 in proceeds and $206,868 in non-proceeds.[5] When Great Basin transferred the $900,000 back to the Concentration Account, the transfer included all $206,868 in non-proceeds, plus $693,132 in proceeds.[6] (The remaining $3,014,385 in proceeds

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[5] Because of rounding, the figures in the Tracing Analysis do not always match up precisely. Also, the figures stated here in the text do not directly appear in the Tracing Analysis because the analysis shows the balances in the accounts after the $900,000 was transferred. The Tracing Analysis shows $1,824,549 in proceeds in the account at the start of December 29, plus the $1,882,967 deposited that day, adding up to the $3,707,516 in proceeds mentioned in the text.

[6] Because the $900,000 transferred on December 29 from the First Security Account to the Concentration Account was immediately dissipated, Volvo Finance and

stayed in the First Security Account, were traced to Zions Bank, and, to a large extent, were ultimately recovered by Volvo Finance.) Thus, Volvo Finance is suing Wells Fargo for the $693,132 in proceeds transferred to the Concentration Account and seized by Wells Fargo.

d. Wells Fargo's Treatment.

Wells Fargo, however, contends that the December 21 and 22 transfers included, at most, only $1,066,584 in proceeds. (See R. 1276, Add. Ex. 6.) Wells Fargo asserts that under LIBR, the first funds taken out of a commingled account are assumed to be free of a creditor's security interest, even if the debtor retains control and possession of those funds. Thus, under Wells Fargo's view, the funds transferred on December 21 and 22 must be treated, to the greatest extent possible, as if they included all *non*-proceeds. Because there were $933,416[7] in non-proceeds in the account at the time, Wells Fargo asserts that the $2 million transferred includes those $933,416 in non-proceeds, with the remainder ($1,066,584) treated as proceeds subject to Volvo Finance's interest. All other

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Wells Fargo agree that under LIBR, the transfer is deemed to include any non-proceeds that were then in the First Security Account, with any remainder made up by proceeds.

[7] Wells Fargo's modified tracing analysis, Addendum Exhibit 6, is difficult to read, but Wells Fargo's conclusions can be derived from Volvo Finance's Tracing Analysis (Add. Ex. 2), as follows. As noted in the text, the Concentration Account held $1,297,489 in non-proceeds (black ink) at the start of the day on December 21. During that day, four deposits of non-proceeds were made into the Concentration Account ($29,099, $9,180, $1,789, and $2,500), and $406,641 was disbursed from the Account, bringing the total non-proceeds to $933,416. Wells Fargo asserts that all of these non-proceeds were included in the December 21 transfer of $1,500,000 to the First Security Account. Volvo Finance, on the other hand, asserts that these non-proceeds remained in the Concentration Account, which is why the "non-proceeds" balance at the start of December 22 was $933,415. (Once again, numbers do not match up exactly because of rounding.)

funds in the Concentration Account on December 21 subject to Volvo Finance's interest stayed in that account and were lost when that account was dissipated.

Wells Fargo thus asserts that on December 29, prior to the $900,000 transfer, the First Security Account included, at most, $2,982,181 in proceeds,[8] with the remaining $932,203 as non-proceeds. Id. So when Great Basin transferred $900,000, that transfer included only non-proceeds, and all proceeds remained in the First Security Account. Under this approach, Wells Fargo would not have received any funds subject to Volvo Finance's interest, and as such Volvo Finance would have no claim.

The parties' respective treatments of the December 21-22 transfers, and the effect of those treatments, are set forth in the following table (proceeds shown in bold):

	Dec. 21-22 Transfers to First Security Acct ($2,000,000 Total)	Dec. 29 Balance in First Security Acct Pre-$900K Transfer ($3,914,384)	Dec. 29 Transfer to Wells Fargo Acct ($900,000)
Volvo Finance	**1,791,919**	**3,707,516**	**693,132**
	208,081	206,868	206,868
Wells Fargo[9]	**1,066,584**	**2,982,181**	**0**
	933,416	932,203	900,000

Once again, the parties agree that $1,915,597 ($32,630 + $1,882,967) in proceeds was deposited into the First Security Account on December 27 and 29. The parties also agree that when Great Basin transferred $900,000 from the First Security Account to the

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[8] The $1,066,584 transferred on December 21 and 22, plus the $32,630 deposited on December 27 and the $1,882,967 deposited on December 29.

[9] Wells Fargo's expert raised other challenges to Volvo Finance's conclusions regarding the amount of sales proceeds that were in the relevant accounts at any given time. The numbers presented in the table, and in the discussion in the text, represent Wells Fargo's position for purposes of the summary judgment motion only.

Concentration Account on December 29 and immediately dissipated the funds, LIBR presumes that the transfer included all non-proceeds then in the First Security Account. Thus, while following all of the numbers may be dizzying, the controlling question on appeal is rather straightforward: When Great Basin transferred the $2 million from the Concentration Account to the First Security Account and dissipated the funds left in the Concentration Account, should the transferred funds be treated as including primarily proceeds, or primarily non-proceeds? Put another way, to the extent the funds in the Concentration Account prior to those transfers were subject to Volvo Finance's security interest, did the transfer to the First Security Account preserve Volvo Finance's interest, or defeat that interest?

2. The Lowest Intermediate Balance Rule (LIBR).

As shown in the preceding sections, both Volvo Finance and Wells Fargo purport to apply LIBR, the commonly accepted (and governing in Utah) rule, originally developed for trust law, for tracing funds out of a commingled account. LIBR relies on two basic presumptions. First, when a trustee commingles trust funds and personal (non-trust) funds, and then spends some of the commingled money, the law ordinarily presumes that the trustee spends his personal funds first, thus preserving the trust funds to the greatest extent possible. Second, if trust funds are depleted, they are not usually replenished by subsequent deposits of the trustee's personal funds or funds from a third party. See, e.g., Tooele County Bd. of Educ. v. Hadlock, 79 Utah 478, 11 P.2d 320, 324-25 (1932). So, for example, if a trustee mixes $50 of trust money and $50 of his own money in an account, and then writes a $50 check for dinner, the law presumes (under the

first presumption) that he has spent his own money, and the $50 remaining in the account is subject to the trust. But if the trustee writes another $10 check for dessert, the extra $10 must come from the trust funds, because once the first $50 has been spent, the only money left is trust money. Thus, under this situation, the trust fund is reduced to $40. If the trustee then gets another $60 from an outside source, and deposits that into the account, that deposit would *not* replenish the trust money (under the second presumption), so the trust would still be limited to $40. The trust is thus limited to the "lowest intermediate balance" between the time of the commingling and the time the funds are recovered or paid, i.e., $40. Volvo Finance believes that Wells Fargo would agree so far.

Wells Fargo's motion raised the issue of how to treat retentive transfers. That is, if the trustee transfers money from one account to another, and then spends the money remaining in the first account, are the funds in the second account trust money or personal funds? Wells Fargo contends that the first LIBR presumption (expenditures are deemed to be taken from non-trust money first) should be applied every time funds are taken from an account, even if the funds are not spent or otherwise dissipated. Under Wells Fargo's view, a withdrawal of funds must be treated the same as an expenditure of funds, even if the trustee actually maintains complete control over the funds. Thus, Wells Fargo contends that the December 21-22 transfers included all non-proceeds then in the Concentration Account.

According to the authorities that have actually addressed this issue, however, the first LIBR presumption *applies only when funds are dissipated.* If a trustee or debtor does not dissipate funds withdrawn from a commingled account, but instead maintains

possession of the funds or their product (in cash, in another account, or by investing in other assets), the withdrawal does not defeat the beneficiary's or creditor's interest. Thus, when the $2 million was transferred on December 21 and 22 and kept in the First Security Account, while the Concentration Account was immediately dissipated, the transferred funds kept their status as "proceeds" of the Volvo-Financed Vehicles and remained subject to Volvo Finance's security interest.

3. The Law: Under LIBR, Volvo Finance's security interest remained in the funds transferred from the Concentration Account to the First Security Account.

a. Cases and other authorities recognize that the first presumption of LIBR does not apply unless funds are dissipated.

Utah law has long recognized that where trust funds are converted into another form of property, the trust extends to that property, and to all proceeds of that property, even if the trust funds were commingled with the trustee's own money:

> "The doctrine of equity, as regards property disposed of by persons in a fiduciary position, is that, whether the disposition of it be rightful or wrongful, ***the beneficial owner is entitled to the proceeds, whatever be their form, provided only he can identify them.*** If they cannot be identified, by reason of the trust money being mingled with that of the trustee, then ***the cestui que trust is entitled to a charge upon the new investment to the extent of the trust money traceable into it***; that there is no distinction between an express trustee and an agent, or bailee, or collector of rents, or anybody else in a fiduciary position; and that there is no difference between investments in the purchase of lands, or chattels, or bonds, or loans, or ***moneys deposited in a bank account.***"

Waddell v. Waddell, 36 Utah 435, 104 P. 743, 749 (1909) (emphasis added) (quoting National Bank v. Insurance Co., 104 U.S. 54, 68 (1881)). Thus, the court in Waddell held that the claimant's interest included not only funds that the defendant wrongfully

obtained from a decedent's estate, but also property the defendant purchased from a commingled account. Id. at 750.

Courts therefore have long recognized that where a trustee (1) commingles trust funds and personal funds in an account; (2) transfers some of those funds to another account or form; and then (3) dissipates the funds left in the first account, the transferred funds remain impressed with the trust. For example, more than one hundred years ago, the Supreme Court of Nebraska held that the plaintiff had a right to trace its funds to certain warrants a bank had purchased out of a commingled account, even though the bank subsequently depleted that account. See City of Lincoln v. Morrison, 90 N.W. 905 (Neb. 1902) (Add. Ex. 7). In Lincoln, about a week after the plaintiff city purchased a certificate of deposit from the bank, the bank used $1,750 in cash to purchase certain "state warrants." Eight months after that, the bank suspended operations. When it suspended operations, the bank had depleted its cash, but the receiver recovered $3,300 from selling the warrants. Id. at 906.

The court rejected the receiver's argument, identical to Wells Fargo's, that the funds used to buy the warrants should be presumed to be the bank's own money, because those funds were the first "withdrawn" from the commingled account. Instead, the court held that the first presumption of LIBR applies only to funds that are dissipated:

> The receiver contends that since there was over $40,000 in cash in the bank at the time, of which but $6,000 belonged to the city, it will be presumed that the $1,750 [withdrawn to purchase the warrants] was the bank's own money. ***Such would be the case, without doubt, had the bank withdrawn the money and dissipated it in some fashion. But it did not do this. It merely changed the form of a portion of the fund in which the city's money had been wrongfully mixed.***

Id. at 909 (emphasis added). Because the funds were not dissipated, but were instead used to buy the warrants, the city had a claim to the $3,300 generated by selling the warrants, in preference to the bank's general creditors:

> In accordance with ***the presumption that whatever was retained and not dissipated was the city's money, and not the bank's***, these warrants and their proceeds in the hands of the receiver represent money to which the city has a prior claim, and in which general creditors have no right to share.

Id. (emphasis added).

Similarly, in Brennan v. Tillinghast, 201 F. 609 (6th Cir. 1913) (Add. Ex. 8), the Ironwood Bank wrongfully sold the plaintiff's stock and deposited the $3,500 in proceeds in that bank's own account with a second bank, the Duluth Bank. Over the ensuing seven days, the Ironwood Bank withdrew $2,800 from the Duluth account and put the cash into its own vault.[10] Throughout this time, the Duluth account always contained more than $3,500. A few days later, the Duluth account was fully depleted, and the Ironwood Bank soon closed. Cash remained in the Ironwood Bank's vault, however, and the plaintiff asserted a right to have the wrongfully sold stock proceeds repaid out of that cash. Id. at 611-12.

Once again, as Wells Fargo does in the present case, the bank's receiver argued that the plaintiff could not trace his funds from the Duluth account to the bank's vault, because as the first money taken out of the Duluth account, the $2,800 transferred to the vault was presumed to be the bank's own money, not the plaintiff's. Under the receiver's

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[10] The transfer was actually made through the use of cash drafts.

theory, the plaintiff's funds remained in the Duluth account after the transfers were complete and were therefore lost when that account was depleted. Id. at 612-13.

The court, just like in Lincoln, acknowledged the presumption that "the sums first drawn out were from the moneys which the tort-feasor had a right to expend in his own business, and that the balance which remained included the trust fund, which he had no right to use." Id. at 614. But as in Lincoln, the court concluded that "this rule of presumption has no application where the evidence shows that the first moneys drawn out of the mingled fund by the tort-feasor *were not in fact dissipated by him at all, but were merely transferred, in a substituted form, to another fund retained in his own possession.*" Id. (emphasis added). Instead, the court held that the plaintiff could trace his funds into the bank's remaining cash: "[T]he right to follow the trust in such form is not lost by reason of the fact that the tort-feasor thereafter draws out and spends for his own purposes the balance of the fund in which the trust money was originally mingled." Id.

The Brennan court (and many others) relied heavily on a seminal 1903 English case, In re Oatway, 2 Ch. Div. 356 (Add. Ex. 9). In Oatway, the decedent had wrongfully used funds from a commingled account to purchase stock and then dissipated the rest of the account. Again, as in the present case, if the funds taken from the account were deemed the decedent's personal funds (as Wells Fargo claims here), so that the claimant's funds stayed in the account and were later dissipated, the trust would be extinguished and the claimant left with a personal unsecured claim against the decedent's estate. But if the funds taken from the account were deemed trust funds (as Volvo Finance maintains), the

claimant would be able to trace the funds to the stock and to the proceeds of their sale. The court ruled in favor of the claimant, reasoning that "when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having afterwards been dissipated by him, *he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust.*" Id. at 360 (emphasis added).[11]

The principles established by these cases are recognized as controlling. For example, the Restatement of Restitution explains that where a wrongdoer "makes withdrawals from the [commingled] bank account which are preserved or can be traced, and subsequently withdraws and dissipates the balance of the deposit, the claimant can enforce an equitable lien *on the part withdrawn or its product.*" Restatement of Restitution § 211, cmt. c, at 852 (1937) (emphasis added). Applying this principle to the lowest intermediate balance rule, section 212 of the Restatement of Restitution states that

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[11] Several other courts have recognized that the first presumption of LIBR does not apply when funds are transferred or otherwise not dissipated. See, e.g., In re Pacat Fin. Corp., 27 F.2d 810, 813 (2d Cir. 1928) (the "applicable principle" is set forth in Oatway; also citing Brennan and Lincoln); Mitchell v. Dunn, 294 P. 386, 389 (Cal. 1931) ("The law will not permit the trustee to say that the only permanent investment made with moneys from the fund was with personal funds, and that the dissipated funds belonged to the cestui."); Republic Supply Co. v. Richfield Oil Co., 79 F.2d 375, 377-78 (9th Cir. 1935) (following Brennan and Oatway); In re Erie Trust Co., 191 A. 613, 617-18 (Pa. 1937) (following Oatway and Restatement of Trusts § 202(l)); Central Prod. Credit Ass'n v. Hans, 545 N.E.2d 1063, 1073-74 (Ill. App. Ct. 1989) (recognizing under Restatement of Restitution § 212, cmt. d, that LIBR does not apply "where the money withdrawn or traceable proceeds of that money are redeposited"); In re Goldberg, 168 B.R. 382, 385 (B.A.P. 9th Cir. 1994) ("[T]he presumption will not be applied to the disadvantage of the beneficiary.").

a trust fund is depleted only when a person "makes withdrawals from the mingled fund *and dissipates the money so withdrawn.*" Id. § 212 (emphasis added) (Add. Ex. 10). A comment to section 212 further explains that the rule "is not applicable *where the money withdrawn or traceable proceeds of that money are redeposited.* If the money withdrawn from the account is subsequently redeposited in the account, the effect is the same as though the withdrawal had not been made, and *the claimant's lien is not limited to the lowest intermediate balance.*" Id. § 212, cmt. d (emphasis added). See also Restatement (Second) of Trusts § 202 (1959); Bogert, The Law of Trusts and Trustees § 928 (Rev. 2d ed. 1982) (discussing cases following Oatway); Austin W. Scott, The Right to Follow Money Wrongfully Mingled With Other Money, 27 Harv. L. Rev. 125 (1913).

Given the foregoing, the trial court clearly erred in stating that there was "no authority" for Volvo Finance's position. (Order, Add. Ex. 1, at R. 2213.) To the contrary, Lincoln, Brennan, Oatway, the Restatement of Trusts, the Restatement of Restitution, Bogert's treatise, the Harvard Law Review, and the other cases cited above certainly constitute "authority" that transactions that dissipate funds are treated differently from transactions that preserve funds. As such, Volvo Finance is not seeking to "eliminate the rules for tracing." (Cf. id.) Volvo Finance is merely asking that the tracing rules be applied just as they have been for more than a century.

b. Adopting Wells Fargo's view would defeat the very purpose of the tracing rules.

The Lincoln/Brennan/Oatway rule is supported by the very considerations that led to the development of tracing rules in the first place. The presumption that withdrawals

are deemed to include non-trust funds first is based on a legal fiction that a trustee is presumed to act properly; if a trustee withdraws and spends part of a commingled fund and preserves the rest, the law presumes to the greatest extent possible that the trustee was spending his own money and preserving the beneficiary's. See, e.g., Hadlock, 11 P.2d at 325 ("The presumption is that men act honestly; that when a trustee mingles trust money with his own, and then draws out sums from a common fund by check or otherwise, it will be presumed that he drew out his own in preference to the trust money."). But where a trustee simply transfers one part of a commingled fund into a new account, and then spends the money left remaining in the first account, application of the "trustee acts properly" presumption supports the Lincoln/Brennan/Oatway rule. If the law presumes that the trustee preserves trust funds to the greatest extent possible, then the law must presume that the trust funds were transferred to and preserved in the new account.

Similarly, the purpose of LIBR is to protect the beneficiary's rights to the funds to the greatest extent possible. See, e.g., C.O. Funk & Sons v. Sullivan Equip., 431 N.E.2d 370, 372 (Ill. 1982) ("[T]he lowest-intermediate-balance rule directs that Funk's proceeds in Sullivan's account are preserved to the greatest extent possible as the account is depleted."). Indeed, that is the point of the presumption that the trustee spends his own money first: Doing so presumes that the trust money is spent *last*, i.e., as little as possible. But again, where some funds are transferred to a new account and the rest spent, the purposes of LIBR are best achieved by applying the Lincoln/Brennan/Oatway

rule, i.e., by presuming that the funds transferred to the new account are subject to the trust.

c. Wells Fargo's position is unsupported by law or logic.

Wells Fargo cited no authority below expanding LIBR to cover retentive transfers. Instead, Wells Fargo relied primarily on a Utah bankruptcy case stating, without analysis, that the first funds "removed" from an account are treated as non-trust funds under LIBR. (See R. 883 (citing In re JD Serv., Inc., 284 B.R. 292, 298 (Bankr. D. Utah 2002).) Wells Fargo also cited two additional bankruptcy cases repeating the general proposition that when a commingled fund is "dissipated," the trust fund is also dissipated. (See id. (citing Schuyler v. Littlefield, 232 U.S. 707, 711-12 (1914); Turley v. Mahan & Rowsey, Inc., 817 F.2d 682, 684 (10th Cir. 1987).) Finally, Wells Fargo cited two old Utah cases for the proposition that if a claimant cannot trace the funds at issue, then the claimant loses its special rights to those funds. (R. 832-33 (citing Kent v. Kent, 50 Utah 44, 165 P. 271, 272 (Utah 1917); Hadlock, 11 P.2d at 324-25).)

These cases are inapplicable because they do not deal with the situation presented here, where the funds were transferred between accounts held by the trustee/debtor. In fact, those cases actually *support* Volvo Finance's position. For example, in Hadlock, the court allowed the plaintiff to trace funds into two separate accounts simultaneously, the insolvent bank's own vault and that bank's account with a larger bank. See Hadlock, 11 P.2d at 325-26. The court also recognized that when the trustee is insolvent, "[t]here is a presumption ... that what remains at the time of insolvency is a trust fund. The law presumes that *trust funds were not appropriated and that a balance of cash in the hands*

of the depositary is the trust funds." Id. at 325 (emphasis added, internal quotation and citation omitted). Similarly, the In re JD Services bankruptcy court, allowed a bank that had erroneously credited a large deposit to the debtor to trace the funds when they were transferred to a new account. See In re JD Serv., 284 B.R. at 298-99.

Wells Fargo's position is illogical as well. There is no good reason why a creditor's rights in funds held by a debtor should depend on which account the debtor used to keep the funds. If a debtor commingles $50 of secured proceeds with $50 of its own funds, transfers half of the money to a new account, and then writes a $50 check for dinner, why should it matter if the check is drawn on the second account or on the first? Under either scenario, the debtor still would have $50 of the funds remaining, traceable to the commingled account, enough to satisfy the creditor's claim.

Wells Fargo asks this Court to exalt form over substance by treating funds held in two accounts differently from funds held in a single account and by holding that a secured creditor's ability to trace depends on whether the debtor had kept the funds in the same account, transferred funds between accounts and back, or withdrawn the funds and redeposited them. Indeed, as Mr. Judd pointed out in his deposition, Wells Fargo's preferred approach would allow a debtor to destroy a security interest simply by transferring funds from one account to another and back. (See R. 836.) The Lincoln/Brennan/Oatway rule ignores such trivialities and instead focuses on the substantive question of whether the debtor maintained control of the funds or their product.

d. Summary.

