

1992

Leontine C. Pond and Merle G. Hyer Company v.  
Equitable Life and Casualty Insurance Company,  
Insurance Investment Company, R. Earl Ross, E.  
Roderick Ross, Galen J. Ross, David E. Ross II,  
Diane Ross Worthen, Betsy Ross Rapps, Connie  
Ross : Reply Brief

Utah Court of Appeals

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DOCKET NO. 920759

IN THE UTAH COURT OF APPEALS

LEONTINE C. POND and MERLE G. HYER  
COMPANY, a Utah Corporation, holders of  
Preferred Stock in Insurance Investment  
Company, a Utah Corporation, on behalf of  
themselves and other similarly situated  
holders of such stock,

Plaintiffs and Appellants,

vs.

EQUITABLE LIFE AND CASUALTY INSURANCE  
COMPANY, a Utah Corporation, INSURANCE  
INVESTMENT COMPANY, a Utah Corporation,  
R. EARL ROSS, E. RODERICK ROSS, GALEN J.  
ROSS, DAVID E. ROSS II, DIANE ROSS  
WORTHEN, BETSY ROSS RAPPS, CONNIE ROSS,  
and Does 1 through 20,

Defendants and Appellees.

Case No. 920759-CA

ARGUMENT PRIORITY CLASSIFICATION 15

REPLY BRIEF OF APPELLANT

APPEAL

FROM THE THIRD JUDICIAL DISTRICT COURT

COUNTY OF SALT LAKE, STATE OF UTAH

HONORABLE JAMES S. SAWAYA, JUDGE

**FILED**  
Utah Court of Appeals

MAR 26 1993

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DETERMINATIVE LAW

The interpretation of the following Utah Rules of Civil Procedure is determinative of certain issues in this appeal:

Rule 15 provides in pertinent part:

Otherwise a party may amend his pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires.

Rule 23 is set forth in the addendum at the end of this Brief.

STATEMENT OF THE CASE

Plaintiffs are holders of preferred stock in defendant Insurance Investment Company ("II"). II holds most of the voting stock of the defendant Equitable Life and Casualty Insurance Company ("Equitable"). These companies and their principal officers, R. Earl Ross ("Earl") and E. Roderick Ross ("Rod"), are all jointly referred to as the "Equitable defendants", and sometimes herein as "defendants".

Plaintiff Leontine C. Pond ("Pond"), and later plaintiff Merle G. Hyer Company ("Hyer"), have sought to represent a class comprised of all holders of II preferred stock, except for Earl, Rod, and their relatives ("the Ross family"). The trial court declined to certify this plaintiff class.

Thereafter, other members of this plaintiff class sought to intervene. Their petition to intervene was denied. They did not appeal that denial. Therefore, defendants' statement on page 38 of their Brief that Judge Sawaya did not abuse his discretion when he denied the motion to allow intervention of additional

preferred shareholders is not addressed herein, because it is immaterial.

In their statement of the case, defendants emphasize on page 4 of their Brief that the facts forming the basis of their second motion for summary judgment were not disputed by contradictory evidence, and proceed to list those facts.

However, those undisputed facts likewise do not contradict the facts set forth in the plaintiffs' Brief.

For ease of reference, some of the numbered facts found in the Statement of the Case in the plaintiffs' opening Brief are essentially duplicated here:

1. Pond was issued her 500 shares of II preferred stock after the death of her husband, Stillman H. Pond, upon the cancellation of the certificates that had been issued to him when he purchased them during their marriage in the early 1940's. ROA at 3.

2. In the early 1980's, only members of the Ross family would purchase Equitable or II preferred stock, and then only for less than \$5 per share. Deposition of Rod taken June 10, 1991 - ROA at 759, 549 (Rod Depo) at 120-21. Deposition of Earl taken June 11, 1991 - ROA at 760, 549 (Earl Depo) at 67-71.

3. As of October 31, 1986, the Ross family owned or controlled all or nearly all of the voting common stock of II and about 70% of the II preferred stock. ROA at 475-78.

4. A threat to Earl and Rod's control of Equitable was finally eliminated by Equitable's secret purchase of all of the II common and preferred stock and Equitable stock held directly or



indirectly by defendants Galen Ross, Connie Ross, David Ross and Betsy Ross Rapps, the members of the Ross family who had been pushed from a position of control. ROA at 437, 476-78.

5. This was paid in the form of cash and a new issue of Equitable preferred stock, with the latter likely to be redeemed over a period of about 10 years. ROA at 422-30.

6. The 1988 Annual Statement reported that in the purchase of its own stock pursuant to the 1986 offer, and in the purchase from "a coalition," Equitable paid a total consideration of \$6,809,596 for the equivalent of 300,609 of its own shares, or an average of \$22.65 per share. As part of this purchase, Equitable bought over 40% (based on liquidation rights) of the outstanding II stock. Rod Depo, Exh. 1, 4th page, included in the Addendum hereto.

7. That same 1988 Annual Statement reported that each share it held of II stock, both common and preferred, was equivalent to 3.717 shares of its own stock "(based on liquidation rights)." Id. Thus those same liquidation rights would result in an average value of over \$84 per share of II stock, common or preferred.

8. When equitable made that secret purchase of stock, including II preferred stock, from the said "coalition" of insiders, it made no comparable offer to purchase the II preferred stock held by the plaintiff class, which would have meant an additional investment of less than \$1,730,000. ROA at 11, 43.

