

1957

Mathew J. McCormick v. Life Insurance Corporation of America : Brief of Appellant

Utah Supreme Court

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IN THE SUPREME COURT

of the
STATE OF UTAH
FILED
JAN 4 1957

MATHEW J. McCORMICK,

Respondent,

VS.

LIFE INSURANCE CORPORA-
TION OF AMERICA, a
corporation,

Appellant.

Clerk, Supreme Court, Utah

Case No. 8593

APPELLANT'S BRIEF

Appeal from the District Court of Salt Lake County,
Utah, Martin M. Larson, Judge

REESE C. ANDERSON
Attorney for Appellant

INDEX

	Page
STATEMENT OF THE CASE	1, 2
STATEMENT OF FACTS	2, 3, 4, 5
STATEMENT OF POINTS	5, 6
ARGUMENT	

POINT I — SECTION 31-6-7 UCA, 1953, PROHIBITS EXPENDITURES FOR PROMOTIONAL AND ORGANIZATIONAL EXPENSES OF LIFE INSURANCE CORPORATIONS IN EXCESS OF 15 PER CENT OF THE FUNDS RECEIVED ON STOCK SUBSCRIPTIONS AS AND WHEN ACTUALLY RECEIVED.

A. THE TRIAL COURT ERRED IN STRIKING TESTIMONY REGARDING THE EXPENSES OF ORGANIZATION AND DENYING LICOA'S OFFER OF PROOF OF PAYMENT OF EXPENSES WHICH WOULD ESTABLISH THAT ALLOWANCE OF THE COMMISSION TO McCORMICK WOULD BE IN EXCESS OF 15 PER CENT.

B. THE TRIAL COURT ERRED IN ALLOWING COMMISSIONS ON SUBSCRIPTION NOTES WHICH WERE IN DEFAULT AND CANCELLED AS THE ONLY REMEDY LICOA HAD UNDER THE TERMS OF THE NOTE. 6-14

CONCLUSION	15
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STATUTES CITED

Section 31-6-14 UCA, 1953	12, 13
Section 31-7-7 UCA, 1953	13

CASES CITED

Anchor Life & Accident Insurance Company vs. Taylor, Court Appeals of Ohio (1928) 163 N. E. 631....	9
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TEXT BOOKS CITED

44 CJS, Section 99, pages 632.....	9, 10
18 Appleman's Insurance Law and Practice, Section 10005, page 21	10

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STATEMENT OF THE CASE

This is an action on a contract seeking to recover 20% sales commission for subscriptions to and sales of stock in a life insurance corporation by the respondent, McCormick. The case was tried in the District Court of Salt Lake County, State

of Utah. Trial was before the Honorable Martin M. Larson, Judge without a jury. The trial Judge granted the respondent's motion to strike certain evidence regarding the expenses involved in the sale of the stock and the promotion of the corporation (R 285 & R 299) and denied the appellants offer of proof (R 417-418) showing the expenses of organizing and promoting the corporation and selling the stock which would have shown costs of organizing and promoting in excess of 15%. The trial Judge entered the Findings of Fact and Conclusions of Law allowing a 20 per cent commission on a part of the subscriptions and stock sales and allowing a 15 per cent commission on the balance of the subscriptions and stock sales claimed by the respondent (R 39-57). A part of the commissions were allowed on subscription notes which were cancelled by the corporation and certain so called "personal notes" which were also cancelled or terminated (R 39-R 57). The Judgment and Decree was entered on the 31st day of August, 1956 (R 58). Notice of Appeal was filed on the 2nd day of October, 1956 (R 65), and the Designation of Record was filed on the 2nd day of October (R 69). The Record on Appeal was filed November 8, 1956.

STATEMENT OF FACTS

For convenience, Life Insurance Corporation of America, the defendant and appellant, shall here-

inafter be referred to as Licoa and the plaintiff and respondent, Mathew J. McCormick, shall hereinafter be referred to as McCormick.

