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Dee Schvaneveldt v. Noy-Burn Milling & Processing Corp : Brief of Respondent

Utah Supreme Court

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IN THE SUPREME COURT
of the
STATE OF UTAH

DEE SCHVANEVELDT,
Plaintiff and Respondent,

vs.

NOY-BURN MILLING & PROCESSING CORPORATION, et al.,
Defendants and Appellants.

Case No. 9031

BRIEF OF RESPONDENT

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BRIEF OF RESPONDENT

The statement of facts in the brief of appellants does not refer to the pages of the record which are supposed to support the statements and it draws from all of the evidence indiscriminately, regardless of whether it was accepted by the trial court in its findings and judgment.

This action is brought under Section 61-1-25, UCA 1953, to recover the purchase price paid for shares of Noy-Burn Milling & Processing Corporation, a Utah corporation (herein

called Noy-Burn), which stock was purchased in January 1956 (R. 58, 90-92). The action was commenced in March 1957 (R. 2). The individual defendants are officers or agents of the seller who participated and aided in making the sale. There is no challenge as to the participation of any of the defendants.

Reference is made to Epsolon Uranium Corporation (herein called Epsolon) for two reasons:

1. Respondent testified that he was told and believed that a mill in Washington County, Utah, and a patentable process for milling low-grade uranium ores belonged to Epsolon and Noy-Burn (R. 64, 66, 68, 71, 81, 82, 84, 89, 90, 110, 173).
2. Respondent purchased stock of Epsolon in September, 1955, by the payment of money for which he obtained a receipt mentioning Noy-Burn. (Exhibit P. 10, R. 64.)

Noy-Burn was not incorporated until February 16, 1956 (Ex. 1, R. 46). Some of the officers and stockholders of Epsolon were incorporators of Noy-Burn (R. 64, 73, 169, 171; Wood Deposition, p. 36). Clark Chadburn and H. L. Newby owned controlling interest in both corporations (R. 109, 161, 163, 168, 169 and Exhibit 13). The incorporation of Noy-Burn was preceded by the formation of a joint venture of ten men (R. 92, 167, 168, Wood Deposition, p. 26) who held meetings under the name of Noy-Burn Milling & Processing Corporation and kept minutes as though they had already incorporated (R. 166, 69, Exhibits I-a, b, c, d attached to William Dell Wood Deposition and Deposition pp. 12-18).

Respondent learned of the plans of the ten men in November 1955, following a meeting the ten had had with

their attorney in Salt Lake City (R. 63-64). He was by them invited to go to Washington County to inspect properties and consider becoming manager of Epsolon (R. 63, 73).

Respondent at first was told and believed that the two corporations had identical interests (R. 66, 68, 71, 81, 85, 90, 95, 101, 107, 146, 151, 173, 176, 179, 188 and 203) and understood that the separate corporation Noy-Burn was being set up to permit registration of the stock with the Securities Commission (R. 82-84, 105, 156-157). After respondent had purchased the stock he learned that Noy-Burn was an entirely separate corporation (R. 70, 124, 126, 128, 147).

Respondent learned of the definite plans for a corporation on December 3, 1955 (R. 62) and was first approached and considered purchasing stock in January 1956 (R. 61, 153-154). Respondent believed that he was "someone being a special purchaser" (R. 159), as emphasized by the appellant at page 14. The offer of three shares of stock for each two dollars paid was not a special offer but a general offer virtually to anyone who would come in (R. 191, 192, 78, 204, 209 Wood Deposition, pp 18-19) and although respondent was promised he would be made a director of Noy-Burn (R. 78-79, 110-111, 121-122), the same offer was made to Mr. Wheat (R. 204) and then respondent was told that he had been rejected as a director (R. 91, 92, 96, 110, 205) and there is testimony that he was given the specious reason for not being made a director that it would require rewriting the articles of incorporation (R. 183). Messrs. Bevas and Wood testified that respondent never could have been a director as they were opposed to him (R. 186, 183, 92).

The minutes of the meeting of the Noy-Burn group held before incorporation do not list respondent as a person present or as one of the included group (Wood Deposition, pp. 12-18 and Exhibits I-a, b, c, d, e). The stock records of the corporation show that ten persons purchased stock on a bonus basis with 22 total transactions to such persons prior to the date of incorporation (Exhibit P, 3).

