

1987

In the Matter of the Registration Statement of Amenity Inc. Capital General Corporation v. Utah Securities Division and the Department of Business Regualtion : Brief of Respondent

Utah Court of Appeals

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DOCKET NO. 870567-CA
IN THE COURT OF APPEALS

OF THE STATE OF UTAH

In the Matter of the	:	
Registration Statement of	:	
AMENITY, INC.	:	Case No. 870567-CA
	:	
CAPITAL GENERAL CORPORATION,	:	
	:	
Petitioner and	:	
Appellant,	:	Priority No. 14.a
	:	
UTAH SECURITIES DIVISION	:	
AND THE DEPARTMENT OF	:	
BUSINESS REGULATION,	:	
	:	
Respondents.:	:	

BRIEF OF RESPONDENTS

Appeal from the Order of the Third Judicial
District Court for Salt Lake County, Hon. Pat
B. Brian, upholding Order of the Utah
Securities Advisory Board and the Executive
Director of the Department of Business
Regulation

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STATEMENT OF JURISDICTION

This case is an appeal from the Order of the Third Judicial District for Salt Lake County by Judge Pat B. Brian upholding the Final Order of the Utah Securities Advisory Board ("SAB") and the Executive Director of the Utah Department of Business Regulation ("Executive Director" and "Department") suspending all secondary trading exemptions of the stock of Amenity, Inc. ("Amenity"). Jurisdiction is vested in the Utah Court of Appeals pursuant to Utah Code Ann. § 78-2a-3(2)(a), as an appeal from the District Court's review of the final order of a state agency.

STATEMENT OF ISSUES PRESENTED

1. Whether appellant has met its burden relative to the applicable standard of review of the decision of the Department; to wit:

A. Whether the Department's findings of fact that Amenity circumvented or evaded the registration provisions of the Utah Uniform Securities Act (the "Act") by distributing approximately 90,000 shares of its stock to 900 individuals by gift without registering the stock with the Division is so without foundation in fact as to be arbitrary and capricious.

B. Whether the Department's conclusion that a distribution of securities as indicated above constitutes an "offer or sale" of a security is reasonable and rational; and,

C. Whether the Department's conclusion that Amenity failed to establish that the above-outlined distribution of stock qualified as a "good faith gift" excepted from the

definition of offer and sale and, hence from registration, was unreasonable or irrational.

2. Whether the Utah Securities Division ("Division") and the Department have authority to suspend all trading exemptions of a security.

STATEMENT OF THE CASE

These proceedings were initiated pursuant to a Petition, dated June 5, 1986 wherein the Utah Securities Division alleged that the distribution of stock in a corporation incorporated in the State of Utah on January 7, 1986, Amenity, Inc., was in violation of Utah Code Ann. § 61-1-7. (R. 28) The petition sought the suspension of all possible exemptions for further trading of Amenity stock without registration pursuant to Utah Code Ann. § 61-1-14(3). Id.

Memoranda were filed by the parties outlining their positions, and on September 25, 1986, a hearing was held before J. Steven Eklund, Administrative Law Judge ("ALJ"). Id. Mr. Eklund issued his Findings of Fact, Conclusions of Law and Recommended Order on October 28, 1986. (R. 32) On January 8, 1987, the SAB and the Executive Director issued an Order adopting limited provisions of Mr. Eklund's Findings of Fact and Conclusions of Law, but specifically rejecting the ALJ's determination regarding the issue of whom the registration provisions are to protect, and his determinations concerning whether the disposition of Amenity stock constituted a good faith gift. (R. 22-25) (Any reference by appellant to portions of the ALJ's findings or conclusions is reference to only a proposed

finding or conclusion, and carries no weight or authority. See page 7.) The January 8th Order of the Department called for an evidentiary hearing to be held on January 20, 1987, for the limited purpose of receiving evidence as to whether the distribution of Amenity stock was an effort to frustrate or circumvent the registration provisions of the Act, and the Order enumerated certain factors that should be addressed in making such a determination. (R. 24, 25)

On January 20, 1987, at 3:00 p.m., a hearing was held before the SAB. After consideration of the evidence produced at the January 20th hearing, the SAB and the Executive Director issued an Order on February 18, 1987, suspending the use of all secondary trading exemptions of the securities of Amenity, Inc., its affiliates and successors. (R. 13).

On April 16, 1987, Capital General Corporation appealed the Order to the District Court for review asking the court to set aside the February 18th Order. The District Court conducted a hearing on September 17, 1987 and, after reviewing the briefs on file and examining the administrative proceedings, upheld the Final Order of the Department. (R. 108)

Capital General Corporation now appeals the matter to this Court.

Note On Accuracy Of The Record In its Brief with this Court, appellant makes a claim that the record of this case below is not accurate or complete because such fails to indicate that a hearing was held on June 19, 1986 where the parties allegedly stipulated to a set of facts. Appellant then enumerates a set of

facts it claims are the facts Amenity and the Division stipulated to in the alleged hearing before the Division on June 19, 1986. Appellant Brief at 3-5. Also, in footnote 1 on page 4, appellant indicates it does not believe the respondents will deny its stipulation "because to do so would throw yet another error in the proceedings"

While it is unclear why appellant would be making these allegations unless it is attempting to restrict the Division to a more favorable "set of stipulated facts," nevertheless, appellant makes no claims that the facts reviewed by the judicial bodies in this case are in violation of any "stipulation," or that any other facts besides its "stipulated facts" are not properly before this Court for its review. Nonetheless, appellant takes issue with any disavowal the Division might make concerning any stipulation.

Counsel for the Division on this appeal was not counsel at the administrative level and is unaware of any alleged stipulation, nor are any documents filed with the Division indicating any alleged stipulation was agreed upon by parties. Most importantly, there is no indication in the record that any hearing was held on June 19, 1986. The original Petition filed by the Division against Amenity attached a Notice of Action that indicated a hearing was scheduled for June 19, 1986, however, no hearing ever took place on that date. (R. 28, 75) Thus, the Division denies any stipulated set of facts were arrived at between parties during any hearing on the above date.

If appellant believes that a stipulation was consummated between parties indicating that a particular set of facts was to be before the Department, appellant should have objected to the facts considered by the judicial bodies as being outside the scope of any stipulation, or alternatively, should have entered the "stipulated facts" on the record at the hearing. No where in appellant's memoranda filed with the Division does it raise this issue. In fact, in appellant's Memorandum in Opposition to Memorandum of the Division filed with the Department on August 7, 1986, (two months after the alleged June 19 hearing,) appellant discusses its belief as to the accurate facts before the Department and never raises the issue of any stipulated set of facts. (R. 42)

The Division has no desire to haggle over this alleged problem. If there truly was a stipulated set of facts, the Division would willingly accept whatever impact that may have on the case. However, there is nothing to reflect any such stipulation or set of facts. This whole matter is in fact a moot issue because the Department held its own evidentiary hearing wherein evidence beyond that indicated in appellant's litany was received to address additional matters. And, the evidentiary proceeding was not objected to by appellant nor could it do so with any legal tenacity because administrative proceedings are to be conducted with flexibility, informality and are to be liberally construed and easily amended. See Pilcher v. State Department of Social Services, 663 P.2d 450 (Utah 1983).