The cases, the restatements, and the other authorities agree: Under LIBR, when trust funds are placed into a commingled account, and when funds from that account are withdrawn but retained, with the account then being depleted, the beneficiary or creditor does not lose his interest in the trust funds still in the trustee's possession. Thus, as a matter of law, when Great Basin transferred $2 million from the Concentration Account to the First Security Account, and then spent the rest of the money in the Concentration Account, Volvo Finance's security interest in the funds was *not* defeated; instead, that security interest continued in the funds as they remained in the First Security Account. As such, the trial court erred in concluding that the funds transferred back to the Concentration Account on December 29 did *not* include proceeds traceable to the sale of any of the Volvo-Financed Vehicles. The Judgment should therefore be reversed.

B. The alternative grounds Wells Fargo raised below would not support summary judgment against Volvo Finance.

Because the trial court ruled that the transfer between Great Basin accounts defeated Volvo Finance's claim to the funds at issue, the court did not address the two alternative grounds Wells Fargo raised in support of its motion for summary judgment. The first alternative ground Wells Fargo raised was that under Revised Article 9, Volvo Finance is required to prove "collusion" between Wells Fargo and Great Basin in order to prevail. The second ground is that even if the pre-revised Article 9 governs, Volvo Finance's claim is barred by the "ordinary course" defense that is mentioned in a

comment to former UCC 9-306(2), Utah Code Ann. § 70A-9-306(2). Both arguments should be rejected.

1. Revised Article 9 does not apply because it was not in effect in December 2000.

First, Revised Article 9, which placed additional requirements on a secured creditor in order to maintain priority against a bank,[12] does not apply to the present case. Revised Article 9, by its own terms, did not go into effect until July 1, 2001, and the conversion at issue here happened in December 2000. Revised Article 9 expressly states that it does not affect relative priorities that were established prior to July 2001:

> This act determines the priority of conflicting claims to collateral. However, ***if the relative priorities of the claims were established before this act takes effect, former Chapter 9 determines priority***.

Utah Code Ann. § 70A-9a-709(1) (emphasis added). This statute "serves as a grandfather clause, protecting interests that enjoyed priority under former Article 9 but would lose that status under the revised provisions. It ensures that '*the mere taking effect of [revised Article 9] does not of itself adversely affect the priority of conflicting claims to collateral.*'" Interbusiness Bank v. First Nat'l Bank of Mifflintown, 318 F. Supp. 2d 230, 238 (M.D. Pa. 2004) (emphasis added, bracketed material in original, citations omitted).

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[12] Revised Article 9 requires a creditor to obtain "control" over a debtor's bank account to preserve its priority over a setting-off bank: "The exercise by a bank of a set-off against a deposit account is ineffective against a secured party that holds a security interest in the deposit account *which is perfected by control* under Subsection 70A-9-104(1)(c), if the set-off is based on a claim against the debtor." Utah Code Ann. § 70A-9a-340(3) (emphasis added). A secured creditor may obtain "control" of a deposit account by entering into an agreement with the bank or by "becom[ing] the bank's customer with respect to the deposit account." Utah Code Ann. § 70A-9a-104(1)(a), (b). The control requirement did not exist under former Article 9.

In Interbusiness Bank, the court held that former Article 9 governed a priority dispute between creditors whose interests were perfected in February and May 2001, respectively, even though the lawsuit was not filed until 2003 and involved a liquidation that occurred after the Revised Article took effect. See id. at 239-40. Here, whatever rights Wells Fargo and Volvo Finance had in Great Basin's funds were established on December 29, 2000, the day Wells Fargo seized the funds from Great Basin's account. Therefore, former Article 9 controls.

In Utah, statutes do not operate retroactively; instead, the law in effect at the time of the events in question governs liability for those events. See, e.g., WebBank v. American Gen'l Annuity Serv. Corp., 2002 UT 88, ¶ 5 n.3, 54 P.3d 1139. Indeed, retroactively applying Revised Article 9 in this situation would be especially unfair to Volvo Finance and other creditors. As mentioned in footnote 12 above, Revised Article 9 instituted new procedures for a creditor to maintain control over debtor's use of proceeds, e.g., by obtaining "control" over a deposit account. See Utah Code Ann. § 70A-9a-104(1). But Revised Article 9 gave creditors until July 1, 2001, to take such steps. It would be unfair to hold Volvo Finance to the new requirements of the Revised Article 9 *before that article even went into effect.*

2. Summary judgment cannot be justified by the purported "ordinary course" defense of Comment 2(c).

Wells Fargo's second alternative ground below was that the so-called "ordinary course" defense, which appears in a comment to former UCC 9-306, allows Wells Fargo to take the proceeds of the Volvo-Financed Vehicles free and clear of Volvo Finance's

undisputed superior security interest. (Volvo Finance's motion for partial summary judgment also raised the same issue, asking the trial court to strike two "ordinary course" affirmative defenses.)

As noted above, former UCC 9-306(2) states that a security interest in collateral "continues in any identifiable proceeds including collections received by a debtor." Utah Code Ann. § 70A-9-306(2) (2000) (Add. Ex. 4). Comment 2(c) to former UCC 9-306 states as follows:

> Where cash proceeds are covered into the debtor's checking account and paid out in the operation of the debtor's business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds. What has been said relates to payments and transfers in ordinary course. The law of fraudulent conveyances would no doubt in appropriate cases support recovery of proceeds by a secured party from a transferee out of ordinary course or otherwise in collusion with the debtor to defraud the secured party.

Former UCC 9-306, cmt. 2(c). Relying primarily on three out-of-state cases,[13] Wells Fargo argued that under the ordinary course defense, Volvo Finance would have to prove either that Wells Fargo knew, or that Wells Fargo recklessly disregarded, that Great Basin's "payment" of the proceeds to Wells Fargo violated Volvo Finance's security interest. Wells Fargo insisted that because Wells Fargo seized the funds from the Concentration Account without knowing that Volvo Finance had an interest in those funds, Volvo Finance's claims should be dismissed as a matter of law.

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[13] Textron Fin. Corp. v. Firstar Bank Wis., 579 N.W.2d 48 (Wis. Ct. App. 1998); J.I. Case Credit Corp. v. First Nat'l Bank, 991 F.2d 1272 (7th Cir. 1993); Harley-Davidson Motor Co. v. Bank of New England, 897 F.2d 611 (1st Cir. 1990).

The ordinary course defense must be rejected for two reasons. First, the defense does not even apply in Utah in this kind of case. Second, even if the defense *could* apply, Wells Fargo has not established that the defense *does* apply.

a. The ordinary course defense as a matter of law cannot apply to the present facts.

(i) Utah law precludes the defense.

First, a defense based on a "comment" simply cannot trump the plain language of the UCC statutes. As noted above, UCC 9-306(2), which was enacted by the Utah legislature, plainly states that a security interest in collateral includes identifiable proceeds of that collateral. See Utah Code Ann. § 70A-9-306(2). Adopting the ordinary course defense would enable a comment to take precedence over the plain language of a statute. This would not be appropriate.

Second, this case is controlled by Insley, and the principles behind the ordinary course defense are inconsistent with those expressed in Insley. 717 P.2d 1341 (Add. Ex. 5). As discussed earlier, Insley held that when a debtor deposits funds into an overdrawn account, and the bank uses those funds to repay itself for an overdraft advance, the bank is liable for conversion if the funds were proceeds in which a creditor had a perfected security interest. The Utah Supreme Court reasoned that "[t]he purpose and concept of notice filing would be significantly weakened if we held that [a bank] is not bound by that which it would have discovered through a proper inquiry." Id. at 1345. The court further explained that one of the purposes of Article 9 "is to relieve creditors from the age-old requirement of policing collateral in the hands of a debtor. Adoption of the

minority approach [allowing a bank to take priority] places such a duty on creditors and 'would severely undercut significant values of certainty, efficiency, and reliance which are at the heart of the Codal emphasis on public filing.'" Id. at 1346 (citation omitted). Instead, "*[a] secured party should be able to rely on his compliance with the Code's requirements for perfection and his search of the record as against an unrecorded interest of a setting-off bank.*" Id. (emphasis added).

To allow an "ordinary course" defense on the facts of this case, i.e., to require Volvo Finance to establish knowledge or recklessness by Wells Fargo, the Court would have to conclude that Volvo Finance's UCC-1 filings were not enough to put Wells Fargo on notice of Volvo Finance's interest in the proceeds of the Vehicles, and that Volvo Finance was required to take additional steps, beyond the filing, to protect its rights. Insley precludes such reasoning. Indeed, under Wells Fargo's view, the only way a secured creditor could protect its interest would be to physically prevent delivery of inventory until payment was received. But once again, imposing such a requirement would contradict the Utah Supreme Court's recognition in Insley that the purpose of Utah Code Ann. § 70A-9-205 is to relieve creditors of the "age-old requirement of policing collateral in the hands of a debtor." Insley, 717 P.2d at 1346. Volvo Finance respectfully submits that there is no way the Court can adopt the "ordinary course" defense and still remain faithful to Insley.[14]

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[14] Perhaps recognizing this problem, Wells Fargo attempted below to distinguish Insley by denying that Wells Fargo exercised a "setoff." (R. 2164-66.) But the use of the deposited funds to offset the prior "negative balance" is the very *epitome* of a setoff, and any attempt to distinguish Insley would be futile.

Finally, the only Utah Supreme Court case discussing the ordinary course defense, while not directly on point, appears to bar any attempt to apply the ordinary course defense in this case. See J.R. Simplot Co. v. Sales King Int'l, 2000 UT 92, 17 P.3d 1100. In Simplot, a vendor sold the debtor's crops but used the proceeds to pay itself for commissions and other expenses. The debtor's financer, who had a superior security interest in the crops and proceeds, sued for conversion. Among other things, the vendor claimed a right to the proceeds under the "ordinary course" defense of Comment 2(c). Id. ¶¶ 39-42. The court noted that Comment 2(c) had never been adopted in Utah, and that it did not need to consider whether to adopt Comment 2(c) because that comment simply did not apply. Id. ¶ 40. The Simplot court relied on the fact that the debtor in that case did not exercise control over the funds at issue; rather, the vendor received the funds from the crop sales and paid those funds to itself. Id. ¶ 42. That fact distinguishes Simplot from the present case. The rest of the court's reasoning is instructive, however:

> ***This situation more closely resembles a conflict between a perfected security interest and a right of setoff.*** See Insley Mfg. Corp. v. Draper Bank & Trust, 717 P.2d 1341, 1347 (Utah 1986) (ruling that perfected security interest prevails over a right of setoff); First Sec. Bank of Utah v. Utah Turkey Growers, Inc., 610 P.2d 329, 334 (Utah 1980) (holding that setoff was improper). Therefore, Comment 2(c) is inapplicable and the district court did not err in rejecting this argument as a matter of law.

Id. (emphasis added). In other words, because that case "closely resemble[d]" a conflict between a perfected security interest and a setoff, the ordinary course defense did not apply. The present case, of course, is a conflict between Volvo Finance's perfected security interest and Wells Fargo's setoff. Thus, the ordinary course defense cannot apply here, either.

(ii) Even if Utah law were silent, the weight of out-of-state authority rejects the defense in cases such as this.

Even if Insley did not control, it would still be erroneous for the Court to allow Wells Fargo to escape liability for its conversion of Volvo Finance's collateral under the "ordinary course" defense of Comment 2(c). In cases involving setoffs to repay overdraft advances, courts reject the ordinary course defense. See Bank of Brewton v. GMAC, 811 F. Supp. 648, 650-51 (S.D. Ala. 1992) (ordinary course defense not shown because "[t]he Bank admits that it did not do a UCC search that would have turned up GMAC's prior lien"); C & H Farm Serv., 449 N.W.2d at 876-77 (rejecting defense because "the bank's payment of Schellhorns' overdrafts constituted unsecured loans from the bank to Schellhorns" and "the bank may not loan money to Schellhorns by paying Schellhorns' overdrafts and then expect to 'jump over' C & H's priority in identifiable proceeds of C & H's collateral"); GMAC v. Lincoln Nat'l, 18 S.W.3d at 339-40 (ordinary course defense "does not apply when a bank seizes funds deposited in a customer's account and applies such funds to payment of overdrafts or antecedent debts. *Such an interpretation would eviscerate the security interest in proceeds of collateral contrary to [9-306(2)] and permit a bank that had made an unsecured loan to leapfrog secured creditors*") (emphasis added). Even if Insley did not govern, these cases would control.

It is perfectly appropriate to expect a bank -- like any other creditor -- to check a customer's UCC filings when the bank decides to loan a customer money, as in the present case and in Bank of Brewton, C & H Farm Service, and GMAC v. Lincoln National. Indeed, by pursuing its "ordinary course" defense, Wells Fargo claims a right

to loan money to an already overextended customer, without no investigation into the customer's creditworthiness, and then to be protected from its own bad decisions by jumping ahead of secured creditors and taking repayment from proceeds already pledged away. And to make matters worse, by pursuing a defense based on its lack of "actual knowledge," Wells Fargo has claimed special rights because of its own failure to investigate Great Basin's condition. Allowing this would frustrate the purpose of the UCC's filing system. Therefore, even without Insley and Simplot, Wells Fargo's ordinary course defense would fail as a matter of law.

b. Even if an ordinary course defense could apply, Great Basin has not, as a matter of law, satisfied the requirements for that defense.

Finally, even if an ordinary course defense *could* somehow apply to the present situation, Wells Fargo did not establish as a matter of law that the defense does apply based on the undisputed facts.[15] Addressing this issue would require the Court to review

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[15] First, Comment 2(c) refers to funds "paid out" of a checking account, and that is not what happened here; Wells Fargo simply set off the deposited funds against the prior overdrafts. Second, the application of the ordinary course defense is a question of fact. See, e.g., Harley-Davidson, 897 F.2d at 622-23; HCC Credit Corp. v. Springs Valley Bank & Trust, 712 N.E.2d 952, 958 (Ind. 1999). In HCC Credit, the court held that the "ordinary course" defense depends on "(1) the extent to which the payment was made in the routine operation of the debtor's business, and (2) the extent to which the recipient was aware that it was acting to the prejudice of the secured party." 712 N.E.2d at 956-57. The court held that the debtor's payment to the bank was not in the ordinary course because the bank was aware that the plaintiff had a perfected security interest in the debtor's tractor inventory, and the payment was unusually large. See id. at 959. It is Volvo Finance's position that Wells Fargo failed to establish as a matter of law that Great Basin's "payment" to Wells Fargo was made in the "routine operation" of Great Basin's business. Nor did Wells Fargo establish that it was not aware it was acting to Volvo Finance's prejudice in seizing Great Basin's funds on December 29. Indeed, as explained in the Statement of Facts, even apart from Volvo Finance's UCC filing, Great Basin had

the record in detail, however, when the trial court itself has not yet done so on this issue (or, if it has, the results of its review did not appear in the Order). Volvo Finance respectfully submits that, for the reasons set forth above, this Court should rule that the ordinary course defense cannot apply to the present situation, i.e., where a bank exercises a setoff to the prejudice of a secured creditor. However, ***if*** this Court concludes that Utah law allows Wells Fargo to rely on the ordinary course defense, then Volvo Finance submits that the best approach would be to remand to the trial court to apply that defense.

CONCLUSION

As a matter of law, Great Basin did not defeat Volvo Finance's security interest in the proceeds of the Volvo-Financed Vehicles by transferring $2 million to the First Security Account on December 21 and 22 and depleting the rest of the funds in the Concentration Account. Further, Revised Article 9 cannot be applied to bar Volvo Finance's claim, as that statute was not in effect when Wells Fargo converted the funds at issue. Finally, the ordinary course defense should be rejected as a matter of law, because allowing Wells Fargo to escape liability due to its own claimed ignorance of Volvo Finance's interest would flatly contradict the unambiguous holdings in Insley, Simplot, and the out-of-state cases dealing with overdraft advances. Volvo Finance therefore respectfully requests that this Court reverse the trial court's order granting summary judgment to Wells Fargo and remand the matter for further proceedings.

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actual knowledge that Volvo Finance likely had a security interest in Great Basin's inventory and proceeds, and that the funds Great Basin would be transferring to Wells Fargo would likely include such proceeds. (See R. 1004-05.)

DATED: April 12, 2006.

ANDERSON & KARRENBERG

Thomas R. Karrenberg
Stephen P. Horvat
Heather M. Sneddon
Counsel for Plaintiff-Appellant

CERTIFICATE OF SERVICE

On this 12th day of April, 2006, I caused two true and correct copies of the foregoing **APPELLANT'S OPENING BRIEF** to be served via U.S. Mail, postage prepaid, to the following:

James S. Jardine
Elaine A. Monson
Ray Quinney & Nebeker
36 South State Street, Suite 1400
Salt Lake City, Utah 84111

ADDENDUM EXHIBITS

1. Order on Summary Judgment, R. 2210-15.
2. Tracing Analysis, R. 1484.
3. Concentration Account Statement, R. 608-15.
4. Former Utah UCC Article 9 (Assorted Sections).
5. Insley Manufacturing Corp. v. Draper Bank & Trust, 717 P.2d 1341 (Utah 1986).
6. Wells Fargo Tracing, R. 1276.
7. City of Lincoln v. Morrison, 90 N.W. 905 (Neb. 1902).
8. Brennan v. Tillinghast, 201 F. 609 (6th Cir. 1913).
9. In re Oatway, 2 Ch. Div. 356 (1903).
10. Restatement of Restitution § 212 (1937).

Tab 1

FILED DISTRICT COURT
Third Judicial District
NOV 14 2005
SALT LAKE COUNTY
By
Deputy Clerk

IN THE DISTRICT COURT OF THE THIRD JUDICIAL DISTRICT

IN AND FOR SALT LAKE COUNTY, STATE OF UTAH

VOLVO COMMERCIAL FINANCE LLC THE AMERICAS, a Delaware limited liability company, Plaintiff, v. WELLS FARGO BANK, N.A., a national banking association Defendant.	**ORDER on SUMMARY JUDGMENT** **CIVIL NO. 020905207** **JUDGE L.A. DEVER**

This matter came before the Court on cross motions for Summary Judgment. The Court heard argument and has reviewed the memoranda and documents submitted by the parties.

UNDISPUTED FACTS

1. Volvo Finance LLC The Americas (Volvo) financed the purchase of Volvo vehicles by Great Basin Truck Company.

2. Volvo took a security interest in those trucks.

3. In the fall of 2000, Great Basin began to experience financial difficulties.

4. Great Basin maintained a series of operating accounts with Wells Fargo Bank.

5. The funds deposited with Wells Fargo were a combination of trust funds (from the sale of trucks), and non-trust funds (income from other sources).

6. On or about December 26 through December 29, 2000, Great Basin had overdrafts in the Wells Fargo account in the amounts of $281,056 and $828,951.

7. On December 27, 2000, Great Basin transferred $300,000 to the Wells Fargo account from a First Security Bank account. On December 29, 2000, Great Basin transferred $900.000 to the Wells Fargo account from the same First Security account.

8. The sums of money in the Wells Fargo and First Security accounts and the amount of transfers between those accounts are not in dispute.

CLAIM

Volvo claims that a portion of the $900,000 transferred into the Wells Fargo account on December 29th was directly traceable to trust funds received for the sale of trucks and therefore belongs to Volvo.

DISPUTED ISSUES

There are no material facts in dispute. The issues before the Court deal with a legal interpretation of three issues:

1. Under the Lowest Intermediate Balance Rule (LIBR) can Volvo trace any of the monies received by Wells Fargo on December 29th.

2. Does revised Section 70A-9a-322 require dismissal of the claims

asserted by Volvo.

3. If revised §322 does not apply, does Comment 2 (c) of the former §322 dictate dismissal of the claim made by Volvo.

For the reason stated below, the Court need not address issues 2 and 3.

BASIC LAW

The rules for the tracing of monies in a commingled trust/non-trust account are not in dispute and have not been in dispute for generations. The two basic rules that apply are

1. When monies are withdrawn from a commingled account, they are deemed to come first from non-trust funds. Only when insufficient non-trust funds exist are the trust funds invaded.

2. Once trust proceeds are removed from the account, they are presumed not to be replenished by subsequent deposits of non-denominated monies.

ANALYSIS

As previously noted, there is no dispute as to the amount of money in the Wells Fargo account and the transfers or amounts from it to First Security and back. The dispute centers on the character of the transfers of $1.5 million on December 21st and $500,000 on December 22nd.

Both parties agree that at the start of December 21st there was $1.6+ million of

trust funds and $1.2+ million of non-trust funds in the Wells Fargo account. Non-trust monies were received and spent, reducing the non-trust portion to $933,415.65. Also occurring on this day was a transfer of $1.5 million to First Security Bank. It is the character of this sum that is in dispute. Volvo claim the entire $1.5 million should come from the trust portion of the account. Wells Fargo claims that LIBR rules require that $933,415.65 comes from non-trust and the remainder ($566,584.35) comes from the trust portion. Volvo argues that the "transfer" of funds versus the spending of funds should be treated differently. The Court disagrees that there is or should be a difference in the treatment of the funds based upon spending versus transferring. The difference, if one exists, is in the manner of the characterization of the removal. Volvo argues that since the funds were being transferred all of the transferred monies should come from the trust portion. The problem with this view is that there is no authority for such a position. To eliminate the rules for tracing based upon a view of how the money is allegedly disbursed, transfer versus payment, would undermine the rule.

The better reasoned approach is to follow the rule. There was available, on December 21st, non-trust monies of $933,415.65. Therefore, the first $933.415.65 paid to First Security were these non-trust funds. The remaining amount of $566.584.35 was from trust funds. First Security had non-trust funds in excess of $900,000 when that amount was transferred to Wells Fargo on December 29, 2000.

