

1972

Wayne M. Parker and David A. Jones v. Telegift International Inc.: Respondent'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.

Case No.
12941

RESPONDENT'S BRIEF

Appeal from Judgment for Respondent,
Third District Court,
Honorable Ernest F. Baldwin, Judge

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TABLE OF CONTENTS

	<i>Page</i>
ABBREVIATIONS USED HEREIN	1
STATEMENT OF FACTS	2
ARGUMENT	
POINT I	
THE TRANSACTIONS BETWEEN NATIONAL AND TELEGIFT AND KIABAB AND NATIONAL WERE STOCK FOR STOCK ACQUISITIONS NOT MERGERS.	4
POINT II	
THE TRANSACTIONS WERE AT ARMS- LENGTH.	6
POINT III	
KIABAB DID NOT ASSUME THE DEBTS OF TELEGIFT.	6
POINT IV	
PLAINTIFFS FAILED TO SUSTAIN THEIR BUR- DEN OF PROOF.	7
POINT V	
CASES CITED BY PLAINTIFFS ARE NOT IN POINT.	9
UTAH LAW	10
CONCLUSION	11

TABLE OF CONTENTS (Continued)

CASES CITED	Page
<i>Altoona v. Richardson Gas and Oil Co.</i> , 81 Kan. 717, 106, P. 1025 (1910).	9
<i>American Hospital and Life Insurance Co. v. Kunkel</i> , 71 N.M. 164, 376, P.2d 956 (1962).	10
<i>Cooper v. Utah Light and Ry Co.</i> , 35 Ut. 570, 101 P.202 (1909).	9, 7, 10
<i>Costan v. Manila Elec. Co.</i> , 24 F.2d 383 (2nd Cir. 1928).	9
<i>In re Marcella Cotton Mills</i> , 8 F.2d 522 (Dist. Ct. Md. 1925).	9
<i>Lamb v. LeRoy Corporation</i> , 85 Nev. 276, 454 P.2d 24 (1969).	9
<i>Martin v. Development Co. of America</i> , 240 F.42 (9th Cir. 1917).	10
<i>Owl Fumigating Corp. v. California Cyanide Co., Inc.</i> , 24 F.2d 718 (Dist. Ct. Del. 1928).	9
<i>Radio Craft Co., Inc. v. Westinghouse Elec. and Manufacturing Co.</i> , 7 F.2d 432 (3rd Cir. 1925).	9
<i>West Texas Refining and Development Co. v. Commissioner</i> . 68 F.2d 77 (10th Cir. 1933).	9

TREATISES CITED

8	Cavitch, <i>Business Organizations</i> . 161.02[1], 161.08[2], 166.01[1].	4, 7
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Case No.
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RESPONDENT'S BRIEF

ABBREVIATIONS USED HEREIN

Plaintiffs and appellants, Wayne M. Parker and David A. Johns, are herein referred to as "plaintiffs."

Defendant and respondent, Telegift International, Inc., a Utah corporation, formerly Kiabab Uranium Company and Kiabab International, Inc., is herein referred to as "Kiabab."

National Gift Enterprises, Inc., a Utah corporation, is herein referred to as "National."

Telegift, Incorporated, a Utah corporation, is herein referred to as "Telegift."

Messrs. Frank E. Boyd, Max L. Burdick, Louis Haynie, Dean A. Riddle, and Harry M. Weenig, individuals, are herein referred to as "investment group."

Kiabab agrees with the Statement of Kind of Case, Disposition in Lower Court and Relief Sought on Appeal as set forth in the brief of plaintiffs.

STATEMENT OF FACTS

Kiabab was incorporated on June 2, 1954, (R.20 at paragraph 1) for the purpose of mining uranium and other precious minerals and acquiring shares of stock of other corporations and for purchasing real property (R.22 at paragraph 10). After the mining of uranium ore proved unfeasible and Kiabab had depleted its cash reserves, the company became inactive.

On October 16, 1970, Kiabab, in accordance with one of its purposes for incorporation, agreed to acquire all of the issued and outstanding stock of National. This acquisition was accomplished in accordance with a plan of reorganization (Exhibit 4-D). In the transaction, all of the issued and outstanding shares of National (1,750,400 shares) were acquired by Kiabab for 8,752,000 shares of the authorized and unissued shares of Kiabab (Exhibit 4-D, page 2 at paragraph 1). Shareholders of National surrendered their National shares (Exhibit 4-D, paragraph 2 [b]) and received shares of Kiabab. For every one share of National owned, a shareholder received five shares of Kiabab.