If appellant does not believe the record accurately reflects the facts and proceedings below, appellant is welcome to litigate the issue and have the record set straight. The Division would appreciate any proper supplement to the record if it is not fully accurate.

STATEMENT OF FACTS

Amenity, Inc. was incorporated in the State of Utah on January 7, 1986. (R. 28) On January 8, 1986, 1,000,000 shares of Amenity stock were issued to Capital General Corporation (CGC) in exchange for \$2,000.00 cash. Id. At least two of the officers and directors of CGC were incorporators and directors of Amenity. Id. The \$2,000.00 received from CGC was the only asset of Amenity at the time of the filing of the Division's petition. Id.

After receiving the 1,000,000 shares of stock, CGC issued 100 shares of stock to approximately 900 different individuals and organizations. (R. 29) Those who received stock were people who had invested with CGC in the past, and friends and relatives of the principles of CGC. Id. According to CGC, the purpose of the stock distribution was to reward past association and loyalty, and the general exposure of CGC's financial consulting business to persons in the financial world. Id. In other words, the purpose, according to CGC, was the creation and/or maintenance of goodwill. Id. CGC retained the remaining 910,000 shares of Amenity stock. Amenity did not file a registration statement prior to the distribution of the shares.

CGC engaged in a major campaign of incorporating over

30¹ other companies and causing them to go public by distributing its shares to a wide range of shareholders in a similar fashion to Amenity. (R. 18) In the summer of 1986, Amenity Inc. was acquired by Elkin Weiss and Companies Inc. Id. Two of the 30 additional companies have also been acquired. They are Olympus Enterprises, now Florida Growth Industries, Inc., and Y Travel, now H & B Carriers, Inc. Id.

CGC was instrumental in the acquisition of Amenity, Olympus, and Y travel by the acquiring companies and received \$25,000.00 for its role in each acquisition. Id. CGC maintained 300,000 shares of stock in Elkin Weiss. At the time of the hearing in January, Elkin Weiss' unrestricted stock was trading for around \$3.00 a share. (R. 118 Transcript at 27) The Department thus found that the purpose of the distribution of Amenity stock was to circumvent or evade the Act and the registration provisions contained therein. (R. 18)

On page 8 of his brief, appellant refers to a finding by the ALJ that the gift of stock by Amenity was made in good faith. Appellant's reference to the finding by the ALJ carries no weight or authority since the determination by the ALJ is only

¹ In fact, CGC incorporated approximately 48 companies and caused them to go public in the fashion described above. The exact number was not known to the Division at the time of the hearings, however, another case has been filed with the Department concerning the other 47 companies, and a decision concerning that case is pending. See, In re H&B Carriers, et al. Admin. Case No. 97-09-28-01 (filed Dec. 1, 1987). It is interesting to note that, at the district court, appellant claimed that the number of companies involved in the scheme was overstated by the SAB and that it was in error. (District Court Brief at 15) The truth is that the SAB understated the number of companies involved by 17.

a proposal that must be affirmed or adopted by the SAB and the Executive Director. U.C.A. § 61-1-14(3). Unless the Department adopts the ALJ's findings and conclusions, the determinations by the ALJ are without any effect whatever. Thus, appellant's claim that the finding of the ALJ that the gifts were made in good faith is misleading and improper.

SUMMARY OF ARGUMENTS

1. The standard of review is whether the Department Order is arbitrary and capricious.

This Court reviews the administrative decision rather than the district court's order. Appellant has the burden to show that the administrative Order was arbitrary, capricious, irrational and unreasonable in order for this Court to overturn the decision. Mere difference of opinion concerning the correctness or propriety of the decision is not sufficient to overturn it. The Order by the Department suspending all trading exemptions was arrived at in a rational, analytically satisfactory manner as evidenced by statutory and common law, and the findings of the Department were based upon substantial, competent evidence.

The law applicable in this case is "special law," as defined by case law, and the SAB is required to apply its technical expertise in interpreting such law in order to render its decision. The law requires reviewing courts to apply great deference to such technical expertise.

Appellant has failed to meet its burden of proof to show error by the administrative agency, and therefore, this Court must uphold the Department's decision because it was rational.

2. The purpose of the Act is to protect the public, one means of such protection is through the registration requirements.

The major thrust of the Uniform Securities Act is to protect the public in its dealings in the securities market. One of the ways such protection is furthered is through the Act's requirement that all securities offered or sold in this State must be registered with the Division. The registration requirements provide, among other things, information to the public concerning the security and those issuing it.

3. The distribution of Amenity's stock was unlawful because it was not registered with the Division.

The Act provides that it is unlawful to offer or sell any security in this state unless it is registered with the Division, or the security or transaction is exempt. The Act also defines "offer," "sell" and "sale" to include every disposition of a security for value.

Appellant claims that Amenity's disposition of its stock is excepted from the Act's registration requirements because the securities were bona fide gifts to the recipients. That is, the distribution of the stock by "gift" is not a sale, and therefore, no registration of the securities in such a distribution is required.

Clearly, a "gift" of a security constitutes a disposition of the security, and thus it is an "offer" or "sale" if it is a disposition for value. Case law and two examples provided in the Act indicate that a disposition by gift can be for value, and in this case, the creation of a public corporation by gifting securities to 900 individuals is a disposition for

value. Obviously, the gifting of securities for value is required to be registered with the Division unless otherwise exempted.

The Act provides that a "good faith gift" is an exception to the definition of an "offer" or "sale," and thus, appellant claims, it is an exception to the registration requirements. Regardless of the accuracy of that claim, appellant bears the burden of proving to the Department that what Amenity had done constituted a good faith gift in order for Amenity to assert that the disposition did not require registration. A "good faith gift" is not any and all types of gifts--it is a particular type of gift, and the Department has the authority to determine what it is pursuant to its legislative grant of authority and in furtherance of the purposes of the Act.

Appellant failed to convince the Department that its transaction was a good faith gift of securities. It must now show that the Department was unreasonable and arbitrary in its denial of the claim to the exception. The case law and analyses appellant provides fails to show error by the Department in its determination that the distribution of Amenity stock was not a good faith gift.

The Department found that Amenity disposed of its securities in an effort to circumvent the registration requirements of the Act. The Department then concluded that a good faith gift is a bona fide gift given in good faith. i.e., without intent to circumvent the purposes of the Securities Act and its registration requirements. Such a determination is

reasonable, is supported by case law, and is an application of special law to which reviewing courts are to give great deference.

3. The SAB and the Executive Director have authority to suspend all trading exemptions.

The Legislature determined that the proper manner to protect the public in its dealings with the securities market is by requiring that all securities disposed of for value must be registered with the Division unless otherwise exempted. When securities are distributed to the public without such registration, the Division has a duty to act quickly and effectively to prevent further trading of the securities. One resource provided by the Legislature to protect the public from the unlawful trading of illegally distributed securities is by suspending any exemptions that might be improperly claimed by one attempting to trade such securities.

Appellant's claim that the Division must wait until an exemption is claimed by an individual before it can act to deny or revoke such a claim is not founded on any such requirement in the statute, and it ignores the practical realities the Division faces in its regulation of the securities market. An after-the-fact attempt by the Division to declare that the person was in error when he thought he was trading his securities under a proper exemption does too little too late in protecting the public.