9. Dividends have been declared or paid by II in only a very few years since the issuance of the preferred stock therein, and then only at the minimum rate, 6% of the \$1 par value. II has

indicated that dividends have been paid to the preferred shareholders of II on four occasions, namely, in 1954, 1981, 1983 and 1984, and seven times total. ROA 211-12, 500.

#### ARGUMENT

1. THE PLAINTIFF CLASS SHOULD HAVE BEEN CERTIFIED UNDER RULE 23(B) OF THE UTAH RULES OF CIVIL PROCEDURE WHERE THE PROPOSED CLASS CONSISTS OF 105 HOLDERS OF PREFERRED STOCK HAVING CLAIMS BASED ON FACTS SUCH AS THE COMPANY FAILING TO PAY DIVIDENDS, AND CERTAIN INSIDERS SELLING ALL OF THEIR PREFERRED STOCK TO A CONTROLLED COMPANY AT A PRICE PER SHARE OVER 16 TIMES AS GREAT AS THE MEMBERS OF THE PROPOSED CLASS COULD OBTAIN.

The class is numerous enough.

Defendants have not referred the court to any case showing that a class size of 105 preferred shareholders fails to satisfy the first requirement of Rule 23(a) of the Utah Rules of Civil Procedure that the class be so numerous that joinder of all members is impractical. Rather, they say that after solicitation, only 10 demonstrated any interest, a number which did not make joinder impractical. Defendants' Brief at 15, 19-20.

In response, many of the addresses on the records of II shareholders are incorrect. This is not surprising in view of how seldom II sends a dividend or any other communication to those shareholders.

Over twenty envelopes were returned with no indication of the correct address. On a couple there was the additional note that the addressees were deceased. In nearly all cases there

has not been a follow-up to determine if the other addressees ever received the initial correspondence. ROA at 585.

Some of the addressees have responded by stating that they sold their holdings. Others indicated they were relatives of the addressees, now deceased, and they did not know where a certificate was or if the addressees still held the stock at the time of their death. Id.

Only two preferred shareholders stated they had decided not to intervene. One holds 1,000 shares and is apparently the wife of Mark Jensen, a man who

was a stockbroker at the time that Bennett Leasing attempted a hostile takeover of Equitable, and got wind of it through inside information, and went about to attempt to purchase as much stock as he possibly could from a lot of shareholders of Equitable Life & Casualty Company at as low a cost as he could so that he could, therefore, thereafter make a killing by selling said stock to Bennett Leasing. Rod Depo. at 67.

In her case, it would appear that she would prefer to let others pay the costs and attorneys' fees of this litigation and then come forward to demand equal treatment.

In the other case, an apparently retired couple mailed a letter (ROA at 592 and included in the Addendum hereto), and then decided they would just as soon hang onto their 175 shares.

So the fact that relatively few applied to intervene does not prove a class action is unwarranted. If anything, it shows an additional need for certification of the class.

The member's desire to join is not an element of typicality.

Defendants have argued that the proposed class

representatives are not typical, because they have not shown that other members of the proposed class "feel aggrieved" or "had a complaint." Defendants' Brief at 20-21.

The cited case of White v. Gates Rubber Co., 53 F.R.D. 412 (1971) found a lack of typicality because the plaintiff had not yet shown that other minority employees who had been discharged by defendant felt that they were discharged by reason of their race or color.

Defendants' confusion evidently arose from the following sentence paraphrased in defendants' Brief: "It seems apparent that a claim cannot be typical of the claims of a class if no other member of the class feels aggrieved." Id. at 415.

However, the context of the case clearly shows that the ruling was not based merely on the lack of proof of a subjective desire for redress on the part of other members of the class. Rather, the court was concerned that no other member of the class, when asked, would know of evidence or otherwise feel that his discharge was not based on legitimate grounds.

After the statement quoted above, the White opinion explained "we are of the opinion that [typicality] requires the plaintiff to demonstrate that other members of the class he purports to represent have suffered the same grievances of which he complains." Id.

The case of Taylor v. Safeway Stores, Inc., 524 F.2d 263 (10th Cir. 1975) cited by defendants, which case also cited the White case, supports this interpretation.

In the Taylor case, the plaintiff showed the existence of discriminatory employment practices by Safeway in the frozen food warehouse. He evidently could not find many others in the class, if any, that had suffered any legally cognizable damage as a result of such practices.

In citing White, the Taylor opinion stated that the concern in White was whether there was in fact a class needing representation. Taylor indicated that the question was not whether every employee would have the same fact situation. That would be unnecessary for the maintenance of a class action. Rather, the question was whether anyone else had a legitimate claim. Unless that had to be shown, the trial court would unrealistically have "to compare the claims and defenses of the plaintiff with the hypothetical claims of a hypothetical class."

Clearly the instant cases suffers no such infirmity. Every other member of the class suffered the same legally cognizable harm as the representative plaintiff, differing only in the amount, dependent upon the number of preferred shares owned. It is not a prerequisite to show that other members care about receiving the legal and equitable remedies to which they are entitled.