After the exchange was effected Kiabab owned all of the outstanding shares of National. This transaction was not a merger of two corporations into one or the sale of assets of one corporation to another, but was a stock-for-stock exchange creating a parent-subsidary relationship. Each had its own assets and its own liabilities and each continued to exist as a separate corporation (Exhibit 4-D, paragraph 5 [b]).

At the time of this acquisition by Kiabab, National owned all of the issued and outstanding shares of Telegift having acquired the same on August 24, 1970. In this transaction, National acquired all of the issued and outstanding shares of Telegift (1,650,400 shares) for 1,650,400 of the authorized and unissued shares of National. For each share owned by a Telegift shareholder, he received shares of National on a one-for-one basis. National became the sole shareholder of Telegift; therefore, National was the parent corporation and Telegift, its wholly owned subsidiary.

In each of the foregoing transactions, shares not assets were acquired and for this reason not only the corporations were parties to the transaction but also the shareholders. Parties to the National-Telegift transaction were the two corporations and the stockholders of Telegift and in the Kiabab-National transaction, the corporations were parties along with the stockholders of National.

In December, 1970, Telegift was in serious financial trouble (R.230, line 30) and on December 21, 1970, an agreement (Exhibit 5-P) was consummated wherein certain majority shareholders of Kiabab agreed to assign their shares to the investment group and the investment group agreed to settle the debts of Telegift (Exhibit 5-P and R.232, lines 3 through 13). Thereafter, the debts of Telegift were compromised and settled with cash supplied by the investment group and authorized but unissued shares of Kiabab (R.46 at paragraph 9). Plaintiffs refused to settle their claim, however, substantially all other creditors of Telegift were settled for cash or Kiabab stock or a combination of cash and stock.

Telegift continued to operate its gift business and from January 1, 1971, to December 31, 1971, sold merchandise in the ordinary course of business (R.48 at paragraph 21 and R.71 and 72).

Plaintiffs were hired by Telegift (R.168, lines 7, 8, and 9 and R.179, 180, and 181) and received their paychecks from Telegift (R.172, lines 1, 2, and 3) and claim that the sum due them for services performed for Telegift should be paid by Kiabab on the theory that Telegift and Kiabab merged.

ARGUMENT

POINT I

THE TRANSACTIONS BETWEEN NATIONAL AND TELEGIFT AND KIABAB AND NATIONAL WERE STOCK FOR STOCK ACQUISITIONS NOT MERGERS.

The agreement setting forth the terms and conditions of the National-Telegift transaction is contained in Exhibit 3-D. This document indicates that the parties to the agreement were National, a Utah corporation, Telegift, a Utah corporation, and those persons who collectively own 100 percent of the issued and outstanding stock in Telegift, i.e., the shareholders of Telegift. Each shareholder was a party to the action because his shares were being acquired. Had the assets of Telegift been acquired by National, the shareholders of Telegift would not have been parties to the plan of reorganization, the board of directors had the power to consummate the agreement.

These same facts are true of the agreement between Kiabab and National (Exhibit 4-D). The parties were Kiabab, a Utah corporation, and the shareholders of National who agreed to exchange their shares in National for shares of Kiabab.

These transactions meet the requirements and definitions of a stock for stock exchange as set forth in 8 *Cavitch, Business Organizations*.

An acquisition may be effectuated by a transfer by the shareholders of one corporation of their shares in exchange for stock of the acquiring corporation. This type of transaction can be tax-free if it is arranged to comply with the type "B" reorganization provisions of Section 368(a)(1) of the Internal Revenue Code of 1954. (pg. 10)

The stock for stock transaction (whether or not it fits within the tax-free reorganization provisions of the Internal Revenue Code) involves only *indirectly* problems of unknown, undisclosed and contingent liabilities. In such a transaction, however, liabilities of the acquired corporation are not assumed by, nor are they the direct responsibility of, the acquiring corporation. All corporations normally have debts and liabilities which are disclosed on the balance sheet and they may have contingent or inchoate liabilities which are unknown at the time a stock purchase or exchange is consummated. The purchaser of corporate stock necessarily assumes the risk that the purchase price it pays will be excessive if the corporation whose stock it has purchased is, in fact, liable for amounts which were unknown or undisclosed. (pg. 56)