Volvo's claim that $693,132 was traceable trust funds is without merit. Summary Judgment for Wells Fargo is granted.

Dated this 11th day of November, 2005.

BY THE COURT:

L.A. DEVER
DISTRICT COURT JUDGE

THIRD DISTRICT COURT
SALT LAKE CITY
STATE OF UTAH

CERTIFICATE OF MAILING

I hereby certify that on the 14 day of November, 2005, I mailed a true and correct copy of the foregoing ORDER, postage prepaid, to the following:

James S. Jardine
RAY, QUINNEY & NEBEKER
P.O. Box 45385
Salt Lake City, UT 84145-0385

Stephen P. Horvat
ANDERSON & KARRENBERG
50 West Broadway, Ste 700
Salt Lake City, UT 84101

Deputy Court Clerk

Tab 2

Exhibit 1

ucks FSB Activity for December 2000

Description	12/11/00	12/12/00	12/13/00	12/14/00	12/15/00	12/18/00	12/19/00	12/20/00	12/21/00	12/22/00	12/26/00	12/27/00	12/28/00	12/29/00	Ending Balance
GREAT BASIN COMPANIES - WELLS FARGO BANK (409-8328487)															
Beginning Balance:	174,415	-	-	192,734	631,063	698,018	299,615	1,297,489	933,415	661,274	(281,056)	(790,161)	(828,951)	(53,310)	
Total Beginning	753,332	632,689	396,309	597,043	2,270,574	2,349,774	1,991,200	2,989,075	1,125,001	661,274	(281,056)	(790,161)	(828,951)	$ (53,3	
Trust Money															
Transfer fro															
Trust Mc															
Other		65,313	81,734	80,656	156,577	69,652	-	-	-	-	-	124	-		
Tra		291	13,372	27,194	63,433	15,438	18,819	29,099	13,321	72,406	8,858	-	-		
			-	49,928	33,172	-	36,632	9,180	-	-	-	-	-		
			11,406	(91)	18,896	31,230	-	1,789	-	-	-	-	-		
								(1,5							
			-	-	-	-	-	-	(208,081)	-	-	-	-		
			-	-	-	-	-	-	-	-	300,000	-	206,868	$ 900,00	
														Transfe	
			318,956	613,933	134,787	16,450	1,011,385	2,500	653	-	354,348		696		
			(232,734)	(333,289)	(339,909)	(531,174)	(68,961)	(406,641)	(78,035)	(1,014,735)	(1,172,310)	(38,915)	(125,055)		
		$ 597,043	$2,270,574	$2,349,774	$1,991,200	$2,989,075	$1,125,001	$ 661,274	$ (281,056)	$ (790,161)	$ (828,951)	$ (53,310)			
IN TRUCKS - FIRST SECURITY BANK (222-00085-32)															
		-	-	-	-	-	-	-	50,904	455,252	585,936	286,236	405,453	-	
		-	-	-	-	-	-	-	50,904	2,247,171	2,377,856	2,110,786	2,230,002	$3,014,38	
		-	-	-	-	-									
		-	-	-	-	-	-	-	208,081	-	-	-	-		
								-	-	-	(300,000)	-	(900,000)		
		-	-	-	-	-									
		-	-	-	-	-									
		-	-	-	-	-	50,904	196,267	130,685	300	119,217	63,132			
		-	-	-	-	-	-	-	-	-	-	(261,717)			
		$ -	$ -	$ -	$ -	$ -	$ 50,904	$2,247,171	$2,377,856	$2,110,786	$2,230,002	$3,014,385			

Tab 3

WELLS FARGO BANK, N.A.
PO BOX 63020
SAN FRANCISCO, CA 94163

Account No: 409-8328487

Statement Start Date: 12/01/00
Statement End Date: 12/31/00

GREAT BASIN COMPANIES
CONCENTRATION ACCT
2300 S 4000 W
WEST VALLEY UT 84120

For Customer Assistance:
Call your Customer Service Officer or Client Services
1-800-AT WELLS (289-3557)
5:00 AM to 6:00 PM Pacific Time Monday - Friday

Account Number	Beginning Balance	Ending Balance
WellsOne Account 409-8328487	483,775.54	- 53,310.05

Credits
Electronic Deposits/ Bank Credits

Effective Date	Posted Date	Amount	Transaction Detail
	Dec 01	1,405.83	Sweep Dividend Deposit ACH Dividend Tra
	Dec 01	124,168.79	ZBA Funding Account Transfer From 4098328529
	Dec 01	19,495.54	ZBA Funding Account Transfer From 4098328602
	Dec 01	117,688.40	ZBA Funding Account Transfer From 4098328644
	Dec 01	456,226.97	ZBA Funding Account Transfer From 4178529582
	Dec 01	39,456.15	ZBA Funding Account Transfer From 4496807488
	Dec 01	16,153.47	ZBA Funding Account Transfer From 4801908138
	Dec 01	92,091.56	ZBA Funding Account Transfer From 4911433407
	Dec 01	344.45	ZBA Funding Account Transfer From 4098327406
	Dec 04	109,022.53	ZBA Funding Account Transfer From 4098328529
	Dec 04	212,966.43	ZBA Funding Account Transfer From 4098328644
	Dec 04	184,858.08	ZBA Funding Account Transfer From 4178529582
	Dec 04	17,314.79	ZBA Funding Account Transfer From 4496807488
	Dec 04	91,481.57	ZBA Funding Account Transfer From 4801908138
	Dec 04	65,938.00	ZBA Funding Account Transfer From 4911433407
	Dec 04	87,692.84	ZBA Funding Account Transfer From 4098327406
	Dec 05	4,882.51	ZBA Funding Account Transfer From 4098328529
	Dec 05	7,139.49	ZBA Funding Account Transfer From 4098328602

Continued on next page

EXHIBIT 9

Account No: 409-8328487

GREAT BASIN COMPANIES
CONCENTRATION ACCT

Statement End Date: 12/31/00

Electronic Deposits/ Bank Credits

Effective Date	Posted Date	Amount	Transaction Detail
	Dec 05	64,549.86	ZBA Funding Account Transfer From 4098328644
	Dec 05	431,012.77	ZBA Funding Account Transfer From 4178529582
	Dec 05	19,988.77	ZBA Funding Account Transfer From 4801908138
	Dec 05	414,555.14	ZBA Funding Account Transfer From 4911433407
	Dec 05	63,768.81	ZBA Funding Account Transfer From 4098327406
	Dec 06	102,980.75	ZBA Funding Account Transfer From 4098328529
	Dec 06	50,136.08	ZBA Funding Account Transfer From 4098328644
	Dec 06	38,200.54	ZBA Funding Account Transfer From 4496807488
	Dec 06	2,767.69	ZBA Funding Account Transfer From 4801908138
	Dec 06	937.83	ZBA Funding Account Transfer From 4911433407
	Dec 06	86,757.28	ZBA Funding Account Transfer From 4098327406
	Dec 07	325,000.00	Over The Counter Deposit
	Dec 07	38,777.64	ZBA Funding Account Transfer From 4098328529
	Dec 07	42,751.27	ZBA Funding Account Transfer From 4098328602
	Dec 07	144,773.25	ZBA Funding Account Transfer From 4098328644
	Dec 07	162,154.96	ZBA Funding Account Transfer From 4178529582
	Dec 07	23,524.24	ZBA Funding Account Transfer From 4496807488
	Dec 07	30,327.25	ZBA Funding Account Transfer From 4801908138
	Dec 07	2,855.29	ZBA Funding Account Transfer From 4911433407
	Dec 07	23,827.46	ZBA Funding Account Transfer From 4098327406
	Dec 07	294,206.33	Sweep Transfer From Investment
	Dec 08	47,563.17	ZBA Funding Account Transfer From 4098328529
	Dec 08	709.54	ZBA Funding Account Transfer From 4098328602
	Dec 08	206,809.27	ZBA Funding Account Transfer From 4098328644
	Dec 08	18,696.07	ZBA Funding Account Transfer From 4178529582
	Dec 08	149,761.68	ZBA Funding Account Transfer From 4496807488
	Dec 08	5,868.88	ZBA Funding Account Transfer From 4801908138
	Dec 08	208,783.60	ZBA Funding Account Transfer From 4911433407
	Dec 08	68,194.53	ZBA Funding Account Transfer From 4098327406
	Dec 11	25,000.00	Transfer From DDA # 000007483661471
	Dec 11	76,596.34	ZBA Funding Account Transfer From 4098328529
	Dec 11	5,271.16	ZBA Funding Account Transfer From 4098328602

Continued on next page

GREAT BASIN COMPANIES
CONCENTRATION ACCT

Statement End Date. 12/31/00

Electronic Deposits/ Bank Credits

Effective Date	Posted Date	Amount	Transaction Detail
	Dec 11	224,933.76	ZBA Funding Account Transfer From 4098328644
	Dec 11	18,470.53	ZBA Funding Account Transfer From 4178529582
	Dec 11	11,982.98	ZBA Funding Account Transfer From 4801908138
	Dec 11	3,608.18	ZBA Funding Account Transfer From 4911433407
	Dec 11	51,483.97	ZBA Funding Account Transfer From 4098327406
	Dec 12	57,771.00	ZBA Funding Account Transfer From 4098328529
	Dec 12	71,473.14	ZBA Funding Account Transfer From 4098328602
	Dec 12	59,419.18	ZBA Funding Account Transfer From 4098328644
	Dec 12	48,913.82	ZBA Funding Account Transfer From 4178529582
	Dec 12	53,120.23	ZBA Funding Account Transfer From 4496807488
	Dec 12	1,859.30	ZBA Funding Account Transfer From 4801908138
	Dec 12	37,067.94	ZBA Funding Account Transfer From 4911433407
	Dec 12	6,788.51	ZBA Funding Account Transfer From 4098327406
	Dec 13	113,990.89	ZBA Funding Account Transfer From 4098328529
	Dec 13	65,312.97	ZBA Funding Account Transfer From 4098328644
	Dec 13	15,395.30	ZBA Funding Account Transfer From 4496807488
	Dec 13	1,846.75	ZBA Funding Account Transfer From 4801908138
	Dec 13	1,816.83	ZBA Funding Account Transfer From 4911433407
	Dec 14	13,371.76	ZBA Funding Account Transfer From 4098328529
	Dec 14	11,405.97	ZBA Funding Account Transfer From 4098328602
	Dec 14	89,734.36	ZBA Funding Account Transfer From 4098328644
	Dec 14	257,048.88	ZBA Funding Account Transfer From 4178529582
	Dec 14	55,920.19	ZBA Funding Account Transfer From 4801908138
	Dec 14	5,986.44	ZBA Funding Account Transfer From 4098327406
	Dec 15	300,000.00	WT Fed#00126 Zions First Nation /Org=great Basin Gmc Trucks Inc Srf# 20001215095436Cp Trn#001215022310 Rfb#
	Dec 15	27,193.54	ZBA Funding Account Transfer From 4098328529
	Dec 15	1,130,620.64	ZBA Funding Account Transfer From 4098328602
	Dec 15	80,655.79	ZBA Funding Account Transfer From 4098328644
	Dec 15	192,552.52	ZBA Funding Account Transfer From 4178529582

Continued on next page

Account No: 409-8328487

GREAT BASIN COMPANIES
CONCENTRATION ACCT

Statement End Date: 12/31/00

Electronic Deposits/ Bank Credits

Effective Date	Posted Date	Amount	Transaction Detail
	Dec 15	23,857.29	ZBA Funding Account Transfer From 4801908138
	Dec 15	154,417.65	ZBA Funding Account Transfer From 4911433407
	Dec 15	97,523.14	ZBA Funding Account Transfer From 4098327406
	Dec 18	75,677.60	ZBA Funding Account Transfer From 4098328529
	Dec 18	18,895.98	ZBA Funding Account Transfer From 4098328602
	Dec 18	156,577.32	ZBA Funding Account Transfer From 4098328644
	Dec 18	23,408.51	ZBA Funding Account Transfer From 4801908138
	Dec 18	33,171.54	ZBA Funding Account Transfer From 4911433407
	Dec 18	111,378.39	ZBA Funding Account Transfer From 4098327406
	Dec 18	176,087.56	Sweep Transfer From Investment
	Dec 19	15,437.77	ZBA Funding Account Transfer From 4098328529
	Dec 19	31,229.89	ZBA Funding Account Transfer From 4098328602
	Dec 19	109,481.66	ZBA Funding Account Transfer From 4098328644
	Dec 19	15,591.64	ZBA Funding Account Transfer From 4496807488
	Dec 19	858.58	ZBA Funding Account Transfer From 4098327406
	Dec 20	18,818.69	ZBA Funding Account Transfer From 4098328529
	Dec 20	863,133.80	ZBA Funding Account Transfer From 4178529582
	Dec 20	97,020.00	ZBA Funding Account Transfer From 4801908138
	Dec 20	36,632.00	ZBA Funding Account Transfer From 4911433407
	Dec 20	51,231.04	ZBA Funding Account Transfer From 4098327406
	Dec 21	29,098.93	ZBA Funding Account Transfer From 4098328529
	Dec 21	1,788.83	ZBA Funding Account Transfer From 4098328602
	Dec 21	9,179.81	ZBA Funding Account Transfer From 4911433407
	Dec 21	2,500.00	ZBA Funding Account Transfer From 4098327406
	Dec 21	1,701,176.79	Sweep Transfer From Investment
	Dec 22	113,654.52	ZBA Funding Account Transfer From 4098328529
	Dec 22	653.34	ZBA Funding Account Transfer From 4496807488
	Dec 22	350,563.81	Sweep Transfer From Investment
	Dec 26	72,405.71	ZBA Funding Account Transfer From 4098328529
	Dec 26	485,203.72	Sweep Transfer From Investment
	Dec 27	300,000.00	WT Fed#00435 Great Basin Trucks /Org=great Basin Trucks Srf# 200012270828 Trn#001227026891 Rfb# 200012270828

Continued on next page

GREAT BASIN COMPANIES
CONCENTRATION ACCT

Statement End Date: 12/31/00

Electronic Deposits/ Bank Credits

Effective Date	Posted Date	Amount	Transaction Detail
	Dec 27	8,857.67	ZBA Funding Account Transfer From 4098328529
	Dec 27	352,955.32	ZBA Funding Account Transfer From 4178529582
	Dec 27	1,392.68	ZBA Funding Account Transfer From 4801908138
	Dec 28	124.44	ZBA Funding Account Transfer From 4098328644
	Dec 29	900,000.00	WT Fed#00654 Great Basin Trucks /Org=great Basin Trucks Srf# 20
	Dec 29	696.10	ZBA Funding Account Transfer From 4801908138
		14,275,861.94	Total Electronic Deposits/ Bank Credits
		14,275,861.94	Total Credits

Debits

Electronic Debits/ Bank Debits

Effective Date	Posted Date	Amount	Transaction Detail
	Dec 01	941,934.99	ZBA Funding Account Transfer To 4759611866
	Dec 04	804,271.41	ZBA Funding Account Transfer To 4759611866
	Dec 05	134,557.75	ZBA Funding Account Transfer To 4759611866
	Dec 05	121,678.14	Sweep Transfer To Investment
	Dec 06	5,090.76	ZBA Funding Account Transfer To 4098328602
	Dec 06	7,019.11	ZBA Funding Account Transfer To 4178529582
	Dec 06	482,929.11	ZBA Funding Account Transfer To 4759611866
	Dec 06	172,528.19	Sweep Transfer To Investment
	Dec 07	1,209,563.89	ZBA Funding Account Transfer To 4759611866
	Dec 08	223,578.07	ZBA Funding Account Transfer To 4759611866
	Dec 11	763,206.54	ZBA Funding Account Transfer To 4759611866
	Dec 12	325,000.00	WT Fed#01704 Zions First Nation /Ftr/Bnf=great Basin Trucks Srf# PC001212180025233 Trn#001212018579 Rfb# 003471001
	Dec 12	132,055.82	ZBA Funding Account Transfer To 4759611866
	Dec 13	125,000.00	WT Fed#05185 Zions First Nation /Ftr/Bnf=great Basin Trucks Srf# MS1213 Trn#001213037881 Rfb# 003481001
	Dec 13	8,577.89	ZBA Funding Account Transfer To 4098328602
	Dec 13	10,517.72	ZBA Funding Account Transfer To 4178529582

Continued on next page

GREAT BASIN COMPANIES
CONCENTRATION ACCT

Statement End Date: 12/31/00

Electronic Debits/ Bank Debits

Effective Date	Posted Date	Amount	Transaction Detail
	Dec 13	289,592.13	ZBA Funding Account Transfer To 4759611866
	Dec 13	1,055.41	ZBA Funding Account Transfer To 4098327406
	Dec 14	344.60	ZBA Funding Account Transfer To 4496807488
	Dec 14	232,389.20	ZBA Funding Account Transfer To 4759611866
	Dec 14	76,689.54	Sweep Transfer To Investment
	Dec 15	333,289.48	ZBA Funding Account Transfer To 4759611866
	Dec 15	1,533,064.09	Sweep Transfer To Investment
	Dec 18	30,069.65	ZBA Funding Account Transfer To 4178529582
	Dec 18	273.77	ZBA Funding Account Transfer To 4496807488
	Dec 18	09,565.48	ZBA Funding Account Transfer To 4759611866
	Dec 19	54,190.08	ZBA Funding Account Transfer To 4178529582
	Dec 19	94,481.54	ZBA Funding Account Transfer To 4759611866
	Dec 19	82,501.88	ZBA Funding Account Transfer To 4801908138
	Dec 19	44,781.04	Sweep Transfer To Investment
	Dec 20	1,888.06	Client Analysis Srvc Chrg 001219 Svc Chge 1100 000004098328487
	Dec 20	53.00	ZBA Funding Account Transfer To 4098328560
	Dec 20	2,027.79	ZBA Funding Account Transfer To 4098328602
	Dec 20	21,354.92	ZBA Funding Account Transfer To 4098328644
	Dec 20	53.00	ZBA Funding Account Transfer To 4098328685
	Dec 20	215.53	ZBA Funding Account Transfer To 4496807488
	Dec 20	53.00	ZBA Funding Account Transfer To 4496807496
	Dec 20	43,316.02	ZBA Funding Account Transfer To 4759611866
	Dec 20	1,058,497.21	Sweep Transfer To Investment
	Dec 21	1,500,000.00	WT Fed#01596 First Security Ban /Ftr/Bnf=great Basin Trucks Srf# PC00122109164706 Trn#001221018216 Rfb# 003561001
	Dec 21	1,595.78	ZBA Funding Account Transfer To 4178529582
	Dec 21	403,642.20	ZBA Funding Account Transfer To 4759611866
	Dec 21	1,403.38	ZBA Funding Account Transfer To 4801908138
	Dec 22	500,000.00	WT Fed#04251 First Security Ban /Ftr/Bnf=great Basin Trucks Srf# PC00122211554859 Trn#001222040221 Rfb# 003571001
	Dec 22	845.94	ZBA Funding Account Transfer To 4098328602

Continued on next page

GREAT BASIN COMPANIES
CONCENTRATION ACCT

Statement End Date: 12/31/00

Electronic Debits/ Bank Debits

Effective Date	Posted Date	Amount	Transaction Detail
	Dec 22	2,690.52	ZBA Funding Account Transfer To 4098328644
	Dec 22	30,231.19	ZBA Funding Account Transfer To 4178529582
	Dec 22	33,917.02	ZBA Funding Account Transfer To 4759611866
	Dec 22	350.00	ZBA Funding Account Transfer To 4801908138
	Dec 22	10,000.00	ZBA Funding Account Transfer To 4911433407
	Dec 26	66,470.34	ZBA Funding Account Transfer To 4098328644
	Dec 26	153,712.60	ZBA Funding Account Transfer To 4178529582
	Dec 26	770,792.16	ZBA Funding Account Transfer To 4759611866
	Dec 26	841.47	ZBA Funding Account Transfer To 4801908138
	Dec 26	22,918.87	ZBA Funding Account Transfer To 4098327406
	Dec 27	7,062.38	ZBA Funding Account Transfer To 4098328602
	Dec 27	23,286.95	ZBA Funding Account Transfer To 4098328644
	Dec 27	1,141,730.87	ZBA Funding Account Transfer To 4759611866
	Dec 27	230.19	ZBA Funding Account Transfer To 4098327406
	Dec 28	5,205.77	ZBA Funding Account Transfer To 4178529582
	Dec 28	33,376.22	ZBA Funding Account Transfer To 4759611866
	Dec 28	333.08	ZBA Funding Account Transfer To 4801908138
	Dec 29	27,931.49	ZBA Funding Account Transfer To 4098328644
	Dec 29	722.85	ZBA Funding Account Transfer To 4178529582
	Dec 29	96,400.45	ZBA Funding Account Transfer To 4759611866
		14,812,947.53	Total Electronic Debits/ Bank Debits
		14,812,947.53	Total Debits

Daily Ledger Balance Summary

Date	Balance	Date	Balance
Nov 30	483,775.54	Dec 12	632,689.15
Dec 01	408,871.71	Dec 13	396,308.74
Dec 04	373,874.54	Dec 14	520,353.00
Dec 05	1,123,536.00	Dec 15	660,820.00
Dec 06	737,749.00	Dec 18	916,108.00
Dec 07	616,382.80	Dec 19	512,753.00
Dec 08	1,099,191.47	Dec 20	452,130.00
Dec 11	753,331.85	Dec 21	289,233.00

Continued on next page

Account No: 409-8328487

GREAT BASIN COMPANIES
CONCENTRATION ACCT

Statement End Date: 12/31/00

Daily Ledger Balance Summary

Date	Balance	Date	Balance
Dec 22	176,070.00	Dec 28	-828,951.36
Dec 26	-281,056.01	Dec 29	-53,310.05
Dec 27	-790,160.73		

Average Daily Ledger Balance 402,428.39

Tab 4

UTAH CODE, 1953
TITLE 70A. UNIFORM COMMERCIAL CODE
CHAPTER 9 SECURED TRANSACTIONS -- SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER [REPEALED EFFECTIVE JULY 1, 2001]
PART 2 VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO [REPEALED EFFECTIVE JULY 1, 2001]

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70A-9-201 General validity of security agreement [Repealed effective Jul 1, 2001].