Even if defendants' interpretation is correct that the other members of the class must be desirous that their rights be pursued, this can be presumed under the facts of this case. II issued and sold its preferred stock over 45 years ago. Although holders if this stock were to be the first to receive dividends, they have received dividends only seven times, because in only

seven years have dividends been declared. Although the funds they provided have been successfully invested and the value of the company is very high, only the holders of common shares can and do benefit from that value. Although members of the plaintiff class were to share at least pro-rata in any dissolution or liquidation of the company, insiders holding about one-third of the ownership of the company, much in the form of preferred shares, have been able to receive essentially the liquidation value of their shares of the company, while others selling preferred stock must settle for less than one-sixteenth of that value. Under these facts, the class would clearly exist even if to exist the members had to desire enforcement of their rights.

2. WHERE OVER ONE-THIRD (BASED ON LIQUIDATION RIGHTS) OF THE STOCK IN A HOLDING COMPANY IS PURCHASED BY THE COMPANY IT CONTROLS, THERE HAS BEEN "ANY LIQUIDATION" UNDER ITS 1944 AMENDED ARTICLES OF INCORPORATION, ENTITLING ITS SHAREHOLDERS TO BE PAID IN THE MANNER PRESCRIBED THEREIN.

"Any liquidation" does not mean only "complete liquidation".

The Articles of Incorporation of II, as amended July 17, 1944, stated in paragraph B. of Article VII:

In the event of any liquidation, dissolution or winding up of this corporation, the holders of Preferred Stock shall be entitled to be paid in full the par value thereof before any amount shall be paid or any assets distributed to the holders of Common Stock Class "A" and after the payment to the holders of Common Stock Class "A" of an amount equal to the par value of said Common Stock Class "A" the remaining assets of this corporation shall be divided and paid to the holders of Preferred Stock and the Holders of Common Stock Class

"A" according to the number of their respective shares. ROA at 9, 10, 42. [Emphasis added.]

The defendants have argued that "liquidation" can refer only to a complete winding up of II's business, thus deleting the emphasized "any" and changing the emphasized "or" to "and." However, that definition of liquidation is much too narrow.

As a matter of fact, the defendants in their Brief do not confine their use of the term liquidation to such a narrow meaning. On page 30 of that Brief, they state, "Donahue and the other cases cited by plaintiffs all relate to a preferential liquidation or minority shareholder 'freeze out,' ...." But each case cited referred to a situation, such as the instant matter, where those in control used corporate assets to buy a large block of stock from insiders without making a similar offer to all shareholders.

Liquidation is the opposite of capitalization, and involves a return of capital.

By "partial liquidations" we understand to be meant proceedings involving the surrender by the corporation of portions of its capital. Smith v. Dana, 60 A. 117, 123 (Conn. 1905).

In the Smith case, the issue was whether a trust holding the corporation's stock should treat an extraordinary dividend as income or principal. This was also the issue in the case of In re Sears' Will, 26 N.Y.S.2d 912 (N.Y. Surr. 1941), wherein the dividends were ruled liquidating dividends and ordered distributed to the remaindermen of the trust.

In the case of Jay Ronald Co. v. Marshall Mortgage Corp., 40 N.Y.S.2d 391 (N.Y. Sup. 1943), the corporation had reduced its

capital by \$200,000. The court ruled that the corporation had to distribute these funds to its stockholders. However, no interest was awarded. "We are of the opinion that the stockholders are not entitled thereto since a reduction of capital is in effect a voluntary liquidation of the retired capital ...." Id. at 399.

In none of these cases did the corporation dissolve and wind up its business. And in each case the court did not define and refer to liquidation as requiring that finality or intent.

3. A CONTROLLED COMPANY AND ITS OFFICERS AND SHAREHOLDERS ARE NOT INSULATED BY ARTIFICIALITIES FROM ANY FIDUCIARY DUTY TO THE SHAREHOLDERS OF ITS HOLDING COMPANY.

Defendants argue that assuming plaintiffs would have a cause of action for actions of Equitable if they were shareholders of Equitable, their cause of action fails because they are only shareholders of II, a company which controls but is not identical to Equitable.

It is true that the corporate legal fiction arising with the establishment of holding company is not always disregarded as a matter of course. But it is not true that this fiction forms an immutable wall against redress that is otherwise appropriate.

The case of Salt Lake City Corp. v. James Constructors, 761 P.2d 42 (Utah App. 1988) considered the responsibility of a parent corporation for the actions of a subsidiary, and reviewed Utah law pertaining to disregarding the corporate entity.

In that case, the Utah Court of Appeals reversed the summary judgment dismissing the parent corporation in an action



against the subsidiary where it was alleged the parent owned 100% of the subsidiary's stock; the parent financed the subsidiary and paid some of its debts - without formal documentation and with no particular requirements for repayment; the subsidiary was undercapitalized; and the subsidiary's directors and officers did not act independently of the parent. Id. at 47.

The opinion in that case cited the case of Norman v. Murray First Thrift & Loan Co., 596 P.2d 1028 (Utah 1979) and referred to the two-prong test adopted therein to determine when disregarding the corporate entity is justified.

The opinion then referred to the fact that Messick v. PHD Trucking Service, Inc., 678 P.2d 791, 794 (Utah 1984) had called the first prong of this two-prong test found in Norman the "formalities requirement." The Messick opinion referred to the formalities required by statute, including record keeping, shareholders' meetings, adequate capitalization, stock issuance, etc.

Apparently the record has not yet been developed enough to show the complete picture as to the observation of formalities. However, the record does show that on or about March 21, 1989 a request was made for financial information of II, and the response lacked detail, consisting of two pages, a Balance Sheet and a Statement of Profit & Loss, copies of which are included in the Addendum hereto. ROA at 6, 15, 16, 38.

