

2005

Volvo Commercial Finance, LCC The Americas v. Wells Fargo Bank : Brief of Appellee

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

VOLVO COMMERCIAL FINANCE,
LLC THE AMERICAS, a Delaware
limited liability company,

Plaintiff and Appellant,

v.

WELLS FARGO BANK, N.A., a national
banking association,

Defendant and Appellee.

Case No. 20051127-CA

BRIEF OF APPELLEE

APPEAL FROM JUDGMENT ENTERED BY
THE THIRD JUDICIAL DISTRICT COURT, SALT LAKE COUNTY,
THE HONORABLE L.A. DEVER

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JURISDICTION

This Court has jurisdiction over this appeal pursuant to Utah Code Annotated § 78-2a-3(2)(j) (2002).

STATEMENT OF ISSUES AND STANDARD OF REVIEW

Statement of Issues

1. Whether the district court correctly ruled that, as a matter of law, Volvo was not able to trace \$693,132 in funds in which it claimed a security interest because an exception to the neutral lowest intermediate balance tracing rules would not be created and applied in this case for the \$900,000 transferred to Wells Fargo where Wells Fargo was an innocent third party transferee?¹
2. Does Section 70A-9a-332 of Revised Article 9² of Utah's Uniform Commercial Code apply to the transactions at issue, thereby barring Volvo's claims against Wells Fargo?
3. If Revised Article 9 does not apply, are Volvo's claims against Wells Fargo barred under the "ordinary course" defense set forth in Section 70A-9-306(2) and Official Comment 2(c) thereto of pre-Revised Article 9 of Utah's Uniform Commercial Code?

¹ If this Court agrees with the district court's legal ruling, there is no need for further analysis. Otherwise, issues 2 and 3 will need to be decided in this appeal.

² Revised Article 9 of Utah's UCC was enacted by the Utah Legislature in 2000. As part of the revisions to Article 9, transition rules were enacted which set the effective date for the revisions as July 1, 2001, see Utah Code Ann. § 70A-9a-701, but also provided that "except as otherwise provided in this part, this act applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this act takes effect." See Utah Code Ann. § 70A-9a-702(1).

Standard of Review: Because the district court decided the issue on summary judgment, the standard of review is de novo. Bowler v. Deseret Village Ass'n, 922 P.2d 8 (Utah 1996).

DETERMINATIVE STATUTES, RULES, AND REGULATIONS

I. Former Utah Code Ann. § 70A-9-306(2) (pre-Revised Article 9) provided:

(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.

Official Comment 2(c) to pre-Revised § 70A-9-306(2) provides:

(c) 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.

II. Former Utah Code Ann. § 70A-9-306(3) (pre-Revised Article 9) provided:

(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:

.

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

III. Utah Code Ann. § 70A-9a-332 provides:

(2) A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

IV. Utah Code Ann. § 70A-9a-702(1) provides:

(1) Except as otherwise provided in this part, this act applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this act takes effect.

V. Utah Code Ann. § 70A-9a-709(1) provides:

(1) 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.

STATEMENT OF THE CASE

Nature of the Case

Volvo Commercial Finance LLC The Americas (“Volvo”) seeks damages of \$693,000 from Wells Fargo Bank (“Wells Fargo”) relating to monies transferred by Volvo’s debtor, Great Basin, to Wells Fargo to cover checks Great Basin had written on its Wells Fargo accounts to pay business expenses. Wells Fargo received no notice of any kind from Volvo, and had no knowledge that the transfer violated Volvo’s security interest. Rather, Great Basin simply made the transfer to cover its checks as it had promised Wells Fargo. Under these circumstances involving two innocent parties, Volvo’s claims were properly dismissed under the governing tracing rules. Alternatively, Volvo’s claims are barred under applicable Uniform Commercial Code (“UCC”) statutes.

The facts in this case are not in dispute. Volvo financed the purchase of Volvo vehicles by some of the Great Basin truck dealerships and took a security interest in those trucks. In the fall of 2000, the Great Basin truck dealerships began to experience

financial difficulties and got behind in sending truck sales proceeds to Volvo. In late December 2000, some potential overdrafts appeared in a Great Basin concentration account at Wells Fargo. In response to a call from Wells Fargo, Great Basin promised, and then wire-transferred \$900,000 into the concentration account on December 29, 2000, to cover the potential \$830,000 in overdrafts. Those potential overdrafts related to checks that had been written in the regular course of Great Basin's business, including nearly \$500,000 in checks to Volvo Trucks of North America, Inc. ("Volvo Trucks"). Volvo now seeks damages of \$693,000 from Wells Fargo for the monies transferred by Great Basin to cover the checks based on an asserted exception or alteration to the universally accepted and neutral lowest intermediate balance rules of tracing ("LIBR"). However, on the undisputed facts there is no legal or factual basis for such a departure from LIBR. And, in any event, under applicable UCC provisions Wells Fargo received the transferred funds free of Volvo's security interest.

Course of Proceedings

On June 13, 2002, Volvo filed a lawsuit against Wells Fargo alleging that \$693,000 of \$900,000 that was transferred by Great Basin into a concentration account on December 29, 2000, to cover its business checks, constituted traceable proceeds from the sale of 53 vehicles in which Volvo claimed a security interest. Wells Fargo filed an amended answer denying liability and asserting several affirmative defenses.³

³ Because the district court granted Wells Fargo's motion for summary judgment, Wells Fargo's affirmative defenses have never been addressed.

Volvo moved for partial summary judgment solely on the issue of Wells Fargo's liability on the conversion claim but not on damages. R. 761-63. Wells Fargo filed a motion for summary judgment seeking the dismissal of all claims. R. 813-15. On November 11, 2004, the district court issued a Memorandum Decision denying Volvo's motion and granting Wells Fargo's motion for summary judgment, R. 2210-15, and entered Judgment dismissing all claims against Wells Fargo with prejudice. R. 2216-25. On December 7, 2005, Volvo filed its notice of appeal. R. 2226-28.

STATEMENT OF FACTS

The Organization and Financing of the Great Basin Entities.

Great Basin Company, Inc. was the parent company of several dealership and service subsidiaries engaged in the business of selling and servicing GMC, Volvo, Mack, Great Dane, East and Dyna-Weld trucks and trailers (the entities shall collectively be referred to as "Great Basin" or the "Great Basin Entities"). R. 1278. The Great Basin dealerships in Salt Lake, Arizona, Albuquerque, and Idaho obtained floor plan financing from Volvo, secured by all new and used trucks, motor vehicles, tractors, trailers and similar equipment of the foregoing entities (the "Volvo Floor Plan Agreements"). R. 857, 861, 946, 948-71. Other Great Basin dealerships obtained floor plan financing from Associates Commercial Corporation ("Associates") secured by all new and used trucks and trailers. R. 1143, 1147-58. Most of the Great Basin Entities were also obligated on an operating line of credit with Zions First National Bank, N.A. ("Zions Bank") secured by a borrowing base comprised of various assets of the obligors on the line of credit. R. 1078-79, 1143, 1160-64.

Great Basin's Cash Management System.

Given its complex business operations, the Great Basin Entities set up a cash management system at Wells Fargo in 1998 through treasury management accounts (the "Treasury Management Accounts") for each of the separate Great Basin Entities, and a concentration account identified as account no. 4098328487 (the "Concentration Account"). R. 995, 1018. Each day the operating funds generated by the Great Basin Entities were deposited into each individual entity's Treasury Management Account, and then funds in the Treasury Management Accounts were swept into the Concentration Account. R. 996-97, 1018.

As part of the cash management system, a Controlled Disbursement Account was also set up out of which payments to third parties could and generally were made by the Great Basin Entities.⁴ To the extent the Great Basin Entities needed to make a payment for business operations or taxes, they did so from either the Controlled Disbursement Account or the individual Treasury Management Accounts and sufficient funds were transferred into those accounts from the Concentration Account so that the payments could be made. R. 996-97, 1019, 1283.

Great Basin's Financial Difficulties and Notices of its Default.

Certain Great Basin Entities began to experience financial difficulties in the fall of 2000, which caused delays in payments to its flooring lenders, including Volvo. R. 1039-

⁴ The checks for the Controlled Disbursement Account contain a specific reference on the top of the check stating to "Wachovia Bank, N.A. Greenville, South Carolina In Cooperation with & Payable if Desire at Wells Fargo Bank, N.A." Therefore, Volvo cannot claim it was not aware of Great Basin's banking relationship with Wells Fargo. R. 2126-40.

40. In early September 2000, Volvo concluded that payments of the floor plan amounts owed to Volvo were being delayed by Great Basin contrary to the terms of the Volvo Floor Plan Agreements. R. 1039-40. Over the next few months, Volvo conducted several audits of the pertinent Great Basin Entities, which, according to Volvo, “revealed that the Dealerships . . . intentionally and deliberately [withheld] payment from Volvo on sold vehicles.” R. 1031-34, 1045-51, 1062-64.

On December 8, 2000, Volvo sent out a notice of default to the pertinent Great Basin Entities stating that they must pay all the sums due and owing to Volvo in full by December 18, 2000. R. 1034-35, 1051-52. On December 20, 2000, Volvo notified the pertinent Great Basin Entities in writing that because the event of default was not cured, Volvo was suspending the lines of credit under the Volvo Floor Plan Agreements.

R. 1036, 1053-55. On December 21 and 22, 2000, Volvo sent written notices to account debtors of the Great Basin Entities who had purchased Volvo vehicles directing them to pay all funds owed to the Great Basin Entities directly to Volvo. R. 1036, 1056-58. In addition, on December 22, 2000, Volvo sent a written notice to Zions Bank directing it “to segregate any proceeds of the sale of our inventory that come into any dealerships’ account(s) at Zions, to hold the funds as constructive trustee for the benefit of Volvo Finance, and to forward the proceeds directly to [Volvo]” R. 1080-81, 1084-85.

However, no such notice was sent to Wells Fargo. Indeed, at no time did Volvo even notify Wells Fargo that Great Basin was in default under the Volvo Floor Plan Agreements, or make a demand on Wells Fargo that it turn over to or hold for Volvo’s

benefit any of the proceeds received by Great Basin from the sale of Volvo vehicles that were deposited into the Accounts. R. 1088-89.⁵

The Concentration Account Transactions.

On December 21 and 22, 2000, Great Basin caused \$1,500,000 and \$500,000, respectively, to be transferred from the Concentration Account to the First Security Account. R. 1241. Numerous transfers totaling millions of dollars were made by Great Basin into and out of the Concentration Account in the month of December. R. 1236-42.