Pursuant to the legislative mandate to protect the public by the exercise of its authority, the Division acted to protect subsequent purchasers of Amenity's stock by suspending

all trading exemptions on the stock in Utah. For the Division not to so act would be a derogation of its duty to the public. Such an act by the Division is clearly within its authority, and to prevent the Division from so acting would result in substantial harm to subsequent purchasers who act in reliance on the expectation that the Division is properly regulating the securities market in Utah. The public cannot be as adequately and promptly protected in any other way than by the Division's action under § 61-1-14(3).

ARGUMENTS

POINT I. APPELLANT MUST SHOW THAT THE DEPARTMENT'S FINDINGS OF FACT ARE UNSUPPORTED BY THE EVIDENCE AND CONCLUSIONS OF LAW ARE UNREASONABLE

The scope of review of the Department's decision by this Court is limited to determining whether the administrative decision is reasonable and rational and is not arbitrary.² This Court has had occasion to review a decision by the Executive Director and the SAB in the case of Technomedical Labs, Inc. v. Utah Securities Div., 744 P.2d 320 (Utah App. 1987). In that case, this Court set forth the following standard of review applicable to this type of administrative decision:

In Utah Dep't of Admin. Serv. v. Public Serv. Comm'n, 658 P.2d 601 (Utah 1983), the Utah Supreme Court outlined the three standards of review to be applied to decisions of administrative agencies generally. The standard

² While this appeal is from a decision by the district court, this Court reviews the administrative decision as if the appeal had come directly from the agency. Technomedical Labs, Inc. v. Utah Securities Division, 744 P.2d 320, 321 (Utah App. 1987), and Bennion v. Utah State Board of Oil, Gas & Mining, 675 P.2d 1135 (Utah 1983).

which applies in the instant case is that of reasonableness or rationality. Included under this standard are agency questions on "mixed questions of law and fact" and agency interpretations of "special law." "Special law" is defined as "the operative provisions of the statutory law [the agency] is empowered to administer, especially those generalized terms that bespeak a legislative intent to delegate their interpretation to the responsible agency." Id. at 610. Deference is afforded to the expertise and experience of the agency in its interpretation of key provisions of a statute it is empowered to administer. Under this standard, the agency's decision will be set aside "only if it is outside 'the tolerable limits of reason,' or 'so unreasonable that it must be deemed capricious and arbitrary.'" Id. at 612. (quoting Silver Beehive Telephone Co. v. Public Serv. Comm'n, 30 Utah 2d 44, 46, 512 P.2d 1327, 1328, (1973); Williams v. Public Serv. Comm'n, 29 Utah 2d 9, 11, 504 P.2d 34, 36 (1972)).

There is no question that the law involved in this case is "special law," and that "deference is afforded to the expertise and experience of the agency in its interpretation" of the law; the Legislature specifically indicated such in a note to the 1983 Supplement of the Utah Securities Act. Immediately preceding § 61-1-1 of the Utah Securities Act, U.C.A. (1983 Supp.), the legislature presented the purpose of the Utah Securities Division as follows:

Title of Act.

An act relating to securities; providing for a securities division to administer and enforce state securities laws; authorizing the division to set registration and examination fees; modifying bond requirements for registered broker dealers and investment advisors; providing summary powers to deny registration applications; modifying coordinated filing requirements; limiting extension period on summary orders; providing and modifying definition; providing and modifying exemptions from registration; providing for a securities advisory board; increasing interest charges for violations brought by private litigants; providing additional penalties

for securities violations; increasing the ceiling on criminal fines for violation of securities law; and authorizing the division to classify specific acts as unlawful.

See also, Laws of Utah, Chapter 284 at 1108. (Emphasis added.) The statutes at issue in this case are clearly within the categories provided above, and thus are "special law."

Regarding the findings of fact by the Department, the Utah Supreme Court held in Administrative Services that findings on questions of basic fact may be overturned by the reviewing court "only where they are 'so without foundation in fact' that they 'must be deemed capricious and arbitrary.'" 658 P.2d at 608 (emphasis in original). And the findings must be upheld "if 'there is evidence of any substance whatever' which can reasonably be regarded as supporting the determination made." Id. (emphasis in original).

Thus, under the above standard of review, this Court must uphold the Department's decision unless appellant can demonstrate that such decision was not based on any evidence whatsoever, was irrational and unreasonable, and was not done in pursuit of the Division's legislative purpose of protecting the public through the administration and enforcement of the State's securities laws.

**POINT II. THE DISTRIBUTION OF AMENITY STOCK VIOLATES
THE PURPOSES OF THE UNIFORM SECURITIES ACT BECAUSE
IT WAS DISPOSED OF WITHOUT REGISTRATION**

A. Introduction

Since the review of the administrative decision below will be governed by the "reasonableness or rationality" standard as indicated above, in order to aid this Court in its application

of the test for reasonableness, a brief discussion of the intent and purposes of the Utah Uniform Securities Act ("the Act") is in order.

The Utah Supreme Court in Payable Accounting Corp., v. McKinley, 667 P.2d 15, (Utah 1983) noted that "[s]ecurities laws are remedial in nature and should be broadly and liberally construed to give effect to the legislative purpose." In Technomedical Labs, Inc., this Court stated that "[t]he purposes of securities acts in general are to prevent fraud and to encourage disclosure of information through registration, thereby protecting investors from the sale of fraudulent and worthless speculative securities." 744 P.2d at 322. And, in Utah Code Ann. § 61-1-27, the Legislature stated that "[t]his chapter may be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to co-ordinate the interpretation and administration of this chapter with the related federal regulation."

The Minnesota Supreme Court in the case of State v. Horface, 288 N.W. 13, 16 (Minn. 1939) stated that the clear purpose of the Uniform Blue Sky Laws "is to curb the activities of those who by ingenious subterfuge or by fraudulent means seem bent on disposing to the ignorant and gullible, fraudulent or speculative securities."

In the case of SEC v. Harwyn Industries Corp., 326 F.Supp 943, 953 (S.D.N.Y. 1971) the court noted;

[I]t is readily apparent that the Harwyn spin-offs violated the spirit and purpose of the registration requirements of § 5 of the 1933 Act, which is to protect investors by promoting

full disclosure of information thought necessary to informed investment decisions.
. . . Furthermore, the registration provisions are designed not only to protect immediate recipients of distributed securities but also subsequent purchasers from them.
(Citations omitted.)

From the forgoing cases it becomes apparent that the purpose of the registration provisions of the Act is to protect the public through full disclosure, and that the Act should be broadly and liberally construed in order to curb the abuse of the registration provisions of the Act through subterfuge or fraud.

