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W.A. Nielson v. John W. Smith, Albert S. Wheelwright and Smith Land Co v. M.M. Johnson : Reply Brief of Appellant

Utah Supreme Court

J.D. Skeen, E.J. Skeen; attorneys for appellants.

IN THE

SUPREME COURT

OF THE

STATE OF UTAH

W. A. NIELSON.

Plaintiff and Respondent.

vs.

JOHN W. SMITH and J. CAMERON SMITH, E. LINCOLN SMITH, POLLY SMITH, JOHN W. SMITH and MAX GAILEY, Trustees of the SMITH LAND COMPANY, and SMITH LAND COMPANY, a corporation.

Defendants and Appellants.

ALBERT S. WHEELWRIGHT, Trustee in Bankruptcy of John W. Smith, Bankrupt.

Intervenor and Respondent.

No. 6199

SMITH LAND COMPANY, a corporation.

Plaintiff.

vs.

M. M. JOHNSON, Receiver of Nielson-Burton Company, formerly a co-partnership composed of A. J. Nielson and Charles S. Burton, CHARLES D. MOORE and WILSE A. NIELSON.

Defendants.

No. 6198

APPELLANTS' REPLY BRIEF

J. D. SKEEN,
E. J. SKEEN,
Attorneys for Appellants.

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APPELLANTS' REPLY BRIEF

The respondents' brief contains a sketchy statement of facts which carefully omits all evidence which is dam-

aging to them. No reference is made to the pages of the transcript and the Abstract of Record as required by rule Ten of the Rules of Practice of this Court. Many of the statements are inaccurate and misleading and some find no support in the record whatever. Other facts of vital importance are not even mentioned.

The respondents' argument is based upon the assumption of the very thing which they are trying to prove, namely: that the findings of fraud are sustained by the evidence. After discussing several cases involving conveyances to corporations in fraud of creditors, none of which are in point on the facts, it is said on page 17, that John W. Smith transferred his property to the corporation; that after the transfer, he continued to live on the land he had contracted to buy; that he was heavily indebted to his creditors and was being pressed for money and that immediately after forming the corporation, the charter was forfeited for non-payment of the franchise tax. It is then concluded that there was a clear intent to hinder, delay and defraud creditors. Admitting for the purpose of the argument that all of these statements are true, they do not show a fraudulent intent. The courts hold that a transaction in which an insolvent debtor conveys to a corporation all of his property and receives in exchange the stock of the corporation is not a fraudulent conveyance unless it is shown that there was an actual fraudulent intent. The rule is stated in an extensive note on the subject in 85 A. L. R., page 140:

> "Where the only circumstance relied upon as furnishing the intent to delay or defraud creditors is the fact that the debtor transferred his property to

a corporation in consideration of its stock, many courts have refused to declare the transaction fraudulent as having been entered into with intent to delay and defraud creditors, or one without consideration. Such transfers are sustained, in the absence of an actual intent to delay or defraud creditors, which must be deduced from circumstances other than the mere transfer in consideration of stock."

In the case of Sunderlin v. Terry, 95 Conn. 713, 112 Atl. 642, a debtor conveyed his property to a corporation organized by him, received stock for his property, borrowed money and pledged the stock, as security. The creditors attacked the conveyance as fraudulent, but the court refused to set it aside and after analyzing the evidence said:

"To organize a personal business into a corporation is altogether too common to raise any presumption of fraud."

See also:

Jordan v. Lynch Land Company, 83 Ind. App. 33, 147 N. E. 318;

Gardner v. Haines, 19 S. D. 514, 104 N. W. 244;

Shumaker v. Davidson, 116 Iowa 569, 87 N. W. 441;

Plant v. Billings-Drew Company, 127 Mich. 11, 86 N. W. 399;

Thorpe v. Pennock Merc. Company, 99 Minn. 22, 180 N. W. 940;

Persse & B-Paper Works v. Willett, 19 Abb. Pr. (N. Y.) 416;

Byrnet & H. Dry Goods Company v. Willis Dann Company, 23 S. D. 221, 121 N. W. 620, 29 L. R. A. (N. S.) 589;

Bristol Bank & T. Company v. Jonesboro, 101 Tenn. 545, 48 S. W. 228;

Densmore Commission Company v. Shong, 98 Wis. 380, 74 N. W. 114.

