

1972

Wayne M. Parker and David A. Jones v. Telegift International Inc.: Appellant's Brief

Utah Supreme Court

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In The Supreme Court of the State of Utah

WAYNE M. PARKER
and DAVID A. JOHNS,

Plaintiffs and Appellants,

vs.

TELEGIFT INTERNATIONAL INC.,

a Utah corporation,

Defendant and Respondent.

APPELLANTS' BRIEF

Appeal from Judgment for Respondent

Third District Court,

Honorable Ernest F. Baldwin, Judge.

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FILED

AUG 28 1972

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In The Supreme Court of the State of Utah

WAYNE M. PARKER
and DAVID A. JOHNS,

Plaintiffs and Appellants,

vs.

TELEGIFT INTERNATIONAL INC.,
a Utah corporation,

Defendant and Respondent.

} Case No.
12941

APPELLANTS' BRIEF

STATEMENT OF KIND OF CASE

This is an action by the plaintiffs against the defendant for wages earned over a period beginning February 28, 1970, and ending November 18, 1970. Plaintiffs also claimed attorney fees, court costs and interest.

DISPOSITION IN LOWER COURT

The Trial Court, the Honorable Ernest F. Baldwin presiding, found that the plaintiff Wayne M. Parker was employed by Telegift Incorporated (hereinafter sometimes designated "Telegift") from March 3, 1970, till November 18, 1970, in a "managerial capacity" at a salary of \$200.00 per week. The Court also found that the plaintiff David A. Johns was

employed by Telegift from February 28, 1970, until November 18, 1970, at the same weekly salary. The Court concluded that Telegift Incorporated, which was not a party defendant, owed the plaintiffs \$6,500.00 plus an attorney fee of \$1,500.00 (R. 112).

The Court then found that Telegift Incorporated had been acquired by National Gift Enterprises (hereinafter sometimes designated "National" or "National Gift") which, in turn, had been acquired by Telegift International, Inc. (hereinafter sometimes designated "Kiabab" or "Telegift International"). The transactions were designated as stock for stock rather than stock for asset acquisitions, the Court expressly finding that "No assets of Telegift Incorporated were acquired by National" and that "No assets of National were acquired" by Telegift International (R. 112). These findings led the court to conclude that Telegift International "did not assume" and was not obligated for the indebtedness of Telegift. Judgment was entered against the plaintiffs and for the defendants, no cause of action.

From this Judgment the plaintiffs appeal.

RELIEF SOUGHT ON APPEAL

The Trial Court made findings concerning the precise amount of the plaintiffs' wage claims and attorney's fees. Plaintiffs seek the reversal of the Judgment entered on June 1, 1972, and request that this Court

find, as a matter of law, that the respondent is obligated for the indebtedness of Telegift Incorporated to the plaintiffs in those amounts previously specified in the Trial Court's findings.

STATEMENT OF FACTS

Wayne M. Parker and David A. Johns were hired by Telegift Incorporated on March 3 and February 28, 1970, respectively. Telegift, as the name suggests, was in the gift by phone or wire business much like FTD florists. The plaintiffs were hired in managerial capacities as national sales managers (R. 184). Mr. Parker was appointed Eastern Sales Manager and Mr. Johns was appointed Western Sales Manager of the corporation (R. 185). Both were hired for a base salary of \$200.00 per week plus expenses, plus an override for business done within their territory (R. 157, 183, 184). Both were introduced to distributors of the company as management functionaries (R. 184). Both were designated as management employees in correspondence sent from Company headquarters (R. 185). Each had responsibilities consistent with management functions including, but not limited to, opening new sales areas, hiring sales managers, training employees, directing distributors, resolving disputes and handling a multitude of other managerial problems (R. 184, 186). Both of the plaintiffs made sales in the course of supervising the hiring and training of Telegift's sales force. Neither ever received an override or commission on any such

sale (R. 187). Neither Johns nor Parker ever signed an independent contractors agreement although sales personnel were always required to do so (R. 245, 246).

Sometime shortly after the plaintiffs were first employed, Telegift became unable to pay their salaries when due. On several occasions, plaintiffs received checks drawn on insufficient funds (R. 189). In consideration of their agreeing to remain on the job, without regular pay, plaintiffs were promised that their wages would be paid in full and that they would receive stock options (R. 189, 190). Payment was assured, plaintiffs were advised, as soon as Telegift merged with one of several possible merger partners¹ which would, in theory, provide adequate working capital for the corporation (R. 189-190). On the basis of such representations, Mr. Parker worked sixteen and one-half weeks, intermittently, without pay and Mr. Johns worked sixteen weeks (R. 174, 177, 189, 190).

On approximately November 18, 1970, the plaintiffs were jointly terminated. On February 8, 1971, a Complaint was filed against Telegift International, Inc. by the plaintiffs in the Third District Court for Salt Lake County (R. 1). The defendant asserted in its answer that it was not a proper party defendant to the lawsuit and that plaintiffs' claim, if any, was against

¹One of such partners was, reportedly, Argus Camera. (See testimony of Clarence L. Jolley, R. 221).

Telegift Incorporated (R. 4). It was also vigorously contended at the time of trial that the plaintiffs were not salaried employees of Telegift but rather sales personnel hired on a commission basis (R. 227). It was asserted that the money actually paid to the plaintiffs was an advance on commissions (R. 229), and that when the plaintiffs were terminated they were obligated to Telegift for amounts overdrawn (R. 238, 239).

The Trial Court, in the face of the defendant's representations which were "diametrically opposed" (R. 258) to those of the plaintiffs, found that the plaintiffs were not commissioned employees or independent contractors (R. 258, 259).