1. Registration Requirements of the Act

The Act provides protection to the public by requiring the registration of securities to be offered or sold in the State, or an exemption to such registration must be established. Such registration can be carried out through various types of disclosure requirements: Sections 61-1-8, 9, and 10 of the Act provide three separate vehicles for the registration of an initial public offering (IPO); Section 61-1-14 is the section dealing with exemptions from registration.

a. Disclosure Required Under An IPO

Under the Act, a private corporation that wishes to become public can examine and select one of the requirements of the three initial registration sections which best coincides with the goals and objectives of the company. Typically, all three methods require the disclosure of the following:

the principles behind the company, their past business history, and a disclosure of any significant criminal or civil action which has been taken against them;

the capital structure of the company with recent financial data and disclosure of ownership both before and after the public distribution of the security;

a discussion of the company's business history, business purpose, and prospects for the future;

In addition, any individual obtaining a share of the security in the public distribution is required to be furnished a prospectus and sign a subscription agreement. The information provided the investor in the prospectus must contain all relevant information that a reasonable investor would require in order to make an informed investment decision. Both the making of material misrepresentations and the failure to make adequate disclosure are actionable under the fraud provisions of the Act. (See § 61-1-1)

After a given registration has been approved by the Division and become effective, recipients of the initial offering can trade the security for up to a year's time. Once the registration time period has run, the recipients of the security cannot trade the security unless they obtain a trading exemption under § 61-1-14. U.C.A. § 61-1-11(8).

b. Exemptions From Registration Requirements

Section 61-1-14 provides approximately 28 different situations in which the registration requirements of 61-1-7 are inapplicable, and subsection 2 of 61-1-14 pertains to some 17 transactional exemptions which are the type of exemptions applicable to this case. Note that there are only three subsections within 14(2) that call for additional information to

claim an exemption from registration in trading a security, and only two of those could be applied in this case: subsection 14(2)(m) provides for disclosure for trading of the security when it is a non-issuer transaction effected by or through a broker dealer; subsection 14(2)(b) exemption provides for disclosure through recognized securities manuals. But, 14(2)(b) and (m) exemptions do not cover all situations in which securities trading may take place, and the other exemptions under 14(2) (except 2(p)) do not require any disclosure of information.

The disclosure required in 14(2)(b) and (m) is information which supplements and updates the disclosure required for the initial registration, and it typically requires only that the names and addresses of the principals of the company, the name of the registered agent, a brief business history, and a recent unaudited financial of the company be provided.

Thus, the information provided through an exemption under subsections 14(2)(b) and (m), is at best limited, because it does not call for the same disclosure required in an IPO, instead, it calls for supplemental and updated disclosure for secondary trading of an already registered security. Given that the purpose of the registration provisions of the Act is to protect the public through full disclosure, a scheme of distribution which creates a public company and avoids the requirements of initial registration and its accompanying disclosure violates the purpose of the Act.

2. Whom is Registration to Protect?

Appellant argues that by Amenity distributing its stock through gifting to a broad range of individuals, the initial registration provisions of the Act are inapplicable because the initial recipients have not paid anything for the stock received, and do not need any protection.³ Such an argument ignores the aim of the registration requirements. The court in Harwyn indicated that disclosure requirements exist for a broader purpose than that claimed by appellant: "the registration provisions are designed not only to protect immediate recipients of distributed securities but also subsequent purchasers from them." Harwyn Industries Corp., 326 F.Supp at 953 (emphasis added). Thus, the protection afforded to the public by the registration requirements applies to the trading of securities in general, not to any particular party involved in the trading.

³ A significant point is that the anti-fraud provisions of U.C.A. § 61-1-1 apply to the trading of a security whether or not it is required to be registered. Subsection 2 of § 61-1-1 provides that it is unlawful to omit to state a material fact in connection with the offer or sale of a security. The donees of Amenity stock who attempt to trade it under a 14(2) exemption would likely be in violation of § 61-1-1 because there is no information whatsoever available concerning the company that enables the purchaser to make an informed investment decision, unless the company itself provides the type of information disclosed in an IPO to the donees or other buyers. A donee/seller will find himself in the difficult position of explaining that he supplied all the material facts to the buyer that were necessary concerning the security when he attempted to sell it, when in fact no information was available.

It is unlikely that the donees of Amenity stock are aware of the applicability of § 61-1-1 to an attempt on their part to trade the security (if they are aware of § 61-1-1 at all). In the January 20, 1987 hearing, a representative of CGC testified that CGC made a concerted effort to reach persons uneducated as to investing in securities when it carried out the distribution of Amenity and like company stock. (R. 118 Transcript at 31, 35, 36)

The argument presented by appellant shows a callous disregard for those who need protection provided by the Act. Under the Amenity scenario, the initial recipients of the stock are provided no disclosure concerning the company other than that which the gifting company may feel compelled to provide. They are thus placed in jeopardy when they attempt to sell the securities to another because they lack the type of information that may be necessary to avoid the anti-fraud provisions of § 61-1-1. In all likely cases, the sale of Amenity stock by the initial recipients will be done without providing the information to the purchasers that is necessary for trading, and thus, the subsequent purchasers will purchase stock in a company that has not had to disclose anything about itself. Or, if trading is conducted under a 14(2)(b) or (m) exemption and information is provided, it is information of questionable benefit absent the information required in the initial registration. Nevertheless, the subsequent purchasers of the stock make their purchases under the assumption that the stock has passed through the initial registration process, and therefore, the necessary steps have been taken for public protection.

The effect of such a dangerous sequence of events has already transpired in the present case. After becoming a publicly held company by the gifting process, Amenity was merged with a private company, Elkin Weiss, Inc. Elkin Weiss maintained the name "Elkin Weiss, Inc." and began trading on the secondary market. Significant information about Elkin Weiss's background was not required to be disclosed in the secondary trading of the

Amenity-Elkin Weiss security, such as the past business history of the company, the background of the principals of the company, and whether the principals have a history of criminal conduct in fraudulent activities, etc. Subsequent purchasers of Elkin Weiss stock purchased it under the assumption that the initial registration requirements of a public distribution would cull out such information and inform those making the initial purchase of the stock. Individuals purchasing in that instance were indubitably relying on the State's duty to regulate the trading of securities to protect them from securities with questionable backgrounds. The Act surely was not crafted to allow what actually transpired.

**POINT III. THE DISTRIBUTION OF AMENITY STOCK WAS
REQUIRED TO BE REGISTERED WITH THE DIVISION BECAUSE
IT IS AN OFFER OR SALE AS DEFINED BY THE ACT**

In their Final Order, the Department found that the gift of Amenity stock was done for consideration, and thus was an offer or sale of a security as defined by the Act. (R. 19) The Department also concluded that no registration of the security was sought or granted, and that Respondent failed to prove that any exemption or exception such as a "good faith gift" applied to render the security exempt from registration. Id. The Board thus concluded that the distribution of the stock of Amenity was in violation of the Act. Id. As was stated above, appellant must prove that such a conclusion was unreasonable, not rational, and that there was no evidence to support the findings upon which the conclusions are based.

A. The Distribution Of Amenity Stock Constituted An Offer Or Sale As Defined By The Act

Utah Code Ann. § 61-1-7 states that "[i]t is unlawful for any person to offer or sell any security in this state unless it is registered under this chapter or the security or transaction is exempted under 61-1-14." Section 61-1-13(15)(a) and (b) provides:

"Sale" or "sell" includes every contract for sale of, contract to sell, or disposition of, a security or interest in a security for value.

"Offer" or "offer to sell" includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.

(Emphasis added.) The facts present a situation wherein Amenity distributed approximately 90,000 shares of its stock to 900 persons by giving it to them in order to create a publicly held corporation. The Department found that such a distribution constituted an offer and sale of a security as defined by the Act. (R. 19) While most of the discussion has focused on whether the distribution by Amenity was a "sale" as defined in § 61-1-13(15), in fact, the attempt by Amenity to dispose of the stock by gift also constituted an "offer" of a security.