On the morning of December 27, 2000, representatives of Wells Fargo received the Daily Management Overdraft Report which indicated that if all the checks from the Controlled Disbursement Account or the Treasury Management Accounts presented for payment against the Concentration Account on December 26, 2000 were processed and honored, then the Concentration Account would be overdrawn in the amount of \$281,056.01. R. 999, 1101, 1109-11. In accordance with company policy and its prior practice with Great Basin, Wells Fargo that same morning contacted Mary Sheets, the appropriate representative at Great Basin, to inform her of the status of the Concentration Account. Ms. Sheets stated that Great Basin would cover the overdraft by making a \$300,000 wire transfer of funds into the Concentration Account. R. 999, 1014-15, 1101-02. Based on Great Basin's oral promise, Wells Fargo permitted the checks that would cause the \$281,056.01 overdraft to be processed in the normal course. R. 999, 1103.

⁵ In its factual statement, Volvo references its settlement with Zions Bank and suggests Wells Fargo should have followed suit (Applt's Brief at 10), but Volvo fails to note the crucial distinction that it gave notice to Zions Bank that it claimed a security interest in proceeds from Great Basin's sale of Volvo trucks. It is undisputed that Volvo gave no such notice to Wells Fargo.

Great Basin then, as promised, caused \$300,000 to be wire transferred from the First Security Account into the Concentration Account on December 27, 2000. R. 1000, 1012.

On the morning of December 28, 2000, Wells Fargo representatives received the Daily Overdraft Management Report indicating that if all the checks from the Controlled Disbursement Account or the Treasury Management Accounts presented for payment against the Concentration Account on December 27, 2000, were processed and honored, then the Concentration Account would be overdrawn in the amount of \$790,160.73. R. 1000-01, 1104, 1113-14. That same morning Wells Fargo again contacted Mary Sheets at Great Basin to inform her of the status of the Concentration Account, and she responded that Great Basin would cover the overdraft by making a wire transfer of funds into the Concentration Account. R. 1104. Based on Great Basin's oral promise, Wells Fargo permitted the checks that would cause the \$790,160.73 overdraft to be processed in the normal course. R. 1104-05. As discussed below, Great Basin made that wire transfer into the Concentration Account on the following day, December 29, 2000.

On the morning of December 29, 2000, representatives of Wells Fargo received the Daily Overdraft Management Report which indicated that another approximately \$39,000 in checks from the Controlled Disbursement Account or the Treasury Management Accounts had been presented against the Concentration Account on December 28, 2000, and if those checks were processed and honored, then the Concentration Account would be overdrawn in the total amount of \$828,951.36. R. 1001-02, 1105, 1116-18. Significantly, the potential \$828,951.36 overdraft was caused

in substantial part by multiple checks totaling \$494,493.77 payable to Volvo's sister company, Volvo Trucks. R. 1218-19.⁶

On December 29, 2000, Wells Fargo's representative again contacted Mary Sheets that morning to inform her of the status of the Concentration Account. Sheets responded by stating that Great Basin would cover the overdraft by making a \$900,000 wire transfer of funds into the Concentration Account to cover the overdraft of December 28th plus the additional \$39,000. R. 1105-06, 1116-18. Based on Great Basin's oral promise, Wells Fargo permitted the approximately \$39,000 in checks that would increase the overdraft to \$828,051.36 to be processed in the normal course. R. 1001-02, 1106. As promised, on December 29, 2000, Great Basin caused \$900,000 to be wire transferred from an account at First Security Bank (the "First Security Account") into the Concentration Account to cover the checks. R. 1002, 1106, 1118. Wells Fargo did not know that the Great Basin Entities were experiencing financial difficulties at the time Great Basin made the wire transfers into the Concentration Account on December 29, 2000. R. 1003.

Great Basin's Bankruptcy Filing and Volvo's Complaint.

On January 5, 2001, some of the Great Basin Entities filed for bankruptcy in Utah. R. 1143, 1187. On June 13, 2002, Volvo filed a lawsuit against Wells Fargo asserting causes of action for conversion, unjust enrichment, and constructive trust premised on the allegation that \$693,000 of \$900,000 that was transferred by Great Basin into a

⁶ Volvo does not contend that the disbursements made on December 28th and 29th were other than for the purpose of paying Great Basin's regular business expenses presumably because more than half of the disbursements that contributed to the total overdraft on December 29, 2000 were made to Volvo Trucks.

Concentration Account on December 29, 2000, constituted traceable proceeds from the sale of the 53 vehicles in which Volvo claimed a security interest. R. 1-15.

SUMMARY OF ARGUMENTS

Because Volvo's claims depend on being able to trace truck sales proceeds to the \$900,000 wire transfer made by Great Basin on December 29, 2000, the analysis in this case begins with the determination of the applicable tracing rules. The law in Utah and elsewhere follows the lowest intermediate balance rule ("LIBR") as the proper tracing method. There is no dispute that if the LIBR rules are followed in this case, no traceable truck sales proceeds in which Volvo held a security interest were in the Concentration Account on the critical date of December 29, 2000, and Volvo's claims fail.⁷

The first rule of tracing under LIBR's is that where there are commingled funds in an account, it is presumed that non-trust funds are removed before trust funds. Because the Concentration Account had a negative balance on December 27, 2000, under LIBR all the proceeds from the sale of Volvo's collateral had been dissipated from the Concentration Account by that date and thus, there were no truck sales proceeds Volvo could trace. In addition, the second rule of tracing under LIBR holds that new deposits generally do not replenish trust funds. Under that rule, the \$900,000 wire transfer made from the First Security Account into the Concentration Account on December 29, 2000,

⁷ The tracing analysis prepared by Derk Rasmussen (a copy of which is attached hereto as Addendum Ex. A), Wells Fargo's accounting expert, which applies the LIBR rules strictly and neutrally to all the transfers in the Concentration Account in December, 2000, shows that no proceeds from the sale of Volvo trucks could have been included in the \$900,000 wire transfer on December 29, 2000.

could not have replenished any proceeds in which Volvo held a security interest that may have previously existed in the Concentration Account.

There are no disputed facts relating to the tracing issue and Volvo does not dispute the applicability of LIBR in this tracing situation. Rather, Volvo's entire argument is based on its claim that there should be a departure from LIBR rules where there is a transfer between a debtor's accounts and the transfer is not made for the purpose of being dissipated to a third party. In support of this argument, Volvo relies principally on three century-old cases that were all decided 1) before the enactment of the UCC, and 2) in an era in which commercial transactions were much simpler. Applying Volvo's exception in the modern commercial world would impose impractical burdens on the system. Accordingly, the modern UCC cases do not support Volvo's argued departure from LIBR's rules. Moreover, to the extent Volvo's century-old cases have any continuing validity in the modern UCC context, they have no application here because they turn either on the wrongdoing of the defendant or on the fact that the funds, in some form, were still in the hands of the trustee, i.e., the equivalent to Great Basin here. Neither situation exists in this case. Additionally, the exception advocated by Volvo is inapplicable in any event because the \$900,000 transfer on December 29, 2000, was made by Great Basin to cover checks for its business operations and thus was intended for dissipation. Finally, the suggested departure from LIBR's neutral tracing rules would be particularly unfair in this case where Volvo seeks to recover funds from Wells Fargo that were paid to Volvo Trucks.

Because the district court followed LIBR's rules in granting summary judgment, it did not need to reach Wells Fargo's additional arguments. However, if Volvo could trace its proceeds into the \$900,000 transfer, either Revised Article 9, adopted in 2000, or pre-Revised Article 9 precludes Volvo's claim. Section 70A-9a-332 of Revised Article 9 states that "a transferee of funds from a deposit account takes the funds "free" of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party." There is no allegation by Volvo that Wells Fargo colluded with Great Basin to harm Volvo or deprive it of its collateral in this case. As such, Wells Fargo, as an innocent transferee, took the \$900,000 in wired funds free of any security interest Volvo had in those funds.

Even if, as Volvo contends, pre-Revised Article 9 applies in this case, Section 70A-9-306(2) and Official Comment 2(c) thereto also provide Wells Fargo an absolute defense to Volvo's claims because that section protects transferees who receive money in the ordinary course. Wells Fargo was clearly an ordinary course recipient of the funds that were transferred by Great Basin. Wells Fargo and Great Basin had a long standing banking relationship and Great Basin was merely taking the necessary and customary action to pay its regular business expenses as evidenced by the fact that the overdrafts included the \$494,493.77 in checks payable to Volvo Trucks.

POINT 1

UNDER THE GOVERNING LOWEST INTERMEDIATE BALANCE TRACING RULE, VOLVO CANNOT TRACE ANY PROCEEDS FROM THE SALE OF ITS COLLATERAL TO THE \$900,000 WIRE TRANSFER ON DECEMBER 29, 2000

A. The Lowest Intermediate Balance Tracing Rule.

Under Utah law, if a party seeks the return of its funds that have been deposited into a commingled bank account, then that party must be able to trace its funds. See Sisman v. Ogden State Bank (In re Ogden State Bank), 94 Utah 61, 75 P.2d 313, 317 (Utah 1938). In Sisman, the Utah Supreme Court stated the tracing requirements applicable to commingled funds and held that the burden of tracing rests on the claimant:

“It is indispensable to the maintenance by the cestui que trust... that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identical piece of property which came into the hands of the receiver, and then the claim can be sustained to that fund or property only, and only to the extent that the trust property or its proceeds went into it. It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and value thereof which came into the hands of the receiver. The burden of tracing the trust fund into the assets of the bank in the hands of the receiver, or of identifying it in his hands, rests upon the cestui que trust or claimant.”

Id. (quoting Braver on Liquidation of Financial Institutions § 859) (emphasis added).⁸

⁸ Likewise, the Utah Supreme Court in Kent v. Kent, 50 Utah 44, 165 P. 271 (Utah 1917), also stated that the trust claimant’s rights fail if it cannot trace its trust funds: When trust money becomes so mixed up with the trustee’s individual funds that it is impossible to trace and identify it as entering into some specific property, the trust ceases. The court will go as far as it can in thus tracing and following trust money; but when, as a matter of fact, it cannot be traced, the equitable right of the cestui que trust to follow it fails. Id. at 272 (quoting Little v. Chadwick, 151 Mass. 109, 23 N.E. 1005 (1890)).