The Salt Lake City opinion stated:

In the parent-subsidiary situation, the central focus of the formalities prong is "the degree of control that the parent exercises over the subsidiary and the extent to which the corporate

formalities of the subsidiary are observed."  
Barber, Piercing the Corporate Veil, 17 Willamette  
 L. Rev. at 397. Salt Lake City Corp. v. James  
Constructors, supra, 761 P.2d at 47.

The opinion then referred with approval to the eleven factors listed on page 398 of the Willamette article relevant to deciding whether the parent exercises "the necessary control" over its subsidiary. Some of these eleven factors are as follows:

- (1) the parent corporation owns all or most of the capital stock of the subsidiary;
- (2) the parent and subsidiary corporations employ common directors or officers;
- (3) the parent corporation finances the subsidiary;
- (4) the parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation;
- (5) the subsidiary has grossly inadequate capital;
- (8) in the papers of the parent corporation or in the statement of its officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial responsibility is referred to as the parent corporation's own;
- (9) the directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter's interest;
- (11) the parent corporation uses the property of the subsidiary as its own.

Usually, the parent-subsidiary relationship is devised to shield the assets of the parent from outside parties. However, in the instant case, the purpose is to try to keep the assets in the subsidiary further removed from the minority shareholders of the parent. Hence a number of the factors enumerated above, as well as those omitted, would be reversed, but still show the applicability of the instrumentality rule.

For example as to the 8th factor, the subsidiary Equitable

shows its holdings of II stock, both common and preferred, as treasury stock, valuing them according to an II liquidation. Rod Depo, Exh. 1, 4th page, included in the Addendum hereto.

Page 47 of the Salt Lake City opinion then referred to the second prong of the Norman test as the "fairness requirement," which, as indicated on page 794 of the Messick case, "is addressed to the conscience of the court."

The defendants cite W. Fletcher, Cyclopedia of the Law of Private Corporations, (perm. ed. 1984) for support against ignoring any aspect of the separate corporate existence of II and Equitable. Defendants' Brief at 29. However, that reference also shows that the corporate veils of parents and subsidiaries can be pierced in a number of circumstances, based on instrumentality, alter ego, and agency, in the presence of bad faith, or some other improper conduct. Id. Sec. 43 at 729.

4. A CORPORATION IS NOT JUSTIFIED IN SECRETLY PURCHASING ALL OF CERTAIN INSIDERS' PREFERRED STOCK OF ITS HOLDING COMPANY, AT A PRICE PER SHARE OVER 16 TIMES AS GREAT AS THE PRICE THE OTHER HOLDERS OF THAT STOCK COULD OBTAIN FROM THE CORPORATION OR ANYONE ELSE, ESPECIALLY IN ORDER TO RESOLVE DISPUTES OVER A CORPORATION'S CONTROL, DESPITE THE BUSINESS JUDGMENT RULE..  
Equitable should have offered to buy plaintiffs' II preferred shares.

Equitable should have offered to buy plaintiffs' II preferred shares at the same price and on the same terms as those applicable to its purchase of II preferred shares from the defendants Galen J. Ross, David E. Ross II, Betsy Ross Rapps, and Connie Ross.

Defendants argue that this would require Equitable to offer to buy out its own shareholders. Appellee's Brief at 30 n. 8. However, Equitable already offered to buy out its own shareholders for \$22.50 per share of Equitable, which was a fair price. Rod Depo, Exh. 1, 4th page, included in the Addendum hereto.

On page 30 of their Brief, defendants cite three cases as support for their statement that Donahue v. Rodd Electrotpe Co. of New England, Inc., 328 N.E.2d 505 (Mass. 1975) does not represent the law in Utah. Actually, all three cases fail to mention Donahue or its principles: Lochhead v. Alacano, 697 F. Supp. 406 (D. Utah 1988) held that the minority shareholders had stated an individual cause of action rather than derivative when their holdings had been diluted; Nash v. Craigco, 585 P.2d 775 (Utah 1978) held that punitive damages were available where a person obtained an option for shares that were subsequently diluted; and In re Black, 787 F.2d 503, 506 (10th Cir. 1986) ruled that an officer who embezzled corporate funds had breached his duty to the corporation rather than to an individual stockholder.

On that same page 30, defendants state that Donahue represents a rule that has been soundly rejected. Actually, only a per se rule, one that would require a corporation to give all shareholders an equal opportunity to sell their stock in every case, has been rejected. And the cases cited by defendants, Clagett v. Hutchison, 583 F.2d 1259, 1264 (4th Cir. 1978) (which distinguished Donahue) and McDaniel v. Painter, 418 F.2d 545, 547 (10th Cir. 1969) (which predated Donahue), did not deal with the

purchase by a corporation of its own stock, but rather the sale of a controlling block of stock to an outsider.

In reality, Donahue has withstood the test of time, though its principles have been "refined." Crowley v. Communications for Hospitals, 573 N.E.2d 996, 1001 (Mass. App. 1991).

The Crowley case pointed out that the controlling group must be given an opportunity to "demonstrate a legitimate business purpose for its actions." Id. However, the Crowley case did not need to decide the extent to which the refinement applied, because in that case, as in the instant matter:

There is manifest unfairness to the excluded, nonconsenting minority interests for the majority, year after year, to appropriate to themselves substantially all of the net income of the enterprise, and such an operational policy, which deprives the company, and therefore its stockholders, of all opportunities for growth in net worth, serves no legitimate business purpose. Id.