Except as otherwise provided by this act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this chapter validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales, or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto.

History: L. 1965, ch. 154, § 9-201.

NOTES, REFERENCES, AND ANNOTATIONS

Repealed effective July 1, 2001.--Laws 2000, ch. 252, § 176 repeals this chapter effective July 1, 2001.

Cross-References. --Variation by agreement, § 70A-1-102(3).

COLLATERAL REFERENCES

Am.Jur.2d. --68A Am. Jur. 2d Secured Transactions § § 160 et seq., 192 et seq.

C.J.S. --79 C.J.S. Supp. Secured Transactions § 11

A.L.R. --Liability for the statutory penalty of persons other than the offending lender in a usurious loan transaction, 4 A.L.R.3d 650.

What is "compound interest" within meaning of statutes prohibiting the charging of such interest, 10 A.L.R.3d 421.

Usury as affected by mistake in amount of calculation of interest or service charges for loan, 11 A.L.R.3d 1498.

U.C.A. 1953 § 70A-9-201

UT ST § 70A-9-201

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UTAH CODE, 1953
TITLE 70A. UNIFORM COMMERCIAL CODE
CHAPTER 9. SECURED TRANSACTIONS -- SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER [REPEALED EFFECTIVE JULY 1, 2001]
PART 2. VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO [REPEALED EFFECTIVE JULY 1, 2001]

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70A-9-203 Attachment and enforceability of security interest --Proceeds -- Formal requisites [Repealed effective July 1, 2001].

(1) Subject to the provisions of Section 70A-4-208 on the security interest of a collecting bank, Sections 70A-9-115 and 70A-9-116 on security interest in investment property, and Section 70A-9-113 on a security interest arising under the chapter on sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

(a) the collateral is in the possession of the secured party pursuant to agreement, the collateral is investment property and the secured party has control pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned;

(b) value has been given; and

(c) the debtor has rights in the collateral.

(2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in Subsection (1) have taken place unless explicit agreement postpones the time of attaching.

(3) Unless otherwise agreed, a security agreement gives the secured party the rights to proceeds provided by Section 70A-9-306.

(4) A transaction, although subject to this chapter, is also subject to the Utah Uniform Consumer Credit Code, and in the case of conflict between the provisions of this chapter and the Utah Uniform Consumer Credit Code, the provisions of the latter statute control. Failure to comply with any applicable statute has only the effect which is specified therein.

History: L. 1965, ch. 154, § 9-203; 1969, ch. 18, § 9.103 (2) (b); 1977, ch. 272, § 14; 1989, ch. 218, § 48; 1996, ch. 204, § 64.

NOTES, REFERENCES, AND ANNOTATIONS

Repealed effective July 1, 2001.--Laws 2000, ch. 252, § 176 repeals this section effective July 1, 2001.

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Amendment Notes. --The 1996 amendment, effective April 29, 1996, in Subsection (1) substituted "Sections 70A-9-115 and 70A-9-116" for "Section 70A-8-321" and "investment property" for "securities," and in Subsection (1)(a) inserted "the collateral is investment property and the secured party has control pursuant to agreement."

Utah Uniform Consumer Credit Code.--The Utah Uniform Consumer Credit Code, referred to in Subsection (4), is former Title 70B, which was repealed by Laws 1985, ch. 159, § 9. Present similar provisions appear as Title 70C, the Utah Consumer Credit Code.

COLLATERAL REFERENCES

Am.Jur.2d. --68A Am. Jur. 2d Secured Transactions § 267.

C.J.S. --79 C.J.S. Supp. Secured Transactions § 34.

A.L.R. --Sufficiency of description of crops under UCC § § 9-203(b) and 9-402(1), 67 A.L.R.3d 308.

Conveyance of land as including mature but unharvested crops, 51 A.L.R.4th 1263.

U.C.A. 1953 § 70A-9-203

UT ST § 70A-9-203

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UTAH CODE, 1953
TITLE 70A. UNIFORM COMMERCIAL CODE
CHAPTER 9. SECURED TRANSACTIONS -- SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER [REPEALED EFFECTIVE JULY 1, 2001]
PART 2. VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO [REPEALED EFFECTIVE JULY 1, 2001]

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70A-9-205 Use or disposition of collateral without accounting permissible [Repealed effective July 1, 2001].

A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

History: L. 1965, ch. 154, § 9-205; 1977, ch. 272, § 16.

NOTES, REFERENCES, AND ANNOTATIONS

Repealed effective July 1, 2001.--Laws 2000, ch. 252, § 176 repeals this section effective July 1, 2001.

COLLATERAL REFERENCES

Am.Jur.2d. --68A Am. Jur. 2d Secured Transactions § 210.

C.J.S. --79 C.J.S. Supp. Secured Transactions § 89.

U.C.A. 1953 § 70A-9-205

UT ST § 70A-9-205

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UTAH CODE, 1953
TITLE 70A. UNIFORM COMMERCIAL CODE
CHAPTER 9. SECURED TRANSACTIONS -- SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER [REPEALED EFFECTIVE JULY 1, 2001]
PART 3. RIGHTS OF THIRD PARTIES -- PERFECTED AND UNPERFECTED SECURITY INTERESTS -- RULES OF PRIORITY [REPEALED EFFECTIVE JULY 1, 2001]

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70A-9-302 When filing is required to perfect security interest --Security interests to which filing provisions of this chapter do not apply [Repealed effective July 1, 2001].

(1) A financing statement must be filed to perfect all security interests except the following:

(a) a security interest in collateral in possession of the secured party under Section 70A-9-305;

(b) a security interest temporarily perfected in instruments, certificated securities, or documents without delivery under Section 70A-9-304 or in proceeds for a ten-day period under Section 70A-9-306;

(c) a security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

(d) a purchase money security interest in consumer goods; but filing is required for a motor vehicle required to be registered; and fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 70A-9-313;

(e) an assignment of accounts which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor;

(f) a security interest of a collecting bank as provided in Section 70A-4-208, or arising under the chapter on sales as provided in Section 70A-9-113, or covered in Subsection (3) of this section;

(g) an assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder.

(2) If a secured party assigns a perfected security interest, no filing under this chapter is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(3) The filing of a financing statement otherwise required by this chapter is not necessary or effective to perfect a security interest in property subject to:

(a) a statute or treaty of the United States which provides for a national or

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international registration or a national or international certificate of title or which specifies a place of filing different from that specified in this chapter for filing of the security interest;

(b) those statutes of this state which provide for the indication of security interests on certificates of title as a condition of the perfection of such security interests, but during any period in which collateral is inventory held for sale by a person who is in the business of selling goods of that kind, the filing provisions of this chapter, Part 4, apply to a security interest in that collateral created by him as debtor; or

(c) a certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection by Subsection 70A-9-103(2).

(4) Compliance with a statute or treaty described in Subsection (3) is equivalent to the filing of a financing statement under this chapter, and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in Section 70A-9-103 on multiple state transactions. Duration and renewal of perfection of a security interest perfected by compliance with the statute or treaty are governed by the provisions of the statute or treaty; in other respects the security interest is subject to this chapter.

History: L. 1965, ch. 154, § 9-302; 1977, ch. 272, § 18; 1989, ch. 218, § 49; 1996, ch. 204, § 66.

NOTES, REFERENCES, AND ANNOTATIONS

Repealed effective July 1, 2001.--Laws 2000, ch. 252, § 176 repeals this section effective July 1, 2001.

Amendment Notes. --The 1996 amendment, effective April 29, 1996, in Subsection (1)(b) added "certficated securities"; in Subsection (1)(f) deleted "in securities as provided in Section 70A-8-321"; and made a stylistic change.

Cross-References. --County recorder's fees, § 21-2-3.

Index of chattel mortgages, county recorder to keep, § 17-21-6.

Required filings, § 70A-11-106.

Security interests in inventory, vehicles held for sale, § 41-1a-601.

COLLATERAL REFERENCES

Utah Law Review. --Comment, In re Littlejohn: Equitable Departure from State Certificate of Title Act Filing Requirements, 1975 Utah L. Rev. 726.

Washington Law Review.--Uniform Commercial Code Section 9-301(1) and Accounts, Contract Rights, and Chattel Paper: The Non-existent Priorities, 41 Wash. L. Rev. 195.

Am.Jur.2d. --68A Am. Jur. 2d Secured Transactions § § 288, 289, 293.

C.J.S. --79 C.J.S. Supp. Secured Transactions § § 52 to 58.

A.L.R. --What constitutes "security interest" as to which financing statement

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must be filed under Uniform Commercial Code § 9-302, 11 A.L.R.3d 1231.

Determination of purchase price of farm equipment for purposes of UCC § 9-302(1)(c) excusing filing of financing statement, 85 A.L.R.3d 1037.

When is filing financing statement necessary to perfect an assignment of accounts under UCC § 9-302(1)(e), 85 A.L.R.3d 1050.

U.C.A. 1953 § 70A-9-302

UT ST § 70A-9-302

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UTAH CODE, 1953
TITLE 70A. UNIFORM COMMERCIAL CODE
CHAPTER 9. SECURED TRANSACTIONS -- SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER [REPEALED EFFECTIVE JULY 1, 2001]
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70A-9-304 Perfection of security interest in instruments, documents, proceeds of a written letter of credit, and goods covered by documents -- Perfection by permissive filing --Temporary perfection without filing or transfer of possession [Repealed effective July 1, 2001].

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in the rights to proceeds of a written letter of credit can be perfected only by the secured party's taking possession of the letter of credit. A security interest in money or instruments, other than instruments which constitute part of chattel paper, can be perfected only by the secured party's taking possession, except as provided in Subsections (4) and (5) of this section and Subsections (2) and (3) of Section 70A-9-306 on proceeds.

(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

(3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(4) A security interest in instruments, certificated securities, or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument, a certificated security, a negotiable document, or goods in possession of a bailee other than one who has issued a negotiable document therefor:

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange, but priority between conflicting security interests in the goods is subject to Section 70A-9-312; or

(b) delivers the instrument or certificated security to the debtor for the

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purpose of ultimate sale or exchange or of presentation, collection, renewal, or registration of transfer.

(6) After the 21-day period in Subsections (4) and (5), perfection depends upon compliance with applicable provisions of this chapter.

History: L. 1965, ch. 154, § 9-304; 1977, ch. 272, § 19; 1989, ch. 218, § 50; 1996, ch. 204, § 68; 1997, ch. 241, § 26.

NOTES, REFERENCES, AND ANNOTATIONS

Repealed effective July 1, 2001.--Laws 2000, ch. 252, § 176 repeals this section effective July 1, 2001.

Amendment Notes. --The 1996 amendment, effective April 29, 1996, in Subsection (1) deleted "certificated securities or" before the second occurrence of "instruments"; in Subsections (4) and (5) deleted "other than" before "certificated securities"; added "or certificated security" in Subsection (5)(b); and made a stylistic change.

The 1997 amendment, effective July 1, 1997, added the second sentence in Subsection (1), relating to perfecting security interest in rights to proceeds of a written letter of credit.

Cross-References. --Warehouse receipts, bills of lading and other documents of title, § § 70A-7-101 to 70A-7-603.

COLLATERAL REFERENCES

Am.Jur.2d. --68A Am. Jur. 2d Secured Transactions § § 476, 479.

C.J.S. --79 C.J.S. Supp. Secured Transactions § 59.

U.C.A. 1953 § 70A-9-304

UT ST § 70A-9-304

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70A-9-306 "Proceeds" --Secured party's rights on disposition of collateral or debtor's insolvency [Repealed effective July 1, 2001].

(1) "Proceeds" includes whatever is received upon the sale, lease, exchange, collection, or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Any payments or distributions made with respect to investment property collateral are proceeds. Money, checks, deposit accounts, and the like are "cash proceeds." All other proceeds are "noncash proceeds."

(2) Except where this chapter or Chapter 2a, Leases, otherwise provides, a security interest continues in collateral notwithstanding sale, exchange, or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless:

(a) a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds;

(b) a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds;

(c) the original collateral was investment property and the proceeds are identifiable cash proceeds; or

(d) the security interest in the proceeds is perfected before the expiration of the ten-day period. Except as provided in this section, a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this chapter for original collateral of the same type.

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected

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security interest only in the following proceeds:

(a) in identifiable noncash proceeds and in separate deposit accounts containing only proceeds;

(b) in identifiable cash proceeds in the form of money which is neither commingled with other money nor deposited in a deposit account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a deposit account prior to the insolvency proceedings; and

(d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this Subsection (d) is:

(i) subject to any right of setoff; and

(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings less the sum of:

(A) the payments to the secured party on account of cash proceeds received by the debtor during such period; and

(B) the cash proceeds received by the debtor during such period to which the secured party is entitled under Subsections (a) through (c) of this Subsection (4).

(5) If a sale or lease of goods results in an account or chattel paper which is transferred by the seller or lessor to a secured party, and if the goods are returned to or are repossessed by the seller, lessor, or the secured party, the following rules determine priorities:

(a) If the goods were collateral at the time of sale or lease, for an indebtedness of the seller or lessor which is still unpaid, the original security interest attaches again to the goods covered by the sale or lease and continues as a perfected security interest if it was perfected at the time when the goods were sold or leased. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.

(b) An unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under Subsection (a) to the extent that the transferee of the chattel paper was entitled to priority under Section 70A-9-308.

(c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under Subsection (a).

(d) A security interest of an unpaid transferee asserted under Subsection (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods.

History: L. 1965, ch. 154, § 9-306; 1977, ch. 272, § 21; 1990, ch. 197, § 84; 1996, ch. 204, § 70.

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NOTES, REFERENCES, AND ANNOTATIONS

Repealed effective July 1, 2001.--Laws 2000, ch. 252, § 176 repeals this chapter effective July 1, 2001.

Amendment Notes. --The 1996 amendment, effective April 29, 1996, added Subsection (3)(c), making related redesignation changes, and in Subsection (1) added the sentence beginning "Any payments..." and made a stylistic change.

Cross-References. --Course of dealing and usage of trade, § 70A-1-205.

Entrusting possession of goods to merchant, power to transfer rights of entruster, § 70A-2-403(2).

COLLATERAL REFERENCES

Brigham Young Law Review. --Bankruptcy Law, Secured Transactions, Bankruptcy Trustee's Power to Avoid as Preferential a Creditor's Perfected Security Interest Under U.C.C. Section 9-306(4)(d) in Excess Proceeds, 1976 B.Y.U. L. Rev. 938.

Am.Jur.2d. --68A Am. Jur. 2d Secured Transactions § § 85 to 100.

C.J.S. --79 C.J.S. Supp. Secured Transactions § § 117, 118.

A.L.R. --Effectiveness of original financing statement under UCC Article 9 after change in debtor's name, identity, or business structure, 99 A.L.R.3d 1194.

Construction and effect of UCC § 9-311 giving debtor right to transfer his interest in collateral, 45 A.L.R.4th 411.

Secured transactions: government agricultural program payments as "proceeds" of agricultural products under UCC § 9-306, 79 A.L.R.4th 903.

Equitable estoppel of secured party's right to assert prior, perfected security interest against other secured creditor or subsequent purchaser under Article 9 of Uniform Commercial Code, 9 A.L.R.5th 708.

U.C.A. 1953 § 70A-9-306

UT ST § 70A-9-306

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Tab 5

[5] The possible interests of others in the vehicle have been adequately protected by the legislature and should not have been relied upon by the district court as a basis for denial of the petition. All persons having claims in the property must be notified of the petition for forfeiture.[1] Any person claiming an interest in the vehicle can file a petition for release of his interest in the property.[2] If the claimant has a valid interest that is not subject to forfeiture, the court shall order release of the property or partial release and forfeiture,[3] in which case the property is sold and the proceeds distributed among legitimate claimants first.[4]

The district judge expressed concern that the persons penalized on forfeiture would be the bank that loaned Arave the purchase money for the car and Arave's father who stood as guarantor for the loan. The record does not show that either the bank or Arave's father filed a claim on the vehicle. There is no assertion that they failed to receive notice or were prevented from entering evidence at the hearing. If the district court concluded that they had legitimate claims, the statute clearly provided a method for satisfaction of the claims upon forfeiture of the vehicle.

[6] As to the final point that the value of the car was disproportionate to the use made of the vehicle in transporting contraband, we hold that the value of the property seized is immaterial. The statute is devoid of any intent to the contrary. To hold that property would not be subject to forfeiture due to its value would seem to be contrary to the intent and purpose of the statute. The law was not meant to reward the drug dealer who is "prosperous in his traffic" by refusing to forfeit his expensive car.[5] The statute manifests the opposite intent.

We hold therefore that the trial court erred in denying the petition for forfeiture. The order of denial is reversed, and the case is remanded with direction to grant the petition.

HALL, C.J., and DURHAM and ZIMMERMAN, JJ., concur.

STEWART, J., dissents.

1. U.C.A., 1953, § 58-37-13(9)(c).
2. U.C.A., 1953, § 58-37-13(9)(e).
3. U.C.A., 1953, § 58-37-13(9)(j).
4. U.C.A., 1953, § 58-37-13(9)(j)(i).
5. *State v. One Porsche, supra* (Crockett J., dissenting).

INSLEY MANUFACTURING CORPORATION, Plaintiff and Respondent,

v.

DRAPER BANK & TRUST, Defendant and Appellant.

No. 19317.

Supreme Court of Utah.

April 24, 1986.

Creditor brought action against bank for conversion of secured collateral. The Third District Court, Salt Lake County, Judith A. Billings, J., entered judgment in favor of creditor, and bank appealed. The Supreme Court, Hall, C.J., held that creditor's perfected purchase money security interest in cash proceeds of inventory sold by debtor had priority over bank's setoff rights after proceeds were deposited in debtor's account.

Affirmed.

Howe, J., concurred in result.

1. Secured Transactions ⇐168

Creditor's perfected purchase money security interest in cash proceeds of inven-

tory sold by debtor had priority over bank's setoff rights after proceeds were deposited in debtor's account, which previously had been overdrawn. U.C.A.1953, 70A–9–104(i), 70A–9–306(3).

2. Appeal and Error ⇐173(2)

Bank could not raise issue of whether it was holder in due course of check deposited in debtor's account for first time on appeal.

Dwight L. King, Salt Lake City, for defendant and appellant.

Kim R. Wilson, Henry C. Chai, Salt Lake City, for plaintiff and respondent.

HALL, Chief Justice:

Insley Manufacturing Corp. ("Insley") sued Draper Bank & Trust ("Draper") for conversion of secured collateral. About a year later, both parties moved for summary judgment. The trial court ruled in favor of Insley. On appeal, Draper seeks reversal of the lower court order and judgment entered in favor of its summary judgment motion or, alternatively, that the case be remanded for trial. We affirm.

I.

Insley sold to Schneider Machinery Sales ("Schneider") an H 1500–C backhoe. Insley financed the transaction and received a security interest in the equipment and its proceeds on October 16, 1978. Insley then filed a financing statement with the Secretary of State's office on November 20, 1978. The statement covered: "All Insley Backhoes, Attachments, Accessories, and Parts sold to Debtor by Secured Party for resale or rental by the debtor, in which secured party has a security interest whether now owned or hereinafter acquired, including proceeds from such sale or rental payments received under the rental of such equipment." The H 1500–C was shipped by Insley on March 1, 1979.

In March of 1979, Draper established business checking account No. 81–02047–1 for Schneider. Sometime *prior* to October 5, 1979, five checks totalling $91,621.25 and drawn against the account were presented to Draper for payment. On October 5, Draper determined that the account contained insufficient funds to cover the checks and decided to pay them in overdraft. Accordingly, on that date, Draper notified Schneider in a debit memo that the bank intended to cover the checks and charge the account a $15 service charge and 18% interest for use of the funds. According to Schneider's bank statement, however, this transaction was posted on October 9, 1979.[1]

On October 9, 1979, Schneider completed the sale of the H 1500–C backhoe and an H 1000 backhoe to L.J. O'Brien for $237,918.30. The proceeds from the sale were given to Schneider in the form of a check from O'Brien's financing company, ITT Industrial Credit Company ("ITT"). The same day, Schneider deposited the check along with others into the Draper account. The total deposit was $238,491.53. Draper, in turn, credited Schneider's account for the deposit and then paid itself from the account for the money loaned to pay the checks. Schneider then paid Insley $79,212.80 for the H 1000 backhoe, but could not pay for the H 1500–C because of Draper's debit of the account. A deposition relied on by plaintiff in its summary judgment motion indicates that Schneider owed approximately $130,000 to Insley for the H 1500–C.