Although pre-Revised Article 9 is silent on the appropriate way to “identify” cash proceeds that have been commingled with other funds in the debtor’s general bank account, the courts have permitted a secured party to assert a perfected security interest in any cash proceeds remaining in a general bank account under the LIBR method of tracing. See Tooele County Board of Education v. Hadlock, 79 Utah 478, 11 P.2d 320, 324-25 (Utah 1932) (explains how the “lowest intermediate balance” rule applies in these situations and follows a “group of cases [that] holds that trust money must be traced into a specific fund in the receiver’s hands . . .”).

The Utah bankruptcy court in In re JD Services, Inc., 284 B.R. 292, 298 (Bankr. Utah 2002), explained the LIBR rules as follows:

Under the lowest intermediate balance rule, any funds removed from a commingled account are presumed to be the Debtor’s funds to the extent the funds exceed the beneficiary’s equitable interest. If the Trustee deposits other funds into the commingled account, it is generally held that the Trustee is not replenishing trust funds. New deposits are not subject to the equitable claim of the trust beneficiary and subsequent withdrawals are presumed to draw first upon the new funds. Applying the rule, a constructive trust beneficiary may retrieve the lowest balance recorded after the funds were commingled. [Citation omitted].

The United States Supreme Court in Schuyler v. Littlefield, 232 U.S. 707, 711-12 (1914), also made it clear that when a commingled fund is dissipated, the trust fund is also dissipated. See also Turley v. Mahan & Rowsey, Inc., 817 F.2d 682, 684 (10th Cir. 1987) (the lowest intermediate balance rule is applied to tracing, and if the fund is dissipated, subsequent deposits into a commingled bank account do not replenish the trust funds.)

The accepted application of LIBR thus involves two rules. First, when withdrawals are made from a commingled general bank account, such withdrawals are

deemed to have first come from non-proceeds funds, and only after those funds are fully exhausted are the proceeds from the sale of the secured party's collateral invaded.

Second, once the proceeds are removed from the account, they are presumed not to be replenished by subsequent deposits. In re JD Services, Inc. 284 B.R. at 298. Applying these rules, if the balance of the commingled account is at any time reduced below the amount of the cash proceeds that have been deposited into the commingled general bank account, the secured party cannot recover more than the lowest balance in the account even though subsequent deposits increase the balance of the commingled account. Id.

Volvo does not dispute that the LIBR rules are the proper tracing method under Utah law. Nor does Volvo dispute that if LIBR's two rules are followed, it cannot trace any of its proceeds into the \$900,000 transfer into the Concentration Account. Rather, Volvo argues for a convenient exception to the LIBR rules, namely that LIBR's first rule does not apply to all transfers but only to transfers that are "dissipated." Applt's Brief at 26. In other words, Volvo argues for an exception to LIBR that when "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 other assets), the withdrawal does not defeat the beneficiary's or creditor's interest." Id. at 26-27.

However, this theory fails as a matter of law because there is no authority for that exception as to an innocent transferee, and because as a matter of fact, all the funds were dissipated.

B. Volvo's Proposed Exception to LIBR' First Rule Should be Rejected.

Volvo's accounting expert, David Judd, prepared a tracing analysis of the proceeds from Great Basin's December 2000 sale of Volvo vehicles in which Volvo asserts a security interest. Mr. Judd concluded that \$693,132 of the \$900,000 that was wire transferred into the Concentration Account on December 29, 2000 can be traced to the sale of 53 Volvo vehicles in which Volvo held a security interest. In doing so, Mr. Judd acknowledged that LIBR is the proper method of tracing and, indeed, defined it correctly as follows: "funds are traced or identified based on the assumption that the entity/debtor spends its own money from the accounts before it spends the security interest proceeds or trust funds. If the account balance falls below the amount of such proceeds, the security interest in the funds held in the account reduces accordingly." R. 1255-56. However, Mr. Judd then departed from the proper application of LIBR in three separate instances, departures which Mr. Judd acknowledged but justified on his proffered distinction for treating transfers between Great Basin's accounts not as transfers for LIBR purposes, a distinction he admitted was unsupported by any authority.⁹ First, Mr. Judd assumed that the \$1,500,000 which was withdrawn from the Concentration Account on December 21, 2000 consisted entirely of trust funds (or Volvo truck sales

⁹ Mr. Judd was asked whether he had relied on any authority to support his departure from LIBR and he responded as follows:

Q. Do you have any authority for the tracing treatment that is reflected in your treatment of the \$1.5 million?

A. Making reference to legal authority?

Q. Any authority – accounting authority, tracing authority, legal authority.

A. No.

R. 1136.

proceeds) even though non-trust funds were available in the Concentration Account in the amount of \$1,297,489. See Applt's Add. Ex. 2. Under LIBR's tracing rules, non-trust funds are treated as having been withdrawn from the Concentration Account before the trust funds. Thus, Mr. Judd departed from LIBR rules in his treatment of the \$1,500,000 withdrawal on December 21, 2000.

Second, Mr. Judd assumed that \$291,919 of the \$500,000 that was withdrawn from the Concentration Account on December 22, 2000, consisted of "trust funds" (or Volvo truck sales proceeds) even though non-trust funds were available in the Concentration Account in the amount of \$933,415. R. 1131. Under LIBR, those non-trust funds should have been treated as withdrawn from the Concentration Account before the trust funds. Thus, in his treatment of the December 22, 2000 withdrawal, Mr. Judd again departed from LIBR's first rule.

Third, Mr. Judd assumed that the \$900,000 that was wire transferred on December 29, 2000, by Great Basin from the First Security Account to the Concentration Account consisted of \$693,132 of "trust funds" (or Volvo truck sales proceeds) even though under LIBR's second rule, subsequent deposits into the Concentration Account are presumed not to replenish trust funds. R. 1131. Once again, Mr. Judd departed from LIBR's neutral rules in order to make Volvo's claims work in this case.

In order to justify Judd's departures, Volvo argues for an exception to LIBR and principally relies on three century-old cases in support thereof. However, Volvo's argument for altering the two well accepted and longstanding rules of LIBR in cases in which funds "are transferred but not dissipated" should be rejected for a number of

reasons. First, the modern UCC cases apply LIBR without recognizing the departure suggested by Volvo. Second, even the old cases cited by Volvo do not stand for the legal proposition asserted by Volvo. All of these cases pre-dated the adoption of the UCC and as such their continuing validity is questionable. Moreover, these cases either involve wrongdoing by the trustee/debtor (e.g., Brennan, In re Oatway), or a circumstance in which funds remained in the hands of the trustee-debtor (Lincoln). Clearly, neither of those circumstances exists here. Put simply, Volvo points to no case where its proposed exception to the LIBR rules is applied against an innocent transferee, such as Wells Fargo, and especially where the funds were dissipated at the debtor's own direction. Third, the undisputed facts of this case, including the fact that Wells Fargo is an innocent transferee, do not support a departure from LIBR, and in fact, show that LIBR should be applied strictly. Finally, the application of Volvo's proposed exception would not aid Volvo's cause because the funds in question have in fact been dissipated and non-dissipation is the essential element of the exception.

1. The Modern Cases Apply LIBR Without the Departure from the First Rule of LIBR that Volvo Suggests.

The modern cases have adopted LIBR as the appropriate tracing method in determining whether trust funds that have been commingled with other funds are identifiable. In re JD Services, 284 B.R. at 297. In the modern commercial context, the cases apply LIBR's two rules strictly and neutrally, and without the exception Volvo advocates. See, e.g., Meyer v. Norwest Bank Iowa, Nat. Ass'n, 112 F.3d 946, 951 (8th Cir. 1997) (The court employed a strict LIBR analysis in that case and found that the

creditor could only trace a limited amount of funds.); Bank of Kansas v. Hutchison Health Services, Inc., 735 P.2d 256 (Kan. App. 1987) (The court employed a strict application of LIBR in determining that some of the proceeds from the debtor's disposition of collateral were "identifiable" and the security interest continued in those proceeds.); Foster v. Hill, 275 F.3d 924, 927 n.1 (10th Cir. 2001) (the Tenth Circuit provided an example of the application of LIBR in which it applied its two rules strictly.); In re Edison Brothers, Inc., 268 B.R. 409, 413-14 (Bankr. D. Del. 2001) (The application of LIBR defeated a party's claim to trust funds because the debtor's cash management account had been completely dissipated.).

The reason the modern courts strictly apply LIBR is because the fraud, breach of fiduciary duty, or conscious wrongdoing that are often at the heart of the old common law cases cited by Volvo typically do not exist in a commercial setting. Rather, the cases most often deal with two innocent parties, as here. While the UCC recognizes that a secured party, by virtue of its security agreement, typically has greater rights in identifiable collateral than an unsecured creditor, when a secured party's collateral proceeds become commingled with other funds, the secured party's position becomes more akin to that of an unsecured creditor. The reason for that outcome is that a secured creditor, such as Volvo, could have protected itself by requiring the debtor to segregate its collateral proceeds (as Volvo did with Zions), but having failed to do so, the secured party cannot then complain that it may lose its security interest as to certain funds that are transferred to an innocent party. In short, modern courts will allow a secured party to trace its proceeds to the extent possible under a strict application of LIBR, but will go no

further absent exceptional circumstances because there is no difference or disparity in the equitable status between the secured creditor and the unsecured creditor.¹⁰

2. Volvo's Cases Do Not Support A Departure from LIBR.

Volvo relies primarily on three non-Utah cases from the early 1900's as alleged support for the proposition that the first rule of LIBR must be departed from when tracing funds that have been "transferred but not dissipated," which Volvo describes as the Lincoln/Brennan/Oatway rule.¹¹ Applt's Brief at 28-32. However, those cases do not stand for the proposition asserted by Volvo. Rather, the cases ultimately turned on a finding of either conscious wrongdoing on the part of the holder of the funds or that the funds remained in the hands of the debtor-trustee, neither of which conditions exist in this case. Moreover, those cases were decided before the adoption of the UCC for the modern commercial world.

¹⁰ Another problem with Volvo's proposed exception is its potential complicated application in a modern commercial context because it is not clear when funds are "transferred but not dissipated." Such a proposed exception apparently introduces an "intent" element, i.e. at what point does the transfer change from a "regular" transfer to a transfer intended for dissipation? For instance, what if the funds are transferred from one account into another account and then sit there for an hour, or five hours, or one day, or one week? It would be difficult to make that determination for a single transfer let alone hundreds of transfers that may occur in a commercial context. And, in the case at bar, how would the district court determine that Great Basin's transfers of the \$1.5 million and \$500,000 in December of 2000 were not intended for dissipation?