Defendants distinguish Donahue on the basis that control was not at issue in that case. However, control was the issue in the case of Comolli v. Comolli, 246 S.E.2d 278 (Ga. 1978).

In that case, two brothers, Louis and Mario, joined forces to oust the oldest brother, Felix, from his positions as president and general manager of their company. When Mario died, his widow Christine would not sell Mario's stock to Felix for \$800 per share, but she would sell it to the other brother Louis for that price. Louis bought 10 shares personally, and ran out of money. So he used his control to have the corporation buy the rest. Thus the corporate assets were used to prevent the risk of a sale of

stock to Felix and the accompanying change of control.

The court stated that in Georgia directors have a duty to act in good faith and with ordinary diligence. This good faith does not just apply to the corporation, but "also requires that stockholders be treated fairly and that their investments be protected." Id. at 280.

The court pointed out that minority stockholders in close corporations may have relative insignificance and their investments be held captive. But this should not be aided or reinforced by the use of corporate funds. Id. at 281.

The action of the directors demonstrated a lack of good faith, since the funds used to purchase the shares from Christine were not then available for dividends. "[G]ood faith require[d] the directors to authorize a corporate purchase of Felix' stock at the same price and the same terms given to Christine," if there were to be any corporate purchase at all. Id.

The court then cited Donahue, supra, and added that such a course of action would eliminate any question of a preferential distribution of assets and provide Felix with an opportunity to liquidate his investment. Id.

The defendants cited the case of Delahoussaye v. Newhard, 785 S.W.2d 609 (Mo. App. 1990) as a counter-example. However, that opinion distinguished the Donahue case on its facts, pointing out that in Donahue the directors who discriminated in their purchase of stock with corporate funds were a "controlling group," owning or controlling a majority of the stock issued and outstanding.

In Delahoussaye the directors who approved the stock purchase did not own or control a majority of the outstanding shares.

At the time Equitable selectively purchased stock of its holding company, the named defendants controlled II and Equitable. Not only that, but the named defendants, excluding the selling defendants, controlled II and Equitable; although in view of the litigation, that control was tenuous. They had gained this control by means of the sale of some pivotal II stock from a charitable foundation to a person friendly to their position. Earl Depo at 12. Defendants are not excused by the business judgment rule.

The defendants cite Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. Supr. 1985) to show that their actions were justified by the business judgment rule. That case involved a decision by the directors, a majority of whom were outsiders. After hours of deliberations, some involving only the outside directors, the board unanimously agreed to offer to buy the company's stock from any stockholder except the party engaged in a hostile takeover attempt. Thus the business judgment rule and presumption described in Aronson v. Lewis, 473 A.2d 805, 812 (Del. Supr. 1984) of action having been taken in good faith would apply.

But even that presumption of adequate justification would be overcome upon a showing that the directors "acted out of a sole or primary purpose to entrench themselves in office." Unocal, supra, 493 A.2d at 954.

Not only can the presumption be overcome, but where a threat to control is involved, the burden shifts to the directors

to show that the purchase of stock is primarily in the corporate interest. Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964).

In the Cheff case, cited by defendants, the appellate court found that the directors carried that burden. The directors had adduced evidence showing that their motivation for the use of corporate assets to selectively purchase stock was a valid business purpose. To reach this result, the appellate court reversed two findings of fact, finding instead that all evidence demonstrated that there was a real threat the company would be liquidated and that this threat had caused employee unrest.

In the instant matter, insiders and major stockholders controlled the decision. Control was clearly involved. Hence the burden to show a valid business purpose is on the defendants. They have shown no threat of liquidation. And it cannot otherwise be said that as a matter of law they have carried their burden to show that the primary purpose was a valid business purpose, rather than to maintain control.

The defendants' argument that control was not involved in purchasing II preferred stock is flawed. The purchase of II preferred stock enabled the purchase of II common stock, which involved control. Whether this control was threatened by Bennett Leasing or by other members of the Ross family is irrelevant.

5. EVERY ACTION FOR BREACH OF FIDUCIARY DUTY OF THE OFFICERS AND DIRECTORS OF A CORPORATION NEED NOT BE BROUGHT AS A DERIVATIVE ACTION.

Defendants argue that any claim against them belongs to



II or Equitable, and can therefore only be brought as a derivative action. Appellee's Brief at 34-35.

This distinction was discussed in detail in the case of Crowley v. Communications for Hospitals, 573 N.E.2d 996 (Mass. App. 1991). That case stated:

A finding of a "freeze-out" scheme may well be an element of a case for direct relief, but it is not necessarily sufficient to preclude the need for derivative relief. Id. at 1004.

Wording this another way, while facts such as excessive officer salaries may provide the basis for an action which is necessarily derivative, they can still also support elements of a case for direct relief on the basis of a "freeze-out" scheme.

In footnotes, the Crowley opinion pointed out that the transaction complained of in the Donahue case was fair as between the corporation and the sellers of the stock. Thus that did not show a violation of fiduciary duty to the corporation and justify a recovery by the corporation. Id., nn. 15-17.

Likewise in the instant matter, the stock purchase was fair as to the corporation. But it served to further ensure that the minority stockholders would be frozen out.