1. At argument, counsel for Draper argued that a computer printout constituting Schneider's October 1979 bank statement failed to reflect an overdraft. However, the deposition of Draper's president and director, Dewey Bluth, explains that the transaction is not reflected because of Draper's procedure in handling returnable items and in posting transactions on its computer; in short, the printout fails to reflect the actual timing of events at the bank. Bluth, who approved all of Draper's items paid in overdraft, admitted the overdraft existed. Also, the charges listed in the overdraft debit memo correspond to those on Schneider's bank statement. In view of the facts submitted below taken in light of the midnight deadline imposed by U.C.A., 1953, § 70A–4–301(1), the claim of no overdraft is spurious.

Schneider filed for voluntary bankruptcy on August 6, 1980. Insley filed this action on March 25, 1982. On April 7, 1983, Insley moved for summary judgment. On April 21, 1983, Draper also moved for summary judgment based on "undisputed facts that are presented by the Motion, Affidavits, deposition of President Dewey C. Bluth, Draper Bank & Trust Company, and the Memorandum submitted by plaintiff and defendant." Insley's motion was granted on April 26, 1983. The following day, defendant filed its objections, claiming material issues of fact remained. Specifically, Draper contended that there was no evidence presented that the debtor (Schneider) had not paid the balance owing on the H 1500–C. Draper also moved the court for permission to file the voluntary bankruptcy petition and schedules attached thereto as exhibits. Draper's motion to file the exhibits was denied on May 18, 1983. Further, on May 31, 1983, Insley filed a supplemental affidavit which stated that the indebtedness secured by the H 1500–C backhoe had exceeded $91,621.25 since October 9, 1979, and remained unpaid on the 17th of May, 1983. Accordingly, on June 6, 1983, the trial judge entered judgment in Insley's favor.

II.

[1] Insley entered into the H 1500–C security agreement with Schneider to secure the purchase price of the backhoe. Insley then filed a UCC–1 with the proper filing officer. Thus, after Insley delivered the H 1500–C to Schneider, Insley had a perfected purchase money security interest in the inventory.[2] When Schneider sold the H 1500–C backhoe, Insley lost its security interest in that inventory,[3] but its interest remained in the identifiable cash proceeds (the portion of the ITT check attributable to the H 1500–C sale price).[4] When Schneider deposited the ITT check on October 9, its account was credited with the entire amount. The account, a "deposit account," then contained, in part, identifiable cash proceeds from the H 1500–C sale.[5] Draper contends that Insley's security interest became unperfected because Draper is not constrained by section 9–306(3).[6] Such a broad assertion is untenable, however, particularly in light of the 1977 amendment to the Utah Code excepting proceeds from its exclusion provisions.[7]

2. *See* U.C.A., 1953, §§ 70A–9–203(1)–(2), –107(a), –302(1), –303(1), –401(1), –402(1), (3), (10). The Insley/Schneider transaction was a multistate transaction. For purposes of this opinion, we presume sections 70A–9–103(1)(a) and (b) are controlling. U.C.A., 1953, § 70A–9–109(4) provides that goods held by a person for sale or lease are classified as inventory. *See also* U.C.A., 1953, § 70A–9–105(1)(h).

3. *See* U.C.A., 1953, §§ 70A–9–205, –307(1). Insley's security agreement expressly provided that Schneider could sell the inventory in the ordinary course of business.

4. *See* U.C.A., 1953, §§ 70A–9–306(1)–(2), –203(3). The bank was not a buyer in the ordinary course of business. *See* U.C.A., 1953, § 70A–1–201(9).

5. *See* U.C.A., 1953, §§ 70A–9–105(e), –306(1)–(2). The case law authority is almost unanimous that commingling of cash proceeds with other funds does not necessarily make the proceeds unidentifiable. *E.G., C.O. Funk & Sons, Inc. v. Sullivan Equip., Inc.*, 89 Ill. 2d 27, 31, 59 Ill. Sec. 85, 87, 431 N.E.2d 370, 372 (1982) (argument that security interest in proceeds terminates when deposited in bank account because identification is impossible has found little favor in the courts); *Michigan Nat'l Bank v. Flowers Mobile Homes Sales, Inc.*, 26 N.C.App. 690, 695, 217 S.E.2d 108, 111–12 (1975) (rule requiring separate account for earmarked proceeds incompatible with underlying purpose of code); *Anderson, Clayton & Co. v. First Am. Bank*, Okla., 614 P.2d 1091, 1093–94 (1980). *See also* U.C.A., 1953, § 70A–1–102(2) (purpose of the UCC), § 70A–9–205 (concerning in part the freedom of a debtor to commingle proceeds), § 70A–1–103 (code is to be supplemented by "principles of law and equity").

6. Unless otherwise indicated, all references are to the Uniform Commercial Code contained in U.C.A. tit. 70A.

7. The Code now provides that article nine does not apply "to a transfer of interest in any deposit account, . . . except as provided with respect to proceeds (section 70A–9–306) and priorities in proceeds (section 70A–9–312)." U.C.A., 1953, § 70A–9–104(*l*). Prior to the 1977 amendment the substance of § 70A–9–104(*l*) was contained at U.C.A., 1953, § 70A–9–104(k). That provision provided that article 9 did not apply "to a transfer in whole or in part of any of the following:

Although Draper claimed at argument that Insley's cited authority was inapposite, we find that Insley's authority squarely addresses the dispositive issue in this case: [8] whether section 9–104(i), stating that article nine does not apply "to any right of setoff," has any applicability to the priority provisions of article nine.

A small minority of jurisdictions and some commentators have construed 9–104(i) broadly, taking the position that the provision excludes all situations concerning setoffs, not only from the Code's security and filing provisions, but also from the Code's *priority provisions.*[9] The principal reasoning underlying these decisions is as follows: First, the official comment to the Uniform Commercial Code can be read as favoring this view. For example, the official comment to 9–101 provides "[t]his Article sets out a comprehensive scheme for the regulation of security interests in personal property and fixtures." Since setoffs are excluded from the Code's definition of security interests, it is possible to conclude "interests in property other than security interests are beyond the scope of all portions of Article 9." [10] Second, other 9–104 exclusions, such as the "landlord's lien," have been construed as controlling over the Code's priority provisions.[11] Third, commentators claim the Code can be read as indicating its drafters intended 9–104(i) to be absolute.[12] Fourth, the language in Professor Gilmore's commentary (quoted *infra*) has been extended beyond its meaning.[13]

A majority of jurisdictions have construed section 9–104(i) narrowly to mean that a right of setoff may exist in a creditor who fails to comply with the security agreement and filing provisions of article nine, but that the section 9–104(i) exclusion does not extend to the Code's priority provisions.[14] The reasoning underlying the majority view is significantly more persuasive than that underlying the broad interpretation followed by the minority of courts.

In regard to section 9–104(i), Professor Gilmore, a principal reporter for article nine, explained:

any claim arising out of tort; any deposit, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization." *See also* Coogan, Kripke & Weiss, *The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements,* 79 Harv. L. Rev. 229, 263 (1965), *cited with approval in Commercial Discount Corp. v. Milwaukee W. Bank,* 61 Wis. 2d 671, 684 n. 18, 214 N.W.2d 33, 39 n. 18 (1974).

8. Specifically, Insley cites *Citizens Nat'l Bank v. Mid-States Dev. Co.,* 177 Ind.App. 548, 380 N.E.2d 1243 (1978). *Citizens National* squarely deals with offsets against cash proceeds held by banks in deposit accounts, *United States v. Handy & Harman,* 750 F.2d 777, 787 (9th Cir. 1984).

9. E.g., *State Bank v. First Bank,* Minn., 320 N.W.2d 723, 725 (1982); *First Nat'l Bank v. Lone Star Life Ins. Co.,* Tex., 529 S.W.2d 67, 68 (1975) (per curiam); Skilton, *The Secured Party's Rights in a Debtor's Bank Account Under Article 9 of the Uniform Commercial Code,* 1977 S.Ill. U.L.J. 120, 201–05.

10. *See National Acceptance Co. of Am. v. Virginia Capital Bank,* 498 F.Supp. 1078, 1085 (E.D.Va. 1980), *aff'd in part, reversed in part,* 673 F.2d 1314 (4th Cir.1981). *See also National Acceptance Co. of Am. v. Virginia Capital Bank,* 491 F.Supp. 1269, 1273 (E.D.Va.1980).

11. 1 P.Coogan, W. Hogan, D. Vagts & J. McDonnell, Secured Transactions Under the Uniform Commercial Code § 5A.15[2] (1985).

12. *See generally* Note, *Conflicts Between a Bank's Common Law Right of Setoff and a Secured Party's Interest in Identifiable Proceeds,* 9 Loy.U.Chi.L.J. 454, 462–65 (1978).

13. 1 P. Coogan, W. Hogan, D. Vagts & J. McDonnell, Secured Transactions Under the Uniform Commercial Code § 5A.15[2] (1985).

14. *E.g., Continental Am. Life Ins. Co. v. Griffin,* 251 Ga. 412, 414, 306 S.E.2d 285, 287 (1983); *Farms Assocs. v. South Side Bank,* 93 Ill.App.3d 766, 771–72, 49 Ill.Dec. 128, 132–34, 417 N.E.2d 818, 822–24 (1981); *Citizens Nat'l Bank v. Mid-States Dev. Co.,* 177 Ind.App. 548, 556, 380 N.E.2d 1243, 1248 (1978); *Coachmen Indus., Inc. v. Security Trust & Sav. Bank,* Iowa, 329 N.W.2d 648, 650 (1983); *Morris Plan Co. v. Broadway Nat'l Bank,* Mo.App., 598 S.W.2d 557, 560 (1980); *Associates Discount Corp. v. Fidelity Union Trust Co.,* 111 N.J.Super. 353, 357–58, 268 A.2d 330, 332 (1970); *First Wisconsin Nat'l Bank v. Midland Nat'l Bank,* 76 Wis.2d 662, 670, 251 N.W.2d 829, 833 (1977).

> This exclusion is an apt example of the absurdities which result when draftsmen attempt to appease critics by putting into a statute something that is not in any sense wicked but is hopelessly irrelevant. Of course a right of set-off is not a security interest and has never been confused with one: the statute might as appropriately exclude fan dancing. A bank's right of set-off against a depositor's account is often loosely referred to as a "banker's lien," but the "lien" usage has never led anyone to think that the bank held a security interest in the bank account. Banking groups were, however, concerned lest someone, someday, might think that a bank's right of set-off, because it was called a lien, was a security interest. Hence the exclusion, which does no harm except to the dignity and self-respect of the draftsmen.[15]

This language indicates that banks need not comply with article nine to create a right of setoff, but given the narrow purpose of the exclusion it is unsound to read it as removing transactions in the commercial arena from the Code when the priority of a setoff is involved.[16] Additional support for the majority rule can be found by examining other exclusion sections in 9–104. For example, 9–104(c), the exclusion for mechanic's liens and liens for services, and 9–104(h), the exclusion for the judgment lienor, have their priority in terms of secured property clearly spelled out in the Code's various priority provisions.[17] Arguably, had drafters of the Code intended 9–104(i) to exclude setoffs from the priority provisions, they would have expressly so provided as they did with other exclusion sections. This rationale may be extended further by examination of 9–201, which provides that security agreements are effective according to their terms between the parties, and against *third-party creditors*, except as otherwise provided by the Code. There is no express provision in the Code suggesting a perfected security interest is subordinate to a right of setoff.

Further support for a narrow interpretation of 9–104(i) is gleaned from examination of 9–306(4)(d), which provides:

> In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:
>
> ....
>
> (d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this paragraph (d) is
>
> (i) subject to any right of setoff....

The contention is that "this provision would be unnecessary if the relative priority of any right of set-off was unaffected by Article 9 because all perfected security interests, and not merely those recognized under section 9–306(4)(d), would be equally 'subject to any right of setoff.' "[18]

Moreover, section 1–102[19] mandates that the Code is to be liberally construed to promote its underlying purposes and policies, including the clarification of the law governing commercial transactions. The purpose and concept of notice filing would be significantly weakened if we held that Draper is not bound by that which it would have discovered through a proper inquiry.[20]

Finally, section 9–205 provides in part: "A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral ... or to use, commingle or dispose of proceeds...."

15. G. Gilmore, Security Interests in Personal Property 315–16 (1965).

16. *E.g., Citizens Nat'l Bank,* 177 Ind.App. at 555, 380 N.E.2d at 1248.

17. *See, e.g.,* U.C.A., 1953, §§ 70A–9–310, -301(1)(b).

18. *National Acceptance Co.,* 498 F.Supp. at 1084.

19. Principles of construction found in chapter one are integrated into article nine by section 70A–9–105(4).

20. *See Farns Assocs.,* 93 Ill.App.3d at 772, 49 Ill.Dec. at 133, 417 N.E.2d at 823.

The purpose of the provision is to relieve creditors from the age-old requirement of policing collateral in the hands of a debtor. Adoption of the minority approach places such a duty on creditors and "would severely undercut significant values of certainty, efficiency and reliance which are at the heart of the Codal emphasis on public filing." [21] A secured party should be able to rely on his compliance with the Code's requirements for perfection and his search of the record as against an unrecorded interest of a setting-off bank.[22]

In its brief, Draper contends that proceeds in the form of checks which are deposited in checking accounts should not be held in abeyance for ten days. Draper implies that such a result is necessary if this Court rules in favor of Insley. Drafters of the Code were also concerned with this problem. Section 4–208 provides that a *collecting* bank has a perfected security interest in a deposited item as a matter of law when it credits a customer's account in reliance on the deposited item. The section also gives the collecting bank priority in the security interest.[23] In this case, however, Draper, while standing in the shoes of a *payee* bank, determined on October 5, 1979, that Schneider's account contained insufficient funds to cover the presented items. Draper could have most easily and least expensively avoided this dispute; Draper could merely have returned the items it covered for Schneider in overdraft.[24] Instead, Draper advised Schneider on October 5 that it was extending nearly $100,000 to cover the checks. A debit memo in the record indicates that Draper notified Schneider that Draper was charging Schneider a $15 fee and 18% interest for this "service." This transaction was not secured since the bank was not lending against a deposited item.

Draper contends that section 9–306(4) governs the priority dispute in this case since Schneider was not able to cover the checks as they were presented to the bank. Draper relies on *Citizens & Southern National Bank v. Weyerhaeuser Co.*[25] However, that case is easily distinguished. In *Citizens & Southern*, the bank exercised its right of setoff only after the debtor acknowledged in writing that it was in default, authorized the bank to take possession of its assets, and ceased operations. Here, the fact that Draper agreed to lend Schneider the funds to pay the checks on October 5 establishes that Schneider was solvent; a company is not insolvent merely because it has to pay its bills with borrowed funds. The court in *Citizens National Bank* [26] was unpersuaded by a similar argument:

> This argument is without merit. It is premised on a misconstruction of the language and purpose of section 9–306(4)(d). The triggering phrase of that section is "In the event of insolvency proceedings instituted by or against a debtor...." It is plain that the limiting provisions of subsections (4)(d)(i) and (ii) are to serve as tracing rules for the secured party asserting an interest in proceeds *only* when they are brought within the debtor's estate in an insolvency proceeding. Here the funds in question were not made a part of Huntington's estate in bankruptcy. For purposes of determining the validity and extent of Soya's proceeds security interest, the subsequent institution of bankruptcy proceedings in the present case is irrelevant. Since the limitations contained in section 9–306(4)(d) have no operation outside the area of insolvency proceedings the trial court properly disregarded them.[27]

21. *Id.*

22. *Citizens Nat'l Bank*, 177 Ind.App. at 559, 380 N.E.2d at 1249.

23. *See also* U.C.A., 1953, §§ 70A-9-203(1), 9-302(1)(f), 9-312(1).

24. U.C.A., 1953, § 70A-4-301.

25. 152 Ga.App. 176, 262 S.E.2d 485 (1979).

26. 177 Ind.App. at 548, 380 N.E.2d at 1243.

27. *Id.* at 553, 380 N.E.2d at 1246 (citations omitted). *See also National Acceptance Co.*, 498 F.Supp. at 1084 n. 5 ("present proceedings, while occasioned by Structures' insolvency, are not insolvency proceedings, defined at section

This is not an insolvency proceeding instituted by or against Schneider. Further, Schneider's bankruptcy in 1980 has no bearing on this case since the conversion occurred on October 9, 1979.

Analysis of the facts of this case pursuant to section 9–306(3) shows that Insley's purchase money security interest in the proceeds was perfected on October 9.[28] As noted above, Draper was an unsecured creditor on October 9. Although no specific rule deals directly with the priority conflict between Insley's perfected security interest and Draper's setoff rights, we believe that the Code's priority rules require that Insley's interest must prevail over Draper's right of setoff. The cornerstone of the Code's complex priority provisions, section 9–201, provides in pertinent part: "Except as otherwise provided by this act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors." As stated in *Continental American Life Insurance Co.:*[29] "The effect of this section is to give the Article Nine secured party, upon a debtor's default, priority over 'anyone, anywhere, anyhow' except as otherwise provided by the remaining Code priority rules." Since there are no other rules in the Code to resolve the conflict, section 9–201 is controlling.

[2] Draper also contends that it was a holder in due course and thus took the instrument free of Insley's security interest. However, the record does not reflect that Draper argued the holder-in-due-course theory below. Its papers all reflect argument as to why it and not Insley was entitled to the deposit account. Draper may not raise this issue for the first time on appeal.[30]

Draper's claim that disputed material facts should have prevented the granting of Insley's motion is not well taken. Specifically, Draper claims there is a question as to whether Schneider fully or partially paid the H 1500–C debt. Contrary to claims in Draper's brief, Insley filed an affidavit in support of its motion for summary judgment which states the debt exceeded $91,621.25 as of January 24, 1983.[31] Only after the denial of Draper's motion did counsel attempt to introduce Schneider's bankruptcy schedules, though the same were available prior to the lower court order. Even if the trial court had permitted the schedules into evidence, the fact they show Insley as having no security interest in an H 1500–C does not support Draper's claim of disputed material facts. The sale to O'Brien of the H 1500–C (the only H 1500–C Schneider ever received) cut off Insley's security interest in the H 1500–C. Moreover, the schedules *do* show Insley with a security interest in proceeds of sale of $142,000. Finally, when Draper raised the issue in its objections, Insley filed another affidavit stating the balance was still owing. There are no disputed facts.

The judgment is affirmed. Costs to Insley.

STEWART, DURHAM and ZIMMERMAN, JJ., concur.

HOWE, J., concurs in the result.

1–201(22) of the Code"); *Michigan Nat'l Bank,* 26 N.C.App. at 695, 217 S.E.2d at 112.

28. *See* U.C.A., 1953, §§ 70A–9–306(3)(b), (c), –302(1)(b).

29. 251 Ga. at 414, 306 S.E.2d at 287 (citations omitted).

30. *E.g., Bundy v. Century Equip. Co.,* Utah, 692 P.2d 754, 758 (1984). Even if Draper was a holder in due course, it would only take the ITT check free of Insley's security interest. The credit to Schneider's deposit account given in exchange for the check was proceeds under the Code, and Insley's security interest would have remained in the deposit account until depleted in the ordinary course of Schneider's business.

31. The affidavit provides in part: "5. In October 1979, Schneider Machinery Sales owed Insley Manufacturing in excess of $91,621.25 on the H 1500–C backhoe. 6. Demand has been made upon Schneider Machinery Sales for payment, but Schneider Machinery Sales *has* failed to pay the amount it owes to Insley." (Emphasis added.)