¹¹ Volvo also cites Waddell v. Waddell, 36 Utah 435, 104 P. 743 (1909), for the proposition that where trust funds are converted into another form of property (even if those trust funds have been commingled with other funds) that the trust will extend to that new property. Applt's Brief at 27. This is an overstatement. The court in Waddell made it clear that a trust can be imposed on new property only to the extent that the original trust proceeds are traceable into that property. *Id.* at 749. Because Volvo cannot trace any of its collateral proceeds into the \$900,000 wire transfer on December 29, 2000, it has no claim against Wells Fargo.

a. **Brennan v. Tillinghast**

The first case that Volvo relies on is Brennan v. Tillinghast, 201 F. 609 (6th Cir. 1913). In that case, John Brennan borrowed \$1,000 from Ironwood Bank (“Ironwood”) secured in part by 200 shares of the capital stock of Shattuck-Arizona Copper Company. Subsequently, Ironwood wrongfully sold 195 of the shares of the stock and deposited the \$3,558.75 in proceeds into a pre-existing account that Ironwood had with Duluth Bank. Against this open account, Ironwood subsequently drew four drafts in favor of the American Express Company for which Ironwood was paid \$2,807.32 in cash by American Express. At all times until the Ironwood was closed and a receiver was appointed, it continually had in cash in its own vaults the sum of at least \$3,500. Eventually, more than \$15,000 in cash came into the hands of the receiver of Ironwood. Brennan filed an action against the receiver asserting a preferred claim as to the value of the stock he had pledged as collateral. The appeals court upheld the decision in favor of Brennan based on the analysis that the four cash drafts drawn in favor of American Express, constituted in effect, a transfer of \$2,807.32 of the stock proceeds to cash which remained in the vaults of Ironwood Bank until it came into the possession of the receiver. Id. at 613. The court rejected the receiver’s tracing argument similar to LIBR’s first rule, holding that Brennan should prevail over the conscious wrongdoer, Ironwood, i.e., “[i]n such a case, it must be held that the trust attached to the substituted form in which the property is retained by the tort-feasor...”. Id. at 614. In other words, the court refused to apply the neutral rules of LIBR to the benefit of the wrongdoer.

b. In re Oatway

The second case cited by Volvo is In re Oatway, 2 Ch. Div. 356 (1903). In that case, Maxwell Skipper and L.J. Oatway were the co-trustees of the estate of Charles Skipper. Three thousand pounds was advanced in breach of trust out of Charles Skipper's estate to Maxwell Skipper, which advance was secured by a mortgage of an undivided share of certain real estate to which Maxwell Skipper was entitled under his grandfather's will. Oatway subsequently sold Skipper's undivided interest in the real estate for the sum of 7000 pounds and placed that money into his own bank account. Oatway never paid back the 3000 pounds to the estate of Charles Skipper. Subsequently, Oatway purchased 1000 shares of Oceana stock for 2137 pounds which he paid for by check from his bank account. At the time the Oceana stock was purchased, Oatway's checking account contained a balance of 6,635 pounds which included the 3000 pounds that belonged to the estate of Charles Skipper. Subsequently, Oatway's bank account was exhausted. Oatway died and the issue decided by the court was whether the estate of Charles Skipper or the estate of L. J. Oatway should receive the Oceana stock. The English Court of Chancery rejected the argument that because Oatway's own funds in the checking account were in excess of the 2137 pounds that were paid for the stock, he was entitled to withdraw that sum and apply it for his own purposes, and the Oceana shares should belong to his estate. The court held that because Oatway was a fiduciary, "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. The court also held that Oatway "never was entitled

to withdraw the 2137 $\frac{1}{2}$ from the account, or . . . hold it . . . freed from the charge in favor of the trust.” Id. at 361. Thus, the holding in Oatway is based on the fact that Oatway had acted wrongfully and that as a fiduciary he should not be able to use the tracing rules to the detriment of the beneficiary.

c. **City of Lincoln v. Morrison**

Volvo also cites to City of Lincoln v. Morrison, 90 N.W. 905 (Neb. 1902). In that case, the City of Lincoln, in contravention of the law, had placed \$5,000 of the City’s money into Lincoln Savings Bank, taking a certificate of deposit in return. After the deposit was made, the Bank had \$41,699.96 in cash on hand. Subsequently, the Bank purchased state warrants for \$36,750 using as partial payment \$1,750 of the cash on hand at the Bank. Thereafter, the Bank suspended operations and a receiver was appointed. The receiver received, inter alia, \$3,334.37 from the sale of the state warrants. The City then asserted a preferred claim for the \$5,000.

The court ultimately ruled in favor of the City, finding that it had a preferred claim to the remaining funds from the sale of the warrants, or the \$3,334.37. Id. at 909. In reaching this conclusion, the court held that when trust monies are commingled with non-trust monies remaining in the hands of the trustee,¹² then the cestui que trust is entitled to a charge upon the whole so long as any portion of the mass into which the trust monies

¹² The Lincoln court described this factor as requiring the beneficiary to “show that the estate out of which he claims such preference has been increased to some extent by the misappropriation of the trust property.” Id. at 908. However, the court also rejected the Bank’s argument that the “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...” Id. Thus, Lincoln provides no guidance in a case like this where the funds in question were transferred to Wells Fargo to be used to cover business expenses.

were placed remained in any form, and may be claimed. (Emphasis added). Id. at 908. Because the court found that the City had a charge (or lien) on the whole of the funds out of which the warrants were purchased, it followed that it also had a charge (or lien) on the warrants. Id. at 909. Indeed, the court did not attempt to do a LIBR tracing analysis to determine whether the City's money was used to purchase the warrants. Rather, the court simply concluded that as to as to the bank (the debtor/trustee) it did not matter that "no one can say what part of the cash on hand in the bank went into the warrants" because where the bank still held the asset it could not avoid its duty to the trust beneficiary.

Lincoln is inapposite for several reasons. First, its general holding has been rejected in modern cases which hold that merely tracing funds into a general account or showing that assets were increased is not sufficient to establish that the funds have been traced. See, e.g., In re Winkle, 128 B.R. 529, 535 (Bankr. S.D. Ohio 1991) (the beneficiaries of a trust must be able to trace their funds to identifiable trust assets and not merely to the general funds of the debtor). Second, Lincoln's rationale was that the debtor-trustee (which in this case would have been Great Basin) remained obligated if any part or form of the trust funds remained in its hands.¹³ For that reason, the Lincoln holding, even if good law, would have no application as against an innocent third party like Wells Fargo because the funds at issue no longer exist.

¹³ Thus, Lincoln also held that "if the whole of the cash . . . was used in paying off other depositors or in running expenses, the city is not entitled to a preference over general creditors. . . ." Id. at 908.

Accordingly, the courts in Brennan, Oatway and Lincoln¹⁴ reached the conclusions they did because of conscious wrongdoing by the person against whom the trust was impressed or because the funds remained in the hands of the trustee. They did not adopt the exception for funds “transferred but not dissipated” as claimed by Volvo here.¹⁵

¹⁴ In footnote 11 of its appellate brief, Volvo cites six other cases as alleged support for the proposition that the first rule of LIBR does not apply when funds are transferred but not dissipated. However, these cases are distinguishable and do not support Volvo’s argument. In In re Pacat Finance Corp., 27 F.2d 810, 812 (2d Cir. 1928), Beradini contended that the trustee in bankruptcy of Pacat Finance Corporation came into possession of 750,000 lire which belonged to Beradini and Beradini sought to establish his right to that money under, inter alia, a constructive trust theory. Beradini contended that he could trace his own dollars into lire credits held by Credito Italiano and then back into dollars held by the trustee. The court conceded that none of Beradini’s dollars could literally be traced into any of the lire credits, but nevertheless still imposed a trust in favor of Beradini on monies held by the trustee. Id. at 813. Thus, Pacat has no application here because it is at odds with modern case law which only permits tracing to “identifiable proceeds.” In Mitchell v. Dunn, 294 P. 386 (Cal. 1930), a guardian took funds from an incompetent and commingled them with her own funds. In deciding who was entitled to property purchased with the funds, the court ruled in favor of the incompetent because the guardian had been dishonest. Republic Supply Co. of California v. Richfield Oil Co., 79 F.2d 375 (9th Cir. 1935), involved a situation in which Richfield, with knowledge that Universal had cash of \$1,625,000 in its bank account, deliberately purchased sufficient stock in Universal to procure control of Universal. Richfield then misappropriated the cash and commingled it with Richfield’s general funds in its checking account. Given the facts, the court found that general tracing principles should not be used to favor Richfield. In re Erie Trust Co., 191 A. 613 (Pa. 1937), also involved wrongdoing. In that case, the estate of W.W. Gingrich filed an action against the Erie Trust Company because it took cash from the estate as commissions to which it was not entitled. Likewise, in Central Prod. Credit Ass’n v. Hans, 545 N.E.2d 1063 (Ill. App. Ct. 1989), the Hanses had participated in a scheme in which they would dispose of certain assets and execute certain notes in favor of Lindstrom to keep their farm operational. The court also found that LIBR did not even apply in that case. Finally, In re Goldberg, 168 B.R. 382, 385 (9th Cir. BAP 1994), contains language that actually supports Wells Fargo’s position. The court stated that “[g]enerally, it is true that where a constructive trust is sought to be imposed against the property of an insolvent debtor, strict tracing is required. The purpose of this rule is to treat creditors equally.” (Emphasis added).