6. PUNITIVE DAMAGES MAY BE AWARDED AGAINST THE OFFICERS AND DIRECTORS FOR BREACH OF FIDUCIARY DUTY WHEN ONLY EQUITABLE RELIEF INVOLVING THE COMPANY, AND NO GENERAL OR COMPENSATORY DAMAGES FROM THE OFFICERS AND DIRECTORS, IS SPECIFIED IN THE PRAYER. Equitable relief suffices.

Defendants cite the case of Atkin Wright & Miles v. Mountain States Tel., 709 P.2d 330 (Utah 1985) as if it overruled the case

of Nash v. Craigco, 585 P.2d 775 (Utah 1978). However the Atkin opinion did not address Nash because the situations were so different.

In Nash only equitable relief was granted. Nevertheless punitive damages were awarded. "Whether a party gets relief in equity or as a substitute therefor gets money ought not make a difference." Id. at 777.

In Atkin no equitable relief had been sought. The Supreme Court first vacated the award of monetary damages and then the award of punitive damages. The Nash case was never mentioned. The prayer need not be specific.

Since plaintiffs will not prevail by default, they are not limited by the prayers of the complaints. Thus nominal damages, general damages, compensatory damages, etc. may be awarded.

The argument that such relief may be an afterthought or unexpected does not remove the possibility of its being granted.

In a close corporation, however, a minority shareholder who merely receives an offer from a majority shareholder to sell stock at an inadequate price, but does not accept that offer, can still seek damages if the shareholder can prove that the offer was part of a plan to freeze the minority shareholder out of the corporation. Sugarman v. Sugarman, 797 F.2d 3, 8 (1st Cir. 1986).

7. PLAINTIFFS WERE ENTITLED TO AMEND THEIR COMPLAINTS TO ADD A CAUSE OF ACTION BASED ON OPPRESSIVE CONDUCT WHEN THE CASE WAS STILL IN THE DISCOVERY AND MOTION STAGE.

Claims previously denied can be reiterated.

Defendants state that plaintiffs' Motion to Allow Amended Complaint was denied after their other claims were all dismissed.

However, the Motion was filed well over a month before the trial court heard argument and decided to dismiss those other claims. ROA at 525, 593, 595.

The fact that the Amended Complaint included all claims, and not just those based on oppressive conduct, did not justify the refusal to allow it. It could easily have been allowed subject to the decisions made with respect to claims in the original complaints.

Disallowance of amendment could cause deprivation of claims.

Although the overall standard of review applicable to this issue is whether the trial court abused its discretion, Stratford v. Morgan, 689 P.2d 360 (Utah 1984), it would seem clear that this should resolve into a question of law as to whether the claims added in the proposed Amended Complaint (ROA at 529), and particularly those pertaining to oppressive conduct (ROA at 544), stated a cause of action upon which relief could be granted.

Rule 15 of the Utah Rules of Civil Procedure provides that when a party seeks to amend his pleading, "leave shall be freely given when justice so requires." This needs to be more than just an ineffective platitude.

The facts showing oppressive conduct are in large measure the facts supporting plaintiffs' other claims. Thus plaintiffs must pursue the oppressive conduct claims in this action or be forever barred. Penrod v. Nu Creation Creme, Inc., 669 P.2d 873 (Utah 1983).

So if a cause of action has been stated for oppressive

conduct, and it is barred forever because it was not initially stated in the complaints (although the pertinent facts were pled), then form is certainly being exalted over substance. This is particularly true if no other cause of action has been stated based upon those facts and plaintiffs can obtain no relief whatsoever.

What the defendants have done to the outsiders who invested in II preferred stock, many of whom have held that stock over 45 years and are now widows and widowers, is shocking to the conscience. At least as shocking would be a ruling that the plaintiffs are barred forever based on a procedural matter such as this, that is, a delay in fully describing their cause of action until the motion and discovery stage.

Claims exist on the basis of oppressive conduct.

Shareholders have a statutory cause of action when the acts of the directors or those in control are oppressive. Utah Code Subsec. 16-10-92(a)(2) or, since 1992, 16-10a-1430(2)(b).

Defendants have argued that they have done only what they had a right to do. For example, they cite Donahue for the proposition that they do not have to answer to the courts for their decisions as to dividends. Appellees' Brief at 40-41.

The excerpt from Donahue cited by the defendants is part of the material supporting the statement in that case that "the corporate form ... supplies an opportunity for the majority stockholders to oppress or disadvantage minority stockholders." Donahue v. Rodd Electrotpe Co. of New England, Inc., 328 N.E.2d 505, 513 (Mass. 1975). Donahue pointed out that, as a practical matter, it

is hard to prove a violation of fiduciary duty just because dividends are not declared.

Again looking at factual matters individually, the defendants state that excessive officer salaries are only relevant to derivative actions. Appellees' Brief at 41.

However, the plundering of a corporation by means of excessive salaries often constitutes "oppressive" conduct:

Thus, an abuse of corporate position for private gain at the expense of the stockholders is "oppressive" conduct. Or the plundering of a "close" corporation by the siphoning off of profits by excessive salaries or bonus payments and the operation of the business for the sole benefit of the majority of the stockholders, to the detriment of the minority stockholders, would constitute such "oppressive" conduct as to authorize a dissolution of the corporation under the terms of ORS 57.595. Baker v. Commercial Body Builders, Inc., 264 Ore. 614, 507 P.2d 387, 394 (1973).