1. Offer

Black's Law Dictionary at 975 (5th ed. 1979) defines "offer," in part, as follows:

To bring to or before; to present for acceptance or rejection; to hold out or proffer; to make a proposal to; to exhibit something that may be taken or received or not. To attempt or endeavor; to make an effort to effect some object, as, to offer to bribe, in this sense used principally in criminal law.

(Emphasis added.) Thus, the act involved in the giving of Amenity's stock to the 900 recipients constituted an offer of the security. It certainly was an attempt to dispose of the security. (The discussion concerning whether a "disposition for value" can be by gift shall be addressed later.) In addition, in order for one to give something to another, the gift must be offered, and if the gift is to consummate, the offer of the gift must be accepted by the recipient. Nothing in the facts of the case indicate that the recipients of Amenity's stock were forced to receive and accept the stock; that they had no choice in the matter. It is clear that the giftees could either accept the gift (or the offer of the gift) of stock or reject it. Thus, the offer to give the stock was a presentation for acceptance or rejection, or an exhibition of the security that could be taken or received or not, and was thus an "offer to dispose" according to the definition provided above. If the disposition by Amenity involved an offer, § 61-1-7 requires that the security be registered with the State. The acceptance of the argument here that the gifting of Amenity stock involved an offer leaves behind the issue raised by appellant that a gift cannot be a sale, and thus no registration was required for the distribution; the Act requires registration for an offer as well as the sale of securities. However, the consummation of the gift of Amenity stock by the offerees acceptance of the offer constituted a sale as defined by the Act.

2. Sale

Regarding the question of whether the disposition by Amenity constituted a "sale," one should bear in mind that the terms "sale" and "sell" are to be broadly construed. In interpreting statutes virtually identical to U.C.A. § 61-1-13(15)(a), courts have held:

These terms "sale" and "security" are to be given liberal construction. United States v. Moniar, 47 F.Supp 421, 426(12) (D.C.Del. 1942, aff'd. 147 F.2d 916 (3rd Cir.), cert. den. 325 U.S. 859, 65 S.Ct. 1191, 89 L.Ed 1979.

The term "sale" or "sell" is not limited to technical common-law sales, or transactions ordinarily governed by the commercial law of sales. Spector v. L.O. Motor Inns, Inc., 517 F.2d 278, 286, (5th Cir. 1975), Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir.), cert. den. 389 U.S. 977, 88 S.Ct. 480, 19 L.Ed.2d 470 (1967).

Peoples Bank of LaGrange v. North Carolina Nat'l Bank 228 S.E.2d 334, 338, 139 Ga.App. 405 (1976).

Clearly a gift of a security is a disposition of the security. Black's Law Dictionary defines "disposition" to be the "[a]ct of disposing; transferring to the care or possession of another. The parting with, alienation of, or giving up property." Black's Law Dictionary at 423 (5th ed. 1979) (emphasis added). In addition, other cases have held the word "disposition" in various statutes to include a transfer by gift: See, e.g. Bayer v. United States 382 F.Supp 576, 580 (N.D.Ohio 1974); Litch v. People ex rel. Town of Sterling, 75 P 1079, 1080, 19 Colo.App. 421 (1904).

Hence, a "gift" of a security constitutes a disposition of the security, and thus it is a "sale" within the definitions provided in § 61-1-13(15)(a) if it is a disposition of the

security for value. Appellant argues that a gift cannot be a sale; that the Act in no way contemplates that a gift could constitute a sale. However, § 61-1-13(15)(c) provides a number of "examples" of what would constitute a sale of securities, and the first two examples presented are dispositions of securities by gift. (See, 61-1-13(15)(c)(i): "any bonus given;" and (ii): "a purported gift of assessable stock.")

B. Distribution Of Amenity Stock Was A Disposition For Value

A significant question here is whether the distribution of stock by Amenity was a disposition for value. The Department determined that there was a disposition for value. (R. 19, 23, 30) Its determination was that value was received because the distribution was done for the "creation and/or maintenance of good will and the resulting beneficial exposure of [CGC]'s business in various areas represents the value envisioned by [U.C.A. § 61-1-13(15)(a) and (b)]. See Blackburn v. Ippolito Fla., 156 So.2d 550 (1963); King et. al. vs. Southwestern Cotton Oil Co., Okla. App., 585 P.2d 385 (1978)." (R. 30)

Cases that support the conclusion that disposition of Amenity stock was done for value are not lacking. Perhaps the most compelling case to support this finding is Technomedical Labs, Inc. In Technomedical, this Court cited two federal cases: S.E.C. v. Harwyn Industries (cited supra), and S.E.C. v. Datronics Engineers, Inc., 490 F.2d 250 (4th Cir. 1973) as support for its affirmation of the Department's decision. While the issue in Technomedical was whether "benefit" was received by the company creating spin-offs, in fact, the cases relied on by

this Court pertain to the question of "value" in the same sense being addressed here: what constitutes a disposition "for value" and thus, a sale requiring registration. Technomedical stated the following:

In Datronics and Harwyn, the courts were asked to decide if the distribution of a subsidiary's unregistered shares as a dividend to the parent's shareholders constituted a "sale" requiring registration under the Federal Securities Act of 1933 ("1933 Act"), 15 U.S.C. § 77b. Whether a "sale" had occurred depended upon whether the distribution was "for value." Both courts held value would be gained by the creation of a public market. Datronics, 490 F.2d at 253-54; Harwyn, 326 F.Supp. at 952-953. Such value includes: 1) an enhanced ability to borrow; 2) an enhanced ability to raise equity; 3) the availability of a method of valuing assets; 4) an enhanced liquidity of assets; and 5) the prestige associated with publicly held companies. The Department concluded the term "value" in Harwyn and Datronics is substantially synonymous with "benefit" in the instant case.

744 P.2d at 324 (emphasis added).

Clearly, the disposition of the stock by gifting to some 900 shareholders resulted in the creation of a public corporation, and therefore, value was received. Amenity greatly benefited from the public distribution of the stock. Not only was goodwill created or maintained as acknowledged by Petitioner, but Amenity received the value of becoming a public company without the disclosure or the restrictions of the registration process. As a public company, Amenity received enhanced ability to borrow money, raise capital and became a ripe target for acquisition. In addition, CGC received \$25,000 as commission from the merging of Amenity with Elkin Weiss, and also received approximately 300,000 shares of Elkin Weiss stock, which was

trading at one point for about \$3.00 a share. Thus, value was received by its distribution. Appellant cannot in any way demonstrate that such a conclusion by the SAB was unreasonable.

C. Appellant's Cases Are Not Analogous And/Or Are Not Applicable

Appellant disputes the claim that a gift is a disposition for value in that appellant views the category of "gift" to be beyond the reach of the statute, and he cites several cases in support of his theory. Appellant's perspective on the issue of gift v. sale is fatally flawed and the cases cited by appellant are not analogous to this case.

For example, appellant relies heavily on an early Utah Supreme Court case, Andrews v. Chase, 49 P.2d 938 (Utah 1935), as support for his analysis that a gift is simply not a sale, nor can it be. There are some serious problems with appellant using the Andrews case as support for his position. One problem is that the facts in Andrews are significantly different than the present case. In the Andrews case, the gift of treasury stock took place because the company intended on levying assessments on the stock to finance the development of its mining property. Neither the aim nor the effect of the distribution was to create a publicly held company. In the present case, it is irrefutable that the purpose of the gifting of the stock was to create a public corporation (to be discussed below).