¹⁵ Volvo also cites Restatement of Restitution §§ 211 and 212, Restatement of Trusts § 202, and Bogert, The Law of Trusts and Trustees § 928, Rev. 2d ed. (1982), as further

3. The Undisputed Facts in this Case Do Not Support a Departure From the Universally Accepted Application of LIBR.

On the undisputed facts of this case the two well accepted rules of LIBR should be followed for several reasons. First, there is no alleged wrongdoing on the part of Wells Fargo, which was an innocent transferee in the ordinary course of business. Wells Fargo

support for its argument that the first rule of LIBR should not be followed in this case. Volvo is wrong. These sections do not state that funds that “are transferred but dissipated” must be treated differently from other transfers, as suggested by Volvo. Rather, Restatement of Restitution § Section 211 indicates that where a person wrongfully commingles personal and trust funds into a single account, the claimant may be entitled to assert an equitable lien upon whatever remains of the whole of the deposit. See comment a. to Section 211. Furthermore, the modern courts hold that the beneficiary of a trust must be able to trace its funds to identifiable trust assets and not merely to general funds in the hands of the debtor. See In re Winkle 128 B.R. 529, 535 (Bankr. S.D. Ohio. 1991). Restatement of Restitution § 212 appears to follow a strict application of LIBR and states that where a person wrongfully commingles personal and trusts funds, makes withdrawals that are dissipated and then subsequently adds money of his own to the fund, the claimant ordinarily cannot enforce an equitable lien upon the account for a sum greater than the lowest intermediate balance of the deposit. Restatement of Trusts § 202 simply provides that a beneficiary of a trust is entitled, at its option, to enforce a constructive trust or equitable lien on other property acquired with trust funds, so long as the other property is held by the trustee and can be traced. Finally, Bogert indicates that Oatway has been followed in some jurisdictions, but not in others, and is critical of those courts that follow Oatway without regard to strict tracing rules or technical reasoning. Bogert states,

“[t]he results in the Oatway case and the authorities following it seem based on a strong preference for the trust claimant as against a trustee who has been guilty of an intentional breach of trust. As between these two disputants it is natural that the courts should favor the beneficiary without regard to strict tracing rules or technical reasoning. But they ignore the fact that the real parties in interest who are contesting with the beneficiary are the creditors of the defaulting trustee who had advanced value and have a claim against all his assets which are not earmarked as security for other claims. The creditors’ position would seem fully as strong from an ethical and equitable point of view as that of the beneficiary of the trust who is usually a donee.

Bogert, § 928 at pp. 491-92.

had a typical banking relationship with the Great Basin Entities in which it provided requested banking services to assist Great Basin with its cash management system. Between December 27 and December 29, 2000, Wells Fargo representatives received daily overdraft management reports which indicated that if all of the checks that had been presented against the Concentration Account were processed and honored, then the Concentration Account would be overdrawn. In each instance, in accordance with Wells Fargo policy, a Wells Fargo representative contacted Great Basin's authorized representative who responded that Great Basin would make the requisite wire transfers into the Concentration Account to cover any overdrafts, which Great Basin in fact did. Wells Fargo had absolutely no knowledge that the Great Basin Entities were in default of their obligations to Volvo. As such, Wells Fargo appropriately permitted the checks to be processed in the normal course.¹⁶ Based on these undisputed facts, there is no basis to alter LIBR's rules as to Wells Fargo.

Second, in this particular case Volvo is not entitled to any special relief from the LIBR rules because Volvo knew in the fall of 2000 that Great Basin was delinquent in its payments to Volvo. Indeed, Volvo believed that Great Basin was deliberately

¹⁶ Volvo attempts to attribute some responsibility to Wells Fargo because it knew that Volvo provided inventory financing to the Great Basin Entities. However, Volvo's argument falls far short. Such knowledge does not in and of itself form a basis to impose liability on Wells Fargo. See Harley Davidson Motor Co. v. Bank of New England, 897 F.2d 611, 612 (1st Cir. 1990). Large truck dealers such as Great Basin almost always obtain inventory financing so such knowledge by itself, would not have been alarming to Wells Fargo or constituted a basis for further inquiry. Also, it is not unusual for sellers of financed inventory to use a portion of the proceeds from those sales to run its business operations. As such, even if Wells Fargo had known that Great Basin was using some of the proceeds from the sales of trucks secured by Volvo to pay its business expenses in December of 2000, this knowledge would not have raised any "red flag" to Wells Fargo.

withholding payments from Volvo on sold vehicles. R. 1029-36. Notwithstanding this information, Volvo failed to take any of the following actions available to it: (1) ask Great Basin to segregate the funds from the sale of its collateral from the other funds that were being generated by the various Great Basin Entities; (2) suspend Great Basin's lines of credit under the Volvo Floor Plan Agreements; (3) take possession of the financed vehicles that constituted its collateral, which vehicles it left at Great Basin; (4) require direct payment from the parties who were purchasing the financed vehicles from Great Basin (instead Volvo continued to allow those proceeds to be deposited into the Concentration Account until late December 2000); and (5) notify Wells Fargo that Great Basin was in default of its obligations under the Volvo Floor Plan Agreements. In fact, Volvo did not provide notice of any kind to Wells Fargo that there were concerns or problems relating the funds in the Concentration Account.¹⁷ Since Volvo was better positioned to protect its security interest than Wells Fargo, the LIBR rules should not be altered to benefit Volvo.

Third, it would be especially unfair in this case to alter the LIBR rules to benefit Volvo over Wells Fargo because the proceeds in question were dissipated by Great Basin to cover business expenses. In fact, nearly \$500,000 of the transferred monies went to Volvo Trucks. It would be patently unfair to impose liability on Wells Fargo which

¹⁷ The reason Volvo may have failed to act was that a pending sale was being negotiated of substantially all of Great Basin's Volvo-related dealership assets to its sister company, Volvo Trucks. A major condition of the sale was that the Great Basin truck dealerships needed to be ongoing business concerns. R. 1031, 1045, 1166-84. However, to accomplish that condition Great Basin needed to use the proceeds from the sales of the Volvo trucks to keep its business operations going.

retains no funds, while allowing Volvo to obtain damages for monies that ended up in the hands of its sister company, Volvo Trucks.

Finally, Mr. Judd candidly stated in his deposition that another rationale for his approach in applying LIBR was to apply it in a way that most protected Volvo. R. 1141. That rationale is contrary to the purpose of LIBR, which is designed to protect fairly and neutrally the rights of all creditors. For instance, if under LIBR the proceeds are not traceable into the commingled Concentration Account, then Volvo would become an unsecured creditor of the Great Basin Entities to the extent of its loss, and it must be treated on an equal basis with other unsecured creditors of the Great Basin Entities. See J.D. Services, Inc., 284 B.R. at 298 (since the Bank could not trace the funds, the Bank became a creditor to the extent of its loss and had to be treated on an equal basis with other similarly situated creditors). LIBR cannot be manipulated in the manner advocated by Volvo and Mr. Judd to protect Volvo, because that would be unfair to other creditors and innocent third parties like Wells Fargo.

4. Volvo's Theory Has No Relevance In This Case Because The Funds Were In Fact Dissipated.

Finally, even if this Court were to adopt the exception to LIBR advocated by Volvo, the exception has no application in this case because the funds at issue - the \$900,000 wire transferred into the Concentration Account by Great Basin on December 29, 2000 - were in fact "dissipated" by Great Basin. Specifically, the funds were dissipated because they were used to cover the checks drawn by Great Basin to pay

its regular business expenses. As such, the exception to LIBR suggested by Volvo is factually inapplicable in this case.¹⁸

C. Insley Has No Application To This Case.

Volvo argues that the holding in Insley Mfg. Corp. v. Draper Bank & Trust, 717 P.2d 1341 (Utah 1986), means that Volvo's "interest takes precedence over any interest Wells Fargo could possibly claim." Applt's Brief at 18. Volvo is simply wrong because in Insley, unlike this case, the proceeds were traceable and Draper Bank exercised a set-off. In Insley, the debtor had a bank account at Draper Bank. Id. at 1342. Sometime prior to October 5, 1979, five checks totaling \$91,621.25 were drawn against the bank account and were presented to Draper Bank for payment. Draper Bank determined that the account contained insufficient funds to cover the checks but decided, without consulting the debtor, to pay them in overdraft. On October 5, 1979, Draper Bank prepared a debit memo to the debtor informing it that it intended to cover the checks and would be charging a \$15 service charge, along with 18% interest for the debtor's use of bank funds. The debtor's bank statement, shows that the transaction was posted on October 9, 1979. Id. On the same date, the debtor completed the sale of a backhoe to a third party and \$237,918.30 in funds from that sale were deposited into the debtor's bank account at Draper Bank. Id. Draper Bank, in turn, credited the debtor's account and then

¹⁸ Indeed, the three cases of Oatway, Brennan and City of Lincoln, upon which Volvo relies, all involved scenarios in which the funds or property at issue were still in existence. Volvo already has had the opportunity to make a claim to any remaining proceeds from the sale of its collateral in Great Basin's bankruptcy case. Indeed, Volvo, Zions Bank, Associates and others battled in Great Basin's bankruptcy case for many months over how the remaining funds, i.e. non-dissipated funds, should be divided.

paid itself by exercising a set-off for the money it had previously advanced to pay the overdrafts. The creditor who claimed a security interest in the backhoe, brought an action against Draper Bank for converting the proceeds from the sale of the backhoe. Id. at 1346-47. The Utah Supreme Court, ruling for the creditor, focused on Draper Bank's argument, under Utah Code Ann. § 70A-9-104(i) that Article 9 does not apply "to any right of setoff," and that therefore the UCC will have no application when there is a priority dispute between a party that has a perfected security interest and a party that has exercised a right of set-off. Id. at 1345. The supreme court rejected the argument that under pre-Revised Article 9 the creditor's perfected security interest in cash proceeds of inventory sold by the debtor had priority over Draper Bank's set-off rights. Id. at 1347.

Insley has no applicability here for several reasons. First, unlike the debtor in Insley, Volvo cannot trace its proceeds into the Concentration Account on December 29, 2000. Second, unlike Draper Bank in Insley, Wells Fargo did not exercise a set-off in this case. Here, Great Basin took the affirmative and voluntary step of wiring money from its First Security Account into the Concentration Account for the express purpose of covering the checks for the business expenses it had written.

This distinction between a voluntary payment and a set-off has been recognized in Textron Financial Corp. v. Firststar Bank Wisconsin, 579 N.W.2d 48 (Wis. Ct. App. 1998). The debtor in Textron, Nelson's Sports Center, operated a retail boat and accessory business. Nelson's had loans with Firststar Bank that were secured by a blanket security interest in all of Nelson's assets except those specifically pledged elsewhere. Nelson's also had a security agreement with Textron Financial to finance boats, trailers, and other

marine products. After receiving final payment on a boat financed by Textron, Nelson's deposited the full amount in its checking account with Firststar. Nelson's failed to promptly pay Textron on the boat, thereby violating its security agreement. Three days later, with Nelson's express permission, Firststar recovered funds from Nelson's checking account to be applied to a delinquent loan. Firststar claimed it had no notice that the funds were proceeds from inventory sold under Textron's security interest. Textron brought an action against Firststar claiming wrongful conversion. One of the arguments Textron made was that Firststar's collection really amounted to a set-off. However, the appellate court rejected that argument, holding:

As established in *Commercial Discount Corp.*, a bank's right to keep a set-off is defeated by any security interest in the same funds, whether or not the bank had knowledge that its set-off violated a security interest. We do not agree, however, that Nelson's loan payment was a set-off. As Firststar notes, a set-off is the involuntary taking of funds from a debtor's account. Because no facts are alleged that would tend to show the loan payment to Firststar was involuntary, we reject this claim.