It appears from the testimony (or the absence of testimony) that respondent at no time held any position with Noy-Burn, or had any responsibility whatever, or was ever authorized to sell or offer for sale Noy-Burn stock in behalf of the corporation (R. 204) and was never admitted to the inner planning of the ten men joint venture or the Noy-Burn Corporation.

The trial court found:

"8. Plaintiff was not one of the promoters of defendant corporation" (R. 29).

STATEMENT OF POINTS RELIED ON

Respondent does not agree with appellants on the points as stated in their brief. It is true that Judge Ellett at the hearing before trial stated:

> "However, the court is of the opinion that there will be an issue of fact as to whether or not the plaintiff was one of the active promoters of the organization and will hold as a matter of law that if he was such a promoter, that the statute relied upon by plaintiff does not apply in this case." (R. 27.)

The word "promoter" does not appear in the Utah Securities Statute (Title 61, Chapter 1) but respondent does not take issue with the idea stated by Judge Ellett if it means that a person who is in pari delicto or who is an active seller of stock for a corporation should be precluded or estopped from bringing an action. The issues would be more properly stated as follows:

POINT I

RESPONDENT WAS NOT IN PARI DELICTO WITH APPELLANT.

POINT II

RESPONDENT SHOULD NOT BE ESTOPPED FROM BRINGING THIS ACTION.

POINT III

KNOWLEDGE THAT STOCK IS NOT REGISTERED DOES NOT BAR THIS ACTION.

POINT IV

HAVING INFORMATION ABOUT THE CORPORATION DOES NOT PRECLUDE ACTION UNDER THE SECURITIES ACT.

ARGUMENT

POINT I

RESPONDENT WAS NOT IN PARI DELICTO WITH APPELLANT.

Judge Ellett included as an issue of fact the question whether respondent was one of the active promoters of the organization (R. 27). There being no appeal from this holding the issue merits the consideration of this court. Appellant's brief assumes that the only question was whether respondent could be considered a promoter, and argues that he was, although this is against the finding of fact which is amply supported by evidence.

Respondent recognizes that there are factual situations which would make it inequitable to permit the purchaser of stock to recover from the sellers under the Securities Act. If the person were himself the active organizer of a corporation and of its selling campaign and as part of the campaign purchased stock himself, it would seem that he should not be allowed to recover from his corporation the price he had paid. The Securities Act does not mention such a limitation and for this reason some cases hold simply that a sale of securities contrary to a securities act is illegal and the purchaser is given an absolute remedy. *Flournoy vs. Highlands Hotel,* 170 Ga. 467, 153 S.E. 26, where the court said: "The law will not lend its aid to enforcing contracts criminal, immoral or contrary to declared public policy." See also the annotation on Blue Sky Laws at 87 A.L.R. 42, 117-121 and particularly the cases at page 118 of *Tatterson vs. Kehrlein,* 88 Cal. App. 34, 263

Pac. 285, and *Herkner vs. Rubin,* 126 Cal. App. 677, 14 Pac. 2nd 1043.

But there are numerous cases which hold that a purchaser of stock can be considered in pari delicto and therefore precluded from maintaining an action where the facts show that he was in fact equally guilty with the seller. See 53 Corpus Juris Secundum, p. 787.

Although not actually a Securities Act case, this court considered a similar problem in *Powerine Company vs. Russells, Inc.,* 103 Utah 441, 135 Pac. 2nd 906. In that case John H. Russell became the chief holder of stock in a corporation formed by his son, George R. Russell, and the court observed:

> "There is nothing in the evidence to the effect that John H. Russell took any active part in the various preliminary negotiations to the forming of the corporation and therefore the conclusion must follow that he could not be considered as a promoter of Russells, Inc."

A purchaser was held in pari delicto in *Norton vs. Lamb,* (Kansas) 62 Pac. 2nd 1311, where the court said:

> "He was an incorporator, he was an original subscriber, he was a director of the corporation, the treasurer of it, and a member of the executive committee of the Board of Directors. If the stock had to be registered, it was a part of his duties to see that it was done. He will not now be heard to raise the question."