Throughout the presentation of the facts and the argument, the respondents seek to give the impression that in 1930 when the alleged fraudulent assignment occurred, John W. Smith was the owner of valuable land which he was seeking to keep away from creditors. The fact is that Smith had a contract of purchase upon which he had defaulted to the extent of $1208.91 besides interest in 1929. He was in default on taxes for three years and had received several letters threatening cancellation prior to 1930. (Abs. 89, 101.) In the fall of 1930 he was faced with a principal payment of $2,000.00 together with interest at Seven percent and he was without money to meet the payments. The contract was subject to forfeiture and no doubt would have been cancelled but for the timely assistance of J. Cameron Smith. At the time of the assignment, Smith was valiantly seeking to keep the contract of purchase in good standing. In October, Smith owed a judgment to W. A. Nielson for $54.90 and one to Bertha Skeen for $100.00. Another judgment for $1278.92 in favor of W. A. Nielson was in 1930 being appealed to the Supreme Court and a stay bond was on file. The sureties qualified before Judge McKinney and Smith expected to reverse the case in the Supreme Court. (Abs. 93.95.) The

respondents contend that this scheme of incorporating was not to provide a means of getting family help to save a $10,000.00 contract but was all devised for the purpose of defrauding creditors of $154.90. The same argument was made in the case of Sunderlin v. Terry, supra, the court said:

> "To organize a personal business into a corporation is altogether too common to raise any presumption of fraud. Moreover, as an ordinary business proposition it seems improbable that one having $10,000 of property should transfer the whole to escape the payment of the small sum of $150 to $160, and retain in the bank half enough cash to pay even that, so that $80.00 was the claimed motive for the fraudulent transfer."

There is no evidence that the sureties on the appeal bond refused to pay or that any effort was made to exhaust the security for payment of the judgment for $1278.92. The fact of the matter is that W. A. Nielson didn't collect the judgment in 1930 because he was looking for larger "game" than $54.90. He was willing to stand by until the contract of purchase was paid out by the Smith Land Company with the idea of acquiring all of the outstanding accounts and then attempting to get the land. The respondents have cited a number of fraud cases, particularly those using such words as, "parasitic growth, a mass of fungus," etc., but W. A. Nielson and his predecessors did not hesitate to accept payments over a period of many years from the "fungus" until the contract was paid down to where there was an equity. It is argued that the corporation was only the *alter ego* of John W. Smith and the fact that the court found that J. Cameron

Smith had paid $1,000.00 on the contract which was credited on his stock account and the fact that he turned to the corporation a tractor for which he testified he had paid $1500.00 is entirely ignored. J. Cameron Smith was not a judgment debtor and there is no evidence in the record that he was interested in the slightest in defrauding creditors of John W. Smith and yet the trial court made no effort to protect his interests as a stockholder or otherwise.

The court found that J. Cameron Smith paid for his stock but that all other shares, except John W. Smith's, were distributed to members of the family wholly without consideration. This finding is contrary to the uncontradicted testimony of John W. Smith that he was indebted to his mother for $1,000.00 cash borrowed from her, owed Clarence Smith "Seven Hundred odd dollars," owed E. Lincoln Smith $600.00 and also owed money to S. M. Smith and Andrew Smith, a son. (Abs. 90.) This was a family corporation and all of the members of the family were cooperating with an elderly father to enable him to keep his ranch. For a similar situation see the case of Shumaker vs. Davidson, 116 Iowa 569, 87 N. W. 441. In that case, the debtor organized a corporation for the purpose of transferring to it certain land which was heavily encumbered. Some of his relatives including his wife and brother-in-law conveyed land to the corporation and one near relative paid $1200.00 cash for his stock. The debtor owed sums to unsecured creditors aggregating about $17,000.00 and the transfer was attacked as fraudulent. The court refused to set the transaction aside because there was consideration for the

transfers, namely: the stock, and there is no evidence of fraudulent intent other than the transfer itself. The court said:

> "If the corporation were a mere scheme for the purpose of concealing covin equity would look behind the curtain to discover the real purpose. It is not denied that the other incorporators invested money in the scheme and transferred property in consideration of stock received. This they would not have done had the transaction been as claimed by the creditors and their representatives. We are asked to say, however, that notwithstanding there is no conflict in the evidence regarding the manner and method of organization, the whole scheme was a fraud and the witness should be disbelieved. This we are not prepared to do. When the facts disclosed are as consistent with honesty and good faith as with fraud and deceit we must sustain the transaction."