Licoa was initially organized as a mutual benefit company to conduct a life insurance business in the State of Utah (R 39). It was decided by the Board of Directors and the policy holders of the mutual benefit company to form a stock corporation for profit for the purpose of conducting the life insurance business (R 100-101). On or about the 18th day of September, 1952, Licoa and McCormick entered into an agreement in writing (the first three pages of Exhibit #13) which provided among other things that the plaintiff had the exclusive right to sell the stock in the defendant company for 18 months and receive as a commission 20 per cent of the bankable receipts (Exhibit #13). In performance of the contract, McCormick sold for cash and delivered to the company shares of stock for a purchase price of \$142,729.86 (R 41). McCormick also delivered to the company certain "personal notes" for shares issued or to be issued equal to the sum of \$32,961.71 (R 41). McCormick also delivered to Licoa certain real estate mortgages and contracts for which stock was issued or to be issued for a purchase price of \$41,180.00 (R 41). McCormick also delivered to the company certain so called "subscription notes" which had a balance due, at the

time of cancellation in the amount of \$59,008.43 (R 42). Such subscription notes contained a provision to the effect that the only remedy on the instrument as far as Licoa was concerned in the event of default was to retain the amounts paid as liquidated damages (R 42). In March or April, 1954 the notes were cancelled (R 396). At that time, the notes were past due (R 399). During the trial the court granted McCormick motion to strike certain evidence regarding the expenses involved and the sale of the stock and the promoting of the corporation (R 285-299) and denied the appellant's offer of proof (R 417-418) showing the expenses of promoting the corporation and selling the stock. Judgment was entered awarding McCormick \$24,783.57 plus \$7,500.00 as attorneys fees.

The trial court found that some of the conventional notes, some of the real estate mortgages and contracts, and all of the subscription notes were cancelled by the defendant during the months of February and March, 1954 (R 42), and that Licoa made no attempt to enforce the provisions of the notes nor was McCormick given an opportunity to enforce the notes (R 42). Monthly statements were rendered to the persons on the subscription notes to the subscribers by the company (R 195). The trial court held that Licoa had a duty to McCormick to attempt in good faith to enforce the mortgages,

subscription notes, and contracts according to the terms and provisions thereof so that McCormick would receive his lawful share of the cash which Licoa was entitled to receive pursuant to the provisions of all of the instruments (R 42), that cancellation of all of the subscription notes, mortgages, and contracts without giving McCormick an opportunity to collect or enforce them was a violation of Licoa's duties to McCormick. The notes which were cancelled were found by the insurance commissioner of the State of Utah to be non-admissable assets (R 396-401). The trial Court also found that McCormick would be permitted to retain the 20 per cent commission on everything upon every sale which a 20 per cent commission had been allowed by the company (R 44) and allowed a 15 per cent commission on all subscription notes, personal notes, mortgages, and real estate contracts, and defendant appeals.

STATEMENT OF POINTS

POINT I

SECTION 316-7 UCA, 1953, PROHIBITS EXPENDITURES FOR PROMOTIONAL AND ORGANIZATIONAL EXPENSES OF LIFE INSURANCE CORPORATIONS IN EXCESS OF 15 PER CENT OF THE FUNDS RECEIVED ON STOCK SUBSCRIPTIONS AS AND WHEN ACTUALLY RECEIVED.

A. THE TRIAL COURT ERRED IN STRIKING TESTIMONY REGARDING THE EXPENSES OF ORGANIZATION AND DENYING LICOA'S OFFER OF PROOF OF PAYMENT OF EXPENSES WHICH WOULD

ESTABLISH THAT ALLOWANCE OF THE COMMISSION TO McCORMICK WOULD BE IN EXCESS OF 15 PER CENT.

B. THE TRIAL COURT ERRED IN ALLOWING COMMISSIONS ON SUBSCRIPTION NOTES WHICH WERE IN DEFAULT AND CANCELLED AS THE ONLY REMEDY LICOA HAD UNDER THE TERMS OF THE NOTE.

POINT I

SECTION 316-7 UCA, 1953, PROHIBITS EXPENDITURES FOR PROMOTIONAL AND ORGANIZATIONAL EXPENSES OF LIFE INSURANCE CORPORATIONS IN EXCESS OF 15 PER CENT OF THE FUNDS RECEIVED ON STOCK SUBSCRIPTIONS AS AND WHEN ACTUALLY RECEIVED.

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Licoa agreed to pay McCormick a 20 per cent commission from the proceeds of the sale of stock. In addition to the commission to be paid Licoa, certain other expenses for the promotion and organization of the corporation were paid by Licoa. McCormick sold a part of the stock to be issued by the company for cash, a part for real estate contracts and mortgages, a part for personal notes, and a part for subscription notes which subscription notes provided that the only remedy of Licoa was the forfeiture of amounts paid under the notes. Licoa paid

McCormick a 20 per cent commission on approximately all cash receipts of the company and on the real estate contracts received by the company to the date of termination of McCormick's agreement. Commissions were paid at the rate of 20 per cent on receipts. The so called personal notes and subscription notes were in default and found to be non-admissible assets by the Insurance Commissioner. The company cancelled the notes and returned them to the subscribers. The company issued stock for the sums which had been paid in on the subscription, and personal notes. The trial court granted McCormick's motion to strike all evidence concerning the expenses of promoting and selling the stock which were above the commission paid to McCormick (R 285 & R 295) and denied Licoa's offer of proof with regard to the expense of selling the stock (R 417-418). The proof offered would establish that the expenses borne by Licoa were in excess of 15 per cent. The denial of this proof and the failure to use such in computing the sum which might be paid to McCormick denied the stockholders their rights under the code and violated the trust of the policy holders.

