

1961

# William D. Johnson v. Robert Crail, Henry M. Scheurn and Daniel S. Bushnell : Brief of Appellant

Utah Supreme Court

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Ramon M. Child; Child, Spafford & Young;

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# In the Supreme Court of the State of Utah

**FILED**

WILLIAM D. JOHNSON,

OCT 20 1960

*Plaintiff and Appellant*

Clerk, Supreme Court, Utah

vs.

ROBERT CRAIL, HENRY M.  
SCHEURN, and DANIEL S.  
BUSHNELL,

Case No. 9291

*Defendants and Respondents*

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## BRIEF OF APPELLANT

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addresses this 20th day of  
October 1960

William J. Jaffell

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# In the Supreme Court of the State of Utah

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WILLIAM D. JOHNSON,

*Plaintiff and Appellant*

vs.

ROBERT CRAIL, HENRY M.  
SCHEURN, and DANIEL S.  
BUSHNELL,

*Defendants and Respondents*

Case No. 9291

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## BRIEF OF APPELLANT

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### STATEMENT OF THE CASE

In this action the Appellant alleges that he caused to be transferred to Prudential Oil and Minerals Company, a Utah Corporation of which the Respondents were the chief officers and stockholders, title to eighteen (18) mining claims as consideration for the sale to Appellant of 40,000 shares of stock in the said Prudential Oil and Minerals Company (R. 7). Appellant alleges that the eighteen (18) mining claims transferred to Prudential Oil and Minerals Company had a reasonable value of \$40,000.00 and that

the 40,000 shares of stock received by the Appellant were represented by the Respondents to have a value of \$40,000.00 (R. 7). Upon learning that the 40,000 shares of said Company stock were in fact worthless, the Appellant commenced this action seeking recovery from the Respondents on two causes of action. *First*, Appellant sought to recover damages from Respondents on the basis of fraud for the difference in the value of the 40,000 shares of stock as represented and as they were in fact. This cause of action has been dismissed and is not before this court in this appeal. *Second*, Appellant attempted to recover from the Respondents the value of the consideration paid for the said 40,000 shares of stock, the Appellant claiming the right to rescission of the transaction, alleging the said sale to be a violation of the Securities Act of the State of Utah, 61-1-7, U.C.A., 1953 (R. 8).

On the 25th day of April, 1960, the Honorable Stewart M. Hanson, District Judge, ruled that the transaction was not a violation of the State Securities Act but was an exempt transaction thereunder, and that said second cause of action should be dismissed (R. 26). The said District Court determined that the transaction was an exemption to the Securities Act within Section 61-1-6, U.C.A., 1953 (R. 24).

On the 10th day of May, 1960, the said District Court caused to be entered an order dismissing Appellant's second cause of action (R. 27), which order of dismissal is the basis for this appeal.

## STATEMENT OF FACTS

On September 27th, 1960 there was filed with the Clerk of the Supreme Court of the State of Utah a supplemental record on appeal, which was in fact a statement of the case stipulated to by each of the parties hereto or his respective counsel and approved by the District Judge. Said stipulated facts are as follows:

“On the 20th day of June, 1956, the only shares of stock issued by Prudential Oil and Minerals Company, a Utah Corporation, with the exception of nominal shares, had been issued to three of the original incorporators, the defendants herein. On or about that date, the officers of the Company, the defendants herein, consummated negotiations involving the acquisition of eighteen mining claims and certain items of personal property and equipment located thereon in exchange for 60,000 shares of the unissued authorized capital stock of the company. Deeds of Conveyance were received from Empire Mining Company, an Iowa Corporation, and W. D. Johnson, in consideration for which 40,000 shares of said stock were issued to W. D. Johnson, the plaintiff. Bills of sale were received from Fred B. Grube and Grube Harman Mining Company, a partnership, for which 20,000 shares of said stock were issued to Fred B. Grube. By reason of an affidavit which the said Grube or his father had caused to be recorded, claiming an interest in the above referred to 18 mining claims, the said Fred B. Grube was also required to furnish a quit claim deed to the said 18 mining claims at a later date.”

“At the time of the sale of the said stock, there was no



registration of the same with the Securities Commission of the State of Utah.”