Another problem is the potential for significant harm to the public that can occur from a broad reading of the Andrews decision as urged by appellant. The dissenting opinion in Andrews spends a great deal of time on the issue of the problems

inherent in the giving of assessable stock to the public, the potential for fraud created thereby, and the belief that the gifting of assessable stock is a disposition for value. 49 P.2d at 943-945. The following statement by Justice Hanson in his dissent expresses his feelings about the harmful applications of the Andrews decision.

[I]t is clear that the disposition of the copper company's stock, as alleged, would be a sale for value within the definition of that term as stated in . . . the Blue Sky Law. Certainly such a disposition was an attempt to dispose of a security for value. It may be conceded that a gift of stock does not come within the purview of the Blue Sky law. But, as herein shown, to call the arrangement described in the complaint a bestowing of gratuitous issues of stock, is begging the question and fails to distinguish between form and substance. If this court gives legal sanction to such a plain and palpable attempt to evade the intent and purpose of our constitutional and statutory provisions, then indeed will the doors be wide open to every one who may resort to the specious expedient of making "gifts" of stock. The law would be nullified; the legislative regulations intended to protect the public would be inoperative; and additional impetus would be given to the ever present tendency to invent means to circumvent such regulations.

49 P.2d at 945.

No more persuasive statement could be made by the Division than that made by Justice Hanson that such attempts to evade statutory requirements ought to be struck down. While in the present case the stock given to the public was not assessable, the intent to circumvent the legislative requirement of registration is just as palpable. Fortunately, the potentially disastrous result that could be felt by the Andrews case should courts construe it in the manner urged by appellant

was thwarted by the changes the Legislature made to § 61-1-13 of the Act in 1963 and in 1983.

In spite of what appellant claims, the statute applicable at the time of the Andrews case is not the same as it is today⁴, and the amendments to that statute prove a Legislative intent to overrule the Andrews decision. The fact in Andrews relevant to the changes made in the amendments of the Act is that the type of stock given out by the company in Andrews was assessable stock. In its enactment of the Utah Uniform Securities Act in 1963, the Legislature, in giving the definitions to the Act provided that "A purported gift of assessable stock is considered to involve an offer or sale." U.C.A. § 61-1-13(10)(d) (1965 Supp.) Such an amendment was clearly enacted to overturn the ruling by the Utah Supreme Court in Andrews. If there was any ambiguity in that statute as drafted by the 1963 Legislature, the 1983 Legislature eliminated any question as to its possible interpretations by providing that: "A purported gift of assessable stock is an offer or sale, as is each assessment levied on the stock." U.C.A. § 61-1-13(14)(c)(ii) (1983 Supp.) (emphasis added.) The 1983 Legislature also amended 61-1-13 to exclude from the definition of sale a "good faith gift." U.C.A. § 61-1-13(14)(d)(i) (1983 Supp.) provides "The terms defined in subsections (a) and (b) do not include: (i) A good faith gift." It is clear that the

⁴ The Utah Uniform Securities Act was not adopted by this State until 1963, and thus, much of the policy applicable to the Uniform Securities Act was not applicable to the Utah statute in effect in 1935.

amendment to the definitional section of the Act by both the 1963 and 1983 Legislatures is pointed directly to the Andrews decision.

In his brief, appellant spends considerable time on the "plain meaning" doctrine of statutory construction to support his claim that the plain meaning of the statute does not contemplate that a gift is a sale. The above discussion clearly indicates that the Legislature did intend that a gift could constitute a sale because it specifically provided for examples in which gifts are sales, and it provides a type of gift excepted from a sale.

Additional support for the conclusion that Andrews was overruled is found in the rule of statutory construction that requires a presumption of legislative intent to overrule conflicting case law when statutes are amended:

The general rule of statutory interpretation that a provision in an act is to be read in its context, is applicable to the interpretation of amendatory acts. . . .

The legislature is presumed to know the prior construction of the original act or code and if previously construed terms in the unamended sections are used in the amendment, it is indicated that the legislature intended to adopt the prior construction of those terms. . . .

If the section as amended is inconsistent with prior judicial interpretation of related sections, it is presumed that the legislature knew it, and the amendment controls.

1A Sutherland Statutory Construction § 22.35 at 296 (4th ed. 1985 rev.) (footnote references omitted). Thus, appellant's reliance upon Andrews places him in the unenviable position of arguing a case specifically overturned by legislative amendment.

Appellant may claim that the effect of overruling Andrews related to the issue of assessable stock only. However, it is clearly more logical to conclude that the issue overruled by the amendment dealt with the attempt to circumvent registration requirements by gift, because, "good faith gifts" was an exception to the general rule specifically created by the 1983 Legislature. Thus, the legislature did not want to require the registration of all types of gifts, as could be interpreted by the amendment, so it gave an exception to the general rule and excluded good faith gifts. As will be discussed below, the distribution by Amenity of its stock was not a good faith gift.

The other cases relied on by appellant regarding this issue are wholly inapplicable to the present case. Appellant cites Truncale v. Blumberg, 80 F.Supp. 387 (S.D.N.Y. 1948), and Shaw v. Dreyfus, 172 F.2d 140 (2nd Cir. 1949), as support for his assertion that gifts of securities cannot constitute sales requiring registration. However, neither case involves a situation remotely related to the present case; the statute and issues involved have nothing to do with the registration of securities. Rather, suits by stockholders of the corporations were commenced to recover corporate profits from the subsequent sales of stock warrants issued to employees of the respective companies. The statute on which both cases were based was 15 U.S.C.A. §78p(b), 16(b) Securities and Exchange Act of 1934. That statute pertains to unlawful trading on insider information and the obtaining of profits from the sales of securities based on the information.

Additionally, in Shaw, the gift to which the term "sale" did not apply happened to be the donation of the warrants by the employee to various charities. Such a situation--that of donating publicly traded stock by an individual to a charity--would not be a sale for which registration is required under the present statute either. Another glaring difference between the facts in those cases and the present case is that the companies involved were publicly held corporations, and the stocks were readily traded on the market. In those cases, the effect of distributing warrants to employees did not create a publicly held corporation.

Thus, appellant has failed to provide this Court with cases to support his own hypothesis that disposition by gifts are excluded from registration requirements within the Act. Even if appellant had cases to support such dogma, this Court would not overturn the Department's Order unless appellant could show by such cases that the Order was irrational and unreasonable.

**POINT IV. DISTRIBUTION OF AMENITY STOCK WAS NOT
A GOOD FAITH GIFT AND THUS WAS NOT EXCEPTED
FROM THE DEFINITION OF OFFER OR SALE**

**A. Appellant Has Burden To Show Disposition Was Excepted From The
Definition of Offer Or Sale**

Since the gifting of Amenity stock was a disposition for value, appellant bore the burden of demonstrating to the Department that the stock or the transaction was, nevertheless, exempt or excepted from registration, or the distribution would be in violation of the Act. As stated in Utah Code Ann § 61-1-14.5: "the burden of proving an exemption under § 61-1-14 or an exception from a definition under § 61-1-13 is upon the person

claiming the exemption or exception." The only exemption or exception Amenity laid claim to was the "good faith gift" exception provided in 61-1-13(15)(d)(i), which provides: "The terms defined in Subsections (a) and (b) [of 61-1-13(15)] do not include: (i) a good faith gift; . . ."

