

1968

Harold R. Rainford v. William R. Rytting and Altzanne H. Rytting : Brief of Appellants

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IN THE SUPREME COURT OF THE STATE OF UTAH

HAROLD R. RAINFORD,

Plaintiff and Respondent

— VS. —

WILLIAM B. BYTTING and

RUZANNE H. BYTTING,

Defendants and Appellants

BRIEF OF APPEAL

APPEAL FROM THE
THIRD JUDICIAL DISTRICT
SALT LAKE COUNTY,

HONORABLE STEWART M. ...

FILED

3 1 1968

Court, Utah

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IN THE SUPREME COURT OF THE STATE OF UTAH

HAROLD R. RAINFORD,
Plaintiff and Respondent,

— vs. —

WILLIAM R. RYTTING and
SUZANNE H. RYTTING,
Defendants and Appellants.

} Case
No. 11476

BRIEF OF APPELLANTS

STATEMENT OF KIND OF CASE AND DISPOSITION IN LOWER COURT

This is an appeal by the defendants and appellants, William R. and Suzanne H. Rytting, from a Summary Judgment granted in favor of Harold D. Rainford, plaintiff and respondent, by the Third District Court in and for Salt Lake County. The Honorable Stewart M. Hanson, Judge, granted the Summary Judgment on the 16th day of April, 1968.

The Summary Judgment was granted apparently on the grounds and for the reasons that there were no issues

of fact based on the pleadings and Affidavits on file, and further, that the defendants' and appellants' position on the questions of law was without merit.

RELIEF SOUGHT

Defendants and appellants seek to have the decision of the District Court granting the Summary Judgment reversed and the matter remanded for trial.

STATEMENT OF FACTS

On the 30th day of March, 1965, William R. and Suzanne H. Rytting and Harold D. Rainford, as the only three organizing directors, formed a corporation in Yakima, Wahington, called The Carriage House, Inc., for the purpose of engaging in the retail and wholesale merchandising business. Suzanne H. Rytting was elected President, William R. Rytting was elected Vice-President, and Harold D. Rainford, Secretary-Treasurer.

The corporation had 500 shares of \$100.00 par value capital stock authorized, and there were only 90 shares of said stock outstanding on or about the 27th day of May, 1966. The directors-officers of the corporation solely owned the oustanding stock in the following amounts: Suzanne H. Rytting, 33 shares; William R. Rytting, 32 shares, and Rainford owned 25 shares.

On the 27th day of May, 1966, the Ryttings on behalf of The Carriage House, Inc., and Rainford, entered into a Conditional Sale of Stock Agreement (hereinafter referred to as the "Agreement") whereby The Carriage

House, Inc., would purchase Rainford's 25 shares of stock at par value (or for a total of \$2,500.00). The purpose for entering into the Agreement was to attempt to wind up the corporate business and affairs in the State of Washington and terminate the corporate structure. The Ryttings planned to return to the State of Utah, and Rainford desired to remain in Washington.

At the time of the Agreement and prior thereto, the corporation was insolvent; its liabilities exceeded its assets and it was unable to pay its debts in the usual course of business. There was, in fact, no earned or paid in surplus with which to attempt to purchase the stock that the corporation had issued to Rainford.

Further, at the time of the execution of the Agreement, the corporation had on hand certain assets consisting of various items of operating equipment and fixtures including an air conditioner, valued at approximately \$1,200.00, along with various accounts receivable in the approximate sum of \$500.00. Pursuant to an explicit agreement and understanding, these items were left by the Ryttings at the corporate place of business in Yakima, Washington, under the control and supervision of Rainford. The proceeds from the sale of these assets were to be used as an offset or credit against the \$2,500.00 purchase price of Rainford's shares of stock.

This understanding was arrived at prior to, and existed contemporaneously with the execution of the Agreement previously referred to; it was definitely understood by the parties that the funds derived from the

sale of the equipment and fixtures and collection of the accounts receivable would be applied as an offset or credit against the purchase price of the stock above referred to.

Subsequent to the execution of the Agreement, the Ryttings left the State of Washington and returned to Utah, leaving the equipment, fixtures and accounts receivable within the control and supervision of the one remaining officer, director and shareholder in Washington, Harold D. Rainford.