“The plaintiff filed a Complaint to recover on two causes of action, the first for fraud and the second for rescission based on 61-1-25 Utah Code Annotated, 1953. The plaintiff claiming that under the provisions of 61-1-7 the 40,000 shares of said corporation stock should have been registered. The defendants claim the sale of said stock to be exempt from the requirements of registration of stock as provided in the Utah Securities Act. Part of the Pre-Trial Order of 28th September, consented to by the plaintiff, provided as follows:

“In explanation of the plaintiff’s complaint herein the plaintiff does not claim that these defendants participated in the issuance or offering of any other stock in this corporation; to wit, the Prudential Oil and Mineral Company, other than the issuance of the stock to Fred B. Grube and W. D. Johnson, the plaintiff herein, and that this was a single transaction in stock for these 18 mining claims.”

To this portion of the said pre-trial order, plaintiff raised later objection in due time which objection was over-ruled.

“After various procedures the matter came before the Honorable Stewart M. Hanson, one of the judges of the above court, who ruled that the sale of the 40,000 shares of stock by Prudential Oil and Minerals Company and the defendants herein was not a violation of the Utah Securities Act as appears in the ruling and order dismissing the plaintiff’s second cause of action.” (Supplemental Record, pages 1 and 2)

## STATEMENT OF POINTS

## POINT I

THE DISTRICT COURT ERRED IN RULING THAT THE SALE BY THE DEFENDANTS HEREIN TO THE PLAINTIFF OF 40,000 SHARES OF AUTHORIZED, BUT UNISSUED CAPITAL STOCK WAS NOT A VIOLATION OF THE SECURITIES ACT OF THE STATE OF UTAH.

## ARGUMENT

## POINT I

THE DISTRICT COURT ERRED IN RULING THAT THE SALE BY THE DEFENDANTS HEREIN TO THE PLAINTIFF OF 40,000 SHARES OF AUTHORIZED, BUT UNISSUED CAPITAL STOCK WAS NOT A VIOLATION OF THE SECURITIES ACT OF THE STATE OF UTAH.

61-1-7, Utah Code Annotated, 1953, provides as follows:

“No securities, except of a class exempt under any of the provisions of section 61-1-5, or unless sold in any transaction exempt under any of the provisions of section 61-1-6 shall be sold within this state unless such securities shall have been registered by notification or by qualification as hereinafter defined.”

The 40,000 shares of Prudential Oil and Minerals Company, the defendants' corporation, as above set forth were sold to the plaintiff without any registration thereof as provided in the Utah Code. Defendants do not deny this

fact. The only question which the defendants raise is to the effect that the sale may have been exempt. As to this proposition we call the court's attention to section 61-1-22, Utah Code Annotated, 1953, which provides as follows:

"It shall not be necessary to negative any of the exemptions or classifications in this chapter provided in any complaint, information or indictment or in any writ or proceedings laid or brought under this chapter, and *the burden of proof of any such exemption shall be upon the party claiming the benefit of such exemption or classification.*"  
(emphasis added)

If the defendants therefore claim this sale of stock subject of this action, to have been exempt, the burden is thus upon themselves to prove this fact.

Under the terms of section 61-1-25, Utah Code Annotated, 1953, which provides for remedies available to the victim of sales done in violation of the chapter of the

Code, the section reads as follows:

"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*, and the person making such sale or contract for sale and every director, officer or agent of or for such seller who shall have participated or aided in any way in making such sale shall, upon tender to the seller of the securities sold or of the contract made, be jointly and severally liable to such purchaser for the full amount paid by him; provided, that no action shall be brought for the recovery of the purchase price after two years from the date of such sale or contract for sale; and provided further, that no purchaser otherwise entitled shall claim

or have the benefit of this section who shall have refused or failed within a reasonable time to accept the voluntary offer of the seller to take back the security in question and to refund the amount paid by such purchaser, together with interest on such amount for the period from the date of payment by such purchaser down to the date of repayment, such interest to be computed:

(1) In case such securities consist of interest bearing obligations, at the same rate as provided in such obligations; and

(2) In case such securities consist of other than interest-bearing obligations, at the rate of six per cent per annum; less, in every case, the amount of any income from such securities that may have been received by such purchaser.”  
(emphasis added)

The above sale being therefore voidable, the plaintiff has elected to declare it void, and has so advised the defendants and started his action within the time provided.