Id. at 592 (emphasis added) (citation omitted).¹⁹ Likewise, in *Security State Bank v. Firststar Bank Milwaukee*, 965 F. Supp. 1237 (N.D. Iowa 1997), the court applied LIBR

¹⁹ It is also clear from Utah case law that the \$900,000 wire payment made by Great Basin to Wells Fargo could not have constituted a set-off because the requirements of "mutuality" and "separate transactions" are lacking. As stated in *Mark VII Fin. Consultants v. Smedley*, 792 P.2d 130, 132 (Utah App. 1990), a "setoff refers to an unrelated transaction." See also *Black's Law Dictionary* 1404 (8th ed. 2004) (Set-off defined as a "defendant's counterdemand against the plaintiff's claim"). Accordingly, no set-off could have occurred in this case because the obligations that purportedly gave rise to the set-off arose from the same transaction. Based upon Great Basin's assurance of payment, Wells Fargo processed Great Basin's checks and then Great Basin made the promised wire transfer from the First Security Account to the Concentration Account to cover those checks. It was all part of the same transaction, and thus could not have been a set-off. The requirement of mutuality is also lacking in this case. See *Mark VII*, 792

and found that all of the proceeds from the sale of Security Bank's collateral were dissipated when the funding account became overdrawn, and Firststar Bank's payment of overdrafts did not change this result since the payments were made by transfers from the debtor's line of credit on debtor's own instructions, rather than from Firststar's initiative.

Because Wells Fargo merely accepted a voluntary payment from Great Basin to cover the overdrafts, Insley has no application to this case.

POINT 2

UTAH'S UCC PERMITTED WELLS FARGO, AS AN INNOCENT TRANSFEREE, TO RECEIVE FUNDS FROM THE CONCENTRATION ACCOUNT FREE AND CLEAR OF VOLVO'S SECURITY INTEREST

Although the District Court was not required to address Wells Fargo's additional, alternative grounds for dismissal, Volvo's claims against Wells Fargo are also barred by either Utah Code Ann. § 70A-9a-332 of Revised Article 9 of Utah's UCC, or Utah Code Ann. § 70A-9-306(2) and Official Comment 2(c) thereto of pre-Revised Article 9.²⁰

P.2d at 132. This requirement "allows parties that owe mutual debts to state the accounts between them, subtract one from the other and pay only the balance." See Blacks Law Dictionary 1404 (8th ed. 2004). However, on December 29, 2000, which is the date Volvo claims Wells Fargo exercised the set-off, there were no mutual debts that existed between Wells Fargo and Great Basin. Although Volvo claims that Great Basin owed an obligation to Wells Fargo to cover the overdraft, Wells Fargo owed no corresponding obligation to Great Basin because there were no funds in the Concentration Account. They had all been dissipated and it contained a negative balance. Furthermore, the \$900,000 wire transfer into the Concentration Account on December 29, 2000 could not have created the corresponding obligation on the part of Wells Fargo because that transfer represented the payment to Wells Fargo.

²⁰ On appeal, this Court can affirm dismissal on alternative grounds that were properly presented below. See Debry v. Noble, 889 P.2d 428, 444 (Utah 1995) ("[a]n appellate court may affirm a trial court's ruling on any proper grounds, even though the trial court relied on some other grounds.").

A. **Revised Article 9 of Utah Code Ann. § 70A-9a-332 Bars Volvo's Claims Against Wells Fargo.**

Section 70A-9a-332 of Revised Article 9 of Utah's UCC, which was enacted by the Utah Legislature in 2000, provides in pertinent part as follows:

(2) A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

Barkley Clark, a respected commentator on the UCC, explained the policy behind Section 70A-9a-332 as follows:

Under Rev. UCC § 9-332(b), a transferee of funds from the deposit account takes free for a security interest in proceeds unless the transferee is acting in "collusion" with the debtor. Under this rule, non-collusive transferees of funds from the debtor's deposit account are protected more than any other class of transferees. Their knowledge of the prior security interest is irrelevant in the absence of collusion. The policy behind this priority, as stated by the drafters, is to respect the finality of payments in the banking system. Protected transferees include junior secured parties. . . .

See Clark, The Law of Secured Transactions Under the Uniform Commercial Code., Rev. Ed., Volume 1 at § 16.07[8] (emphasis added). Revised Section 70A-9a-332(b) recodifies pre-Revised Section 70A-9-306(2) and Official Comment 2(c) thereto except that it sets forth a narrower "bad actor/collusion" test as contrasted with the "ordinary course of business" test set forth in Section 70A-9-306(2).

Volvo does not argue that if Section 332(b) applies, its claim fails. Volvo, however, argues that Section 332(b) does not apply to this case because its effective date was July 1, 2001 (see Utah Code Ann. § 70A-9a-701(1)). Volvo is mistaken. The Utah Legislature indicated that the provisions of Revised Article 9 could be considered in

transactions or liens that fell within its scope even if they occurred prior to Revised Article 9's effective date. Specifically, Revised Section 70A-9a-702(1) provides:

(1) Except as otherwise provided in this part, this act applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this act takes effect.

Volvo argues that Revised Section 70A-9a-702(i)'s transition rule does not apply to this case because another transition rule, Section 70A-9a-709(1), precludes the application of Revised Article 9 where the relative priorities between the parties were established prior to July 1, 2001:

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.

However, Volvo is wrong because this case does not involve a priority dispute between competing creditors because Wells Fargo does not claim a priority to the funds in question.²¹ Rather, because Wells Fargo is a transferee in the ordinary course and without collusion under the UCC, it simply took free of any security interest claimed by Volvo. In other words, there are not relative priorities at issue within the meaning of Section 70A-9a-709(1).

Furthermore, although Volvo argues that Revised Article 9 cannot apply because statutes do not operate retroactively, Applt's Brief at p. 38, that is not true if the statute expressly provides for retroactive application. See Utah Code Ann. § 68-3-3 (1953) ("No part of these statutes is retroactive, unless expressly so declared."). Because the

²¹For that reason, Volvo's reliance on Interbusiness Bank v. First Nat'l Bank of Mifflintown, 318 F. Supp. 2d 230 (M.D. Pa. 1994) is misplaced. Applt's Brief at 37-38.

transition rules of Revised Article 9 do provide expressly that Revised Article 9's provisions should be applied to transactions or liens that fall within its scope even if they occurred prior to Revised Article 9's effective date, Volvo's retroactivity argument must fail. Accordingly, Section 70A-9a-332 bars Volvo's claims against Wells Fargo.

B. If The Court Determines that Pre-Revised Article 9 Applies in this Case, Then Section 70A-9-306(2) and Official Comment 2(c) Bar Volvo's Claims Against Wells Fargo.

Alternatively, if pre-Revised Article 9 applies, Volvo's claims are barred by pre-Revised Section 70A-9-306(2) and Official Comment 2(c) thereto. Section 70A-9-306(2) states as follows:

(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.

However, Official Comment 2(c) to this section identifies an exception to a secured creditor's right to recover proceeds transferred to third parties in the ordinary course:

(c) 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.

The application of Official Comment 2(c) to this fact situation is a matter of first impression in Utah. If Official Comment 2(c) does apply, it disposes of Volvo's claims because the transfer was clearly in the ordinary course. However, Volvo argues that

Official Comment 2(c) should not apply in this case for a number of reasons. First, Volvo argues that Official Comment 2(c) conflicts with the language of Section 9-306(2) and that the latter controls. Second, Volvo suggests that the ordinary course defense of Official Comment 2(c) appears to be barred by the holding in J.R. Simplot Co. v. Sales King International, 17 P.3d 1100 (Utah 2000). Applt's Brief at 42. Third, Volvo contends that an ordinary course defense is precluded by Insley. Id. at 40-41. Fourth, Volvo argues that even if Utah law is deemed silent on the issue, the weight of out-of-state authority precludes an "ordinary course" defense under Official Comment 2(c) in this case. Id. at 43-44. Finally, Volvo argues that even if the ordinary course defense does apply, Wells Fargo has failed to satisfy the requirements of that defense. Id.

As shown, all of these arguments fail, and thus the Court should affirm the judgment of the district court.

1. Official Comments Provide Persuasive Guidance to Courts.

Volvo first argues that the language of Official Comment 2(c) cannot trump the plain language of Section 9-306(2). Applt's Brief at 40. However, the drafters of the UCC also drafted the official comments thereto and they obviously did not regard Official Comment 2(c) as inconsistent with the language of Section 9-306(2). Moreover, the Utah Supreme Court has specifically held the official comments to the UCC provide persuasive guidance to courts. See, Simplot, 17 P.3d at 1108.

2. In Simplot, the Utah Supreme Court Specifically Left Open the Question of Whether Official Comment 2(c) is Authoritative.

Volvo contends that J.R. Simplot Co. v. Sales King International, 17 P.3d 1100 (Utah 2000), appears to bar the ordinary course defense in this case. Applt's Brief at 42. However, Volvo ignores the Simplot court's language directly relating to Official Comment 2(c) that the issue is open in Utah:

The official comments to the UCC have not been adopted by the Utah legislature and are therefore not authoritative, but rather, persuasive as to the code's interpretation. Nor is it the case that this court has previously recognized Comment 2(c) as an exception to the Code's general priority rules. However, we find it unnecessary to address the authority of Comment 2(c) at this time because it is not applicable to the instant case.

Id. at 1108.

In Simplot, Bountiful Valley Produce ("BVP") produced onion and squash crops. Simplot sold chemicals and fertilizer on credit to BVP and to secure its interests Simplot maintained annual security agreements with BVP. BVP entered into a marketing agreement with Sales King. As BVP's agent, Sales King sold BVP's crops but never took ownership of them. Pursuant to their agreement, Sales King collected the proceeds from the crop sales and then retained amounts from those proceeds to cover its sales commissions and various expenses. Simplot was not paid for the chemicals and fertilizer that it provided to BVP in 1995 and 1996, and it brought suit against Sales King for conversion of the crop proceeds. As a defense, Sales King argued that it should be allowed to retain the proceeds from the crop sales because they were paid to it in the ordinary course of BVP's business under Section 9-306 and Official Comment 2(c). The Utah Supreme Court found it was unnecessary to address the authority of Official

Comment 2(c) because it only applies if the “cash proceeds are covered into the debtor’s checking account” and since BVP never had access or control over the cash proceeds, Official Comment 2(c) was not applicable in the case. Id. at 1108-09.