In Thorpe v. Pennock Merc. Company, 99 Minn. 22, 108 N. W. 440, the court said:

> "In fact, as the partnership was insolvent the parties may well have reasoned that the interests of the creditors would be advanced by the organization of the corporation under conditions which would render solvent the holders of the stock who were responsible for partnership debts."

John W. Smith testified that some time earlier in October, 1930, he went to D. A. Skeen's office and told him about the organization of the corporation and that he had reserved stock for the payment of creditors. He said that he offered to pay the W. A. Nielson and Bertha Skeen claims in that way and D. A. Skeen referred him

to Mr. Spence. He made the same proposition to Mr. Spence, who, a few days later, notified him that the proposal would be rejected. (Abs. 79, 81, 83.)

The articles of incorporation show that 2,799 shares were reserved by John W. Smith, as trustee. D. A. Skeen testified that he had never heard such a proposal and Ben Spence testified that he had met John W. Smith for the first time in court at the trial. (Abs. 91.)

On redirect examination, John W. Smith said that he met Spence in 1930 and had seen him a half a dozen times since, twice in D. A. Skeen's office and further that he had seen him when the sureties qualified on the appeal bond. This testimony is corroborated by the order with respect to the qualification of the sureties. (Abs. 95, 96.)

In answer to appellants' argument of estoppel (pleaded in answer of Smith Land Company, Abs. 30), the respondents contend;

(1) That it is "far fetched," and

(2) That there could be no estoppel as against the trustee in bankruptcy. (Res. Br., 29.) When an argument cannot be met, it is convenient to say it is "far fetched" but this bare statement is no more convincing than the argument that there is no basis for estoppel "as applied to the trustee in Bankruptcy." Apparently respondents believe that a trustee gets a bright new title to all claims and that he enters the picture carrying the halo of innocence. This, of course, is not the law. The trustee merely steps into the shoes of the creditors and he takes the claims subject to all of the infirmities incident to them

in the hands of the original creditors. In Remington on Bankruptcy, last edition, Section 1509, it is said:

> "It is well established that the effect of 70 e is to clothe the trustee with no new or additional rights other than those which a creditor would have possessed but simply puts him in the shoes of a creditor as regards a fraudulent transaction subject to the same limitations and disabilities that would have beset a creditor in the prosecution on his own behalf."

Security Warehouse Company v. Hand, 206 U. S. 415, 51 L. ed. 1117, 27 S. Ct. 789;

Globe Bank v. Martin, 236 U. S. 288, 59 L. ed. 583, 35 S. Ct. 377;

Davis v. Willey, 263 Fed. 588.

Some startling inconsistencies in respondents' argument should be noticed. It is pleaded in the complaint:

> "That upon the entry of said judgment, execution was issued thereon and delivered to the Sheriff of Box Elder County and said executions were duly returned by the said Sheriff wholly unsatisfied and the said judgments, nor any part thereof, have not been paid." (Abs. 2.)

This, by the way, is omitted from the respondents' resume' of the pleadings although the authorities hold that to entitle the plaintiff to equitable relief in proceedings of this kind, there must be a showing that execution has been issued and returned unsatisfied. It is next contended that the respondents and their attorneys had no notice whatever of the return on execution until June, 1937—(Res. Br. 30) some two years after the complaint was filed in which it is alleged that the execution in ques-

tion was returned unsatisfied. This fancy dodging does not carry conviction. If W. A. Nielson didn't know in 1935 that the execution had been returned unsatisfied in 1930, he perjured himself when he pleaded that it had been returned unsatisfied. Yet, with the return showing the fact of the transfer in 1930 in the possession of the agent of the plaintiff—the sheriff—the following statement is made in the respondents' brief, page 32:

> "There is not a scintilla of evidence in the record to show that the sheriff of Box Elder County ever learned that the contract has been assigned to this corporation or that Mr. Smith transferred his property."

