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Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

NATURE'S SUNSHINE PRODUCTS, INC., a Delaware corporation Plaintiff-Appellee, vs. MONEYCODE, INC., a Nevada corporation, and WAYNE WATSON, an individual, Defendants-Appellant.	:	**REPLY OF THE APPELLANT** Case No.: 20060534 CA Oral argument requested

Appeal from the Judgment of the Fourth Judicial District Court
County of Utah, State of Utah
The Honorable Anthony W. Schofield

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ARGUMENT

I. THE TRIAL COURT MISINTERPRETED THE TRUST DEED.

Appellee's position on this appeal is based on two primary arguments: First, that the trial court was correct in nullifying paragraph 10(d) of the First Security Trust Deed ("Trust Deed") agreement, and in construing the recital paragraph or, as Appellee describes it, the "for the purpose of securing" paragraph in the Trust Deed as the only operative provision dealing with modification of the terms of the underlying agreement. Second, after Appellee assumes that paragraph 10(d) is effectively nullified, Appellee argues that §7.3(b) is the applicable Restatement (Third) of Property which controls the facts in this case. However, as was shown in the Brief of the Appellant, and is further demonstrated below, the trial court was in error when it nullified paragraph 10(d) and refused to apply §7.3(c) as the applicable and controlling section of the Restatement.

Appellee incorrectly asserts that Appellant failed to address the trial court's analysis of the separate provisions in the Trust Deed. However, as pointed out in the Brief of the Appellant, the "for the purpose of securing" clause in the Trust Deed is a dragnet clause, while paragraph 10(d) of the agreement (in the "it is mutually agreed" portion of the Trust Deed) is a provision allowing the parties to modify the terms of the agreement ("Modification Clause"). Appellant analyzed both provisions, and demonstrated why the trial court's limited focus on the dragnet clause was incorrect, and why the trial court should have given validity and enforcement to the Modification

Clause. In the first and third section of the Brief of the Appellant, Watson explains how the trial court misinterpreted these two clauses in the Trust Deed.

However, Watson will clarify what he has already analyzed. The dragnet clause is not the provision at issue in this case. R. at 162. In the trial court, Watson relied on paragraph 10(d) of the Trust Deed as the operative provision which permitted the parties to modify the terms of the agreement. R. at 161. As stated in the Note of October 22, 2003, Watson and MoneyCode made the modification of the Trust Deed "pursuant to and in accordance with the language of the Note and Paragraph 10 of the Trust Deed." R. at 190-91. As argued on this appeal, and as a matter of law, the dragnet clause is inapplicable to Watson's argument for modification and any reliance by the trial court to this provision is incorrect and irrelevant.

Although the dragnet clause, in describing the instrument secured by the Trust Deed, identifies the "First Security Home Equity Line Agreement, Note, and Disclosure Statement" as evidencing a "revolving credit line in the maximum principal sum of" $75,000.00, it does not contain any prohibitory language with respect to the parties rights to modify the terms of that underlying obligation. R. at 162. It specifically provides for the parties to make "extensions, renewals, modification, and future advances and thus can be easily recognized as a dragnet clause. R. at 162.

However, it is the Modification Clause found in paragraph 10(d) of the Trust Deed which controls the question presented on this appeal. That provision broadly

allows that the trustee may "grant <u>any</u> extension or modification of the terms of the Agreement." (Emphasis added.) R. at 161. It is this Modification Clause that is the applicable provision of the Trust Deed which controls the actions of the parties in the case at issue. R. at 6. However, the trial court incorrectly interpreted this provision and erroneously failed to apply it to the facts of this case. R. at 181-184. The trial court erred in its conclusion and limited interpretation of paragraph 10(d) by holding: "this section does not expand upon what the trust deed secures . . . rather it sets forth a number of provisions which are intended to give additional protection to the beneficiary extending credit on the strength of the trust deed." R. at 183. Thus, the trial court erroneously found that the Modification Clause was limited to "describing ministerial functions which a trustee may take," and concluded that a trustee did not have the power to extend or modify the amount of the Trust Deed. R. at 181.