Respondents urged the District Court that the transaction was exempt from the requirements of the Securities Act of the State of Utah by reason of Section 61-1-6, subsection 3, Utah Code Annotated, 1953. In order for the questioned sale to be thus exempt it is necessary *first*, that the securities were sold by “the owner thereof,” and *second*, if the defendants were able to meet this obstacle it would be necessary for the defendants to prove that the sale was an “isolated transaction,” within the meaning of said provision of the code.

## I

THE PRUDENTIAL OIL AND MINERALS COMPANY AND THE DEFENDANTS WERE NOT THE OWNERS OF THE STOCK SOLD TO THE PLAINTIFF.

Appellant cites to the court the case of Smith vs. Crawford, Kentucky, 1929, 15 Southwest 2nd, page 249. In that case Plaintiff Smith purchased five (5) shares of \$50.00 par stock of Rotary Stores Corporation from the corporation through the agency of the defendant Crawford who was President of the corporation. The stock thus sold was from unissued, authorized capital stock of the corporation. Said stock turned out to be worthless, and Smith sued to recover the purchase price paid on the grounds that the corporation sold the stock thorough the agency of Crawford without compliance with the statute requiring registration. The trial court dismissed the complaint, whereupon Smith appealed. His appeal was granted and the judgment reversed. Smith claimed his right of recovery under a Kentucky statute which was substantially identical to 61-1-25, Utah Code Annotated, 1953. Crawford defended and claimed, among other things, that the sale was exempt under a section of the Kentucky statute which provided the following exemption:

“An isolated transaction in which any security is *bought*, sold, offered for sale, subscription or delivery by the owner thereof, or by his representative for the owner’s account, such purchase, sale or offer for sale, subscription or delivery not being

made in the course of repeated and successive transactions of a like character by such owner, or on his account by such representative, and such owner or representative not being the underwriter of such security."

A careful reading of the exemption under the Utah Statute upon which the defendants rely would show that the Kentucky statute was identical with the first sentence of 61-1-6 (3), U.C.A., 1953, the Utah Statute upon which the defendants rely for their exemption, with the exception of the word "bought," which has been italicized in the quotation above. In ruling for the plaintiff in support of the argument that a corporation is not the "owner" of its own unissued, authorized capital stock, the Kentucky court said:

"This exemption does not relate to sales by the corporation of its own capital stock. It exempts transactions by the *stockholders*, in which individual stock may be sold in isolated transactions . . . but this particular provision was intended to exempt an individual *owner* from complying with the act when all that he desired was to dispose of corporate stock which he *owned*."

In 47 American Jurisprudence, page 579, Security Acts, Section 21, we find the following:

"Under some statutes, it is held that a provision exempting from its application of isolated transactions does not relate to sales by a corporation of its own capital stock."

In pointing out the difference between authorized capital stock of a corporation as being mere potential stock and the creation and existence of actual shares of

stock, the authors of American Jurisprudence make the following statement:

“There must be some further act, such as an issuance of certificate or a subscription. *Shares and their ownership are created* by the payment or agreement to pay for stock, accepted by the corporation.” (13 American Jurisprudence 320, corporations, section 203.)

In the case of *Com vs. Johnson* (1926) 89 Pennsylvania Superior Court page 439, the court held as follows:

“Exception of isolated transaction . . . manifestly was intended to apply to isolated and occasional sales of issued stock, or other securities, in the possession of *ordinary holders who are the bona fide owners* and neither dealers in nor underwriters thereof, and who make such sales personally or through their representatives or agents, for their own individual accounts.”

In the Utah case of *Buttrey vs. Guaranteed Securities Company*, (1931) 78 Utah 39; 300 Pac. 1040, the plaintiff paid \$5,000.00 for 50 shares of the defendant corporation's stock at a time when the defendant had no permit to sell the stock. In that case the court held that the plaintiff could recover from the corporation and such of its officers as actually participated in the sale of the stock.