The defendant supported its argument that Telegift International was not obligated for Telegift's indebtedness by producing two separate Plans of Reorganization as Exhibits D-3 and D-4. The Exhibits were introduced as proof that on August 24, 1970, National Gift Enterprises acquired all of the issued and outstanding shares of Telegift Incorporated, and that on October 16, 1970, Kiabab International Inc. (formerly Kiabab Uranium Corporation and later Telegift International, Inc.) acquired all of the outstanding and issued shares of National Gift Enterprises. These transactions were each characterized by the defendant as stock for stock transactions resulting in the acquisition of Telegift by Telegift International. The latter was, allegedly, a holding company, the former its wholly

owned subsidiary (See defendant's Memorandum, R. 83).

Several months after Telegift was acquired by Telegift International, several "investors" acquired control of Telegift International. The new "investors", supposedly operating as an unincorporated entity called Weenig Enterprises (R. 46), settled numerous claims of creditors for a small percentage of their face value.

ARGUMENT

POINT I

THE TRANSACTIONS BETWEEN TELEGIFT, INCORPORATED, NATIONAL GIFT ENTERPRISES AND TELEGIFT INTERNATIONAL, INC. WERE ILLUSORY. THE TRIAL COURT ERRED IN FINDING THAT STOCK FOR STOCK ACQUISITIONS BETWEEN CORPORATIONS DEALING AT ARMS-LENGTH ACTUALLY OCCURRED.

The issue before the Court on this appeal is whether or not Telegift International is chargeable with Telegift's obligations. The problem in resolving that question is complicated by a series of transactions involving allegedly separate corporations. The legal theory of the defendant is that in a stock for stock acquisition the acquiring corporation is not liable for the acquired corporation's indebtedness. Consequently, the defendant asserts that National Gift Enterprises was not obligated for the debts of Telegift Incorporated and that Tele-

gift International Inc. was not obligated for the debts of either National Gift Enterprises or Telegift Incorporated. Defendants argue that National Gift was a subsidiary of Telegift International and that Telegift was the subsidiary of National Gift.

Telegift Incorporated before its involvement with the defendant or National Gift had good and bad features. The good features included the assets of the corporation which were the product of much travel expense and leg work and which were simply not replaceable without substantial and costly duplication and effort. Those assets were "nine distributors covering fifteen states, 89 dealers, and approximately 600 dealer applications and inquiries for dealerships" (Exhibit P-2). They included the "Telegift system and trademark" which was, after the work that had been done, an asset of significant value to the success of the business (R. 45, paragraph 2). The corporation, however, also had, according to its counsel, debts in the amount of \$133,817.00 at the time it was "acquired" by National Gift (R. 76).

The critical problem concerned how to claim the corporation's benefits and yet substantially avoid its burdens. Stripped to the bare bones, the procedure used was as follows. On August 24, 1970, National Gift acquired all of the stock of Telegift Incorporated (R. 76). When this transaction occurred Clarence L. Jolley was the President of Telegift Incorporated, Max L.

Burdick was Vice President and Dennis Grimshaw was Secretary-Treasurer (R. 204). Thomas R. Blonquist was its attorney and resident agent. On October 16, 1970, a scant three weeks later, National Gift and its new subsidiary was acquired by Telegift International (then Kiabab) an old uranium corporation, which had been dormant for fourteen years but whose shares could be publicly sold without further qualification with state or federal regulatory bodies. After this transaction Telegift International was, until a surrender of control to the "investors" on December 20, 1970, several months later, managed by its President, Clarence L. Jolley, its Vice President, Max Burdick, and its Secretary-Treasurer, Dennis Grimshaw (R. 204). Its legal affairs were handled by its attorney and resident agent Thomas R. Blonquist and the corporation operated under the substantially same name and from the same address as the subsidiary of its subsidiary, Telegift Incorporated. During this period, each of the officers and directors ostensibly operated in a dual capacity for both Telegift International, Inc. and Telegift Incorporated.²

From the time of the so-called acquisition, Telegift International treated, as will be later seen, both the

²In a companion case presently pending before the Third District Court, *Larry Wilkins vs. Telegift International, Inc.*, Civil No. 197927, the defendant admitted that Messrs. Jolley, Burdick, and Grimshaw also became directors of National Gift Enterprises during October of 1970, and that these three were the only directors present at the last meeting of National Gift's Board on December 21, 1970. Mr. Blonquist was apparently also the attorney for National Gift Enterprises (R. 217).

assets and creditors of Telegift as its own, controlling the corporation's activities such as they were.³ With respect to creditors, however, the convenient fiction of multiple corporations was maintained. With cash allegedly received from an investment group comprised of the "investors", all of whom sat on Telegift International's Board of Directors, and with capital stock of Telegift International, the corporation induced 85 creditors to settle claims totalling \$15,748.07 for \$5,206.95 in cash and 18 creditors to settle claims of unknown value for 259,735 shares of Telegift International, Inc., the old uranium corporation's, capital stock (R. 61-65).

POINT II

TELEGIFT INTERNATIONAL INC. WAS NOT A HOLDING COMPANY. THE TRIAL COURT ERRED IN FAILING TO FIND THAT TELE-GIFT INTERNATIONAL ACTIVELY ENGAGED IN THE GIFT TRANSFER BUSINESS.

Defendant's counsel asserted numerous times in argument that the defendant was a holding company and that its only asset was the issued and outstanding shares of National Gift Enterprises which in turn owned Telegift (R. 76, paragraph 6). A holding company is, of course, a corporation created for the express purpose

³The last meeting of Telegift's Board of Directors was in December of 1970 (R. 48, 206, 207). The corporation was suspended on September 15, 1971, for failing to pay franchise taxes (R. 107).

of acquiring and holding stock of other corporations. 8
Fletcher, "Corporations" § 7046.