However, paragraph 10 clearly states that the <u>beneficiary</u> (MoneyCode) may request the trustee to "grant any extension or modification of the terms of the Agreement." R. at 161. Contrary to the trial court's interpretation, the beneficiary is the party making the decision to modify the trust, which he or she may do, and the trustee merely carries out the wishes of the beneficiary. In essence, the trustee is only given the power to implement the wishes and desires of the beneficiary, who has power the power to act on his wishes and desires. The trustee is merely an instrumentality of

the beneficiary in carrying out the beneficiaries desires. The beneficiary always retains the power to act.

In this case, with the assignment of the Trust Deed and Note, MoneyCode became the beneficiary under the Trust Deed. R. at 191. As such, the beneficiary had all rights to request or allow a modification of the agreement, if agreed to by the Trustor (Watson). Consequently, a reading of the entire agreement compels the conclusion that the modification of the terms of the agreement by MoneyCode and Watson was allowed under the circumstances of this case. Although the modification of the terms of the agreement in this case substantially increased the amount of the obligation secured by the Note, it must be acknowledged that such a modification of terms was within the scope of the Modification Clause, which does not put any limitations on what may be extended or modified or the magnitude of the modification. R. at 161. Therefore, an extension on the amount is included and permitted. The trial court's limitation and misinterpretation of the Modification Clause was erroneous.[1]

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[1] Appellee's reliance on *In re Cole v. Federal Land Bank of Baltimore*, 60 B.R. 325 (Bkrtcy) E.D. Pa. 1986) is misplaced. *In re Cole* is a case regarding a future advance or dragnet clause. As stated above, the dragnet clause is not applicable to this case.

II. THE TRIAL COURT APPLIED INCORRECT LAW IN ITS RULING DUE TO ITS MISINTERPRETATION OF THE TRUST DEED.

A. Restatement 7.3(c) Applies To This Case.

Restatement 7.3 does not apply to future advances or dragnet clauses. Chapter 2 of the Restatement applies to future advances mortgagees. *Restatement (Third) of Property,* §2.1 et seq., §7.3, comments (d). Therefore, since the trial court found that Watson could make modifications under the dragnet clause but not under the Modification Clause, it both incorrectly invalidated the provision of the Trust Deed having direct application to the circumstances of this case, and it erroneously applied the wrong section of the Restatement to the facts herein. If, as it concluded, the trial court wanted to interpret and enforce only the dragnet clause, it should have restricted its legal analysis to the Chapter 2 of the Restatement. R. at 176-194. Instead, and erroneously, the trial court focused its analysis on 7.3(b) of Restatement. R. at 180-181. However, since the Modification Clause expressly allowed MoneyCode and Watson to modify the amount of the Trust Deed, and since the Note of October 22, 2003 expressly referred to the Modification Clause in increasing the amount of the obligation secured by the Trust Deed, the trial court should have applied Restatement 7.3(c).[2] R. at 161.

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[2] Contrary to what Appellee argues, Watson did address material prejudice in his Brief of the Appellant. Watson stated that under the Restatement §7.3(c), material prejudice does not apply because no exception is given under that section for material prejudice.

A closer analysis of the Trust Deed reveals that the dragnet clause or the so called "for the purpose of securing" clause is located in a section of the Trust Deed that fills a purpose similar to the "recitals" in an ordinary contract. R. at 162. In other words, this provision identifies the Note that is being secured and while the description contains the language "in the maximum principal sum of $75,000.00", it does not attempt to bind the parties to prevent that obligation, or its amount, from modification. R. at 162. The language of the dragnet clause concerning the obligation is descriptive, not prohibitive.

By contrast, paragraph 10 is included in that portion of the Trust Deed agreement clearly specified as the operative portion, below the heading: "IT IS MUTUALLY AGREED THAT." R. at 161. The contractual nature of paragraph 10(d) makes clear that the parties agreed at the time the agreement was entered into that the beneficiary could "at any time, and from time to time . . . grant any extension or modification of the terms of the Agreement." (Emphasis added.) R. at 161. Appellee's argument in support of the trial court's conclusion that the Modification Clause at paragraph 10(d) is invalid in this case is based in large part upon an analysis of mortgages that do not contain a modification clause. However, such argument is irrelevant because, in this case, the Trust Deed contains the Modification Clause.