Tab 6

Volvo Commercial Finance, LLC the Americas v. Wells Fargo Bank, N.A.
Salt Lake City, Utah

RGL RECREATION OF MR. JUDD'S EXHIBIT 1 - MODIFIED FOR TWO TRANSACTIONS NOT ACCOUNTED FOR USING THE LOWEST INTERMEDIATE BALANCE RUL — *Schedule 1*

GREAT BASIN GMC TRUCKS, INC — **Exhibit 1**
Analysis of Trust money - Wells Fargo Concentration and Great Basin Trucks FSB Activity for December 2000

Description	12/7/00	12/8/00	12/11/00	12/12/00	12/13/00	12/14/00	12/15/00	12/18/00	12/19/00	12/20/00	12/21/00	12/22/00	12/26/00	12/27/00	12/28/00	12/29/00	Ending Balance
GREAT BASIN COMPANIES - WELLS FARGO BANK (409-6328487)																	
Beginning Balance																	
Trust Money	$ -	$ 125,925	$ 420,620	$ 578,917	$ 632,689	$ 396,309	$ 404,309	$ 1,639,510	$ 1,651,755	$ 1,691,585	$ 1,691,585	$ 1,125,001	$ 661,274	$ -	$ -	$ -	$ -
Other	1,031,955	490,458	678,571	174,415	-	-	192,734	631,063	698,019	299,615	1,297,489.44	-	-	(281,056)	(790,161)	(828,951)	(53,310)
Total Beginning Balance	1,031,955	616,383	1,099,191	753,332	632,689	396,309	597,043	2,270,574	2,349,774	1,991,200	2,989,074	1,125,001	661,274	(281,056)	(790,161)	(828,951)	$ (53,310)
Transfer from Salt Lake Volvo WFB Account:																	
Trust Money	125,925	190,450	158,297	-	-	8,000	-	-	39,830	-	-	-	-	-	-	-	
Other	18,848	16,359	66,637	59,419	65,313	81,734	80,656	156,577	69,652	-	-	-	-	-	124	-	
Transfer from Arizona WFB Account:																	
Trust Money	-	16,695	-	-	-	-	-	12,245	-	-	-	100,334	-	-	-	-	
Other	42,751	30,668	76,596	57,771	113,991	13,372	27,194	63,433	15,438	18,819	29,098.93	13,321	72,406	8,858	-	-	
Transfer from Southwest WFB Account:																	
Trust Money	-	87,350	-	-	-	-	104,490	-	-	-	-	-	-	-	-	-	
Other	2,855	121,434	3,608	37,068	1,817	-	49,928	33,172	-	36,632	9,179.81	-	-	-	-	-	
Transfer from Idaho WFB Account:																	
Trust Money	-	-	-	69,427	-	-	1,130,712	-	-	-	-	-	-	-	-	-	
Other	38,778	710	5,271	2,046	-	11,406	(91)	18,896	31,230	-	1,788.83	-	-	-	-	-	
Transfer to Great Basin Trucks FSB Account:																	
Trust Money	-	-	-	-	-	-	-	-	-	-	(566,584.35)	(500,000.00)	-	-	-	-	
Other	-	-	-	-	-	-	-	-	-	-	(933.416)	-	-	-	-	-	
Transfer from Great Basin Trucks FSB Account:																	
Trust Money	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	$ 900,000
Other	-	-	-	-	-	-	-	-	-	-	-	-	-	300,000	-	900,000	Transfer
Other Receipts and Disbursements																	
Receipts	564,834	242,521	106,937	110,682	17,242	318,956	613,933	134,787	16,450	1,011,385	2,500.00	653	-	354,348	-	696	
Disbursements	(1,209,564)	(223,578)	(763,207)	(457,056)	(434,743)	(232,734)	(333,289)	(339,909)	(531,174)	(68,961)	(406,641.36)	(78,035)	(1,014,735)	(1,172,310)	(38,915)	(125,055)	
Ending Balance	$ 616,383	$ 1,099,191	$ 753,332	$ 632,689	$ 396,309	$ 597,043	$ 2,270,574	$ 2,349,774	$ 1,991,200	$ 2,989,074	$ 1,125,001	$ 661,274	$ (281,056)	$ (790,161)	$ (828,951)	$ (53,310)	
Trust Money	125,925	420,620	578,917	648,344	632,689	404,309	1,639,510	1,651,755	1,691,585	1,691,585	1,125,001	725,335	661,274	-	-	-	
Other	490,458	678,571	174,415	(15,655)	(236,380)	192,734	631,063	698,019	299,615	1,297,489	-	(64,061)	(942,330)	(790,161)	(828,951)	(53,310)	
GREAT BASIN COMPANIES - FIRST SECURITY BANK (222-00085-32)																	
Beginning Balance																	
Trust Money	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,066,584	$ 1,066,584	$ 1,099,214	$ 1,099,214	$ 2,982,181
Other	-	-	-	-	-	-	-	-	-	-	-	50,904	1,180,587	1,311,271	1,011,571	1,130,786	32,203
Total Beginning Balance	-	-	-	-	-	-	-	-	-	-	-	50,904	2,247,171	2,377,856	2,110,786	2,230,002	$ 3,014,385
Transfer From WFB Concentration Account																	
Trust Money	-	-	-	-	-	-	-	-	-	-	-	1,066,584	-	-	-	-	
Other	-	-	-	-	-	-	-	-	-	-	-	933,416	-	-	-	-	
Transfer to WFB Concentration Account	-	-	-	-	-	-	-	-	-	-	-	-	-	(300,000)	-	(900,000)	
Associated Foods Truck Payment (Trust Money)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,882,967	
Johnston Supply Truck Payment (Trust Money)	-	-	-	-	-	-	-	-	-	-	-	-	-	32,630	-	-	
Other Receipts and Disbursements																	
Receipts	-	-	-	-	-	-	-	-	-	-	50,904	196,267	130,685	300	119,217	63,132	
Disbursements	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(261,717)	
Ending Balance	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 50,904	$ 2,247,171	$ 2,377,856	$ 2,110,786	$ 2,230,002	$ 3,014,385	

RGL File No : 091176
Printed: 12/10/2003

Tab 7

Supreme Court of Nebraska.

CITY OF LINCOLN
v.
MORRISON ET AL.

May 21, 1902.

Syllabus by the Court.

***905** 1. Misappropriation of a trust fund does not entitle cestui que trust, merely as such, and for that reason alone, to a preference over general creditors of an insolvent trustee.

2. In order to obtain a preference, cestui que trust must show that the estate out of which he claims such preference has been increased to some extent by the misappropriation of the trust property, and he is entitled to a preference to the extent of such increase only.

3. Where a trustee mingles trust moneys with his own funds, cestui que trust is entitled to a charge upon the whole; and, so long as any portion of the mass into which the trust fund has entered remains in any form, it is subject to such charge, and may be followed and claimed.

4. The burden is upon cestui que trust to show that the trust money did in fact increase the estate out of which he seeks a preference, or is represented therein in some form. But it seems that where such money has gone into the general estate of a trustee, who afterwards becomes insolvent, there is a presumption that it remains therein at his insolvency; and the court will not say that it cannot be traced or has wholly disappeared, where the contrary may fairly be inferred.

5. It is presumed that moneys drawn out of a fund wherein the trustee has mingled his own money and that of cestui que trust are his own, and, so long as any portion of the fund so constituted remains, it may be followed, and the charge of cestui que trust thereon may be asserted.

6. But if the whole of such fund, or a greater portion thereof than that representing the trustee's own money, is used by an insolvent trustee in paying his debts, cestui que trust is not entitled to a preference over general creditors for the amount of his money so lost.

7. Property or assets of the insolvent trustee acquired before, or with the proceeds of property held before, the trust money came into his hands, and not in any way mingled therewith, are not subject to any lien or claim in cestui que trust, and the rights of the latter with respect thereto are those of a general creditor only.

8. A change in the form of a portion of a fund in which money of the trustee personally and of cestui que trust has been mingled is not necessarily a withdrawal of such portion. When the trustee retains such portion and dissipates the remainder, the portion retained in the altered form is taken to represent such fund, and may be claimed by cestui que trust.

9. Where a portion of a fund made up of trust money and of individual money of the trustee is invested, and a profit results, cestui que trust, in following the trust money into the investment, may claim such profits as the proceeds of the original fund upon which he had a charge, at least to the extent of said charge upon the original fund.

***906** 10. Capital Nat. Bank v. Coldwater Nat. Bank, 60 N. W. 115, 49 Neb. 786, 59 Am. St. Rep. 572, and State v. Midland State Bank, 71 N. W. 1011, 52 Neb. 1, 66 Am. St. Rep. 484, limited. State v. Bank of Commerce, 75 N. W. 28, 54 Neb. 725, and Morrison v. Lincoln Sav. Bank & Safe Deposit Co., 77 N. W. 655, 57 Neb. 225, adhered to.

Commissioners' opinion. Department No. 2. Error to district court, Lancaster county; Holmes, Judge.

In the matter of the insolvency of the Lincoln Savings Bank & Safe Deposit Company. In such matter the city of Lincoln intervenes, seeking a preference over the general creditors, and from the denial of the same it brings error. Reversed.

West Headnotes

Trusts 342
390k342 Most Cited Cases
Where the whole of a fund created by the moneys of

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a trustee and those of his beneficiary is used by an insolvent trustee in paying his own debts, the beneficiary is not entitled to a preference over the general creditors for the amount of his money so lost.

Trusts 342
390k342 Most Cited Cases
Misappropriation of a trust fund does not entitle the beneficiary for that reason alone to a preference over general creditors of an insolvent trustee.

Trusts 342
390k342 Most Cited Cases
Assets of an insolvent trustee, acquired before or with the proceeds of property held before the trust money came into his hands, and not in any way mingled therewith, are not subject to any lien in favor of the beneficiary.

Trusts 353
390k353 Most Cited Cases
The burden is on a beneficiary to show that the trust money did in fact increase the estate out of which he seeks a preference, or is represented therein in some form.

Trusts 353
390k353 Most Cited Cases
Where a trustee retains a portion of a fund in which his own money and that of the beneficiary has been mingled, and dissipates the remainder, the portion retained may be claimed by the beneficiary.

Trusts 353
390k353 Most Cited Cases
Where a trustee mingles trust property with his own funds, a beneficiary is entitled to a charge upon the whole, and, so long as any portion of the mass into which the trust fund has entered remains in any form, it is subject to such charge and may be followed and claimed.

Trusts 353
390k353 Most Cited Cases
In order that a beneficiary of an insolvent trustee may obtain a preference, he must show that the estate out of which he claims such preference has been increased to some extent by the misappropriation of the trust property, entitling him to a preference to the extent of such increase.

Trusts 354
390k354 Most Cited Cases
Where a portion of a fund made up of trust money and of individual money of the trustee is invested, and a profit results, the beneficiary, in following the trust money into the investment, may claim such profits as the proceeds of the original fund on which he had a charge, to the extent of said charge on the original fund.

Trusts 358(2)
390k358(2) Most Cited Cases
Funds.
Where trust money has been wrongfully commingled by a trustee with his own, and he makes payment from the common fund, it will be presumed that he paid out his own, and not trust, money.

Lambertson & Hall, for plaintiff in error.

A. S. Tibbetts and L. C. Burr, for defendants in error.

POUND, C.

This is a petition in error prosecuted by the city of Lincoln, an intervener in a suit brought to wind up the Lincoln Savings Bank & Safe Deposit Company, other phases whereof have been before this court several times. The plaintiff in error by its petition in intervention sought a preference over general creditors for some $5,000,--a balance of moneys of said city loaned to the bank upon certificate of deposit by the city treasurer in contravention of law, and with knowledge on the part of the bank officers as to whose money it was. It appeared from a stipulation of the parties and from the evidence adduced that on April 9, 1895, the city treasurer placed $6,095.35 of the city's funds in the bank, taking a certificate of deposit therefor. Afterwards $1,055.35 was paid on the certificate, and a new certificate was issued for $5,000. After said deposit was made, the bank had on deposit, in all, about $240,000, of which $41,699.96 was on hand in cash. On December 16, 1895, the bank suspended. At that time the deposits had fallen to about $150,000, or, to be precise, $92,534.43 had been paid out to depositors between the time when the city's money had been placed in the bank and the date of suspension. No money was loaned and no investments were made during this period, except that on April 16, 1895, the bank bought state warrants of the market value of $36,750, using in payment therefor $1,750 of the cash on hand, and $35,000 borrowed of a bank in New York. The remainder of the cash on hand on April 9, 1895, and such moneys as accrued from collection or sale of paper already in the bank, it used in paying depositors and in running expenses. At the time the bank suspended there was but $200 cash on hand. This sum had been pledged to secure sureties upon a supersedeas bond in a case wherein judgment had been rendered against the bank, and was afterwards applied upon such judgment. A receiver was appointed on January 22, 1896. When he took possession he received $1,562.61 in cash, and "cash items" to the amount of $239.07. He also received $3,334.37 from sale of the

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warrants above referred to; such sum being the $1,750 originally invested therein, and the profit after repaying the money borrowed to make the purchase. But it appears from the evidence that the cash and cash items which came into the hands of the receiver accrued from loans made by the bank, or from paper which it held, before the city's money was deposited therein. The district court, upon this testimony, found generally for the receiver, and dismissed the city's petition.

Under the rulings of this court in Morrison v. Lincoln Sav. Bank & Safe Deposit Co., 57 Neb. 225, 77 N. W. 655, and State v. Bank of Commerce, 54 Neb. 725, 75 N. W. 28, several of the questions raised may be disposed of readily. But the former case does not of necessity involve the questions presented by the case at bar, nor were the facts such as to require an affirmance of State v. Bank of Commerce, supra, while the latter case is vigorously assailed by counsel, and we are asked to overrule it, and to reaffirm the rule recognized in prior decisions. Ordinarily we should not feel justified in reviewing a question determined by two recent decisions of this court. Were it a mere matter of these two decisions, so long as we feel satisfied that they are sound, we should do no more than cite them, and proceed to apply them to this controversy. But in several prior cases (State v. State Bank of Wahoo, 42 Neb. 896, 61 N. W. 252; State v. Midland State Bank, 52 Neb. 1, 71 N. W. 1011, 66 Am. St. Rep. 484; and especially Capital Nat. Bank v. Coldwater Nat. Bank, 49 Neb. 786, 69 N. W. 115, 59 Am. St. Rep. 572) this court had expressly or by strong implication recognized and adopted a different rule. The cases last cited are sought to be distinguished in State v. Bank of Commerce, supra. Counsel have pointed out, however, that the attempt to distinguish the latter case from Capital Nat. Bank v. Coldwater Nat. Bank, supra, is founded on an entire misapprehension of the facts there presented; and, in any event, the reasoning in these two cases and the authorities severally relied on therein cannot be reconciled. For this reason we think it expedient to state plainly that this court no longer adheres to the extreme view as to the right of cestui que trust to be preferred on insolvency of the trustee, expressed in the cases of State v. State Bank of Wahoo, State v. Midland State Bank, and Capital Nat. Bank v. Coldwater Nat. Bank, but adheres to the position taken in State v. Bank of Commerce and Morrison v. Lincoln Sav. Bank & Safe Deposit Co., supra; to set forth our reasons for rejecting the one view and adopting the other; and to state as clearly and definitely as we may the rules by which causes such as the one at bar are to be decided.

The origin of the rules now recognized ***907** with respect to following trust money which has been mingled with the personal funds of the trustee, or has passed into his general estate, is to be found in the opinion of Jessel, M. R., in Knatchbull v. Hallett, 13 Ch. Div. 696. Prior to that decision it was said that money had no earmark, and that when a trust fund, in the form of money, became mingled with the moneys of the trustee personally, it lost its identity and could not be traced. Since that vigorous and convincing judgment, the idea that money, as such, could not be traced, and that trust property lost its identity when turned into money and confused with the trustee's funds, has been abandoned completely. But the limits of the extension of the rights of cestui que trust with respect to the property of insolvent trustees, to which the decision in Knatchbull v. Hallett gave rise, were not perceived at first. All which that decision did was to wipe out the old dogma that money had no earmark, and to substitute the sensible rule that whenever trust property enters into a mass, to which the property of cestui que trust and that of the trustee have contributed, so long as the trust property remains in or forms a part of such mass, cestui que trust has a claim or charge thereon to that extent, and general creditors cannot take advantage of or derive a benefit from, the increase in the assets due and traceable to misappropriation of the trust fund. Several courts in this country, however, went much further, and established a rule which, though generally abandoned or modified in the more recent authorities, is still adhered to in some quarters, and at one time had the support of the decisions of this court. McLeod v. Evans, 66 Wis. 401, 28 N. W. 173, 57 Am. Rep. 287; Bank v. Hummell, 14 Colo. 259, 23 Pac. 986, 8 L. R. A. 788, 20 Am. St. Rep. 257; Peak v. Ellicott, 30 Kan. 156, 1 Pac. 499, 46 Am. Rep. 90; Myers v. Board, 51 Kan. 87, 32 Pac. 658, 37 Am. St. Rep. 263; Evangelical Synod v. Schoensich, 143 Mo. 652, 45 S. W. 647; Tierman's Ex'r v. Association, 152 Mo. 135, 53 S. W. 1072; Independent Dist. v. King, 80 Iowa, 497, 45 N. W. 908; Plow Co. v. Lamp, 80 Iowa, 722, 45 N. W. 1049, 20 Am. St. Rep. 442. The supreme court of Iowa has receded somewhat in District Tp. of Eureka v. Farmers' Bank of Fontanelle, 88 Iowa, 194, 55 N. W. 342. And a divided court in Wisconsin has overturned McLeod v. Evans, supra, which was itself the decision of a divided court. Silk Co. v. Flanders, 87 Wis. 237, 58 N. W. 383. See, also, Bircher v. Walther (Mo.) 63 S. W. 691. But this court, in Capital Nat. Bank v. Coldwater Nat. Bank, supra, expressly refused to follow the latter case, and adhered to McLeod v. Evans. In the view of these

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authorities, if trust property has been misappropriated and has gone into the estate of the trustee, cestui que trust is to be preferred, and is to receive his money to the exclusion of general creditors. As the court put it in Capital Nat. Bank v. Coldwater Nat. Bank, supra, the question is not one of identifying or claiming a sum actually deposited, but of compelling the insolvent to first restore the trust property, treating that as something which he had no power to commingle with other funds, but must keep whole and make up so long as he has any funds or property out of which to do so. Other cases do not go so far expressly, but reach the same result, either by holding that, if the insolvent trustee uses the whole fund to pay his debts, the effect is to increase his general estate, and create a charge thereon in favor of cestui que trust, or by ruling that, when the trust fund is once traced into the general property of the trustee, it is conclusively presumed to remain there. McLeod v. Evans, supra; Peak v. Ellicott, supra; Myers v. Board, supra; Independent Dist. v. King, supra.

We are not able to agree to the rule just stated in any of the forms which it has assumed. We are satisfied that the court did well when, in State v. Bank of Commerce, it withdrew its support therefrom, and took a position in accord with the great weght of recent authority. The court was in error in saying (54 Neb. 731, 75 N. W. 28) that the moneys which came into the hands of the receiver of the Capital National Bank on its insolvency were more than sufficient to meet the preferred claims established in Capital Nat. Bank v. Coldwater Nat. Bank, supra, and its companion cases. Such sum was greater than the preferred claim established in any one suit, but the aggregate considerably exceeded it, and the record in each case showed that fact. Hence State v. Bank of Commerce is not reconcilable with prior decisions of the court, and must stand on its own foundation, which we think it may do safely. Not only is it in accord with the overwhelming majority of recent decisions upon this point, and with the general tendency to abandon or recede from McLeod v. Evans and the cases following that decision, but on principle it is clearly right. Of express decisions in the last three years upon this very point, we may cite Ellicott v. Kuhl, 60 N. J. Eq. 333, 46 Atl. 945; Collins v. Steuart, 58 N. J. Eq. 392, 44 Atl. 467; Same v. Lewis, 60 N. J. Eq. 488, 46 Atl. 1098; Mercantile Co. v. Melbye, 78 Minn. 357, 81 N. W. 20; Beard v. Independent Dist., 60 U. S. App. 372, 31 C. C. A. 562, 88 Fed. 375; Robinson v. Woodward (Ky.) 48 S. W. 1082; Wilbern v. Timmons, 55 S. C. 466, 33 S. E. 568; Byrne v. McGrath, 130 Cal. 316, 62 Pac. 559, 80 Am. St. Rep. 127; Shutt v. Hinman, 34 Or. 578, 58 Pac. 832, 56 Pac. 412, 47 L. R. A. 265; Bircher v. Walther (Mo.) 63 S. W. 691. These cases, and many others cited in State v. Bank of Commerce, supra, and Morrison v. Lincoln Sav. Bank & Safe Deposit Co., supra, establish clearly that misappropriation of a trust fund does not entitle cestui que trust, merely ***908** as such, and for that reason alone, to a preference over general creditors of an insolvent trustee. So long as the trust property, in any shape or form, can be recognized, it belongs to cestui que trust. So long as it enters into any fund property, or mass of assets in any way, cestui que trust has a charge or lien, which he may enforce upon the whole. But if the trustee "destroys a trust fund by dissipating it altogether, there remains nothing to be the subject of the trust." Wood, V. C., in Frith v. Cartland, 2 Hem. & M. 417. In such case, cestui que trust has no specific claim against any property or fund. He is merely a creditor of the trustee, and stands on the same basis as other creditors. The right to a preference is based on his ownership of some specific fund or assets, or on a claim or charge upon all the fund or assets, because his property is contained in, or has contributed to, them. In other words, to obtain a preference, cestui que trust must show that the estate out of which he claims such preference has been increased to some extent by the misappropriation of the trust property, and he is entitled to a preference to the extent of such increase only. This proposition in no way detracts from, and is but another way of stating, the general rule, announced in the cases cited, that, where a trustee mingles trust moneys with his own funds, cestui que trust is entitled to a charge upon the whole, and, so long as any portion of the mass into which the trust fund has entered remains in any form, it is subject to such charge, and may be followed and claimed. In State v. Bank of Commerce and Morrison v. Lincoln Sav. Bank & Safe Deposit Co. it was held that the burden is upon cestui que trust to show that the trust money did in fact increase the estate out of which he seeks a preference, or is represented therein in some form. This is only to say that a plaintiff must prove his case. He claims a specific fund as his, or he claims a charge on the general mass of assets, and he must show the facts to justify his claim. But we think this should not be pushed too far. When it is once proved that trust money has gone into the general estate of a trustee who afterwards becomes insolvent, it would seem that we ought to presume, in the absence of other evidence, that it remains therein at his insolvency, and that we ought not to say it cannot be traced, or has wholly disappeared, where the contrary may fairly be inferred. Sherwood v. Bank, 103 Mich. 109, 61 N. W. 352; Independent Dist. v.

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King, 80 Iowa, 498, 45 N. W. 908. In the case at bar the city showed that its money was put into, and became part of, the general fund of "cash on hand" in the bank. It appeared also that the receiver came into possession of cash or "cash items" amounting to some $2,000. If these facts stood alone, we should feel obliged to allow the city a preference to the extent of what came into the receiver's hands when he took possession. State v. Bank of Commerce, 54 Neb. 725, 75 N. W. 28. But as the evidence stands, it is clearly proved that the cash and cash items taken over by the receiver do not represent the city's money in any form. The city's money entered into, and was part of, the $41,000 cash on hand on April 9, 1895. The city had a charge on that fund for its money. Whatever moneys were drawn out of that fund and dissipated are presumed to be those of the bank. The portion that remains in the bank, in whatever form, is taken to be and represent the trust fund, and to be liable to be followed and claimed as such by the city. But if the whole of the cash on hand into which the city's money entered, or a greater portion thereof than that representing the bank's own money, was used in paying off other depositors or in running expenses, the city is not entitled to a preference over general creditors for the amount of its money so lost. Morrison v. Lincoln Sav. Bank & Safe Deposit Co., 57 Neb. 725, 77 N. W. 655; Cavin v. Gleason, 105 N. Y. 256, 11 N. E. 504; Collins v. Steuart, 58 N. J. Eq. 392, 44 Atl. 467; Ellicott v. Kuhl, 60 N. J. Eq. 333, 46 Atl. 945.