The testimony of Clarence L. Jolley, who sat at counsel table with defense counsel during the trial, and who served simultaneously as President of Telegift and President of Telegift International, Inc., did not support this analysis. His testimony, as pertinent, was as follows:

MR. ALLRED: "Now, when you were serving as President of both of those corporations, which were supposed to be separate . . . what were the functions of Telegift, Inc., and what were the functions of Telegift International, Inc.?"

MR. JOLLEY: "Essentially they had the same function."

Q. "In other words, they were both in the same business; is that correct?"

A. "Yes".

Q. "Meaning the gift transfer business?"

A. "Yes".

Q. "And there was no distinction, to your knowledge, as to any diverse functions, as between those two corporations?"

A. "No". (R. 218, 219).

Although Mr. Jolley's admission should dispose of the matter, there are several additional things which

suggest that the functions of Telegift International went far beyond those of a mere holding company.

The name, Telegift International, Inc., itself, argues against the theory that the corporation is a holding company. All of the good will of a gift by phone or wire business such as Telegift Incorporated, and all of its prior efforts and expense to geographically expand and publicize its services, is tied up in the name. The original name of Telegift International was Kiabab Uranium Corporation (R. 22, paragraph 12). This was subsequently changed on October 20, 1970, to Kiabab International, Inc. Presumably, if Kiabab had been a holding company, the name change was intended to imply that it was a holding company of international dimensions. A much more plausible explanation, however, of this initial change is furnished by some consideration of the nature of the "gift by phone or wire business". On November 12, 1970, the name was changed to Telegift International, Inc. (R. 22, paragraph 12). The final change was effected because the name Kiabab International Inc. "did not describe the *activities* of the Corporation" (R. 48, paragraph 22). The name Telegift did. For, as the Proxy Statement sent to shareholders in connection with the transaction between "Kiabab" and Telegift indicated, "If the Shareholders ratify the acquisition of all of the outstanding stock of National, Kiabab *will be actively engaged in the gift business* and the name KIABAB INTERNATIONAL, INC. would not describe the activities of

the Corporation" (Emphasis supplied) (Exhibit P-2). So, we are told, the alleged "holding" company took the name of a subsidiary of a subsidiary to describe more appropriately its function.

The facts elicited during the course of the trial clearly indicate that the defendant was not a holding company but that it was "actively engaged" in the gift transfer business using all of the resources but failing to assume the responsibilities of the subsidiary whose name it bore. Telegift International was merely a continuation of Telegift by Telegift's own management under a slightly altered name.

POINT III

TELEGIFT INTERNATIONAL, INC. EXPRESS- LY OR IMPLIEDLY ASSUMED THE INDEBT- EDNESS OF TELEGIFT INCORPORATED.

Clarence L. Jolley, the dominant figure in both corporations, prior to the trial and in other proceedings filed Affidavits concerning the precise question of assumption. Upon examination, Mr. Jolley admitted that certain Affidavits in Support of Motions for Summary Judgment in cases previously considered by the Third District Court, were prepared by his then attorney, Ronald C. Barker, read by Jolley and signed in the presence of a Notary Public. He indicated that the contents of the Affidavits represented the truth (R. 213).

Speaking as a past President of both corporations,

and with the unique knowledge of one who supposedly served in this dual capacity when the transactions relating to the acquisition, or merger, or name change, as the case may be, took place, Mr. Jolley under oath asserted that the “*assets*” of Telegift Inc. were “*transferred*” to Telegift International, Inc. and that Telegift International, Inc. “*assumed and became liable* for all of the debts and obligations” of Telegift Incorporated.⁴

Although the Affidavit was received in evidence with some reservations (R. 213), Mr. Jolley admitted, with some later hedging (R. 215), that it was true (R. 213). The Court did receive the Affidavit in evidence (R. 213, 214).

The assumption by Telegift International of Telegift's debts as expressly set out in the Jolley Affidavit is strongly further referenced in correspondence from the attorney, Thomas R. Blonquist, to the transfer company concerning the settlement of Telegift Incorporated accounts with Telegift International, Inc. stock (R. 61). The letter reads, in pertinent part, as follows:

June 30, 1971
Nelson Transfer Company
366 South Fifth East
Salt Lake City, Utah

⁴Based on these Affidavits, the Third District Court in two earlier decisions had held Telegift International, Inc. liable for obligations of Telegift Incorporated. See: *Murray State Bank vs. Telegift Inc. et al*, Civil No. 197329, *Bank of Salt Lake vs. Telegift Inc. et al*, Civil No. 197085.

Re: *Telegift International, Inc.*

Gentlemen:

"Over the past six months an investment group has been working with the *above referenced corporation* in an effort to solve *its* financial problems.

As a result of the effort of the investment group, many creditors of Telegift have agreed to settle their claims against the corporation for investment stock. In each case the creditor has signed a settlement agreement and an investment undertaking.

In the board of directors meeting held June 29, 1971, a resolution was passed authorizing the issuance of Telegift International, Inc. capital stock to those creditors who have signed the heretofore referred to investment undertakings. A copy of the minutes is enclosed herewith for your file.

You are hereby instructed to issue shares of Telegift International, Inc. capital stock to the following persons or companies in the amounts indicated. All certificates are to be stamped with the investment stamp and the restricted transfer stamp."

(Then follows a list of the creditors of Telegift Incorporated. Example: Malcolm C. Petrie, the accountant who prepared the Financial Statements which constitute Exhibit "E" to defendant's Answer to plaintiff's second set of Interrogatories, R. 66).

Concluding, Mr. Blonquist says:

"Thank you for your promptness in handling

Telegift matters." (Emphasis supplied).

The tone of the letter; its reference to the debts of Telegift Incorporated; its characterization of such debts as being those of Telegift International, Inc., strongly suggests at the least an assumption of liability and at the most the disregard of the fiction concerning the separate identities of the two corporations.