In a stock transaction, whether tax free as a "reorganization" or taxable, formal stockholder approval is not required. Any shareholder who wishes to sell simply does so, subject, of course, to any consensual or legal restrictions on the transferability of his shares. The shareholder does not act through the conduit of the corporation whose shares he owns. (pg. 72)

The purchasing corporation assumes the risk that the acquired corporation has debts which were unknown or undisclosed at the time of the purchase. The purchaser does not, however, become *personally liable* for these debts. Rather, the existence of these debts may reduce the value of its investment by reducing the net worth of the corporation whose shares are acquired. This risk may be minimized by securing personal warranties and indemnification agreements from the selling stockholders. (pg. 372)

The trial court viewed the facts of the transactions in light of the applicable law and found that each transaction constituted a stock for stock exchange in which no assets of Telegift were acquired by National and no assets of National were acquired by Kiabab. Kiabab urges that this finding is correct and should be upheld.

POINT II

THE TRANSACTIONS WERE AT ARMS-LENGTH.

While plaintiffs state in their brief that the corporate transactions between National, Telegift and the stockholders of Telegift, and Kiabab, National and the stockholders of National were not arms-length transactions, no such evidence was introduced at the trial. The agreements themselves show the separate identity of each corporation and that each transaction was negotiated at arms length.

Exhibit 3-D was executed by J. Karl Huntsman, president of National, who was not an officer, director or shareholder of Telegift and had no other affiliation with Telegift. Exhibit 4-D was executed by Michael W. Piliaris, president of Kiabab, who was not an officer, director or shareholder of National and had no other affiliation with National.

POINT III

KIABAB DID NOT ASSUME THE DEBTS OF TELEGIFT.

The law is clear that in a stock for stock exchange, the purchasing corporation does not become liable for the debts of the acquired corporation.

In such a transaction, however, liabilities of the acquired corporation are not assumed by, nor are they the direct responsibility of, the acquiring corporation. (pg. 57)

The purchasing corporation assumes the risk that the acquired corporation has debts which were unknown or undisclosed at the time of the purchase. The purchaser does not, however, become *personally liable* for these debts. Rather, the existence of these debts may reduce the value of its investment by reducing the net worth of the corporation whose shares are acquired. (pg. 372)

The foregoing was viewed by the trial court and it was concluded that National did not assume the liabilities of Telegift and that Kiabab did not assume the liabilities of National. Kiabab urges that this conclusion of law is correct and that the same should be upheld.

POINT IV

PLAINTIFFS FAIL TO SUSTAIN THEIR BURDEN OF PROOF.

Plaintiffs were hired by Telegift, worked for Telegift, and were paid by Telegift; therefore, a claim for unpaid wages would be against Telegift unless it merged with another corporation or conveyed its assets to another corporation in fraud of its creditors.

It is elementary corporate law that when two corporations merge, the surviving corporation is liable for all debts of the merged corporations. Plaintiffs, however, failed to prove a merger in that no plan and agreement of merger was introduced at the trial nor were articles of merger introduced in evidence.

Under the doctrine of *Cooper v. Utah Light and Ry Co.*, *supra*, a conveyance of corporate assets in an attempt to

place them out of the reach of creditors of the corporation is fraudulent and unlawful. It was plaintiff's burden to prove that the assets of Telegift were transferred to National and then Kiabab and that the transfers were to the detriment of Telegift creditors.

The only evidence presented at trial that even approached the subject of the transfer of assets from one corporation to another was an affidavit of Clarence L. Jolley (Exhibit 2-D) which affidavit was admitted in evidence for a limited purpose. No evidence of proper corporate action, deed of conveyance, bill of sale, or assignment was produced by plaintiffs to show that assets of Telegift were transferred to National and from National to Kiabab.

To the contrary, Kiabab's answers to interrogatories dated February 28, 1972, (R.45) indicate that the Telegift system and trademark are assets of Telegift:

Interrogatory 1: State the name of the present owner of the "Telegift system and trademark" mentioned in your answers to the Interrogatories heretofore submitted by the Plaintiffs.

Answer: Telegift Incorporated.