In May, 1967, Rainford referred the matter from Washington to Golden W. Robbins, Esp., for collection and a Complaint was filed for the entire \$2,500.00, plus interest and attorney's fees, with no reference to the approximate \$1,700.00 offset to which defendants-appellants are entitled. In spite of the Answer, Affidavits, Answers to Interrogatories, Admissions, and Counter-Affidavits, filed on behalf of defendants-appellants, raising among other issues, the factual issue of the offset, a Summary Judgment was granted in favor of plaintiff-respondent Rainford, for the full amount prayed for, from which this appeal is taken.

ARGUMENT

POINT I

IT WAS ERROR FOR THE COURT TO GRANT A SUMMARY JUDGMENT IN FAVOR OF RAINFORD AND AGAINST THE RYT-TINGS AS THERE EXISTED A GENUINE ISSUE OF MATERIAL FACT AS RAISED BY THE PLEADINGS ON FILE HEREIN.

Rule 56(c) Utah Rules of Civil Procedure, 1953, as amended, provides:

“The Judgment sought shall be rendered forthwith if . . . there is no genuine issue as to any material fact. . . .”

This direction requires by its terms and by interpretation that the evidence, admissions and inferences supporting the Motion for Summary Judgment be viewed in the light most favorable to the loser; such showing must preclude all reasonable possibility that the loser could, if given a trial, produce evidence which would reasonably sustain a judgment in his favor. *Bullock v. Desert Dodge Truck Center, Inc.*, 11 Ut. 2d 1, 354, P.2d 559; *Frederick May and Company, Inc., v. Dunn*, 13 Ut. 2d 40, 328 P.2d 266; and more recently, *Sumner J. Hatch, et al. v. Sugarhouse Finance Company*, Case No. 10807 filed December 1, 1967 (not yet cited in Utah Reports).

The pleadings on file herein put in issue the factual question of whether or not an understanding or agreement existed at the time of the execution of the Condi-

tional Sale of Stock Agreement, whereby an offset or credit (for the funds received from the sale or use of the corporate fixtures and equipment remaining under the supervision and control of Rainford) was to be applied to the purchase price of Rainford's stock. And further, whether the amounts to be collected from the accounts receivable would likewise be used.

William R. Rytting, by his Answer, Admissions and Answers to Interrogatories, Second Admissions and Answers to Interrogatories, Affidavit of October 26, 1967, and Affidavit of April 15, 1968, explicitly alleges that Harold D. Rainford as an officer, director, and shareholder of the corporation had, and still has control of the fixtures, equipment and air conditioner of the corporation and control of the accounts receivable; further, that the proceeds to be derived therefrom were to be applied as an offset against the balance allegedly owing on the purchase price of the stock. Rytting also avers that there was a specific condition and understanding between the parties to the Agreement that the approximate value of these fixtures and air conditioner was the sum of \$1,200.00; that the approximate value of the accounts receivable owing to the corporation was \$500.00; and that these assets were left in the control and supervision of Harold D. Rainford when the Ryttings returned to Utah.

In Harold D. Rainford's Counter-Affidavit of February 8, 1968, he specifically states that the condition and agreement regarding the fixtures, equipment and accounts receivable described in Rytting's Affidavit above-referred to, did not exist at any time; that the accounts

receivable were never the subject of any agreement between the parties.

A comparison of these pertinent provisions of the Affidavits and Counter-Affidavits referred to, reveals an obvious factual issue which needs to be resolved.

There is indeed an issue of fact raised in opposition to plaintiff-respondent's Motion for Summary Judgment and therefore the same should not have been granted.

POINT II

THE COURT ERRED IN GRANTING THE MOTION FOR SUMMARY JUDGMENT IN THAT THE CONDITIONAL SALE OF STOCK AGREEMENT WAS AND IS ILLEGAL AND THUS VOID AND UNENFORCEABLE.

The acquisition or purchase of its own stock by a corporation while insolvent or when the transaction will render it insolvent is invalid. 19 Am. Jur. 2d, Corporations, Section 1000.

A number of cases support the proposition that a corporation may, in the absence of statutory or charter restrictions, purchase its own stock, provided it acts in good faith and is neither insolvent nor in the process of dissolution; and provided such purchases are not prejudicial to the rights of its creditors or stockholders. Under this rule, a corporation may sell stock with an agreement or option to repurchase it; or it may purchase its own stock for the purpose of effecting a reduction of its capital

stock; or it may receive a donation of its own stock; or a corporation authorized by its charter to act as a trustee, may hold its own stock in trust for beneficiaries designated by the donor. Ibid, Section 997.