1. Appellant Failed To Show Findings By Department Were Without Foundation In Fact.

In order to succeed on this issue before this Court, Appellant must show that there was no evidence presented to the Department to support its finding that "[t]he distribution of the Amenity stock was done with an intent to circumvent or frustrate the purposes of the . . . Act. (R. 18) Appellant claims the decision by the SAB to deny appellant's claim to the "good faith gift" exception is not supported by the evidence, and he enumerates a number of factors in the record demonstrating that the gifts were done in good faith. Appellant Brief at 24.

However, appellant's demonstration that Amenity presented some self-serving evidence that the gifting of the stock was done with good intentions misses the whole concept behind the aim and purpose of the Act. The Act does not concern itself in this setting regarding good faith with the sincerity of the giver but whether there has been an intent to evade the requirements of the law. Appellant must show that the Department's determination that the law was intentionally evaded is baseless. As is pointed out in Administrative Services, the standard of review applicable to an administrative body's finding of fact is that such findings must be upheld if there is "evidence of any substance whatever," and can only be overturned

if "they are 'so without foundation in fact' that they 'must be deemed capricious and arbitrary.'" 658 P.2d at 608 (emphasis in original).

The finding by the SAB that the distribution of stock was done to circumvent the Act was based in part upon the facts presented at the hearing specifically called for by the SAB in order to provide Amenity an opportunity to prove its claim to the good faith gift exception. The additional evidence received at the hearing on January 20, 1987, combined with the findings of fact adopted from the original hearing, clearly provided the Department with more than "evidence of any substance whatever."

The evidence in support of such the finding that the gifting was not done in good faith is as follows: Amenity was formed in January of 1986, and on the day of its formation, CGC purchased 1,000,000 shares of stock from Amenity for \$2,000 and became its sole shareholder (R. 28); shortly thereafter Amenity disbursed approximately 90,000 shares to 900 individuals (R. 29); no registration was sought or obtained for the distribution of the stock, and thus by avoiding the initial registration process, Amenity was able to become a public company without disclosure (R. 118 Transcript at 17); CGC had incorporated approximately 30 other companies during the same period of time and caused them to go public by distributing their shares to a wide range of shareholders in a similar fashion to Amenity (R. 118 Transcript at 18, 30); the shareholders who received the gifts were generally the same individuals, the names of which were obtained from a list of CGC's clients (R. 118 Transcript at 30, 31);

Amenity Inc., and two additional companies were acquired through merger by private companies (R. 118 Transcript at 18, 20); CGC was instrumental in the acquisition of those three companies by the acquiring companies, and CGC received \$25,000 for the services it performed for each acquisition, and received 300,000 shares of Elkin Weiss stock which was trading at the time of the January 20 hearing at \$3.00 a share. (R. 118 Transcript at 27) The SAB viewed the evidence presented at the hearing to indicate that the gifting process committed by Amenity was not done in good faith.

It should be remembered that this is not the typical gift situation arguably envisioned by 61-1-13(15)(d)(i). We do not have the case of a grandfather giving his grandson a stock certificate, nor do we have a case of a company giving its employees stock which had previously been registered in order to award performance. Amenity was a private corporation until it publicly disbursed the stock. It was the act of public distribution of the stock that changed Amenity from a private to a public corporation. The stock was not, nor had it ever been, registered.

There is ample evidence in the record to support the finding that the distribution of the Amenity stock was "done with an intent to circumvent or frustrate the purposes of the Utah Uniform Securities Act and the registration provisions contained therein," and hence, the finding must be upheld.

2. The Conclusion By The Department That The Good Faith Gift Exception Did Not Apply To Amenity Distribution Was Reasonable

In its conclusions of law in the Order dated January 8, 1987, and as reiterated in its Final Order, the SAB provided what it determines the term "good faith gift" found in § 61-1-13(15(d)(i) to mean:

We find as a matter of law that the term "good faith gift" in the context in which it is used, i.e., in the Utah Uniform Securities Act, means a bona fide gift of securities given in "good faith," i.e. not given with an intent to circumvent or frustrate the purposes of the Utah Uniform Securities Act and, most relevant to the instant case, the registration provisions contained therein.

(R. 23) Clearly, the fact that CGC had created over 30 companies and distributed them to the general public in similar fashion to Amenity indicates a scheme to circumvent or frustrate the registration requirements of the Act, and therefore was not in good faith.

Appellant continues to claim that the "good faith gift" exception simply requires that the security be given for free, without any strings attached. While that may be his opinion, such an analysis fails to indicate the irrationality or unreasonableness of the Department's conclusion. Since this is an area of special law, "[d]eference is afforded to the expertise and experience of the agency in its in its interpretation" of the statute. Technomedical Labs, Inc., 744 P.2d at 323. And, hence, the Department's interpretation can "be set aside 'only if it is outside "the tolerable limits of reason," or "so unreasonable it must be deemed capricious and arbitrary."'" Id. Thus, unless appellant can set forth some reasons or point to some law indicating the unreasonableness or irrationality of the Department decision, he cannot have the decision overturned.

The following cases demonstrate a generally accepted interpretation of the phrase "good faith" refers to an intention to comply with the law, and lack of good faith indicates an intent to circumvent the law. For example: "Good faith means not acting with the intent improperly to circumvent the warrant requirement" United States v. Kunkler, 679 F.2d 187, 191 (9th Cir. 1982); "[T]his amendment was not promulgated as a subterfuge to evade the holding of the A&P case, but rather as a good faith endeavor to conform to the technical requirements of Sections 8(a)(3)" Nat'l Labor Relations Board v. Bakery & Confectionary Workers, 245 F.2d 211, 213 (3rd Cir. 1957); "The evidence before the Court is that CCWD acted in good faith and without intent to evade the usury laws when it entered into the 1981 transaction." In Re Pillon-Davey & Associates 52 B.R. 455, 461 (N.D.Cal. 1985); "[A] transfer or reassignment which is not made in good faith and is intended to subvert the intent of the Teacher Tenure Act is in effect removal" Danno v. Peterson, 421 F.Supp 950, 952 (N.D.Ill. E.D. 1976); "[T]he job abolishments were not made in good faith and were used to subvert the civil service system." State, ex rel. Gould et al., v. Ohio Bureau of Employment Services, 501 N.E.2d 648, 650, 28 Ohio App.3d 30 (1985). In Windling v. Cundill, 568 P. 2d 888, 890 (Wyo. 1977), the Wyoming Supreme Court defined "good faith" to be honest, lawful intent, the condition of acting without knowledge of fraud or without intent to assist in a fraudulent or otherwise unlawful scheme

'Good faith consists of an honest intention to abstain from taking advantage of another, even through the forms or technicalities of the law, together with an absence of all information or belief of facts which would render the transaction unconscionable.'

(Citations omitted.) Applying these definitions in concert with the purpose of the registration provisions of the Act, i.e. to protect the public through full disclosure, and considering that the Act should be broadly and liberally construed in order to curb the abuse of the registration provisions of the Act through subterfuge and fraud, it becomes evident that the SAB's interpretation not only "falls within the limits of reasonableness and rationality," but is the only legitimate conclusion the SAB could make in carrying out its statutory duty to protect the public.