Section 31-6-7 UCA, 1953 provides:

RECITALS REQUIRED IN PERMIT—DURATION OF PERMIT

Every solicitation permit issued by the commissioner shall:

1. * * * *

2. * * * *

3. Limit the portion of funds received on account of stock subscription, if any are proposed to be taken, which may be used for promotion and organization expenses to such amount as he deems adequate, but in no event to exceed fifteen per centum of such funds as and when actually received;

4. * * * *

The purpose of the code provision limiting expenditures for promotion is to assure subscribers that 85 per cent of their funds paid in shall be safe from appropriation by promoters and is to be held in trust for the benefit of the subscribers for use by the corporation and for the protection of policy holders who purchase policies with the corporation. It is for the further purpose that in the event that the promoters are not successful in promoting the corporation and qualifying it to do business under the laws of the state, that the subscribers will have returned to them 85 per cent of the funds that they have delivered into trust.

One dealing with a trustee is charged with a knowledge of the trustees power and McCormick is so charged in this action. When he went to work for Licoa he knew or should have known the limitations of the power of the promoters of the corpora-

tion. Out of the 15 per cent available for expenses must come all expenses of promoting and organizing the corporation including the commissions of McCormick.

If the promoters can use 15 per cent of the money paid in on stock subscribers in partial satisfaction of the promotion and organization expenses and then incur debts and obligations which the corporation must pay, as soon as it is licensed, out of funds which are theretofore immune, the statute becomes worse than useless. It denies the subscribers and the policy holders in the corporation the protection which they are given under the code and the code provision would become a decoy for credulous subscribers and credulous policy holders and the corporation would become a prey to those who had evaded the statute. The entire organization expense and promotion expense should all be considered in determining any sum that might be due McCormick as commissioned.

In *Anchor Life & Accident Insurance Company vs. Taylor*, Court Appeals of Ohio, (1928) 163 N. E. 631, a similar statutory provision to that of the Utah provision was interpreted by that court as holding that commissions must be limited by other organizational expenditures.

44 CJS, Pages 632, Section 99 states the proposition as follows:

“Statutory limitation on promotion expenses. Under statutes providing that promotion and organization expenses of insurance companies cannot exceed a prescribed percentage of the amount actually raised on stock subscriptions, an insurance corporation which is in process of formation, preliminary to its license to do business, has no power to contract for preliminary expenses beyond the percentage prescribed by statute. The purpose of such a provision is to insure that a certain percentage of the funds paid in shall be safe from appropriation by promoters, and held in trust for the benefit of those subscribing to the corporate stock. Out of the prescribed percentage must come all the expenses of promotion, including compensation for an individual who has performed work in connection with the sale of the company’s corporate stock preliminary to securing a license. A promoter cannot use the prescribed percentage in partial satisfaction of the promotion expenses and then incur further debts which the corporation will be required to pay out after being licensed.”

See also 18 Appleman’s Insurance Law and Practice Section 10005 at Page 21 in which Appleman recognizes and follows the law as announced in the Ohio case.

Under a statute such as the Utah statute, it is beyond the power of the corporation and the power of the Insurance Commissioner of the State of Utah to contract for or to authorize expenditures for promotion and organization expenses of an in-

surance company in any amount in excess of 15 per cent of the funds as and when they are actually collected.

It was error for the trial court to deny the introduction of proof of expenditures for the organization and promotion of Licoa and such proof be used in the determination of any recovery that might be had by Licoa.

POINT I

SECTION 31-6-7 UCA, 1953, PROHIBITS EXPENDITURES FOR PROMOTIONAL AND ORGANIZATIONAL EXPENSES OF LIFE INSURANCE CORPORATIONS IN EXCESS OF 15 PER CENT OF THE FUNDS RECEIVED ON STOCK SUBSCRIPTIONS AS AND WHEN ACTUALLY RECEIVED.