Further proof of an assumption is found in the Agreement of December 21, 1970, which is in evidence as Exhibit P-2. In this document the Telegift International, Inc. "investors" who were, after the execution of the Agreement its new officers and directors, characterized themselves as an investment group. Jolley, Grimshaw, Jackson and Burdick, who were, historically, the officers of Telegift Inc., assigned their shares, resigned their positions and made other adjustments.

Note that Clarence Jolley, as "Director" (he was in fact also President) of Telegift International, Inc., signed on the Defendant's behalf and indicated as follows:

6. "It is agreed between Telegift ["Telegift International, Inc." — See Introductory Paragraph] and the investment group that the latter shall have Carte Blanche authority to deal with the creditors of Telegift in such manner as they see fit, including the issuance of capital stock to them, if necessary, to satisfy the corporation's debts."

Again, Telegift International, Inc. gives authority to settle *its* debts. What those debts consisted of is unmistakable. As Mr. Jolley testified, Telegift International, Inc., the shell, prior to acquiring Telegift Incorporated had no debts other than the \$9,000.00 for activation expenses and the "historical" indebtedness to its ancient shareholders (R. 210, 211). This was most assuredly not the subject matter of the Agreement of December 21, 1970, and the stock did in fact subsequently issue to creditors of Telegift Incorporated (R. 61). Telegift International, Inc. also agreed to convey title to the 1968 Cadillac automobile driven by Jolley but owned by Telegift Incorporated (Exhibit P-2).⁵ Surely the \$10,000.00 settlement figure referred to in Exhibit P-2 for Clarence Jolley did not relate to obligations of Telegift International to him for the approximate 40-day period during which he served as its President after the date of the original transaction between the two corporations and prior to his resignation on December 20, 1970. It also related to indebtedness of Telegift Incorporated.

These facts support an assumption and the concept of "de facto" merger. The Third District Court.

⁵Note that Telegift International treated the Cadillac automobile as its own asset in direct contradiction to the statement of counsel in the defense memorandum that, "No evidence . . . was produced to show that assets of Telegift were transferred to Kiabab" and directly contrary to the Trial Court's factual findings that "No assets of Telegift Incorporated were acquired by National" and "No assets of National were acquired by Defendant. . .". See also the testimony of Clarence Jolley on this point (R. 211, 212).

Judge Stewart M. Hanson presiding, found such an assumption and joint and several liability based on Jolley's Affidavit and the Plan of Reorganization (Exhibit P-4). The result of the Trial Court's ruling in the instant case was to put the Third District Court in the position of making varying and inconsistent determinations on identical legal issues in companion cases. Several other cases presently pending will be determined by the decision on this appeal.⁶

Courts have been liberal in finding the "implied assumption" of liabilities and in determining under similar circumstances that the new corporation was "merely a continuance of the old" *Altoona v. Richardson Gas and Oil Co. v. Commissioner* 81 Kan. 717, 106 P. 1025, *West Texas Refining and Development Company v. Commissioner* 68 F.2d 77 (10th Cir. 1933). The facts arguing for such a conclusion here are compelling and persuasive.

POINT IV

THE DEFENDANT, TELEGIFT INTERNATIONAL, INC., CONTRARY TO THE FINDING OF THE TRIAL COURT, ACQUIRED THE ASSETS OF TELEGIFT INCORPORATED AND WAS, ASSUMING A PROPER ACQUISITION, SUBJECT TO RULES OF LAW PERTAINING TO STOCK FOR ASSET ACQUISITIONS.

The effect of the transactions between the common

⁶*Larry Wilkins vs. Telegift International, Inc.*, Civil No. 197927, *Globe Travel Agency vs. Telegift International, Inc.*, Civil No. 40522.

directors and officers of Telegift and Telegift International was to place the assets of the former at the disposal of the latter. The Trial Court erred in finding that the transactions between Telegift, National Gift Enterprises and Telegift International were stock for stock acquisitions.

It is apparent from the Affidavit of Clarence L. Jolley in the earlier cases that "the assets of Telegift, Inc. were transferred to Telegift International, Inc." (Exhibit P-2). The Affidavit and the testimony of Jolley constitutes the admission of the President of both corporations that such a transfer actually took place. It is apparent from the terms of the Agreement between the investment group and Telegift International that the assets of Telegift were treated as the assets of Telegift International (Exhibit P-5). Speaking of Exhibit P-5, Mr. Jolley's testimony is enlightening with respect to several specific assets.

MR. ALLRED: "Now it [the Agreement, P-5] also made mention of a Cadillac automobile owned by you. Did you own a Cadillac automobile at that time?"

MR. JOLLEY: "No, I didn't."

Q. "Who did own the Cadillac, 1968 Cadillac?"

A. "Telegift, Inc."

Q. "Telegift, Inc., did, but this agreement with Telegift International, Inc., made reference to that vehicle, and said that you would be permitted to retain it; is that correct?"

A. "That's right."

Q. "You signed that, [the Agreement] again, on behalf of Telegift International, Inc. giving authority to permit you to retain the Cadillac; right?"

A. "Yes."

Q. "And that was equally true of Mr. Charles Jackson, who had a 1969 Cadillac of his own. Who owned the Cadillac driven by Mr. Jackson?"

A. "Mr. Jackson."

Q. "He owned it, in his own name?"

A. "Yes."

Q. "What was the reason for including that as a part of this contract and agreement?"

. . .

A. ". . . it was part of his compensation. Payments were made on his car as part of his compensation."

Q. "By Telegift, Inc.?"

A. "Yes".

Q. "And in this case, again, and I hate to repeat the obvious, but Telegift International, Inc., said the automobile can belong to you, hereinafter."