Generally, oppressive conduct involves a pattern of activities which are markedly unfair, violate the fiduciary responsibility of the majority shareholders, or thwart the reasonable expectations of the minority shareholders:

Oppressive conduct suggests "burdensome, harsh and wrongful conduct, a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members, or a visible departure from the standards of fair dealings and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely." Whale Art Co., Inc. v. Doctor, 743 S.W.2d 511, 514 (Mo. App. 1987).

Thus, we conclude that our cases involving the fiduciary duty owed by majority shareholders, officers and directors of a corporation embrace the same standard which other courts have evolved under the term "oppressive conduct."

Masinter v. Webco Co., 262 S.E.2d 433, 440  
(W.Va. 1980).

The [New York] court stated that "oppression should be deemed to arise only when the majority conduct substantially defeats expectations that, objectively viewed, were both reasonable under the circumstances and were central to the petitioner's decision to join the venture," .... Balvik v. Sylvester, 411 N.W.2d 383, 387 (N.D. 1987).

The case of Fox v. 7L Bar Ranch Co., 645 P.2d 929 (Mont. 1982) reviewed these definitions and applied them to show oppression where dividends had not been declared:

It can be said here that the corporations are in a position to declare dividends, that the refusal to do so acts as a hardship on Melvin, and when considered in light of all other circumstances, that such refusal strengthens Melvin's argument that he is being squeezed. This is a case where the cumulative effects of many acts and incidents constitute sufficient evidence of oppressive conduct to compel liquidation without a showing of inevitable ruin. Id. at 934.

Although dissolution was found to be the appropriate remedy in the Fox case, a "buy-out" has often been found to be the appropriate remedy for oppressive conduct, even in the absence of express statutory or contractual authority. See Davis v. Sheerin, 754 S.W.2d 375, 379 (Tex. App. 1988) and the cases cited therein.

In the instant matter, obviously there has been the financial ability to pay dividends. It can hardly be said, and certainly not as a matter of law, that outsiders reasonably would have been purchased II preferred stock over 45 years ago at \$1 per share with the expectation that despite a successful and robust venture, they would be limited to receiving \$.06 seven times over

that period, and have nothing for retirement.

CONCLUSION

The trial court should have certified the plaintiff class under Rule 23(b) of the Utah Rules of Civil Procedure, since the class was numerous enough and no subjective desire is necessary.

The trial court erred in ruling as a matter of law that there was not "any liquidation" as that term was used in the Amended Articles of Incorporation, and thus that there was no requirement to evenly allocate the funds paid to the II shareholders.

The existence of a holding company does not shield the wrongful conduct of the common directors. Those directors cannot cause the subsidiary to expend a huge amount of corporate assets to buy out only certain holders of the parent's stock where their purpose was to maintain control.

Where there has been discrimination against certain shareholders, these shareholders have a cause of action which is not just derivative. They also have a cause of action for punitive damages against all involved in a breach of fiduciary duty even though their main remedy sought may be equitable.

The shareholders had a right to amend their complaint by adding a cause based on oppressive conduct, since they did indeed state a cause of action on that basis.


DATED this 26<sup>th</sup> day of March, 1993.

LYNN P. HEWARD & DELWIN T. POND  
Attorneys for Plaintiffs and Appellants

by Lynn Heward  
LYNN P. HEWARD

CERTIFICATE OF SERVICE

I hereby certify that two copies of the foregoing Brief were mailed with postage attached thereon to P. Bruce Badger, 215 South State Street #1200, P.O. Box 510210, Salt Lake City, Utah 84151 on this 26<sup>th</sup> day of March, 1993.





## ADDENDUM

Rule 23 provides:

(a) Prerequisites to a class action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class action maintainable. An action may be maintained as a class action if the prerequisites of Subdivision (a) are satisfied, and in addition:

(1) The prosecution of separate actions by or against individual members of the class would create a risk of:

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) The party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) The court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by order whether class action to be maintained; notice; judgment; actions conducted partially as class actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under Subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the

judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under Subdivision (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under Subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in Subdivision (c)(2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

...

A. The Company is controlled by Insurance Investment Company, a Utah corporation, which has two classes of stock. There are 25,000 shares of voting stock and 77,177.5 shares of 64 noncumulative, nonvoting, \$1.00 par value of preferred stock. Ownership and control of this voting stock is described in Schedule Y, Organizational Chart.

B. The Company owns 11,802.23 voting shares and 25,050 preferred shares of Insurance Investment Corporation.

C. During 1986, the Board of Directors of Equitable Life and Casualty Insurance Company (hereafter the "Company") determined that it would be in its best interest to purchase some of the Company's outstanding common stock and the common and preferred stock of Insurance Investment Company, the Company's parent corporation. The Utah Department of Insurance was notified of this intent and gave its consent to the same where necessary. The stock purchase program would satisfy any or all of the following purposes:

- (1) To create a market for stockholders desiring to sell their stock of the Company who have been unable to do so in the past because of lack of marketability.
- (2) To reduce the cost of communication to stockholders.
- (3) To make shares of the Company and Insurance Investment Company available for employee benefit programs.
- (4) To make shares of the Company and Insurance Investment Company available for use in the acquisition of other companies.
- (5) To increase the percentage of ownership of Insurance Investment Company in the Company. Such an increase would permit Insurance Investment Company to qualify for the 100 percent dividend exclusion for federal income tax purposes and/or entitle Insurance Investment Company to file a consolidated return with the Company.
- (6) To eliminate the Company's appearance as a potential candidate for an outside takeover. The Company's publicly held stock gave the appearance to uninformed individuals that it was possible to purchase control of the Company by offering to purchase the Company's publicly held stock. Although it was believed that such attempts were futile, such attempts were nevertheless being made, and were extremely disruptive and detrimental to the operation of the Company.