Accordingly, Simplot is distinguishable because the debtor, BVP, never obtained control of the money, never deposited the funds into its checking account and thus never made any payments to Simplot out of its checking account. Further, in leaving open the authority of Official Comment 2(c), Simplot actually suggests that § 9-306(2) and Official Comment 2(c) may be applicable where a party receives a voluntary payment from a debtor in the ordinary course which is exactly what happened in this case.

3. Insley Does Not Preclude Application of Official Comment 2(c).

Volvo argues that the supreme court’s holding in Insley also precludes application of the ordinary course defense under Official Comment 2(c). Applt’s Brief at 40. However, Insley was decided 14 years before Simplot, and the supreme court’s indication in Simplot that the authority of Official Comment 2(c) is an open question is the latest pronouncement. Obviously, the supreme court did not read Insley to the contrary.

Moreover, as discussed above, the Insley case is factually distinguishable both because Volvo’s truck sales proceeds cannot be traced into the December 29, 2000 wire transfer and because the transfer was expressly made by Great Basin to cover the specific checks in process and was not a set-off.

Volvo also contends based on Insley that its perfected security interest in the proceeds from the sale of its collateral trumps every defense and argument of Wells Fargo. Applt’s Brief at 41. However, Volvo’s analysis of the effect of the perfection of a

security interest under the UCC is flawed. While it is true that once a party obtains a perfected security interest it need only file UCC continuation statements to maintain that perfection, it is not true that the secured party is never at risk of losing its collateral. The UCC, both under Revised Article 9 and pre-Revised Article 9, recognizes a myriad of situations in which a secured creditor can lose its collateral despite having a perfected security interest. For example, under pre-Revised Article 9, a secured party may lose its security interest if (a) its collateral proceeds cannot be traced and become unidentifiable under Utah Code Ann. § 70A-9-306(3); (b) its collateral proceeds are paid to an ordinary course transferee under Utah Code Ann. § 70A-9-306(2); (c) its collateral is purchased by a buyer in the ordinary course under Utah Code Ann. § 70A-9-307; or (d) the secured party becomes aware of a debtor's name change and yet fails to file a new financing statement under Utah Code Ann. § 70A-9-402(7). Likewise, under Revised Article 9, a secured party may lose its security interest to a transferee of funds from a deposit account under Utah Code Ann. § 70A-9a-332, and to a bank that sets off funds in a deposit account under Utah Code Ann. § 70A-9a-340, unless the secured party has entered into a control agreement. A secured creditor's security interest may also be defeated by common law defenses such as estoppel and waiver, See Utah Code Ann. § 70A-9-103.

Moreover, Volvo's assertion that Wells Fargo should have undertaken a UCC-1 search of all the filings against the Great Basin Entities lacks merit. First, there is absolutely no way that, in the space of a few hours, Wells Fargo could have undertaken a search of the UCC-1 records relating to all of the Great Basin Entities, let alone

determine what all the numerous filings may have meant in that short time.²² Second, it would be bad public policy for the courts to impose liability on a financial institution simply because it covers an overdraft without having done a UCC-1 search. In fact, the courts have already recognized that because of the need for finality in banking transactions there are good commercial reasons for not imposing, even on sophisticated lenders, the responsibility of contacting inventory financiers to secure permission to take payment from a dealer's ordinary bank account. See Harley Davidson Motor Co. v. Bank of New England, 897 F.2d 611, 612 (1st Cir. 1990). That policy is reflected in both pre-Revised and Revised Article 9.

Finally, Volvo's suggestion that Wells Fargo should have just returned the checks prior to the midnight deadline is without merit. It makes no sense for a bank, which has a good business relationship with its customer and which is not aware that its customer has any financial problems, to return checks that its customer has promised to cover, and in fact, did cover. Indeed, if financial institutions were to adopt a policy of always returning checks in order to protect themselves from such liability, it would have a detrimental effect on our economy which relies to a large extent on the free flow of goods and credit.

4. The Weight of the Out-of-State Authority Supports the Application of 9-306(2) and Official Comment (2).

Volvo further argues that if the authority of Official Comment 2(c) is an open question in Utah, this Court should not allow the ordinary course defense because the

²² Even if Wells Fargo knew of Volvo's security interest, that knowledge would not have alerted Wells Fargo to any problems because Great Basin was permitted under the Volvo Floor Plan Agreements to sell Volvo trucks in the ordinary course of its business and to use the profits associated with those sales in its own business operations. R. 865, 923.

weight of out-of-state authority rejects such a defense. Applt's Brief at 43-44. However, cases with fact situations similar to those here do recognize the application of the ordinary course defense. For instance, in Textron supra, a debtor sold collateral in which a secured party claimed a security interest and deposited the cash proceeds of the sale into a deposit account. Subsequently, with the consent of the debtor, the depository bank applied the funds in the account to an amount the debtor owed the depository bank. The court applied Official Comment 2(c) and stated that the depository bank would be permitted to retain the proceeds as an ordinary course transferee of money if it had received the money in connection with the operation of the debtor's business and without knowing or being reckless in knowing that the payment violated the secured party's security interest. Textron, 579 N.W.2d. at 52. The Court also rejected the secured party's argument that the application of the funds in the deposit account to the debtor's obligation constituted a set-off. Id. Instead, the Court stated that "a set-off is the involuntary taking of funds from a debtor's account," and there was no evidence that the payment to the depository bank was involuntary. Id.

Similarly, in J.I. Case Credit Corp. v. First National Bank, 991 F.2d 1272 (7th Cir. 1993), the Seventh Circuit held that a bank with a second lien interest took proceeds from the sale of collateral free of the first lienor's security interest under Official Comment 2(c) because the payments made from the bank account were in the ordinary course, and the bank with the second lien did not know and was not reckless in knowing whether the payments violated the first lienor's security interest. The Seventh Circuit reached this conclusion even though the bank holding the second lien interest knew about the

existence of the first lien because there was no evidence that the bank suspected that the debtor was violating the terms of the first lienor's security interest. The Seventh Circuit also held that a negligence standard was not appropriate to apply to the bank's actions. J. I. Case Credit, 991 F.2d at 1278.²³

Moreover, the Utah Legislature's enactment of Revised Article 9 Section 70A-9a-332, supports the application of Textron, and J.I. Case Credit in this case. As noted in HCC Credit Corp. v. Springs Valley Bank & Trust, 712 N.E.2d 952 (Ind. 1999), the most recent revisions to Article 9 are simply codification of the broad and liberal interpretation of the application of § 9-306(c) and Official Comment 2(c):

We note that in their most recent revision of Article 9, the American Law Institute and National Conference of Commissioners on Uniform State Laws have proposed that this liberal approach [to apply the ordinary course defense broadly] be codified. A new section would be added to Article 9 providing that 'transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.' [Citation omitted]. Broad protection for transferees helps to ensure that security interests in deposit accounts do not impair the free flow of funds. . . Rules concerning recovery of payments traditionally have placed a high value on finality. The opportunity to upset a completed transaction, or even

²³ See also ITT Commercial Finance Corp. v. Bank of the West, 166 F.3d 295, 308 (5th Cir. 1999) ("... , for purposes of Comment 2(c), a payment is within the "ordinary course" if made in the operation of the debtor's business and if the recipient of the payment acted in good faith and without knowledge of or recklessness about whether the payment violated a third party's security interest."); Ford Motor Credit Co. v. State of New York, 641 N.Y.S.2d 742, (N.Y. Sup. Ct. 1996), a car dealer sold a number of vehicles, deposited the cash proceeds into its checking account, and paid the State of New York over \$400,000 to satisfy an existing sales tax liability. The court held that the payments were made in the ordinary course of business applying Comment 2(c), so that the State of New York primed a competing secured creditor which had claimed the funds as proceeds of its perfected security interest in the car inventory. Id. at 203, 204.

to place a completed transaction in jeopardy by bringing suit against the transferee of funds, should be severely limited.

Id. at 956 n.6.

Volvo cites three cases as support for its position: Bank of Brewton v. GMAC, 811 F. Supp. 648 (S.D. Ala. 1992); C & H Farm Serv. Co. v. Farmers Sav. Bank, 449 N.W.2d 866 (Iowa 1989), and GMAC v. Lincoln Nat'l, 18 S.W.3d 337 (Ky. 2000).

While these cases decline to apply the ordinary course defense set forth in § 9-306 and Official Comment 2 thereto, they do not do so because the ordinary course defense is not a valid defense, but because those cases involved a set-off or wrongdoing by the party asserting the ordinary course defense.

For instance, in GMAC, a creditor corporation that had provided floor plan financing to an automobile dealer sued the dealer's bank to recover proceeds from the sales of vehicles in which the creditor claimed a security interest on the basis that the dealer bank had converted those proceeds by applying them to the dealer's account overdrafts. On appeal, the Kentucky Supreme Court held that the creditor's security interest in the proceeds from the sale took priority over the dealer bank's set-off rights, and thus, the dealer bank was liable to the creditor for conversion. GMAC, 18 S.W.3d at 339-40. However, in this case, Wells Fargo did not exercise an involuntary set-off of any of Volvo's collateral proceeds that were deposited into the Concentration Account.

Furthermore, although the court in GMAC did discuss the protection afforded by § 9-306(2) and Official Comment 2 thereto, it declined to apply that protection because of improper behavior on the part of the bank. Contrary to bank policy, the overdrafts in

GMAC were reviewed and approved by the chairman of the bank, who also was the founder of the entity whose account was overdrawn. Id. at 338. Moreover, there had been an ongoing problem with overdrafts and the account had been overdrawn for 38 of 62 business days during the relevant three month time period. Id. Given these facts, the court in GMAC did not grant ordinary course protection to the bank. However, no such inappropriate behavior is alleged against Wells Fargo in this case.

In Brewton, the court ruled in favor of the secured party and against the bank because the bank was on specific notice that the debtor was in default of its obligations to its secured creditor GMAC because the bank had previously dishonored a total of \$130,000 in checks that the debtor had made out to GMAC. Brewton, 811 F.Supp. at 650. Notwithstanding this notice, the bank still accepted proceeds from the debtor that were subject to GMAC's security interest. Id. at 651 Accordingly, the court found that the protections afforded by § 9-306 would not be extended to the bank Id. at 651. Here, Wells Fargo had no notice that Great Basin was in default of its obligations to Volvo.