A. "Yes" (R. 211, 212).

At this time, when Telegift International the alleged holding company, which supposedly held and managed shares and nothing more, was disposing of

Telegift's assets and contracting with Telegift International's Board as individuals for the settlement of Telegift's debts, Telegift Inc. was a corporation without a Board of Directors, which held no meetings during 1971. (R. 107, R. 48, paragraph 16). The admitted sale during 1971 of \$16,000.00 worth of Telegift assets (R. 48, paragraph 21, R. 71) must be deemed to have been conducted, like the disposition of the Cadillac automobiles, on authority of Telegift International Inc.

If this Court concludes that the transaction between the corporations was a stock for asset acquisition rather than a stock for stock acquisition, then the general rule is as follows:

“Generally where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, except: (1) where the purchaser expressly or impliedly agrees to assume such debts, (2) where the transaction amounts to a consolidation or merger of the corporation; (3) where the purchasing corporation is merely a continuation of the selling corporation; and (4) where the transaction is entered into fraudulently to escape liability for such debts.” Fletcher, Private Corporations section 712.

The numbered items in the above quotation were accepted and treated as four separate exceptions, each of which would stand on its individual merits, by the Nevada Supreme Court in the case of *Lamb v. LeRoy*

Corporation 84 Nev.276, 454 P.2d 24. The plaintiffs contend, based on facts and circumstances recited here and elsewhere in the Brief, that each of the four exceptions is applicable in the case before the Court.

Courts have involved a number of theories to impose liability upon purchasers of assets who use their own stock to finance the purchase, whether the shares are delivered to the selling corporation or to its shareholders. Several of these theories which have application to these facts are hereinafter discussed. In the instant case, it is admitted that the Telegift International shares were delivered directly to Telegift Incorporated shareholders (R. 47, paragraph 13).

A. Direct Delivery of Consideration for Purchase to Shareholders.

The direct payment of purchaser's stock to seller's shareholders, leaving the selling corporation without assets to pay creditors, results in the imposition of liability upon the purchaser. *McKee v. Standard Minerals Corp.* 18 Del Ch 97, 156 A.193. See also: *Jennings Neff and Co. v. Crystal Ice Co.* 128 Tenn. 231, 159 S.W. 1088. By deliberately bypassing the selling corporation, the purchaser places the seller in a position in which it can not pay its creditors.

"The theory is that if stockholders of one cor-

poration turn over its assets to another corporation, receiving into themselves the stock of the transferee in payment, the transaction is void as against creditors of the former, and they may look to the latter for satisfaction to the extent of the value of the assets received." *McKee v. Standard Minerals Corp.*, *supra* at 100-101.

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Telegift Incorporated after the transaction with the Defendant theoretically experienced a net loss during 1971 of \$38,179.00 (R. 47, paragraph 11).

B. *De Facto Merger*

The "de facto" merger doctrine has also been invoked to protect creditor's rights in asset acquisitions. The doctrine provides that a transaction in the form of a sale of assets (or a stock acquisition) may, despite efforts to give it another form, be treated as a merger. See: 8 *Cavitch, Business Organizations* at 64, *Hariton v. Arco Electronics, Inc.* 188 A.2d 123, *Heilbrun v. Sun Chemical Corp.* 38 Del Ch 321, 150 A.2d 755.

If treated as a merger, incidents characteristic to statutory mergers apply. The most prominent of those characteristics is the liability of the survivor for the indebtedness of the merged corporation. The principle of "de facto" merger was accepted and applied by this

suggest that the functions of Telegift International went far beyond those of a mere holding company.

The name, Telegift International, Inc., itself, argues against the theory that the corporation is a holding company. All of the good will of a gift by phone or wire business such as Telegift Incorporated, and all of its prior efforts and expense to geographically expand and publicize its services, is tied up in the name. The original name of Telegift International was Kiabab Uranium Corporation (R. 22, paragraph 12). This was subsequently changed on October 20, 1970, to Kiabab International, Inc. Presumably, if Kiabab had been a holding company, the name change was intended to imply that it was a holding company of international dimensions. A much more plausible explanation, however, of this initial change is furnished by some consideration of the nature of the "gift by phone or wire business". On November 12, 1970, the name was changed to Telegift International, Inc. (R. 22, paragraph 12). The final change was effected because the name Kiabab International Inc. "did not describe the *activities* of the Corporation" (R. 48, paragraph 22). The name Telegift did. For, as the Proxy Statement sent to shareholders in connection with the transaction between "Kiabab" and Telegift indicated, "If the Shareholders ratify the acquisition of all of the outstanding stock of National, Kiabab *will be actively engaged in the gift business* and the name **KIABAB INTERNATIONAL, INC.** would not describe the activities of

the Corporation" (Emphasis supplied) (Exhibit P-2). So, we are told, the alleged "holding" company took the name of a subsidiary of a subsidiary to describe more appropriately its function.

The facts elicited during the course of the trial clearly indicate that the defendant was not a holding company but that it was "actively engaged" in the gift transfer business using all of the resources but failing to assume the responsibilities of the subsidiary whose name it bore. Telegift International was merely a continuation of Telegift by Telegift's own management under a slightly altered name.

POINT III

TELEGIFT INTERNATIONAL, INC. EXPRESSLY OR IMPLIEDLY ASSUMED THE INDEBTEDNESS OF TELEGIFT INCORPORATED.

Clarence L. Jolley, the dominant figure in both corporations, prior to the trial and in other proceedings filed Affidavits concerning the precise question of assumption. Upon examination, Mr. Jolley admitted that certain Affidavits in Support of Motions for Summary Judgment in cases previously considered by the Third District Court, were prepared by his then attorney, Ronald C. Barker, read by Jolley and signed in the presence of a Notary Public. He indicated that the contents of the Affidavits represented the truth (R. 213).

Speaking as a past President of both corporations,

Corporation 84 Nev.276, 454 P.2d 24. The plaintiffs contend, based on facts and circumstances recited here and elsewhere in the Brief, that each of the four exceptions is applicable in the case before the Court.