This is a wishful statement. It is surprising that the respondents would make it with the sheriff's return on the record dated December 3, 1930, referring to the letter of J. D. Skeen received by the sheriff on or about November 7, 1930, and attached to the return as an exhibit. The letter is set out in full in the abstract, pages 113-114. Yet, as stated above, the respondents say there is not a scintilla of evidence in the record showing that the sheriff ever knew that the contract had been transferred. When D. A. Skeen, attorney for respondents, was asked where he got the information that the execution was returned unsatisfied and was asked whether he got it from the sheriff or his deputy, he said, "I do not recall ever talking to the sheriff." (Abs. 107.) It will be noticed that he did not deny ever talking with or hearing from the deputy in 1930 when the return was dated. The rule is well settled that notice to an agent is notice to the princi-

pal regardless of the latter's actual knowledge if the information was received by the agent within the course of his employment and within the scope of his authority. 2 Mecham on Agency, Sec. 1803, et seq., 2 C. J. 859, and numerous cases cited. It is also the law that notice to an attorney at law is notice to his client. An additional case on the subject of duty of making inquiry has come to the writer's attention. It is closely in point and we believe clearly states the rule.

Deering v. Holcomb, 26 Wash. 588, 67 P. 240, 561.

The uncontradicted evidence shows notice of the transfer to the sheriff, agent of the plaintiff, Bertha Skeen, in the case in which the $100.00 judgment was procured and under the familiar rules mentioned above, D. A. Skeen, her attorney, and W. A. Nielson, his client and Bertha Skeen, successor, had notice more than four years before suit was instituted. The cause of action, if any ever existed is clearly barred by the Statute of Limitations.

The respondents attempt to answer appellants' argument that the court erred in entering judgment in favor of Wheelwright after he had been replaced as a party by Turley by court order dated February 4, 1939, by saying on page 33 of their brief that:

> "The trustee, however, was not dismissed out of the case, but continued through as a party to the case and the final judgment was entered accordingly."

Apparently the word "substituted" which appears three times in the order is misunderstood. Counsel must think

that when one person is substituted for another he becomes a sort of alternate and the court may at its convenience designate either party as judgment creditor. This is, of course, absurd and is the usual result of shifting positions to gain an advantage. Turley was used by the respondents as a dummy with the idea of acquiring Smith's equity in the property over and above the judgments. They caused him to be substituted for Wheelwright because he had bought the lawsuit from Wheelwright and succeeded to all of his rights. However, they couldn't see any possibility of collecting the $1247.19 bankruptcy costs (which include some $750.00 attorneys fee for D. A. Skeen) through Turley so they switched back to Wheelwright and drew a decree in his favor although the record is clear that he no longer has any interest in the case. Since the assets, if any, of the bankrupt's estate were sold to Turley for $500.00, the estate had money to pay the expense of bankruptcy. It could be paid out of the $500.00. It should be noted that the trial court found that all of Smith's right, title and interest in the land which he attempted to transfer in fraud of creditors was sold to Turley and then the court entered judgment in the Box Elder County case in favor of Wheelwright and against Smith and the corporation.

There has been no attempt made to explain how the state court can enforce payment of the expenses of the bankruptcy court and no explanation is made of the fact that the decrees of the trial court are dated April 3, 1939, and the order of the bankruptcy court, which respondents seek to enforce, is dated April 11, 1939. When the decrees

were entered, the bankruptcy order was not only not final, but it had not even been made!

In the Salt Lake County case, the court made a decree in favor of Wheelwright, *who was never a party,* requiring Smith and the Smith Land Company to pay the judgment and also the expenses of bankruptcy. The decree is also in favor of John W. Smith, who was never a party, requiring specific performance of the contract for his benefit. It is interesting to note that the decree is also in favor of the "fungus" corporation and provides for delivery of a deed to it upon receipt of the $2433.88 which was tendered by the Smith Land Company and by no one else. The court also found that Turley (also not a party) was the owner of the vendee's interest in the contract, but nevertheless decreed specific performance to Smith and the Smith Land Company. That part of the decree which imposes liens upon the land and conditions in favor of strangers to the suit is clearly erroneous and must be stricken. The decree in the Box Elder County case must be reversed.

Respectfully submitted,

J. D. SKEEN,
E. J. SKEEN,
Attorneys for Appellants.