All of the cash on hand after the city's money became mixed therein, with the exception of the $1,750 used in the purchase of warrants, which will be considered presently, and the $200 in the bank when it suspended, was used in paying debts and expenses. The $200, as has been seen, was pledged to indemnify sureties on the bank's bond, was afterwards paid on the judgment superseded thereby, and never came into the receiver's control. In other words, except said sum of $1,750, it was wholly dissipated. Although there are decisions to the effect that the mere fact of use of the money in the trustee's general business or in paying his debts is, in effect, an increase of the assets, and suffices to create a charge thereon, that position is entirely at variance with the principle by which such cases must be governed, and is repudiated by all the later authorities. Spokane Co. v. First Nat. Bank, 29 U. S. App. 707, 66 C. C. A. 85, 68 Fed. 979; Metropolitan Nat. Bank v. Campbell Commission Co. (C. C.) 77 Fed. 27; Bank v. Latimer (C. C.) 67 Fed. 705; Bircher v. Walther (Mo.) 63 S. W. 691. As the court said in Spokane Co. v. First Nat. Bank, supra, "even if it is proven that the trust fund has been but recently disbursed, and has been used to pay debts that otherwise would be claims against the estate, there would be manifest inequity in requiring that the money so paid out should be refunded out of the assets; for in so doing the general creditors, whose demands remain unpaid, are, in effect, contributing to the payment of the creditors whose demands have been extinguished by the trust fund." Moreover in this case the money which came ***909** into the hands of the receiver when he was appointed was the proceeds of loans made before the city's money came into the bank. For reasons already stated, it must be manifest that property or assets of the insolvent trustee acquired before, or with the proceeds of property held before, the trust money came into his hands, and not in any way mingled therewith, are not subject to any lien or claim in cestui que trust, and that the rights of the latter with respect thereto are those of a general creditor only. District Tp. of Eureka v. Farmers' Bank of Fontanelle, 88 Iowa, 194, 55 N. W. 342.

We come now to the money derived from sale of the warrants. It will be remembered that after the city's money came into the bank it bought the warrants, using $1,750 of the moneys in which the funds of the city had been mixed, and $35,000 borrowed on security of the warrants. The receiver contends that since there was over $40,000 in cash in the bank at the time, of which but $6,000 belonged to the city, it will be presumed that the $1,750 was the bank's own money. Such would be the case, without doubt, had the bank withdrawn the money and dissipated it in some fashion. But it did not do this. It merely changed the form of a portion of the fund in which the city's money had been wrongfully mixed. After purchase of the warrants said fund was represented by the cash still in the bank, and by the bank's interest in the warrants. State warrants are readily convertible into cash. If the bank preferred to keep part of its cash fund as warrants, the identity of the fund was not changed. So long as any portion of the fund into which the city's money entered may be traced into money which came to the receiver, the city may assert the claim which it had upon the whole fund. The warrants were all that remained of that fund. In accordance with the presumption that whatever was retained and not dissipated was the city's money, and not the bank's, these warrants and their proceeds in the hands of the receiver represent money to which the city has a prior claim, and in which general creditors have no right to share. The city's right to follow the money does not fail because no one can say what part of the cash on hand in the bank went

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into the warrants. The city had a charge upon the whole in any form in which the bank might keep it. When all was wasted except the warrants, that charge remained upon them, because they were a part of that fund, though in an altered form. Knatchbull v. Hallett, 13 Ch. Div. 696; Bank v. Peters, 123 N. Y. 272, 25 N. E. 319; Byrne v. McGrath, 130 Cal. 316, 62 Pac. 559, 80 Am. St. Rep. 127; Bank v. King, 57 Pa. 202, 98 Am. Dec. 215; Smith v. Combs, 49 N. J. Eq. 420, 24 Atl. 9; Third Nat. Bank v. Stillwater Gas Co., 36 Minn. 75, 30 N. W. 440. We do not think this view of the transaction in question conflicts in any way with the holding of Bradley, J., in Frelinghuysen v. Nugent (C. C.) 36 Fed. 229, followed in Central Nat. Bank v. Connecticut Mut. Life Ins. Co., 104 U. S. 54, 26 L. Ed. 693, and Peters v. Bain, 133 U. S. 670, 10 Sup. Ct. 354, 33 L. Ed. 696, and approved in Morrison v. Lincoln Sav. Bank & Safe Deposit Co., 57 Neb. 225, 77 N. W. 655. In Frelinghuysen v. Nugent, the cashier of a bank had wrongfully turned over large sums to a partnership engaged in manufacturing, under such circumstances as to make the latter constructive trustees. The evidence indicated that the money had been entirely dissipated, and there was nothing to show that the stock on hand represented the trust fund, or a fund with which it had been mixed in any form. On the contrary, it was clear that said stock had been bought recently on credit, and represented the debts of general creditors. But in the case at bar a portion of the fund into which the city's money entered is traced directly into the warrants, in which form that portion was held till the bank suspended. The warrants were a cash asset, and the money thus held was still fairly to be called a part of the cash fund. It was not made way with, and it came into the receiver's hands, on sale of the warrants, as the last remnant of the fund with which the city's money had been mixed. The city had a charge upon the warrants, as upon the fund with a portion whereof they were bought, for the full amount of its moneys contained in said fund. Hence its claim upon the proceeds is not limited to the $1,750 which was used in buying them, but extends to the profit accruing therefrom, as well. The $3,334.37 which came into the hands of the receiver upon sale of the warrants represents the cash fund in which the city's money was mixed, and the profits of an investment of that fund. The profits of trust money belong to cestui que trust, and we see no warrant for limiting recovery to the actual sum invested, especially where there is not enough, in any event, to satisfy the charge on the original fund. Farmers' & Traders' Bank v. Kimball Milling Co., 1 S. D. 388, 47 N. W. 402, 36 Am. St. Rep. 739; Brown v. Ricketts, 4 Johns. Ch. 303, 8 Am. Dec. 567; Frank's Appeal, 59 Pa. 190; Butler v. Hicks, 11 Smedes & M. 78.

We therefore recommend that the order of the district court be reversed, and the cause remanded, with directions to enter a new order granting the city a preference to the extent of the proceeds of said warrants, namely, $3,334.37.

BARNES and OLDEAM, CC., concur.

PER CURIAM.

For the reasons stated in the foregoing opinion, the order of the district court is reversed, and the cause is remanded, with directions to enter an order granting the plaintiff in error a preference to the extent of $3,334.37.

57 L.R.A. 885, 64 Neb. 822, 90 N.W. 905

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Tab 8

C

Circuit Court of Appeals, Sixth Circuit.

BRENNAN
v.
TILLINGHAST.
TILLINGHAST
v.
BRENNAN.

Nos. 2,253, 2,254.

January 7, 1913.

Deposits in bank after insolvency, see note to Richardson v. New Orleans Coffee Co., 43 C.C.A. 588.)

Appeals from the Circuit Court of the United States for the Northern Division of the Western District of Michigan; Arthur C. Denison, Judge.

Bill by John Brennan against Philip Tillinghast, as receiver of the First National Bank of Ironwood, Mich. From a decree awarding complainant a part of the relief demanded, both parties appeal. Affirmed.

West Headnotes

Appeal and Error 719(9)
30k719(9) Most Cited Cases
Where plaintiff's claim against defendant bank was allowed as an offset in accordance with the prayer of complainant's bill, and no error was assigned with reference thereto, the court would not review an objection that it should have been allowed as an offset against complainant's claim as a general creditor.

Banks and Banking 75
52k75 Most Cited Cases
Where a bank receives deposits with knowledge that it cannot pay its debts, and must fail in business, the depositor may reclaim it if he can trace it into the bank's assets coming into the hands of the receiver.

Banks and Banking 75
52k75 Most Cited Cases
Mere insolvency of a bank at the time it received a deposit from complainant *held* insufficient to entitle him to rescind and recover the deposit from the receiver, where it did not appear that the bank's officers did not have reasonable hopes that by continuing in business the bank might retrieve its fortunes.

Banks and Banking 75
52k75 Most Cited Cases
Receipt of a deposit from a customer with knowledge that the bank was insolvent does not constitute such fraud as would authorize a rescission, where it was received with the understanding that it should be used to pay the depositor's debt to the bank.

Banks and Banking 80(6)
52k80(6) Most Cited Cases
An insolvent bank having wrongfully converted certain stock deposited with it as collateral security, the owner *held* to have sufficiently followed the proceeds into the hands of the bankrupt's receiver to entitle him to a preferred claim thereto.

Trusts 352
390k352 Most Cited Cases
Where proceeds of stock wrongfully sold by a bank constituted a trust fund, it did not lose such character by being mingled with other moneys of the bank.

Trusts 358(2)
390k358(2) Most Cited Cases
Proof that a tortfeasor has mingled trust funds with his own and made payments thereafter out of the common fund is a sufficient identification of the remainder as constituting a trust fund.

Trusts 372(1)
390k372(1) Most Cited Cases
The presumption that a tort-feasor, having mingled trust funds with his own, drew out his own moneys, and that the balance included the trust fund, is a mere presumption, which will not stand against evidence to the contrary.

Trusts 372(1)
390k372(1) Most Cited Cases
The presumption that a tort-feasor, having mingled trust funds with funds of his own, first paid out his own funds, has no application where the payment was a mere transfer of a part of the fund in a substituted form to another fund retained in his possession.

***611** Charles M. Humphrey, of Ironwood, Mich., for John Brennan.

I. A. Fish and Quarles, Spence & Quarles, all of Milwaukee, Wis., for the receiver.

Before WARRINGTON and KNAPPEN, Circuit

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Judges, and SANFORD, District judge.

SANFORD, District Judge.

John Brennan, the complainant below, filed a bill in the Circuit Court, sitting in equity, against the First National Bank of Ironwood, Mich., an insolvent banking association, and Philip Tillinghast, receiver of said bank, the defendants below, seeking to recover as preferred claims against the bank the value of certain stock deposited by Brennan with the bank as collateral and sold by the bank, and the sum of $1,000 deposited by Brennan with the bank a short time before it was placed in the hands of the receiver. The court, on final hearing, allowed the first of these items as a preferred claim, and disallowed the second. Brennan and the receiver have each appealed from this decree; and the two appeals have been heard together.

The material facts are these:

The First National Bank of Ironwood, Mich., hereinafter called the Ironwood Bank, was organized as a national banking association in 1888, and conducted a banking business in Ironwood until June 21, 1909, when it closed its doors, and Tillinghast was appointed as its receiver by the Comptroller of the Currency.

On February 1, 1909, Brennan borrowed from the Ironwood Bank the sum of $1,000, for which he executed his promissory note, due in four months, with interest, and deposited with the bank as collateral security certificates for certain shares of mining stock, including 200 shares of the capital stock of the Shattuck-Arizona Copper Company.

On April 8th Brennan deposited with the Ironwood Bank the sum of $1,000, for which he received a certificate of deposit. This deposit was received by the cashier of the bank, with the understanding at the time that it was to be used in paying Brennan's note at its maturity.

The receiver admitted in his answer that the bank was insolvent from February 1st, when the note was given, to June 21st, when the receiver was appointed, including the date, April 8th, on which the deposit was received; and the cashier who received the deposit testified that he had known for about ten years before that the bank was insolvent.

On May 1st the Ironwood Bank, through its cashier, without the knowledge or consent of Brennan, sold 195 of the shares of the stock of the Shattuck-Arizona Copper Company which it held as collateral to his note, the proceeds of which, $3,558.75, were on that day deposited in the City National Bank of Duluth, Minn., hereinafter called the Duluth Bank, to the credit of the Ironwood Bank, in a pre-existing open account.

Against this open account in the Duluth Bank, in which other deposits were made from time to time, the Ironwood Bank drew from day to day various drafts to meet its daily clearing house balances. ***612** And from May 1st to May 8th, inclusive, the Ironwood Bank also drew four drafts on the Duluth Bank against this open account, in favor of the American Express Company, for amounts aggregating $2,807.32. These drafts were purchased by the express company from the Ironwood Bank on the dates on which they were drawn, and the express company on such dates paid the Ironwood Bank the amounts of such drafts, in cash, over its counter. At all times from May 1st to May 10th, inclusive, the open account of the Ironwood Bank at the Duluth Bank, after crediting all deposits made and deducting all drafts drawn, showed a balance in favor of the Ironwood Bank, varying in amount from day to day, but always in excess of $3,558.75. On May 10th this balance amounted to $4,273.39. On May 11th, however, this account of the Ironwood Bank at the Duluth Bank was overdrawn in the sum of $1,068.75.

On June 14th, after Brennan's note had fallen due and when he did not know that any part of his stock had been sold by the Ironwood Bank, he, after a conversation with its cashier, who advised him to let the note run, gave up his original intention of paying his note with his certificate of deposit, and, instead, paid the Ironwood Bank the interest due on his note, and gave the bank a renewal note for the principal.

In addition to these transactions, Brennan also had a checking account with the Ironwood Bank, and, when its doors closed, owed it for an overdraft on this account the sum of $216.07.

The books of the Ironwood Bank furthermore show that at all times from February 1st until it closed on June 21st there was $8,000 or more of cash on hand in its vaults, and $15,652.23 in cash came into the hands of the receiver. And, while it appears that the bank books contained many false cash entries, the evidence fully sustains the finding of the court below that from and after April 8th until the closing of the bank it had continually on hand in cash in its own vaults more than $3,500.

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The remainder of the stock held by the bank as collateral on Brennan's note has been returned by the receiver to Brennan.

The evidence further showed that claims had been filed against the Ironwood Bank aggregating $603,000; that the Comptroller of the Currency had levied an assessment of 100 per cent. on its stockholders; that 30 per cent. dividends had already been paid to creditors; that not exceeding 10 per cent. more could be paid; and that the other claims for preferences which had been filed and which were still pending aggregated between $3,500 and $4,000.

On this state of facts we have reached the following conclusions:

[1] 1. The court below correctly held that Brennan was entitled to recover as a preferential claim, to be paid in full, the sum of $3,558.75 received by the Ironwood Bank from the sale of his stock, less the amount of his note, $1,000, and of the overdraft, $216.07, leaving a balance of $2,342.68, for which sum he was granted a decree against the receiver.

[2] It is undisputed that the proceeds of the sale of Brennan's stock, wrongfully converted by the Ironwood Bank to its own use, constituted *613 a trust fund, which did not lose this character when mingled with other moneys of the bank, and that Brennan was entitled to recover the amount thereof as a preferred claim, if, and to the extent that, he sustained the burden of proof of tracing this money, either in its original shape or in a substituted form, into the moneys which came into the hands of the receiver as part of the assets of the bank. Peters v. Bain, 133 U.S. 670, 693, 10 Sup.Ct. 354, 33 L.Ed. 696; Board of Commissioners v. Strawn (C.C.A. 6) 157 Fed. 49, 54, 84 C.C.A. 553, 15 L.R.A.(N.S.) 1100; In re Brown (C.C.A. 2) 193 Fed. 24, 29, 113 C.C.A. 343, affirmed sub nom. First National Bank of Princeton v. Littlefield, 226 U.S. 110, 33 Sup.Ct. 78, 57 L.Ed. . . . ; Empire State Surety Co. v. Carroll County (C.C.A. 8) 194 Fed. 593, 604, 114 C.C.A. 435, and cases cited.

[3] And proof that the tort-feasor has mingled the trust funds with his own and made payments thereafter out of the common fund, is, nothing else appearing, a sufficient identification of the remainder of that fund coming into the hands of the receiver, not exceeding the smallest amount the fund contained subsequent to the commingling, as trust property, under the legal presumption that he regarded the law and neither paid out the trust fund nor invested it in other property, but kept it sacred. Board of Commissioners v. Strawn, supra, at page 51; Empire State Surety Co. v. Carroll County, supra, at page 605, and cases cited.

Applying these general principles, we are of opinion that the court below correctly held that the proceeds of the sale of Brennan's stock constituted a trust fund held by the Ironwood Bank for his benefit; that the transactions in connection with the four cash drafts drawn in favor of the express company constituted, in effect, a transfer of $2,807.32 of this trust fund in cash to the vaults of the Ironwood Bank; that this portion of the trust fund must be deemed to have remained in the vaults of the Ironwood Bank as part of the trust fund, in cash, until it came into the possession of the receiver; and that as the amount thus remaining in the trust fund was more than sufficient to cover the balance to which Brennan was entitled from the proceeds of the sale of his stock, after deducting the amount due from him to the bank on his note and overdrafts, he had successfully traced the balance of the trust fund thus due to him into the cash assets that came into the hands of the receiver, and was hence entitled to be paid the same as a preferential claim.

It is urged, however, in behalf of the receiver that the cash draft transactions should not be regarded as a transfer of $2,807.32 of this trust fund to the vaults of the Ironwood Bank, for the reason that, after the last of these cash drafts was drawn on May 8th, there remained to the credit of the Ironwood Bank at the Duluth Bank until May 10th a balance of $4,273.39, or more than the amount of the trust fund, which was not dissipated until this balance was changed into an overdraft of $1,068.75 on May 11th; the argument being that under this state of facts it should be presumed that the Ironwood Bank first drew on its open account in the Duluth Bank for its own purposes, intending to leave the trust fund unimpaired; that the $4,273.*614 39 remaining in the Duluth Bank on May 10th hence included the trust fund; and that, as this balance was subsequently dissipated by drafts drawn by the Ironwood Bank for its own purposes, it cannot, for that reason, be traced into the cash which came into the hands of the receiver from the vaults of the bank.

[4] It is true that in the case of blended moneys in a bank account, consisting in part of trust funds, from which there have been drawings from time to time, it has been held, in favor of the cestui que trust, as a presumption of law, that the sums first drawn out

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were from the moneys which the tort-feasor had a right to expend in his own business, and that the balance which remained included the trust fund, which he had no right to use. In re Hallett's Estate, 13 Ch.D. 696, 727; Board of Commissioners v. Strawn, supra, at page 51. It is clear, however, in the first place, that this is a mere presumption, which will not stand against evidence to the contrary. Board of Commissioners v. Strawn, supra, at page 51.

[5] And it is furthermore clear that this rule of presumption has no application where the evidence shows that the first moneys drawn out of the mingled fund by the tort-feasor were not in fact dissipated by him at all, but were merely transferred, in a substituted form, to another fund retained in his own possession. In such case, it must be held that the trust attaches to the substituted form in which the property is retained by the tort-feasor, and that the right to follow the trust in such form is not lost by reason of the fact that the tort-feasor thereafter draws out and spends for his own purposes the balance of the fund in which the trust money was originally mingled. The English case of In re Oatway, L.R. 2 Ch. 356, 359 directly sustains this view. In that case Oatway, a joint trustee under a will, had sold a portion of the trust property and deposited the proceeds to his own credit in bank with other funds belonging to himself. Out of this deposit, consisting in part of the proceeds of the converted trust fund and in part of his own moneys, Oatway purchased certain shares of stock in the Oceana Company, which he took and retained in his own name. Thereafter he drew out and paid away irrevocably for his own individual purposes the entire remainder of the bank deposit. It was held that, under this state of facts, the cestui que trust was entitled to follow the shares of stock thus purchased by Oatway. Joyce, J., said:

'If money held by any person in a fiduciary capacity be paid into his own banking account, it may be followed by the equitable owner, who, as against the trustee, will have a charge for what belongs to him upon the balance to the credit of the account. If, then, the trustee pays in further sums, and from time to time draws out moneys by checks, but leaves a balance to the credit of the account, it is settled that he is not entitled to * * * maintain that the sums which have been drawn out and paid away so as to be incapable of being recovered represented pro tanto the trust money, and that the balance remaining is not trust money, but represents only his own money paid into the account. * * * It is, in my opinion, equally clear that when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having been afterwards dissipated by him, he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust. ***615** * * * The order of priority in which the various withdrawals and investments may have been respectively made is wholly immaterial. * * * In the present case there is no balance left. The only investment or property remaining which represents any part of the mixed money paid into the banking account is the Oceana shares purchased for . . . 2,137. Upon these, therefore, the trust had a charge for the . . . 3,000 trust money paid into the account. That is to say, those shares and the proceeds thereof belong to the trust. The investment by Oatway, in his own name, of the . . . 2,137 in Oceana shares no more got rid of the claim or charge of the trust upon the money so invested than would have been the case if he had drawn a check for . . . 2,137 and simply placed and retained the amount in a drawer without further disposing of the money in any way. The proceeds of the Oceana shares must be held to belong to the trust funds under the will of which Oatway and Maxwell Skipper were the trustees.'

In like manner we are of opinion that in the present case it must be held that the transfer by the Ironwood Bank to its own vaults, through the cash draft transactions, of $2,807.32, of the balance standing to its credit in the Duluth Bank in which the trust fund had been mingled, did not divest the money thus transferred of its character as a trust fund, but as this money remained thereafter in its own vaults and in its own custody, and subsequently passed into the hands of the receiver as part of the cash assets of the bank, it remained subject in all respects to the trust originally impressed upon the proceeds of the sale of Brennan's stock.