Courts have involved a number of theories to impose liability upon purchasers of assets who use their own stock to finance the purchase, whether the shares are delivered to the selling corporation or to its shareholders. Several of these theories which have application to these facts are hereinafter discussed. In the instant case, it is admitted that the Telegift International shares were delivered directly to Telegift Incorporated shareholders (R. 47, paragraph 13).

A. Direct Delivery of Consideration for Purchase to Shareholders.

The direct payment of purchaser's stock to seller's shareholders, leaving the selling corporation without assets to pay creditors, results in the imposition of liability upon the purchaser. *McKee v. Standard Minerals Corp.* 18 Del Ch 97, 156 A.193. See also: *Jennings Neff and Co. v. Crystal Ice Co.* 128 Tenn. 231, 159 S.W. 1088. By deliberately bypassing the selling corporation, the purchaser places the seller in a position in which it can not pay its creditors.

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If treated as a merger, incidents characteristic to statutory mergers apply. The most prominent of those characteristics is the liability of the survivor for the indebtedness of the merged corporation. The principle of "de facto" merger was accepted and applied by this

Court in the case of *Cooper v. Utah Light and Ry. Co.* 35 Utah 570, 102 P. 202. The "de facto" merger doctrine was more recently applied by the Supreme Court of New Mexico in *American Hospital and Life Insurance Co. v. Kunkel* 71 N.M. 164, 376 P.2d 956. See also: 15 Fletcher, "Corporations", section 7127, p. 207, and numerous cases there cited, Allen D. Choka, "Buying, Selling and Merging Businesses," American Law Institute—American Bar Association Publication, at pages 115 and 116.

PRIOR UTAH DECISIONS

Problems similar to those raised on this appeal seem to have been infrequently considered by the Court. The decisions, though ancient, appear, however, to be in line with the predominant authority expressed in more recent opinions from other jurisdictions.

In the Utah case of *Cooper v. Utah Light and Ry. Co.* 35 Utah 570, 102 Pac.202, the plaintiff had a tort claim. His injury occurred on January 2, 1903, on property used by the Utah Light and Power Company. Plaintiff recovered judgment against Utah Light and Power on January 24, 1907. In the meantime, on about January 2, 1904, Utah Light and Power transferred its property to Utah Light and Railway Company. The sole consideration for the transfer was 3,062,500 shares of Utah Light and Railway stock distributed directly to Utah Light and Power's stockholders on a share for share exchange. The purchase agreement provided that

Utah Light and Power "should be sold and transferred to" Utah Light and Railway. Utah Light and Railway claimed ownership of the assets. After the transaction, as in the instant case, officers of the purchased corporation served in identical positions with the purchaser. Utah Light and Railway, like Telegift International, had knowledge of the creditor's claim. The trial court awarded the creditor judgment against Utah Light and Railway which appealed alleging that there was not a consolidation but a sale; and that Utah Light and Power, among other things, did not convey its franchise to be a corporation [i.e. it had a separate existence].

The Court acknowledged that "a separate and distinct" corporation which has succeeded by a "valid" purchase and transfer to the property and rights of another corporation was not liable by reason of its succession unless it affirmatively appears that the transfer "in fact or in law" constitutes a fraud upon creditors or unless "*the circumstances attending the creation of the new corporation, and its succession of the property and franchises of the old corporation, are such as to warrant a finding that it is in reality a mere continuation of the old corporation.*" (Emphasis supplied).

The Court found that, normally speaking, a corporation could sell part or all of its property. But it is "clear", said the court, that it cannot sell, or otherwise dispose of its property to the prejudice of its creditors any more than an individual may sell or dispose of his

property to the prejudice or injury of his creditors. The Court found that the only consideration for the purchase of Utah Light and Power was capital stock of Utah Light and Railway. It stated,

“It may be that a creditor cannot complain when the shares of stock of the purchasing corporation are received and held by the selling corporation as assets and property of the latter corporation, except on the ground that the consideration was not valuable nor adequate, upon the same ground that he might complain of any other consideration . . . But we think he may very properly complain when the selling corporation and the vender enter into an agreement or arrangement whereby all the property of the selling corporation is to be conveyed and transferred upon a consideration, whether cash, shares of stock, or other property, which is not to be paid and received as assets and property of the selling corporation, but which is to be distributed among its stockholders, and the property is so sold and the proceeds of sale so distributed.”

The distinction between the *Cooper* case and the Telegift situation, if there is any substantial difference, centers around the treatment of the assets. In the *Cooper* case the assets were expressly conveyed to Utah Light and Railway. In other words, in the *Cooper* case, Utah Light and Power gave everything it had “except the franchise to be a corporation”, and its tort claims and other indebtedness. In the Telegift situation the stock for stock exchange was carried out in an identical manner, although it was a five share for one share exchange,

with the exception that the assets were not *expressly* conveyed. They were simply treated as if they were the assets of Telegift International, Inc. and there was, according to the President of both corporations, an "arrangement" [to use the *Cooper* terminology] whereby the "assets" were in fact "transferred" notwithstanding the form the transaction took for other purposes.

The Court concluded that the transaction between Utah Light and Power and Utah Light and Railway was, as to creditor, "not only fraudulent, but unlawful." The Court said,

"We can conceive of no arrangement which would more effectually place all the property of a corporation beyond the reach of the general creditors, and which would be more to their prejudice. The selling corporation in such case is for all purposes, outside of the winding up of its affairs, defunct, and in the condition of a dissolved corporation."⁷

This Court accepted the "de facto" merger doctrine acknowledging that there are cases where the transfer is "practically a consolidation."

In deciding for the creditors, the Court concluded that among the circumstances to be considered were the following, each of which has equally strong or stronger parallels in the present case.

⁷Telegift Incorporated was suspended by the Utah Secretary of State for non-payment of franchise taxes on September 15, 1971, (R. 107).