In the Utah case of *Hansen vs. Abraham Irrigation Company*, 25 Pac. 2nd 76, the plaintiff purchased 200 shares from the defendant corporation. In that case an attempt to circumvent the Utah regulation statute was made in having the secretary issue stock to himself and



sell his own personal stock thereby to the plaintiff. However, since the consideration went to the corporation, the court held that this was not a sale of stock by an owner so as to qualify as an exempt transaction.

In the Utah case of *Harper vs. Tri-State Motors*, 58 Pac. 2nd 18, the secretary of the corporation by the name of Richards sold 100 shares of stock in the corporation to the plaintiff Harper for \$1,000.00. The secretary then tried to qualify under the Utah statute by issuing the 100 shares of stock to himself and reissuing the said stock to the plaintiff. The Utah court held that since the money went directly to the corporation, the sale was voidable and not exempt. The holding in this case would appear to be conclusive upon the court in the case now being considered for the reason that the consideration paid for the 40,000 shares of stock did go directly to the Prudential Oil and Minerals Company, corporation.

It is therefore apparent that the Utah Supreme Court, in all cases which have come before it, wherein the corporation has sold from its unissued authorized capital stock, stock which was not registered, and wherein the corporation received the benefit or consideration for the sale, has held such transactions to be not exempt, but voidable under the Utah Securities Act.

## II

THE SALE IN QUESTION WAS NOT AN "ISOLATED TRANSACTION."



If the defendants are successful in persuading the court that a corporation can be the “owner” of its unissued, authorized capital stock, then the defendants must persuade the court that the transaction in question was “isolated.”

In the case of *Kneeland vs. Emerton*, 280 Massachusetts 371, 183 Northeast 155, the court held:

“. . . an isolated sale means one standing alone, disconnected from any other. We think that two sales of securities, made one after the other, within a period of such reasonable time as to indicate that one general purpose actuates the vendor and that the sales promote the same aim and are not so detached and separated as to form no part of a single plan, would be repeated and successive transactions.”

We also cite the following language from the case of *Ersted vs. Hobart Howry Company*, 299 Northwest 66:

“Under statutory provision that blue sky law shall not apply to “isolated sales” of securities by the issuer or owner thereof, such sales not being made in course of “repeated and successive” sales of securities of issue by same issuer or owner, the words repeated and successive are used by way of contrast to “isolated,” and in such context an “isolated” sale means one standing alone disconnected from any other and “repeated and successive sales” mean transactions undertaken and performed one after the other and to sales of securities made one after the other within a period of such reasonable time as to indicate that one general purpose actuates the vendor and that such sales promote the same aim and are not so detached and

separated as to form no part of a single plain, . . .”  
(emphasis added)

These two cases are here cited as authority that the transaction in question was not isolated.

The legislative intent in passing the Securities Act of the State of Utah was to protect the public. The statutes, in order to accomplish this purpose, will be strictly construed against the seller. The Appellant in this action is a member of the public and as purchaser of the 40,000 shares of stock in question is entitled to avoid the sale unless the Respondents by strict construction of the statute can show the transaction to have been exempt.

## CONCLUSION

Corporations are permitted to come into existence by the State after qualifying with the State's requirements and receiving its authority. The original authorized capital of the given corporation is set and approved by the State. The original subscribed portion of that authorized capital stock is approved by and issued upon permission of the State. The State is at all times kept informed as to the functions of this creature which it has tolerated by reason of the filing of amendments to the articles of incorporations being required from time to time as they may be made. The State requires a fee to be paid based upon the amount of the authorized capital stock which is in fact subscribed or issued.

Whether or not a corporation, a tolerated creature permitted by the State, may become a Frankenstein or re-

main a regulated entity can in part depend upon whether or not the State is at all times informed as to its structure. One of these controls and checks upon corporations should be the requirement that when a corporation sells stock from its authorized capital, the State should be notified both for the safety of the public and the information of the State by way of regulation. (See Utah Const. Art XII, Sec. 5, and 21-1-2, U.C.A., 1953)

Since no exemption applies to this sale, plaintiff respectfully submits that the District Court's order dismissing plaintiff's Second Cause of Action should be reversed and the case remanded for the purpose of ascertaining the value of the consideration exchanged for the said stock and for judgment to be entered for the plaintiff accordingly.

Respectfully submitted,

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