2. The court below correctly held that the amount of the $1,000 deposit was not a preferred claim, but that as to this sum Brennan was a general creditor of the Ironwood Bank, to be paid by the receiver the same percentage of dividends that had been and should be paid to other general creditors.

[6] It is true that where a bank, being hopelessly insolvent, receives a deposit, with the knowledge that it cannot pay its debts and must fail in business, this is such a fraud upon the depositor that he may rescind the contract of deposit and reclaim the amount so deposited or its proceeds, if traced into the assets of the bank coming into the hands of the receiver, in like

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manner as other trust funds. St. Louis Ry. Co. v. Johnston, 133 U.S. 566, 576, 10 Sup.Ct. 390, 33 L.Ed. 683; Standard Oil Co. v. Hawkins (C.C.A. 7) 74 Fed. 395, 398, 20 C.C.A. 468, 33 L.R.A. 739; City Bank v. Blackmore (C.C.A. 6) 75 Fed. 771, 773, 21 C.C.A. 514; Richardson v. Coffee Co. (C.C.A. 5) 102 Fed. 785, 789, 43 C.C.A. 583; Hutchinson v. Le Roy (C.C.A. 1) 113 Fed. 202, 209, 51 C.C.A. 159.

[7] However, the mere fact that the bank is known to be insolvent at the time the deposit is received is not in our opinion sufficient of itself, without more, to confer this right of rescission upon the depositor, and such right of rescission would not arise when the bank at the time of receiving the deposit, although embarrassed and insolvent, yet had reason to believe that by continuing in business it might retrieve its fortunes; the necessary condition upon which the right of rescission is predicated being that the deposit was received when the bank was hopelessly embarrassed and so circumstanced as to constitute its receipt of the deposit a fraud upon the depositor. See St. Louis Ry. Co. v. Johnston, supra, at pages 576, 577.

***616** In the present case it merely appears that the bank was insolvent at the time this deposit was received, and had been known to be insolvent for ten years previously by the cashier who received the deposit. The extent of its insolvency at that time is not shown, nor is there any evidence as to what subsequent events precipitated the condition which caused its doors to close, or whether or not at the time the deposit was received the bank, although embarrassed and insolvent, yet had reasonable hopes that by continuing in business it might retrieve its fortunes, just as it had previously continued in business for the ten preceding years during which it had been insolvent. In the light of this meager evidence, we agree in the view expressed by Judge Denison, then district judge, who heard this case below, who said:

'There is no reason to think in this case that the suspension of the bank was any more imminent on April 8th than it had been for a long time, or that the cashier or bank officers anticipated the closing of the bank or had any expectation that complainant would not receive his money when he should ask for it--except their general and vague fear that they might fail to tide over their difficulties. This does not seem to me to raise the necessary trust. Complainant's own showing is that for more than 60 days the deposit would have been repaid on demand, and that it was practically offered to complainant when the note was renewed. For these reasons, I think complainant is not entitled to any preference upon his certificate of deposit, but should prove the same as a general creditor.'

[8] And, whatever would have been the result otherwise, we think it cannot properly be held that the receipt of this particular deposit constituted a fraud upon Brennan within the rule entitling him to follow it as a trust fund, in the light of the undisputed facts, shown by his own testimony that at the time the deposit was made the bank held his $1,000 note for borrowed money, and the deposit was made with the 'understanding' that it would be used in payment of this note at maturity. As this deposit was hence, under this evidence, in effect taken by the bank as quasi security for the payment of a just debt due to itself, this circumstance alone, in our opinion, relieves the bank from the imputation of fraud in receiving the deposit, which might otherwise have existed if the deposit had been merely received in the ordinary course of dealings between the bank and a customer not indebted to it.

[9] 3. It is furthermore suggested in behalf of Brennan that the court below should have allowed his $1,000 note as an offset against his claim as general creditor under his certificate of deposit, instead of allowing it, in effect, as an offset against his preferred claim arising out of the sale of his collateral. It is frankly conceded, however, in the brief filed in his behalf that the opposite view was taken by his counsel in the court below, and it appears, from an examination of the pleadings, that the decree of the court below in allowing this offset against Brennan's preferred claim for the proceeds of his stock was entirely consistent with the prayer of the complainant's bill. Furthermore, Brennan, under his appeal, has assigned no error in reference to the action of the court in this respect. In this state of the record there is obviously nothing in the decree of the court below in this respect of which Brennan is entitled to now complain.

***617** 4. Finding no error in the decree below, it must be in all things affirmed. A decree will be entered accordingly, dismissing both appeals, and taxing each appellant with one-half of the costs of the appeals.

201 F. 609, 120 C.C.A. 37

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Tab 9

JOYCE J.
1903
April 22, 24;
May 2.

In re OATWAY.
HERTSLET *v.* OATWAY.

[1902 O. 273.]

Trustee—Breach of Trust—Following Trust Money—Banking Account—Mixed Fund—Investment—Appropriation of Payments.

Where a trustee paid trust money into his banking account whereby it became mixed with his own money, and out of moneys drawn from the account purchased an investment in his own name, but subsequently applied the balance to his own purposes, his representatives cannot successfully maintain that the investment was purchased out of the trustee's own money, and that what has been spent, and can no longer be traced and recovered, was the money belonging to the trust.

Brown v. *Adams*, (1869) L. R. 4 Ch. 764, is overruled by *In re Hallett's Estate*, (1880) 13 Ch. D. 696.

THIS was a creditor's action for the administration of the estate of Lewis John Oatway, a solicitor, who died insolvent in 1902. The defendant Christiana Mary Oatway was his sole executrix. In the course of the administration a question arose as to the title to a sum of 2474*l.* 19*s.*, being the proceeds of sale of 1000 shares in a company called the Oceana Company, which at the date of the testator's death were standing in his name.

The testator and one Maxwell Skipper were co-trustees under the will of Charles Skipper, deceased. In 1899 and 1900 sums amounting to 3000*l.* were advanced in breach of trust out of Charles Skipper's estate to Maxwell Skipper upon the security of a mortgage of an undivided share of certain real estate to which he was entitled under his grandfather's will. In 1901 Maxwell Skipper went abroad, having given to Oatway a power of attorney under which and as mortgagee he on August 15, 1901, sold Maxwell Skipper's reversionary interest for the sum of 7000*l.* This sum Oatway paid into his own banking account, which at that time was in credit to the extent of 77*l.* 13*s.* 4*d.* He did not replace the 3000*l.* which had been advanced to Maxwell Skipper out of Charles Skipper's trust estate.

On August 15, 1901, Maxwell Skipper was indebted to

Oatway in the sum of 1779*l.* 7*s.* 1*d.*, and also in a further unascertained amount in respect of costs.

On August 24, 1901, Oatway purchased the Oceana shares for 2137*l.* 12*s.* 3*d.*, which he paid for by a cheque on his banking account. Before the purchase of the shares Oatway had made further payments into the account to the extent of 30*l.* 1*s.* 11*d.*, and had drawn out sums amounting to 510*l.* 8*s.* 6*d.*; so that when he drew the cheque for 2137*l.* 12*s.* 3*d.* in payment for the shares the credit balance of his account was 6635*l.* 6*s.* 4*d.*, which sum included the 3000*l.* belonging to the estate of Charles Skipper.

After paying for the shares, Oatway paid further sums into the account, but his subsequent drawings for his own purposes exhausted the whole amount standing to his credit, and there was nothing to represent the 3000*l.* except the proceeds of the Oceana shares.

This was a summons taken out by Maxwell Skipper, who was also a defendant to the action, asking that the sum of 2474*l.* 19*s.*, being the proceeds of the Oceana shares, might be paid to him either in his personal capacity or as trustee under the will of Charles Skipper.

Austen-Cartmell, for the applicant. Oatway was bound when he received the 7000*l.* to replace the 3000*l.*, which, in breach of trust, had been advanced to Maxwell Skipper out of Charles Skipper's estate. He then had to account to Maxwell Skipper for the balance of the 7000*l.* The whole of the 7000*l.* having disappeared except that which can be traced into the Oceana shares, the proceeds of those shares clearly belong to the applicant either personally or as trustee.

In a case of this sort the second part of the holding in *In re Hallett's Estate* (1) does not apply. It cannot be said that the shares were bought by Oatway out of his own money, and that therefore he is entitled to hold them as against the beneficiaries under Charles Skipper's will. Where a trustee has mixed trust money with his own and has purchased land or chattels out of the mixed fund, the beneficial owner can

(1) 13 Ch. D. 696.

JOYCE J. 1903 OATWAY, *In re.* HERTSLET *v.* OATWAY.

follow the trust money and is entitled to a charge on the purchased property: *In re Hallett's Estate.* (1) The applicant does not desire to press his personal claim to the proceeds of the shares, provided that the Skipper trust gets the benefit of them; but he submits that he is entitled to recover against Oatway's estate.

Younger, K.C., and *Ashworth James*, for the plaintiffs, who were beneficiaries under Charles Skipper's will. The proceeds of the Oceana shares clearly belong to the Skipper trust.

Dibdin, K.C., *A. Whitaker*, and *Crossfield*, for the defendant Christiana Mary Oatway. When Oatway bought the shares the balance to his credit at the bank was sufficient to enable him to pay for them apart from the 3000*l.* trust money. The proceeds of the shares belong to Oatway's estate. It was his own money which he drew out to pay for them. He was entitled as against Maxwell Skipper to do that: *In re Hallett's Estate.* (1)

Cur. adv. vult.

May 2. JOYCE J. Oatway was co-trustee with Maxwell Skipper of the will of Charles Skipper, the father of the latter. In breach of trust 3000*l.* was advanced from the trust to Maxwell Skipper upon the security of a mortgage given by him to Oatway alone. Oatway, as mortgagee, and under a power of attorney from Maxwell Skipper, sold the mortgaged property, and as mortgagee received and gave a receipt for the 3000*l.* trust money, part of the proceeds of sale, which amounted to 7000*l.* The rest he received as agent of or on behalf of Maxwell Skipper, from whom he held a power of attorney. Oatway, instead of investing the 3000*l.* upon proper trust securities in the joint names of himself and Maxwell Skipper, the trustees, paid in the whole 7000*l.* on August 15, 1901, to his own banking account, which was then in credit to the amount of 77*l.* 13*s.* 4*d.* Between August 15 and 24 he paid in sums amounting to 30*l.* and drew out 510*l.*, which he paid away to creditors or otherwise applied to his own purposes in such a manner as to be irrecoverable.

(1) 13 Ch. D. 696.

On August 24, out of the balance to the credit of the account, Oatway paid 2137*l.* 12*s.* 3*d.* for the purchase of certain shares in the Oceana Company, which remained in his name at the time of his decease, and have since been sold by arrangement. It is the proceeds of these shares which is now in question. The balance to the credit of the account after this payment, with some other sums paid in from time to time by Oatway, was subsequently exhausted by his drawings on his own account.

The balance of the 7000*l.*, after discharging the mortgage, belonged to Maxwell Skipper, but it is alleged that Oatway as a creditor of his had claims thereon to a large amount. Maxwell Skipper, who was himself a party to the original breach of trust, could not under the circumstances, and in fact does not, oppose the claim of the trust to the proceeds of the Oceana shares. For the purposes of this case we may consider Oatway to have been entitled to the balance of the 7000*l.* after discharging the 3000*l.* mortgage.

There is no conflict between different fiduciary owners or sets of cestuis que trust. It is a principle settled as far back as the time of the Year Books that, whatever alteration of form any property may undergo, the true owner is entitled to seize it in its new shape if he can prove the identity of the original material: see Blackstone, vol. ii. p. 405, and *Lupton v. White.* (1) But this rule is carried no farther than necessity requires, and is applied only to cases where the compound is such as to render it impossible to apportion the respective shares of the parties. Thus, if the quality of the articles that are mixed be uniform, and the original quantities known, as in the case of so many pounds of trust money mixed with so many pounds of the trustee's own money, the person by whose act the confusion took place is still entitled to claim his proper quantity, but subject to the quantity of the other proprietor being first made good out of the whole mass: 2 Stephen's Commentaries (13th ed.), 20. Trust money may be followed into land or any other property in which it has been invested; and when a trustee has, in making

(1) (1808) 15 Ves. 432; 10 R. R. 94.

JOYCE J.
1903
OATWAY, *In re.* HERTSLET *v.* OATWAY.

any purchase or investment, applied trust money together with his own, the cestuis que trust are entitled to a charge on the property purchased for the amount of the trust money laid out in the purchase or investment. Similarly, if money held by any person in a fiduciary capacity be paid into his own banking account, it may be followed by the equitable owner, who, as against the trustee, will have a charge for what belongs to him upon the balance to the credit of the account. If, then, the trustee pays in further sums, and from time to time draws out money by cheques, but leaves a balance to the credit of the account, it is settled that he is not entitled to have the rule in *Clayton's Case* (1) applied so as to maintain that the sums which have been drawn out and paid away so as to be incapable of being recovered represented pro tanto the trust money, and that the balance remaining is not trust money, but represents only his own moneys paid into the account. *Brown v. Adams* (2) to the contrary ought not to be followed since the decision in *In re Hallett's Estate.* (3) It is, in my opinion, equally clear that when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having been afterwards dissipated by him, he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust. In other words, when the private money of the trustee and that which he held in a fiduciary capacity have been mixed in the same banking account, from which various payments have from time to time been made, then, in order to determine to whom any remaining balance or any investment that may have been paid for out of the account ought to be deemed to belong, the trustee must be debited with all the sums that have been withdrawn and applied to his own use so as to be no longer recoverable, and the trust money in like manner be debited with any sums taken out and duly invested in the names of the proper trustees. The order of priority in

(1) (1816) 1 Mer. 572; 15 R. R. 161. (2) L. R. 4 Ch. 764.
(3) 13 Ch. D. 696.

which the various withdrawals and investments may have been respectively made is wholly immaterial. I have been referring, of course, to cases where there is only one fiduciary owner or set of cestuis que trust claiming whatever may be left as against the trustee. In the present case there is no balance left. The only investment or property remaining which represents any part of the mixed moneys paid into the banking account is the Oceana shares purchased for 2137*l.* Upon these, therefore, the trust had a charge for the 3000*l.* trust money paid into the account. That is to say, those shares and the proceeds thereof belong to the trust.

It was objected that the investment in the Oceana shares was made at a time when Oatway's own share of the balance to the credit of the account (if the whole had been then justly distributed) would have exceeded 2137*l.*, the price of the shares; that he was therefore entitled to withdraw that sum, and might rightly apply it for his own purposes; and that consequently the shares should be held to belong to his estate. To this I answer that he never was entitled to withdraw the 2137*l.* from the account, or, at all events, that he could not be entitled to take that sum from the account and hold it or the investment made therewith, freed from the charge in favour of the trust, unless or until the trust money paid into the account had been first restored, and the trust fund reinstated by due investment of the money in the joint names of the proper trustees, which never was done.

The investment by Oatway, in his own name, of the 2137*l.* in Oceana shares no more got rid of the claim or charge of the trust upon the money so invested, than would have been the case if he had drawn a cheque for 2137*l.* and simply placed and retained the amount in a drawer without further disposing of the money in any way. The proceeds of the Oceana shares must be held to belong to the trust funds under the will of which Oatway and Maxwell Skipper were the trustees.

Solicitors: *Fladgate & Co.; J. A. Bartrum.*

G. A. S.

Tab 10

C

Restatement of the Law -- Restitution
Restatement (First) of Restitution
Current through September 2004

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Part II. Constructive Trusts And Analogous Equitable Remedies
Chapter 13. Following Property Into Its Product

§ 212. Effect Of Withdrawals And Subsequent Additions

Link to Case Citations

Where a person wrongfully mingles money of another with money of his own and makes withdrawals from the mingled fund and dissipates the money so withdrawn, and subsequently adds money of his own to the fund, the other can enforce an equitable lien upon the fund only for the amount of the lowest intermediate balance, unless

(a) the fund or a part of it earns a profit, or

(b) the subsequent additions were made by way of restitution.

Comment:

a. The lowest intermediate balance. Where a person wrongfully deposits in a single account in a bank money of another and money of his own, and makes withdrawals from the deposit and dissipates the money so withdrawn, and subsequently makes additional deposits of his own funds in the account, the other person cannot ordinarily enforce an equitable lien upon the account for a sum greater than the lowest intermediate balance of the deposit. If the amount on deposit at all times after the deposit of the claimant's money equaled or exceeded the amount of his money so deposited, the claimant is entitled to a lien upon the deposit for the full amount of his money so deposited. If after the deposit of the claimant's money the deposit was at any time wholly exhausted by withdrawals before subsequent deposits of the wrongdoer's individual funds were made, the claimant's lien upon the deposit is extinguished, and if he is unable to trace the money withdrawn, he is relegated to a mere personal claim against the wrongdoer, and is entitled to no priority over other creditors of the wrongdoer.

Illustrations:

1. A wrongfully deposits in a bank $1000 belonging to B together with $1000 of his own. He draws out $1500 and dissipates it. He later deposits $1000 of his own in the account. B is entitled to a lien on the account for $500, the lowest intermediate balance.

2. A wrongfully deposits in a bank $1000 belonging to B together with $1000 of his own. He draws out $1000 and dissipates it. He later deposits $500 of his own in the account. B is entitled to a lien on the account for the full amount of $1000, since the account was never diminished below that sum.

3. A wrongfully deposits in a bank $1000 belonging to B together with $1000 of his own. He draws out the whole $2000 and dissipates it. He later deposits $500 of his own in the account. B is not entitled to a lien on the account.

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Comment on Clause (a):

b. Where the balance earns a profit. If the lowest balance is invested and earns a profit, the claimant can enforce an equitable lien not only for the amount of the lowest balance but also for the amount of the profit earned by it, although not for more than the total amount of his money which was wrongfully deposited in the account. The claimant is, however, entitled at his option to enforce a constructive trust as to a proportionate share of the product under the rule stated in § 211, although he thereby obtains more than the total amount of his money.

Illustration:

4. A wrongfully deposits in a bank $1000 belonging to B together with $1000 of his own. He draws out and dissipates $1500. He invests the remaining $500 in shares of stock which he sells for $1500. B is entitled to a lien on the proceeds for $1000. If he sells the shares for $3000, B is entitled at his option to enforce a constructive trust as to one-half of the proceeds, or $1500.

Comment on Clause (b):

c. Where later deposits made in restitution. Where a person wrongfully deposits in a single account in a bank money of another and money of his own, and makes withdrawals from the deposit and subsequently makes additional deposits of his own funds in the account, manifesting an intention to make restitution of the claimant's money withdrawn, the claimant's lien upon the deposit is not limited to the lowest intermediate balance. The effect of making the additional deposits by way of restitution for the amount withdrawn is the same as though the amount so restored had not been withdrawn.

The mere fact, however, that a wrongdoer has deposited in his own account money of another and has made withdrawals and subsequently deposits money of his own in the account does not raise an inference of an intention to make restitution. On the other hand, if he deposited the money of another in a fiduciary account for the other, and wrongfully withdrew part of the money and subsequently made additions of his own money, the inference is that he intended to make restitution.

Comment:

d. Redeposit of money withdrawn. The rule stated in this Section is not applicable where the money withdrawn or traceable proceeds of that money are redeposited. If the money withdrawn from the account is subsequently redeposited in the account, the effect is the same as though the withdrawal had not been made, and the claimant's lien is not limited to the lowest intermediate balance. It is immaterial whether the money withdrawn was itself redeposited, or the money withdrawn was invested and the investments were sold and the proceeds were redeposited.

Illustrations:

5. A wrongfully deposits in a bank $1000 belonging to B together with $1000 of his own. He draws out $1500 of which he dissipates $1000 and redeposits the remaining $500 in the account. B is entitled to a lien on the account for $1000.

6. A wrongfully deposits in a bank $1000 belonging to B together with $1000 of his own. He draws out the whole $2000 with which he purchases shares of stock which he later sells for $1500 which he redeposits in the account. B is entitled to a lien on the account for $1000.

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GREAT BASIN GMC TRUCKS, INC.

Analysis of Trust Money - Wells Fargo Concentration and Great Basin Trucks FSB Activity for De

Description	12/7/00	12/8/00	12/11/00
Beginning Balance:			
Trust Money	$ -	1,031,955	490,458
Other	1,031,955	616,383	1,099,191
Total Beginning Balance			
Transfer from Salt Lake Volvo WFB Account:			
Trust Money	18,848	16,359	66,637
Other Funds			
Transfer from Arizona WFB Account:			
Trust Money	42,751	30,668	76,596
Other Funds			
Transfer from Southwest WFB Account:			
Trust Money	2,855	121,434	3,608
Other Funds			
Transfer from Idaho WFB Account:			
Trust Money	38,778	710	5,271
Other Funds			
Transfer To Great Basin Trucks FSB Account			
Trust Money	-	-	-
Other Funds			
Transfer From Great Basin Trucks FSB Account			
Trust Money	-	-	-
Other Funds	-	-	-
Other Receipts and Disbursements:			
Receipts	564,834	242,521	106,937
Disbursements	(1,209,564)	(223,578)	(763,207
Ending Balance	$ 616,383	$1,099,191	$ 753,332

Beginning Balance:			
Trust Money	-	-	-
Other	-	-	-
Total Beginning Balance			
Transfer From WFB Concentration Account	-	-	-
Trust Money	-	-	-
Other Money			
Transfer To WFB Concentration Account	-	-	-
Associated Foods Truck Payment (Trust Money)	-	-	-
Johnston Supply Truck Payment (Trust Money)			
Other Receipts and Disbursements:	-	-	-
Receipts	-	-	-
Disbursements			
Ending Balance	$ -	$ -	$ -