1. The purchasing corporation took the property and franchises of the seller "*and continued to prosecute the business of the selling corporation. . .*" (Emphasis supplied).

2. "Some" of the principal officers of the selling corporation continued to serve in the same capacities for the purchasing corporation.

Aside from the issue of fraud, the court finally concluded, that

"... the transaction, as found, was, according to the authorities heretofore cited, so far as effecting the rights of creditors, like that of a consolidation or a continuing corporation, rendering the purchasing company liable in equity for the debts and liabilities of the selling corporation."

The case has been approvingly cited on a number of occasions. See particularly, *Hoggan v. Price River Irrigation Company* 184 P. 536.

POINT V

TELEGIFT INTERNATIONAL, INC. WAS, UNDER THE CIRCUMSTANCES, LIABLE FOR THE OBLIGATIONS OF TELEGIFT INCORPORATED EVEN IF THERE HAD BEEN, AS THE DEFENDANT ALLEGED, A PURELY STOCK FOR STOCK TRANSACTION BETWEEN TWO SEPARATE CORPORATIONS.

A. Rules of Law Governing a Stock for Stock Acquisition.

If one assumes, arguendo, as Defendant alleges, that the transaction between Telegift and Telegift International was a stock for stock acquisition, and that Telegift International was a "holding" company, the general rule is as follows:

"A holding company is not liable for the torts, debts and obligations of its subsidiary, unless it uses its stock ownership in such a manner as actually to control and operate the properties of its subsidiary." 15 Fletcher, "Corporations", section 7131 p. 217. See: *Martin v. Development Co. of America* 240 F. 42, *Ross v. Texas Co.* 68 A.2d 321, *Costan v. Manila Elec. Co.* 24 F.2d 383, *Berkey v. Third Avenue Ry. Co.* 244 N.Y. 602, 155 N.E. 914, *Borough of Ambridge v. Philadelphia Co.* 283 Pa.5, 129 A.67.

The reason for the stock for stock rule is generally understandable. Under the rule, the purchasing corporation assumes the risk that the acquired corporation has debts which were unknown or undisclosed at the time of the purchase. While the purchaser does not ordinarily become personally liable for these debts, the existence of such debts may reduce the value of the purchaser's investment by reducing the net worth of the corporation whose shares are acquired. 8 *Cavitch, Business Organizations*, section 166.01 (1), p. 372. The theory runs that the purchaser's price will be excessive if the corporation whose stock it has purchased has unknown or undisclosed indebtedness. 8 *Cavitch, Business Organizations*, section 161.02 (1), p. 57.

Implicit in the foregoing, and in the general rule recited above, are the following presumptions:

1. The transaction must be an arms-length transaction between two separate and distinct corporate entities.

2. The purchaser must give value for the shares of the corporation which is acquired. See: *Cooper v. Utah Light and Ry. Co.* 35 Utah 570, 102 P. 101, *West Texas Refining and Development Co. v. Commissioner* 68 F.2d 77 (10th Cir.)

3. The acquired corporation, or subsidiary, must be operated in such a manner as to constitute more than a mere instrumentality of the purchaser, under the purchaser's domination and control.

In the instant case, the reasons for the application of the general rule disappear. Telegift International, the purchasing corporation, had no assets, gave no value and ran no risk that its investment would be damaged by this indebtedness of Telegift. Telegift International had liabilities for expenses to reactivate the corporation in the amount of \$9,000.00 and a "historical deficit" of \$140,000.00. The corporation had been an inactive and dormant shell for approximately fourteen years. (See: Unaudited Financial Statement attached to page 3 of the Proxy Statement, Exhibit P-2). National Gift Enterprises Inc. and Telegift Incorporated, conversely, had, accepting defendant's figures, (which are

questionable) for the nine-month period ending September 30, 1970, alleged net income of \$135,851.58. (See: Financial Statements, Exhibit P-2).

In other words, Telegift International (then Kiabab) the shell, acquired for the exchange of its valueless shares what appeared to be a going organization with substantial assets, an operating history, an organization and profits. Telegift Incorporated's shareholders, who controlled 97% of Telegift International's shares after the merger, received really nothing in consideration of surrendering their interest in Telegift, not even new management.

The alleged acquisition, in its inception, was effected to permit the public sale of the surviving shell's stock without further registration with the Securities and Exchange Commission. It had incidental and secondary benefits with respect to the numerous and pressing claims of creditors. The two corporations were, for all intents and purposes, merged although the fiction of separate identity was retained for convenience and leverage in dealing with creditors. The claims of the appellants were not unknown to Telegift International and Telegift Incorporated's dual management. Telegift International gave nothing of value for the shares of Telegift Incorporated.

B. Control Considerations. Analysis of Exception to General Rule.

While stock ownership alone does not render the stockholding company responsible for the torts, debts and obligations of the subsidiary company, still if the holding company uses its stock ownership in such manner as actually to control and operate the properties of its subsidiary, it does become responsible. See: *Roos v. Texas Co.* 68 F.2d 321; *Costan v. Manila Elec. Co.* 24 F.2d 383; *Berkey v. Third Avenue Ry. Co.* 244 N.Y. 602, 155 N.E. 914.

Where stock control is resorted to not for the purpose of participating in the affairs of the corporation in the normal and usual manner, but for the purpose of controlling the company so that it may be used as a mere instrumentality of the owning company courts will look through the screen of separate control and place the responsibility where it actually belongs. (Emphasis supplied) Radio Craft Co., Inc. v. Westinghouse Elec. and Manufacturing Co. 7 F.2d 432.

Consider the extent of the Defendant's control and operation of its alleged subsidiary, Telegift Incorporated:

1. After their dealings in October of 1970, and prior to December 20, 1970, Telegift and Telegift International had the same President, the same Vice President, the same Secretary-Treasurer, the same Attorney and the same Resident Agent (R. 21, paragraph 6, R. 25, paragraphs 37, 38, Jolley testimony R. 202-206, 216, 217).