The C & H Farm case involved a situation in which a bank routinely covered checks in a debtor account that was often overdrawn during a four year period. The bank also was on notice that sometimes the proceeds being deposited into the account were identifiable proceeds of another parties' collateral. See C & H, 449 N.W.2d at 875. Notwithstanding the foregoing, the bank set-off collateral proceeds that had been deposited into the debtor account to pay itself for the funds it advanced to cover the overdrafts. Id. at 876. The secured creditor sued the bank and the bank argued that its actions should be protected by the ordinary course defense. The court in C & H found

§ 9-306(2) and Official Comment 2 to be instructive, but declined to extend its protections to the bank because it had exercised a set-off. *Id.* at 876-77. The situation is different here because Wells Fargo did not go in and seize (or set-off) any of the funds in the Concentration Account. Instead, Great Basin voluntarily made a payment to Wells Fargo to cover the overdrafts that existed in the Concentration Account.

Moreover, Volvo's arguments are contrary to sound public policy which favors the free flow of credit and recognizes the need for finality in banking transactions. In Harley Davidson *supra*, the First Circuit explained the policy as follows:

... First the courts, using comment 2(c) to U.C.C. § 9-306 to determine when they should trace proceeds through a commingled account, have limited recovery to circumstances where the behavior of the third party, if not fraudulent, has at least seemed highly unfair or improper. ... If, however, courts too readily impose liability upon those who receive funds from the debtor's ordinary bank account—if, for example, they define "ordinary course" of business too narrowly—then ordinary suppliers, sellers of gas, electricity, tables, chairs, etc. might find themselves called upon to return ordinary payments (from a commingled account) to a debtor's secured creditor, say a financier of inventory. Indeed, we can imagine good commercial reasons for *not* imposing, even upon sophisticated suppliers or secondary lenders, who are aware that inventory financiers often take senior secured interests in "all inventory plus proceeds," the complicated burden of contacting these financiers to secure permission to take payment from a dealer's ordinary commingled bank account. [Citations omitted]. These considerations indicate that "ordinary course" has a fairly broad meaning; and that a court should restrict the use of tracing rules to conduct that, in the commercial context, is rather clearly improper.

Harley Davidson, 897 F.2d at 622 (emphasis added).

Volvo also asserts that to permit Wells Fargo to pursue an "ordinary course" defense would be unfair because it would allow Wells Fargo to "claim special rights because of its own failure to investigate Great Basin's condition." Applt's Brief at 44.

This argument ignores the very purpose behind Section 9-306(2) and Official Comment 2(c), which permits transferees of who receive payments in the ordinary course to “take free of any claim” of a secured party without doing a UCC search in order to enhance finality in business transactions and the free flow of credit.

5. The Undisputed Facts of This Case Establish the Applicability of 9-306(2) and Official Comment (2)(c).

Finally, Volvo argues that Wells Fargo has not established “as a matter of law that the ordinary course defense applies on the undisputed facts.”²⁴ Applt’s Brief at 44. Volvo does not specify which facts relating to that analysis are in dispute, only that “addressing the issue would require the Court to review the record in detail – when the trial court has not yet done so on this issue.” Applt’s Brief at 44-45. However, the absence of any allegations by Volvo that the transfer was not in the ordinary course or that Wells Fargo knew that the transfer violated Volvo’s security interest undermines Volvo’s assertion. Indeed, as set forth in Rule 56(e), “[w]hen a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon mere allegations or denials of the pleadings, but the response by affidavit or otherwise, must set forth specific facts showing that there is a genuine issue for trial.”

²⁴Volvo cites HCC Credit Corp. v. Springs Valley Bank & Trust, 712 N.E.2d 952 (Ind. 1999), for the proposition that the application of the ordinary course defense creates a question of fact. However, HCC Credit Corp. actually states that the determination of whether the ordinary course defense is applicable is a “question of law,” although “sometimes an evaluation of the extent to which payment was routine or the extent of the recipient’s knowledge will require factual analysis.” Id. at 958. While the facts of a case must always be applied to the law, if the facts are undisputed, it is appropriate for the court to rule as a matter of law that the ordinary course defense applies. Id. at 958-59.

The undisputed facts here do establish that the ordinary course defense protects Wells Fargo. Whether a transferee of money will be protected by the ordinary course defense under § 9-306(2) and Official Comment 2(c) generally depends on the consideration of two factors: (a) was the money received in connection with the operation of the debtor's business; and (b) did the transferee receive the money without knowing or being reckless in knowing that the payment violated the secured party's interest. See Textron, 579 N.W.2d at 51; J. I. Case Credit, 991 F.2d at 1279. The court in Harley-Davidson explained that the ordinary course defense "should have a fairly broad meaning" and that courts should "restrict the use of tracing rules to conduct that, in the commercial context, is rather clearly improper." 897 F.2d at 622.

Applying the foregoing, it is clear that the \$900,000 wire transfer was paid to Wells Fargo in connection with the operation of Great Basin's business. It is undisputed that the Great Basin Entities had a cash management system at Wells Fargo where each of the Great Basin Entities had its own Treasury Management Account and there was also a Controlled Disbursement Account. The checks to pay Great Basin's business expenses were drawn on one of these accounts, and the requisite funds to cover those checks were transferred into those accounts from the Concentration Account. R. 995-97, 1018-19, 1283. On December 27 and 28, 2000, there were numerous checks that were drawn against the Treasury Management Accounts and the Controlled Disbursement Account that were to be paid with funds from the Concentration Account. R. 1218, 1229-30. There is also no dispute that the list of the payees on the checks shows that they were for Great Basin's business operations, and indeed the vast majority of the amounts paid went

to Volvo Trucks, Associates (Great Basin's other flooring lender) and to make tax payments. R. 1229-30. There also was nothing unusual about the total amount of the checks that had been presented for payment on December 27th and 28th. Indeed, a review of the electronic debits/bank debits in December 2000 bank statement for the Concentration Account show that almost on a daily basis hundreds of thousands of dollars were being transferred from the Concentration Account to the Treasury Management Accounts or the Controlled Disbursement Account to cover payments from those account. R. 608-15. Moreover, it would not be out of the ordinary for Wells Fargo to permit the checks to be honored when Great Basin specifically promised that funds would be transferred into the Concentration Account to cover the overdraft.

With respect to the second factor, there is no allegation and absolutely no evidence that Wells Fargo knew or suspected that the \$900,000 wire transfer it received was in violation of Volvo's claimed security interest. In fact, Dean Luikart, who monitored the Great Basin account for Wells Fargo, specifically testified that he was not aware of any claim by any third party in the funds that Great Basin used to cover the overdrafts. R. 1004-05.²⁵

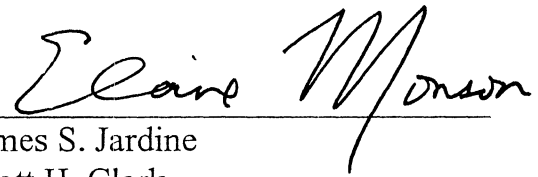
²⁵ Although Volvo makes no factual argument on appeal, Volvo did argue before the district court that Wells Fargo "must have known" that it was acting to Volvo's prejudice because it was aware of Volvo's security interest and knew that the funds that were transferred into the Concentration Account were likely to be proceeds from the sale of Great Basin's truck inventory. However, as explained in J.I. Case Credit, knowledge of a security interest does not mean that the party also has knowledge that the party is receiving a payment in violation of that security interest. 991 F.2d at 1278. Nor is such knowledge sufficient to establish recklessness on the part of the party receiving the payment.

CONCLUSION

For the foregoing reasons, this Court should affirm the judgment entered by the district court in favor of Wells Fargo.

DATED this 14th day of July, 2006.

RAY QUINNEY & NEBEKER P.C.

A handwritten signature in cursive script, reading "Elaine Monson". The signature is written in dark ink and is positioned above a horizontal line.

James S. Jardine
Scott H. Clark
Elaine A. Monson

Attorneys for Defendant and Appellee,
Wells Fargo Bank, N.A.

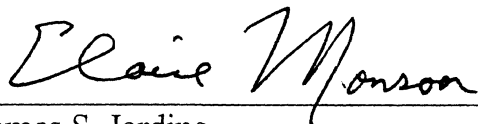
CERTIFICATE OF SERVICE

I hereby certify that two true and correct copies of the foregoing BRIEF OF APPELLEE were hand-delivered on the 14th day of July, 2006 to:

Thomas R. Karrenberg
Stephen P. Horvat
Heather M. Sneddon
ANDERSON & KARRENBERG
700 Chase Tower
50 West Broadway
Salt Lake City, Utah 84101-2006

DATED this 14th day of July, 2006.

RAY QUINNEY & NEBEKER P.C.

A handwritten signature in cursive script, reading "Elaine Monson", is written over a horizontal line.

James S. Jardine
Scott H. Clark
Elaine A. Monson

Attorneys for Defendant and Appellee,
Wells Fargo Bank, N.A.

Tab 1

L RECREATION OF MR JUDD S EXHIBIT 1 MODIFIED FOR TWO TRANSACTIONS NOT ACCOUNTED FOR USING THE LOWEST INTERMEDIATE BALANCE RUL

Schedule 1

EAT BASIN GMC TRUCKS INC

Exhibit 1

lysis 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	End g Balance
GREAT BASIN COMPANIES - WELLS FARGO BANK (409-8321417)																	
nnning Balance																	
rust 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)	
il 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)
sfer from Salt Lake Volvo WFB Account																	
rust 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		
sfer from Arizona WFB Account																	
rust Money		16 895						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			
sfer from Southwest WFB Account																	
rust 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						
sfer from Idaho WFB Account																	
rust Money				69 427			1 130 712										
Other	38 778	710	5 271	2 046		11 406	(91)	18 896	31 230		1 788 83						
sfer to Great Basin Trucks FSB Account																	
rust Money											(566 584 35)	(500 000 00)					
Other											(933 416)						
sfer from Great Basin Trucks FSB Account																	
rust Money																	\$ 900 000
Other														300 000		900 000	Transfer
r 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)	
ng 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)	
rust 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 (222-00015-32)																	
nnning Balance																	
rust 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	32,203
Beginning Balance													50 904	2 247 171	2 377 856	2 110 786	2 230 002
sfer From WFB Concentration Account																	
rust Money												1 066 584					
Other												933 416					
sfer to WFB Concentration Account																	
ciated Foods Truck Payment (Trust Money)														(300 000)		(900 000)	
ston Supply Truck Payment (Trust Money)																1 882 967	
r Receipts and Disbursements																	
Receipts																	
Disbursements																	
ng Balance	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$ 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