A. * * * *

B. THE TRIAL COURT ERRED IN ALLOWING COMMISSIONS ON SUBSCRIPTION NOTES WHICH WERE IN DEFAULT AND CANCELLED AS THE ONLY REMEDY LICOA HAD UNDER THE TERMS OF THE NOTE.

The subscription notes provided that the only remedy of Licoa was to retain the amounts paid as damages on the notes (R 42). This is in keeping with the provisions of Section 31-6-14 UCA 1953 providing that subscription contracts should provide forfeiture as the only remedy for failure to make payments when due on subscription notes. Any coercive of action against the stockholders by the

promoters or to permit McCormick to take any coercive measures against the subscribers would be to delay the formation of the corporation and defeat the apparent purpose of the code. Such a requirement would also have the effect of involving the formation of a life insurance corporation in litigation of subscribers notes and claims against the subscribers who are in default under the note and thereby delaying the effective promotion of a life insurance corporation beyond the term for which a permit can be issued a period of two years as provided in Section 31-6-7 UCA, 1953.

Section 31-6-14 UCA 1953 provides as follows:

PROPOSED INSURER ON SYNDICATE — POWERS OF ISSUANCE OF STOCK OR PARTICIPATION AGREEMENT — FORFEITURE OF SUBSCRIPTION CONTRACT.

1. No such proposed stock insurer, corporation, or syndicate shall issue any share of stock or participation agreement except for payment in cash or in securities eligible for investment of funds of insurers, or until all subscriptions received under the solicitation permit have been fully paid, and, if an insurer, a certificate of authority has been issued to it.

2. Every subscription contract to shares of such insurer or corporation calling for payment in installments, together with all amounts paid thereon, may at the option of

the insurer, be forfeited if payments are not made on or before due dates and upon failure to make good any such delinquency upon not less than forty-five days' notice in writing, and every such contract shall so provide.

Section 31-7-7 UCA 1953, provides—

RECITALS REQUIRED IN PERMIT—DURATION OF PERMIT. Every solicitation permit issued by the commissioner shall:

(1) Expire two years from its date, unless earlier terminated by the commissioner under the provisions of this chapter, and shall so state;

(2) * * * *

(3) * * * *

(4) * * * *

The apparent purpose of the foregoing code provisions is to permit the formation of an insurance corporation for profit and provide that such corporation will be formed within a reasonable time. The desired effect being to have the corporation reach the desired capital structure and qualify as an insurer or return the funds to the subscribers. These sections, read in the light of other code provisions with regard to the formation of stock insurers, seem to establish that it is intended that the subscribers shall have returned to them 85 per cent of their money paid in, in the event that the formation of the insurance corporation fails. With these

provisions in mind to require the promoters of an insurance corporation to bring coercive measures against subscribers to enforce the notes or to permit stock salesman to bring coercive action against the subscribers would be to force the formation of the corporation into a situation where its qualification as an insurer would depend upon the final outcome of the course of action or litigation taken to enforce the subscriptions. This would defeat the purpose of the code provisions as set out above.

It was error for the trial court to hold that there is any duty upon Licoa to return the notes in question to McCormick. Certainly it cannot be held that McCormick would have any right to do anything about the notes that Licoa did not have. Both Licoa and McCormick were subject to the limitations of the code and could only cancel the notes or terminate them and declare a forfeiture was not declared by Licoa but stock was issued by all sums paid in. It cannot be said that the forfeiture provisions are for the protection of the subscriber himself as it can readily be seen, as pointed out above, that it is for the protection of all subscribers, whether they have paid in cash, or merely signed subscription notes, in that the qualification of the corporation to do business as an insurer is dependent upon its formation within the time provided by the code.

CONCLUSION

McCormick sold stock to subscribers for notes as well as other consideration. The notes provided that the only remedy of Licoa was the retention of the amounts paid in by Licoa. Licoa cancelled the notes when they were in default and refused to pay McCormick a commission. The trial court did not consider all promotional and organizational expenses in dealing the amount that could be paid McCormick on his commissions. The trial court awarded commissions in violation of the code provision providing that such commissions would be paid only upon cash receipts or the equivalent of cash receipts. The code provides that commissions shall be paid only upon cash receipts or admissible assets. To violate such code provisions as was done by the trial court is to defeat the purpose of the code. The purpose and intent of the code is to protect the subscribers against the appropriation of their funds by promoters, to protect policy holders to assure that the proceeds of subscriptions will be available to satisfy claims of policy holders and to sustain the trial court would defeat these purposes.

Respectfully submitted,
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