2. Both of the corporations are located at the same address, 336 South Third East in Salt Lake City, Utah (R. 24, paragraphs 32, 33).

3. The only meeting of the Board of Directors of Telegift Incorporated after the alleged acquisition was attended by all of the Directors of Telegift International, the "investors", including Messrs. Boyd, Burdick, Weenig and Haynie, and the attorney, Thomas R. Blonquist (R. 48, paragraph 16).

4. Telegift Incorporated does not have a functioning Board of Directors, nor officers, and has had none since December of 1970 (R. 22, paragraph 14, R. 47, paragraphs 14 and 15).

5. Telegift Incorporated has not had a Board Meeting since December 21, 1970, and has not had an annual meeting since the alleged acquisition (R. 48, paragraphs 16 and 17).

6. Telegift Incorporated is a suspended corporation and has been since September 15, 1971 (R. 107).

7. Telegift International Inc. has taken the name of its alleged subsidiary and is, or has been, engaged in the business of transmitting gifts by phone or wire, the same business conducted by Telegift Incorporated prior to the dealings between the two corporations (R. 25, paragraph 39, R. 218, 219).

8. Telegift Incorporated's debts were compromised by Telegift International, Inc.'s "investors" after consent, not by Telegift Incorporated's Board, (it had none) but rather by Telegift International, Inc. through its President, Clarence L. Jolley (Exhibit P-2, R. 207-212).

9. The indebtedness of Telegift Incorporated was compromised with cash funds contributed by Harry M. Weenig, Dean A. Riddle, Frank E. Boyd, Max L. Burdick and Louis M. Haynie, all directors of Telegift International Inc., and, in part by the issuance of the capital stock of Telegift International, Inc. (R. 45, paragraph 6).

10. Assets of Telegift Incorporated in the amount of \$16,150.30 were sold during the year 1971, while Telegift Incorporated was without a Board of Directors (R. 48, paragraph 21, Schedule "F").

Such assets were sold without Board approval and in violation of the rights of creditors.

Summarizing, the law provides that if one corporation is wholly under the control of another, the fact that it is a separate entity does not relieve the latter from liability for its acts, and even when one corporation is the owner of another, the latter will be regarded as a mere trade name, and the real beneficiary cannot resort to the fiction of claiming in the name of the latter to

defeat bona fide creditors. *In re Marcella Cotton Mills*, 8 F.2d 522.

If by stock ownership, common officers and the relation of debtor and creditor (all of which are factors in the instant case)⁸, or otherwise, a subsidiary corporation becomes a mere agency or department of the holding company, or is used as a blind or instrumentality to perpetuate fraud, the holding company cannot escape liability for the acts of its subsidiary. *Ozel Fumigating Corp. v. California Cyanide Co., Inc.*, 24 F.2d 718.

If these rules did not apply, and if there were no exception to the general rule, then all that counsel would have to do in order to avoid the claims of creditors would be to characterize a merger, or a stock for asset transaction, as a stock for stock acquisition. In the case before the court, there was no valid business purpose for acquiring a subsidiary and letting it die from disuse, or for a putative parent to be actively involved in the same business as its subsidiary and namesake.

CONCLUSION

The defendant "acquired" Telegift through a series of self-dealing manipulations involving interlocking directorates, common officers and conflicts of interest.

⁸Counsel for the defendant argued that defendant's stock was used to settle Telegift Incorporated's debts. The consideration for such a transaction was alleged to be the settlement of the indebtedness of a wholly owned subsidiary. It was alleged that the settlements created obligations running from Telegift Incorporated to Telegift International.

If it is difficult to more accurately describe what actually occurred, it is because the confusion engendered by two separate acquisitions in 23 days, changing nothing but the marketability of the surviving corporation's shares, defies more precise analysis. Under the factual circumstances, however, it little matters whether the dealings between the corporations involved a merger, a stock for asset or a stock for stock acquisition. In each case the law is adequately designed to avoid injustice through the unfair treatment of creditors.

The involvement of the "investors" some two months after the last "acquisition" had occurred in no way altered those rights which had then vested and is of little consequence to these deliberations. The facts with which this appeal is concerned were pre-cast and inherited by Telegift International's present principals who, at the very least, have used the "acquisitions" advantageously.

The defendant's argument that Telegift was a mere subsidiary of Telegift International, a holding company which was not involved in the gift business, was as inaccurate as its argument that the plaintiffs were unsalaried and commissioned employees.

The degree of control exercised by Telegift International, the common officers, directors and names of the two corporations, the brief time which elapsed between the "acquisitions" and the disregard of corporate formalities, all compellingly argue that the transaction

was illusory and that the surviving corporation was a mere continuation of its predecessor, or, at the very least, in complete control of its predecessor's affairs.

This Court is not obliged to accept the defendant's characterization that this was a stock for stock acquisition because the defendant claimed it was before the Internal Revenue Service (Exhibits D-3, D-4).⁹ The substance, rather than the form the transaction took, governs.

The Trial Court made factual findings contrary to the express and uncontradicted admissions of the President of both corporations and inconsistent with prior determinations of the Third District Court. (See Argument, this Brief, Point IV). The Trial Court erred, notwithstanding such findings, in applying the law to the facts it found.

The decision of the Trial Court should be reversed. The Court's dollar findings pertaining to the appellants' loss should be assessed against Telegift International, Inc.

Respectfully submitted,

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⁹Any more than the Internal Revenue Service was obliged to tax a medical partnership as a partnership rather than as a corporation in a state where corporations were not permitted to practice medicine. See the famous *Pelton* case. *Pelton v. Commissioner* 82 F.2d 473 (7th Cir. 1936).