POINT V. UTAH SECURITIES ADVISORY BOARD AND THE EXECUTIVE DIRECTOR HAVE AUTHORITY TO SUSPEND ALL REGISTRATION EXEMPTIONS

As was stated above, the Legislature determined that the proper manner to protect the public in its dealings with the securities market is by requiring that all securities disposed of for value must be registered with the Division unless otherwise exempted from registration. If the registration provisions have not been complied with, the trading of the unregistered securities is unlawful, and the Division has a duty to protect the public through the means provided it by statute.

Section 61-1-14(3) is one of the resources the Legislature provided the Division in order for the Division to protect the public from the unlawful trading of securities. Section 61-1-14(3) authorizes the SAB, in conjunction with the

Executive Director, to suspend the trading exemptions of a security which are in violation of the Act. The pertinent portions of § 61-1-14(3) provides as follows:

Upon approval by the executive director and a majority of the Securities Advisory Board, the executive director may by order deny or revoke any exemption specified in Subsections (1)(h) or (1)(j) or in Subsection (2) with respect to: (a) a specific security, transaction or series of transactions; or (b) any person or issuer, any affiliate or successor to a person or issuer, or any entity subsequently organized by or on behalf of a person or issuer generally. No such order may be entered without appropriate prior notice to all interested parties, opportunity for hearing, and written findings of fact and conclusions of law, except that the division may by order summarily deny or revoke any of the specified exemptions pending the final determination of any proceeding under this subsection. . . . The executive director may not extend any summary order for more than ten business days.

Appellant claims that 61-1-14(3) can only be exercised by the Division after someone has claimed one of the exemptions under section 14 in trading the security. Such a perspective reads into the statute a requirement not provided therein, and ignores the practical realities facing the Division in its regulation of the securities market.

If a security has gotten into the hands of the public, and it is not a lawfully distributed security because it was not registered as required by law, there are some characteristics that weaken the alleged value the security might have. Those characteristics are not usually discoverable by the general public, and thus, the public needs to be protected from it. Some of the obvious problems with such a security is that since it has not been registered, the significant information otherwise

provided that would indicate the questionable worth of the security is not available for public safety. In addition, the value of the security may be questionable because of the legal problems attached to the illegality of the distribution. Civil action by the Division or other parties against the company is likely to take place in the future, and the value of the security because of that action will be weakened.

Appellant believes the Division cannot activate its powers under § 61-1-14(3) until a person holding the security chooses to trade it and at some point is required to justify any exemption she might have claimed. The Division's duty to protect the public from the potential harm one may receive from purchasing such a security is no less viable or compelling simply because the person selling the security has not chosen to inform the Division of her intention to claim the exemption. The unsuspecting public is unaware of the problems inherent with an unregistered security, and assumes the Division has done its job to require that all securities available in the market have been registered by the Division or are otherwise exempt.

Unless those involved in the market are aware that the security involved cannot be lawfully traded because no exemptions are available from such trading, the initial recipient may sell the security to another without ever informing the Division of any claims to an exemption she might make. The Division, after the fact, then, has to find out about the transaction, try and retrace the steps of the transaction, and seek some sort of remedy to rectify the situation. Appellant's argument concerning

the proper application of subsection 14(3) amounts to a claim that the Division cannot shut the door to the henhouse until all the chickens are out. And then, once the chickens have flown the coop, the Division can merely say to the party who traded the security that he had no legal right to trade it. By the time the Division has acted under such a scenario, the security is already in the hands of one who has paid for it based upon the false idea that it was lawfully traded.

In fact, the above scenario has happened in this case. By the time the Division found out about what CGC did with Amenity and the 47 other companies it created, a large number of those companies had been merged with private companies and the stocks in those companies had been traded on the secondary market. Because of the mergers, no background information about the private companies was made available to the public. Those having purchased the stock on the market have bought securities with some significant problems attached to them, among them the questionable worth of the security now that the Division has taken action against the companies involved. The ones harmed are the ones now holding the security.

Section 14 is an attempt by the Legislature to provide the Division with an ability to stop the trading of a security when there is some problem with the type of transaction or the security itself. There are various situations in which exemption denials can take place, of which this case is clearly one.

Summary Orders of the Department

Appellant is dead wrong in his claim that the Division cannot summarily suspend the exemption and then hold a hearing on the propriety of the action after the suspension has been ordered. (See Appellant Brief at 34, 35.) That is specifically what 61-1-14(3) provides: "the division may by order summarily deny or revoke any of the specified exemptions pending the final determination of any proceeding," but for not more than ten business days. (Emphasis added.) The Division has, in fact, issued summary orders under appropriate circumstances in other cases. The power granted the Division by the Legislature to take summary action and later conduct a hearing is specifically addressed to the problem discussed herein. In other words, if the Division deems that summary action is warranted to protect the public, the Division can deny any exemption that might be claimed when it deems that the situation warrants it, and then the Division must conduct a hearing to prove the propriety of the action.

If appellant is nonplussed at this type of authority, he must be unaware of similar authority held by other regulatory bodies. (For example, TRO's granted by district courts apply a similar type of authority, and summary suspension authority is given to the Division of Occupational and Professional Licensing to suspend a controlled substance license if there is imminent danger to public health or safety. A hearing on the merits of the suspension is required in that instance as it is in this case. U.C.A. § 58-37-6(4)(d).) In certain circumstances, the State needs to be provided with the power to prevent or stop the

harm that is or can imminently be perpetrated upon the public without having to deal with the delays inherent in the due process rights of a hearing. The requirements of due process are then promptly applied to insure the rights of the accused.

Pursuant to the legislative mandate to protect the public by the exercise of its authority, the Division acted to protect subsequent purchasers of Amenity's stock by suspending all trading exemptions on the stock in Utah. For the Division not to so act would be a derogation of its duty to the public. Such an act by the Division is clearly within its authority, and to prevent the Division from so acting would result in substantial harm to subsequent purchasers who would otherwise purchase the stock in reliance on the expectation that the Division is properly regulating the trading of securities within the State of Utah.

The Division has alleged and demonstrated that the distribution of Amenity stock violated § 61-1-7 of the Act. The failure to register the distribution of the stock placed present and future stock holders of the Amenity stock in a position of not having received the disclosure contemplated by the Act. The Division must act in every way it can to protect the public from potential harm of transacting in illegal and questionable securities. In order to protect the public, the SAB and the Executive Director had no choice but to suspend trading in order to stop the continued exchange of Amenity stock without sufficient disclosure. A section of the Act had been violated and, pursuant to Section 61-1-14(3), it was well within the


authority of the SAB and Executive Director to order the suspension.

CONCLUSION

It has been established that the Executive Director's Final Order in this case is rational and reasonable and is based upon competent, material and substantial evidence. Appellant has failed to demonstrate error by the Executive Director in such Order. The State therefore respectfully asks this Court to affirm the Order by the Department suspending all trading exemptions of the securities of Amenity, Inc., its affiliates and successors.

DATED this 4th day of March, 1988.


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CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of March, 1988, I hand delivered a true and accurate copy of the foregoing BRIEF OF RESPONDENTS, to:

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