And in *Western Oil & Refining Co. vs. Venago Oil Corp.* and others, 218 Cal. 733, 24 Pac. 2nd 971, the court indicated that a purchaser will not be held in pari delicto except where there is an actual conspiracy or intent to defraud or evade the act or the terms of a permit issued under the Securities Act

in which the purchaser participates. See also *Randall vs. California Land Buyers Syndicate,* 217 Cal. 594, 20 Pac. 2nd 331.

Michell vs. Grass Valley Coal Mining Co., 206 Cal. 609, 275 Pac 418, holds that where the plaintiff was one of five similarly situated controlling persons who participated in the enterprise from its very inception including participation in approval of the promotion agreements he was in pari delicto with the corporation and could not maintain an action for recovery of his purchase price.

But unless the purchaser is active in forming and directing formation of the corporation or enterprise, he is not in pari delicto and under no disability. See *Silva vs. Holme,* 109 Cal. App. 2d 461, 241 Pac. 2nd 21, 24; *Taormina vs. Antelope Mining Co.,* 110 Cal. App. 2d 356, 242 Pac. 2nd 665 and *Veenstra vs. Associated Broadcasting Corp.,* 321 Mich 679, 33 N.W. 2nd 115. In the latter case plaintiffs purchased unlisted stock and one of them attended a meeting of directors and stockholders but took no active part. In holding the plaintiffs not in pari delicto the court said:

> "We are not in accord with defendants' claim that plaintiffs were in pari delicto with defendants, under the case of *Schrier v. B&B Oil Co.,* 311 Mich. 118, 18 N.W. 2d 392. In that case Schrier did not complete his purchase of stock until after he had been elected director and vice president of the corporation; he attended every meeting of directors and stockholders after his purchase of stock and before his rescission approximately 14 months later and had much to do with determining the corporation's policies; he participated in the authorization of increases of capital stock; it was as much his duty as that of any other

officer to see that the increased issue was approved by the State commission.

On the contrary, in the case at bar plaintiffs were not officers or directors of defendant company and took no part in management of the company or determining the policy as to reorganization. The management leading up to reorganization was handled entirely by Versluis and Kelley and their attorney Dunn."

In the instant case the finding of the court and the evidence are negative. Respondent was not one of the incorporators, he was not a member of the original joint venture of ten men which evolved into the corporation, he did not participate in any of the planning of the sale of stock, was never an officer, director or employe. Appellant's brief contains nothing to the contrary. Respondent was not in pari delicto.

POINT II

RESPONDENT SHOULD NOT BE ESTOPPED FROM BRINGING THIS ACTION.

This point actually was not raised by Judge Ellett and is not raised by appellant and is included in this brief to indicate that respondent is not standing on a technical position, but is the type of person who is universally given the benefit of the voidable provisions of Securities Acts.

Section 61-1-25 UCA 1953 simply says "every sale or contract for sale made in violation of any of the provisions of this chapter shall be voidable at the election of the purchaser ***." In some cases the courts have found such a close identity of the purchaser with the affairs of the corporation subsequent

to the purchase that it was found inequitable to permit such a person to declare the sale void and recover his money. At the trial counsel for appellant insinuated that respondent had hoped to become a controlling person in Noy-Burn but there is no evidence of such hope. Respondent testified as supported in our statement of facts that he believed in the beginning that the fortunes of Epsolon and Noy-Burn were the same and there can be no doubt that respondent had high hopes for the financial success of these corporations when he purchased his shares.

But respondent was never made a director, he never cast a vote at a meeting, and attended two of the meetings of directors as an interested prospect, prior to the time that he purchased stock. (Exhibits I-a and I-d attached to deposition of Dell Wood.) In *Hudson vs. Silver & Bunge,* 273 Ill. App. 40, plaintiff had purchased stock in 1927 and brought action for recovery of his money in 1931. In the meantime, he had acted as a director, received dividends on his stock and participated in other affairs of the corporation before and after commencement of his action and it was held that he was not precluded from maintaining his action. There is no such participation as this by respondent in the affairs of Noy-Burn.