Appellee argues that the Modification Clause language is inadequate to permit the First Security Note to be increased and retain priority of the Trust Deed over junior

lien holders because the Modification Clause does not contain language exactly like the language used in an illustration given in the Restatement comments to §7.3(d). However, the illustration used in the Restatement is just that, an illustration. Neither §7.3 of the Restatement nor the comments to that section state that the language allowing modification must be given a specific way, or that language in a Trust Deed which do not specifically follow the language of the illustration will not be effective. Instead, the illustration merely attempts to show an example of how a modification clause would work. In this case, the Modification Clause is more broadly worded to create a less limited and more expansive scope of permissible modifications to the terms of the underlying agreement. The Modification Clause clearly and unambiguously states that "any" modification "to the terms of the Agreement" may be made. R. at 161. Certainly, such language is sufficient to allow a modification of the terms of the Agreement by increasing the principal amount of the Note. Therefore, the language in the Modification Clause is adequate to permit the modification in this case.

B. The *Bank Of Ephraim* Case Does Not Apply To This Case Because It Involves A Dragnet Clause, Not A Modification Clause.

Contrary to the Appellee's analysis, the trial court incorrectly relied on the *Bank of Ephraim v. Davis,* 559 P.2d 538, 540 (Utah 1977). The trial court's error arose from its incorrect conclusion that the operative provision of the Trust Deed under these circumstances was the future advances or dragnet clause (i.e., the "for the purpose of securing" clause). R. at 185-186. However, the trial court erred in reaching that

conclusion. As discussed above and in Brief of the Appellant, the future advances or dragnet clause found in the "for the purpose of securing" provision is inapplicable to this case. Therefore, the *Bank of Ephraim* case (which discusses a dragnet clause) is irrelevant. Both parties to this appeal agree that the correctness of the trial court's decision to give force to the dragnet clause while ignoring the Modification Clause under the circumstances of this case underlies the application and legal analysis of the Restatement sections. Therefore, if the trial court was incorrect in ignoring and failing to apply the Modification Clause to these facts, it was also in error to apply the Restatement §7.3(b) as the controlling law. As argued above, the trial court should have analyzed and applied §7.3(c).

The trial court's decision to apply §7.3(b) to this case led directly to his erroneous decision to grant Appellee's motion for summary judgment. Section 7.3(b) contains the express language that a mortgage modified by the parties <u>in the absence</u> of a reservation of rights to make the modification retains its priority against junior liens, "except to the extent that the modification is materially prejudicial to the holders of such [junior] interests and is not within the scope of a reservation of right to modify as provided in Subsection 7.3(c).

Had the trial court applied Subsection (c), on a determination that the operative section of the Trust Deed was the Modification Clause at paragraph 10(d), it would have been required to conclude that the modified Note "retains priority even if the

modification is materially prejudicial to the holders of junior interests in the real estate." Restatement, §7.3(c). Similarly, under a proper analysis and interpretation of the Trust Deed, the trial court would have concluded that §7.3(d) of the Restatement was inapplicable to this case because the mortgagor never "issue[d] a notice to the mortgagee terminating" the right to modify the agreement.

C. The Reporters' Note And Other Cases Appellee Relies On Are Inapplicable Because They Involve Situations Where No Modification Clause Exists.

The case law and the Reporters' Note to the Restatement given by Appellee in its Brief apply only to those mortgages that do not contain a modification clause. For example, the Reporters' Note to the Restatement is commenting on subsection (b), which is applied when no modification clause exists in the trust deed.[3] See Addendum A to Brief of Appellee at 484-485. Therefore, the cases and notes are inapplicable to this case.

III. *FRIERY* INDICATES THAT A SENIOR LENDER MAY RETAIN PRIORITY OVER A JUNIOR LENDER.

In his opening brief, Appellant relied upon *Friery v. Sutter Buttes Savings Bank,* 61 Cal. App. 4th 869, 878 (Cal. App. 1998) to support and illustrate his position that modifications to a trust deed, when the right to modify is retained, do not alter the senior lien holder's priority. Although *Friery* is somewhat factually distinguishable, in

[3] Watson already distinguished the other cases cited and analyzed by Appellee in the third section of his Brief of the Appellant.

that there is no modification clause in the trust deed, it still sets forth good policy. In *Friery*, the junior lienholder "voluntarily assumed a security position which she knew carried an element of risk." *Id.* at 879. The court found that the senior lender did not have a special duty toward the junior lender. *Id.* Therefore, the "renegotiation of the senior loan upon transfer of ownership without the lender's consent was precisely one of the hazards which [the junior lender] accepted when she sold the property and took back a second deed of trust." *Id.*