The State of Washington adopted the Model Business Corporation Act which took effect July 1, 1967. Prior to that time, the Washington Code section dealing with the purchase and reacquisition of a corporation's own stock was Section 23.01.120 (2). The language of that section is as follows:

“Every corporation organized hereunder shall have the power to purchase, hold, sell and transfer shares of its own capital stock; provided, that no such corporation shall use its funds or property for the purchase of its own shares of capital stock when such use would cause an impairment of the capital stock of the corporation.”

The leading Washington cases dealing with this point of law are *Schwab v. Getty*, 145 Wash. 66, 258 Pac. 1035, 54 A.L.R. 1382; and *Jackson v. Colagrossi*, 50 Wash. 2d 572, 313 P.2d 697 (1957).

In the *Jackson* case, the evidence sustained the finding that there was no earned surplus to pay for the repurchase of the corporation's own stock; that the corporation was unable to pay its debts in the usual course of business and that the corporation was rendered insolvent by the repurchase. The Court stated that a repurchase agreement by a corporation of its own shares of stock can only occur when it would not diminish the corporation's ability to pay its debts or lessen the security of its credi-

tors by reducing the amount of assets of the corporation below the amount represented by aggregate outstanding shares of capital stock of the corporation; and payments made by the corporation to certain of its stockholders in the purchase of its own stock may be recovered from such stockholders where such payments impaired the corporation's capital stock and did not then have sufficient earned surplus with which to pay therefor.

The foregoing rationale has been annotated at 47 A.L.R. 2d 763 as follows:

"A purchase or acquisition of its own stock by a corporation while insolvent or when the transaction will render it insolvent is a violation of the rights of its creditors and is invalid. . . . If an obligation of the corporation has been given by it in return for the stock either the corporation or a representative of creditors may defend against its enforcement; it cannot be proved as a debt with general creditors in liquidation. In this general rule the insolvency referred to is a condition of having debts greater than assets."

The Ryttings have alleged without contradiction in their Answer, Affidavits, and Counter-Affidavits, that the Conditional Sale of Stock Agreement was and is void and illegal under the laws of the State of Washington for the reasons that at the time of the execution of said Agreement the corporation's liabilities exceeded its assets; i.e., the corporation was unable to pay its debts in the usual course of business. The corporation had, in fact, no paid in surplus, undistributed earned profits or surplus with which to attempt to purchase its own stock.

The affiant further alleges that Rainford, being an officer, director and shareholder, was well aware, or should have been well aware of the corporate financial condition. Rainford as an officer and director had a fiduciary obligation to The Carriage House, Inc., to inform himself as to the financial condition of the corporation, and, had he done so he would have been aware that it was without the necessary funds with which to enter into a stock purchase agreement. Therefore, in view of the authorities cited above, the Agreement was void and thus unenforceable.

The Rytings allegedly guaranteed performance of the Agreement between Rainford and The Carriage House, Inc., however, there is abundant authority for the fundamental proposition that a guarantor cannot be held if the principal obligation is invalid. *Krekel v. Thomasma*, 255 Mich. 283, 328 N.W. 285, 81 A.L.R. 786.

The leading Washington case regarding the validity of guarantees is *Robey v. Walton Lumber Company*, 17 Wash. 2d 242, 135 P.2d 95, 145 A.L.R. 924, wherein the Court stated:

“A ‘guarantee’ being a collateral engagement for performance of an undertaking of another imports existence of an obligation of the principal debtor and of the guarantor, and if a primary or principal obligation does not exist, there can be no guarantee.”

The alleged guarantee by the Rytings of the invalid Agreement is equally unenforceable.

CONCLUSION

It seems evident from a comparison of the pleadings, Affidavits and Counter-Affidavits, which have been filed in this matter, that a clear factual question is in issue. That issue is, was there an outstanding agreement supplemental to the Conditional Sale of Stock Agreement, regarding an offset or credit to be given toward the purchase price of Rainford's stock. The amount of the credit being the reasonable value of the fixtures, equipment, air conditioner, and accounts receivable, remaining in the possession of the only stockholder, officer and director of the corporation remaining in the State of Washington, i.e., Harold D. Rainford. This question is an issue of fact which cannot be resolved by the Court, but should be tried to a jury.

As to the merits of the decision that the contract under consideration was apparently legal and valid, it is clear that under the law applicable to the case, a purported attempt by a corporation to purchase its own stock, while, in fact, it had no undistributed earnings, profits, or earned surplus with which to do so, was invalid, and unenforceable, as was the purported personal guarantee by the Ryttings.

Respectfully submitted,

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