A case holding the plaintiff to be estopped and in pari delicto is *Schrier vs. B&B Oil Company,* 311 Mich. 118, 18 N.W. 2nd 392, abstracted by the Michigan Court in the *Veenstra* case (supra.). The case is commented on by Louis Loss, Securities Regulation, pp. 973-974.

These cases indicate why Judge Ellett raised the point, but in the absence of supporting evidence there was no basis for considering the effect of participation of respondent in

affairs of the corporation, and no basis for precluding his maintenance of the action.

POINT III

KNOWLEDGE THAT STOCK IS NOT REGISTERED DOES NOT BAR THIS ACTION.

Respondent testified that he was told and expected that Noy-Burn stock would be registered (R. 82, 84-85) and indeed believed it was being formed for that purpose (R. 105 and 156).

The Utah Securities Act is silent on knowledge of non-registration as a bar to the action and where the question has been raised the courts have held that such knowledge is not a bar. *Sampson vs. Sapoznik,* 124 Cal. App. 2nd 704, 269 Pac. 2nd 209; *Brannan Beckham & Co. vs. Ramsaur,* 41 Ga. App. 166, 152 Southeastern 282; *Foreman vs. Halsman,* 10 Ill. 2nd 551, 141 N.E. 2nd 31, 61 A.L.R. 2nd 1303. The latter case goes so far as to hold that the purchaser may maintain his action even though he executes a waiver or release of such action in connection with the purchase of stock. An annotation of this case in 61 A.L.R. 2nd has other cases to the same effect which are a fortiori of the point under consideration.

POINT IV

HAVING INFORMATION ABOUT THE CORPORATION DOES NOT PRECLUDE ACTION UNDER THE SECURITIES ACT.

In a way this is another strawman erected out of an abundance of caution. Respondent actually was misinformed as to the purpose of Noy-Burn and its relationship to Epsolon; but he had made a trip to southern Utah and was working for Epsolon at the time he purchased the Noy-Burn stock and was therefore not entirely ignorant. Knowledge of the corporation's activities does not preclude maintenance of the action. *Hudson vs. Silver,* supra; *Wehrwein vs. Eastern Springs Beverage Co.,* 238 Ill. App. 443; *Stewart vs. Brady,* 300 Ill. 425, 133 N.E. 310, 315; *Rosenberg vs. Hans,* (CCA 3) 121 Fed. 2nd, 818.

Appellant in his brief has cited the case of *Securities and Exchange Commission vs. Ralston Purina Co.,* 346 U.S. 119. This was a case under the Securtities Exchange Act and involved the technical question under that act of whether a public offering had been made through the mails. The company contended that the offering was limited to the employes, being employes with certain special information and that it was therefore not an offering to a large class. The case holds that the offering was not sufficiently limited and that it amounted to a public offering but is not in point for any issue in the case at bar. Here the minutes of the meetings of Noy-Burn show a great anxiety to obtain money and no restriction whatever as to the class of offerees; and Exhibit P, 3 shows actual sales to ten persons in 22 different transactions prior to the date of incorporation and not including the ten joint venturers.

CONCLUSION AND SUMMARY

The Utah Securities Act is designed to give an action for recovery of purchase price to one who purchases unregistered

securities in Utah. There is no question whatever that respondent is such a person. This remedy is not limited to persons who are ignorant of nonregistration or ignorant of facts concerning the stock which they are purchasing. It is a general statute designed to benefit such purchasers and give them the election of voidability.

Although no Utah cases so hold under the securities act, respondent does not quarrel with a rule that where a purchaser of stock is in pari delicto with other persons who have formed a corporation and launched a stock-selling program he cannot recover; nor with a rule which would hold that where a purchaser of stock becomes active in the management of the corporation and participates in major policy decisions it would be reasonable to hold that such a person has waived a right to rescind his sale and will be estopped to bring an action under the Securities Act. There was no such participation by Schvaneveldt either before or after the purchase of his stock. He is therefore completely outside those cases which might bar this action by respondent. And if the issue be whether respondent was a promoter of Noy-Burn, finding No. 8 disposes of the question.

Respondent therefore respectfully submits that the judgment of the District Court should be affirmed.

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