Evidence that Telegift owns various gifts is also set forth in Kiabab's answers to interrogatories dated February 28, 1972, (R.48, 71 and 72).

Interrogatory 21: Please itemize and describe each asset of Telegift Incorporated transferred since its acquisition by National Gift Enterprises and/or Telegift International, Inc., whether such asset was transferred in the ordinary and normal course of business or not, and indicate the consideration for said transfer.

Answer: The assets of Telegift Incorporated transferred since January 1, 1971, together with the consideration received for the transfer are shown on Exhibit "F" attached hereto. All transfers were in the ordinary and normal course of business.

The only asset of Kiabab is 1,756,400 shares of National. Telegift, however, owns various gift items and has a network of dealers and distributors. Telegift also owns the Telegift system and trademark and has accounts receivable on its books.

POINT V

CASES CITED BY PLAINTIFFS ARE NOT IN POINT.

The failure of plaintiffs to prove that the assets of Telegift were conveyed to National and by National to Kiabab renders valueless the cases cited in plaintiffs' brief.

The *Lamb v. LeRoy Corporation*, case, 85 Nev. 276, 454 P.2d 24 (1969), the *City of Altoona v. Richardson Gas and Oil Co.*, case, 81 Kan. 717, 106 P. 1025 (1910), the *Cooper v. Utah Light and Ry Co.*, case, 35 Utah 570, 102 Pac. 202 (1909) case, the *West Texas Refining and Development Co. v. Commissioners of Internal Revenue*, case, 68 F.2d 77 (10th Cir. 1933), and *In Re Marcella Cotton Mills*, 8 F.2d 522 (Dist. Ct. Md. 1925) involve stock for assets transactions. All of these cases involve situations where corporations have attempted to place assets beyond the reach of general creditors. Plaintiffs have not proved that this was attempted by Kiabab or Telegift. *Owl Fumigating Corp. v. California Cyanide Co., Inc.*, 24 F.2d 718 (Dist. Ct. Del. 1928) was a patent infringement case and *Costan v. Manila Electric Co.*, 24 F.2d 383 (2nd Cir. 1928) was a tort claim action and *Radio Craft Co., Inc. v. Westinghouse Electric and*

Manufacturing Co., 7 F.2d 432 (3rd Cir. 1925) involved the interpretation of a license agreement.

The case of *Martin v. Development Co. of America*, 240 F. 42 (9th Cir. 1917) involves the question of whether a parent corporation is liable for debts of its subsidiary when creditors extended credit to the subsidiary not the parent.

In *American Hospital and Life Insurance Company v. Kunkel*, 71 N.M. 164, 376 P.2d 956 (1962), the court discusses de facto mergers but only in relation to the validity of stock repurchase agreement between the corporation and two of its shareholders.

UTAH LAW

This writer could not find a Utah case that discusses liability of a parent corporation to creditors of a subsidiary where a stock for stock transaction occurred.

Plaintiffs give great weight to *Cooper v. Utah Light and Ry Co.*, *supra*. This case, however, involved a tort claim for an injury which occurred on property owned by Utah Light & Power Company. After the injury but before the judgment was rendered, Utah Light & Power conveyed all of its assets to Utah Light and Ry Co. in exchange for stock of Utah Light and Ry Co. The Court found that the transaction was an attempt to place all assets of Utah Light & Power out of the reach of its creditors and declared the transaction fraudulent and unlawful.

As the holding in the Cooper case indicates, the law properly allows creditors of a corporation to have the transfer of the corporation's assets set aside if the transfer constitutes a fraud upon creditors. This doctrine, however, has no

application here because there was no conveyance of its assets by Telegift to National and by National to Kiabab.

CONCLUSION

The evidence supports the findings of fact made by the trial court and the conclusions of law are in harmony with the writers on corporate law. Neither should be disturbed on appeal.

To uphold the trial court does no prejudice to plaintiffs in that Telegift was not a party to this action, and, therefore, nothing restricts the plaintiffs from filing their wage claim against the proper defendant, Telegift.

Respectfully submitted,

Thomas R. Blonquist
Attorney for Kiabab

The undersigned certifies that a true and correct copy of the foregoing respondent's brief was mailed to Joel M. Allred, 610 East South Temple, Salt Lake City, Utah 84102, this 11th day of October, 1972.