In *Gluskin v. Atlantic Savings and Loan Assc.*, 32 Cal. App. 3d 307 (Cal. App. 1973), the court analyzed material modifications when a seller subordinates a loan in favor of a construction lender. This is easily distinguishable from this case. The court stated that "rights of priority under an agreement of subordination extend to and are limited strictly by the express terms and conditions of the agreement." *Friery*, 61 Cal. App. 4th at 874 (citing *Gluskin*, 32 Cal. App. 3d at 313). As set forth above, the express terms and conditions of the agreement in this case (i.e., paragraph 10(d)), provide that the parties retained the right to make "any modification" to the agreement, "at any time".

In this case, Appellee is the junior lender. It voluntarily took a security position subject to the Trust Deed, which allowed modifications. R. at 161. Thus, Appellee assumed the risk of a junior lender. MoneyCode did not have a special duty toward Appellee. Therefore, the modification of the Trust Deed, without Appellee's consent,

is permitted and enforceable against Appellee. The "hazard" that Appellee accepted when it gave a trust deed included the provision in the Trust Deed allowing for just such a modification to the agreement. What is absent in *Friery* is a modification clause, which exists in this case. R. at 161. Therefore, Watson's position is even stronger than that of the senior Trustor in *Friery* because there is a Modification Clause which notifies the junior lender of the potential that the agreement may be modified as to its terms and conditions.

Appellee argues that the *Friery* case does not involve material modifications. However, Appellee is really arguing that the materiality of the modified terms in this case is much more "material" than the modifications presented in *Friery*. Nevertheless, under the applicable law, the materiality or prejudicial nature of the modification in this case does not matter because Restatement 7.3(c) does not provide an exception for material modifications or for prejudice to the junior lien holder. In addition, this does not involve a subordination agreement, thus, *Gluskin* is inapplicable.

IV. APPELLANT THOROUGHLY BRIEFED HIS POSITION, REFERRED TO AND INCLUDED ALL NECESSARY DOCUMENTATION FOR THE COURT IN AN ADDENDUM SUBMITTED WITH THE BRIEF. APPELLANT HAS FILED AN AMENDED BRIEF OF APPELLANT WITH CITATIONS TO THE RECORD.

First, as shown above, Appellant discussed the misinterpretations by the trial court regarding the Trust Deed in its Brief of the Appellant. Second, Appellant filed an addendum with all the necessary documentation from the trial court for the Court's

review (which are included in the official record). Further, Appellant has requested leave to and has filed with the Court an Amended Brief of Appellant containing reference to and citation of the record.

V. THE BACKGROUND INFORMATION GIVEN BY APPELLANT IS HELPFUL TO THE COURT'S ANALYSIS.

The background information given by Watson in his Brief of the Appellant, in the Statement of Facts section, helps the Court see the reasoning behind the modification of the Trust Deed. In addition, although Appellee points out that the modification was made a day before the foreclosure sale, the question of this appeal is whether the parties retained the right to make such a modification, not the timing and circumstance of the modification. As argued above, the Modification Clause provides that a modification to the terms and conditions of the agreement may be made "at any time, and from time to time" and permits the parties to "grant any . . . modification of the terms of the agreement." R. at 161. Therefore, the circumstances surrounding the modification made in this case are not determinative.

CONCLUSION

For the reasons stated in this reply and Appellant's Brief, Appellant respectfully requests that this Court: (1) reverse the Order Granting Plaintiff's Motion for Summary Judgment, (2) reverse the Order Denying Motion for Reconsideration and Revision of Order on Summary Judgment, (3) reverse the Order Granting Nature's Sunshine Products' Motion to Approve Payment of the 1987 First Security Note, to Reconvey

the 1987 Trust Deed and to Cancel MoneyCode's Notice of Default, and (4) remand this case for a new trial consistent with the Court's rulings.

Dated this 18 day of December, 2006.

HILL, JOHNSON & SCHMUTZ, L.C.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 18 day of December, 2006, I caused to be served two (2) true and correct copies of the foregoing by depositing the same in the United States Mail, postage prepaid, addressed to the following:

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