On November 17, 1986, the Company initiated the above purchase plan by soliciting from its shareholders offers to sell to the Company up to 115,500 shares of its outstanding \$1.00 par value common shares for \$22.50 per share. The Company acquired 95,662.43 common shares under the solicitation and subsequent purchases for an aggregate cash consideration of \$2,152,404.

On October 31, 1987, the Company entered into an agreement with a coalition of some of its remaining shareholders wherein the Company agreed to purchase 44,544.37 shares of its common stock, 25,050.66 preferred shares of Insurance Investment Company, 11,802.23 common shares of Insurance Investment Company and 9,793.10 common shares of National Housing, related corporation, for \$1,450,000 cash and the issuance of 363,000 shares of the Company's newly authorized \$2.00 par value preferred stock. The Company was required to purchase all of this various stock in order to purchase any of it.

Effective April 15, 1988, National Housing was merged into the Company. As a result of the merger, the Company acquired 7,366.65 shares of its common stock, 4,315 preferred shares of Insurance Investment Company and \$662,095 in net assets, based upon their appraised fair value. In consideration for which, the Company paid \$150,000 cash and issued 40,000 shares of the Company's preferred stock.

The total consideration paid by the Company under the above acquisitions is comprised of \$3,752,404 cash and 403,000 shares of \$2.00 par value preferred stock with an assigned cost of \$9.229 per share (the minimum redemption price). Since \$662,095 of nonstock assets were received in the National Housing Merger, the total assigned cost for the treasury stock acquired is \$6,809,596 (\$3,752,404 cash + \$3,719,287 (assigned value of preferred stock) - \$662,095 (net value of nonstock assets acquired)). The aggregate consideration of \$6,809,596 has been assigned to the cost of common treasury stock attributable to the above transaction for financial reporting purposes. During 1988, the Company redeemed 36,803.35 shares of its preferred stock at an average cost of \$10.71 per share.

The owners of the preferred stock may, in the future, if the Company has sufficient earnings in the prior year, cause the Company to purchase up to 40,300 shares per year at a price of \$10.72 per share plus (or minus) a percentage of earnings (or losses) presented on line 31 of the Company's Annual Statement. Although the Company does not know whether or not this right will be exercised, the Company will record a liability as a write-in item appearing on page 3 of its Annual Statement identifying its potential liability for the subsequent year's purchase. This procedure of recording this liability has been reviewed and approved by the Utah Department of Insurance.

The Company's holding of treasury shares consists of 147,573.08 shares of its common stock which are owned directly by the Company and 153,036.28 shares which are held indirectly through the Company's 40.3 percent holding (41,167.89 shares) of its parent company's capital shares (based on liquidation rights). Both the directly and indirectly held shares are deemed to be treasury stock by the Company for financial reporting purposes. The Company is holding such shares as treasury stock to satisfy the previously mentioned purposes.

The Company has received accounting assistance from Peat Marwick Main & Co. and legal assistance from Fabian & Clendenin in recording these transactions.

D. The Company has no guaranties or undertakings for the benefit of an affiliate which might result in a material contingent exposure of the Company's or affiliated insurer's assets to liability.

E. The Company does not have any management or service contracts of insuring arrangements with any affiliated insurer.

#### ERROR COMPENSATION AND RETIREMENT PLANS

A. The Company has an employee profit sharing plan and a Section 401(k) plan for the employees. The Company has no retirement plan for its agents. The Company's Board of Directors determines annually the amount of contributions, if any, the Company will make to the profit sharing plan. Contributions to the S401(k) plan are made solely by employee elected contributions. Each of the plans are fully funded. The Company has no liability for benefits under either of the retirement plans.

Richfield, Utah  
July 29, 1991

Lynn P. Heward  
928 East 5375 So. #E  
Salt Lake City, Utah 84117

Dear Mr. Heward,

We received your letter concerning share of stock in IIC. We are leaving for CA in a matter of minutes. We'll be there a couple of weeks and then return to Utah. As usual we don't understand too well just what the case is and just what it would mean to us. It looks as though funds that might be fourth coming might be used up in fees and such leaving us with about what we have or less. We feel that when Attorneys and the IRS get through with money we receive we just as well have not received it. That is of course if there is any funds to receive.

It may be of interest to us if it looked like there would be any thing for us.

Sincerely,   
R. Chad Peterson

|| Mr. & Mrs. R. Chad Peterson  
712 N. Crestview Dr.  
Richfield, UT 84701

INSURANCE INVESTMENT COMPANY

BALANCE SHEET

December 31, 1988

ASSETS:

|                  |            |
|------------------|------------|
| Checking         | (4.63)     |
| Savings Accounts | 1,403.84   |
| Stock            | 144,334.00 |
|                  | <hr/>      |
|                  | 145,733.21 |

LIABILITIES:

|               |          |
|---------------|----------|
| Notes Payable | 1,777.00 |
|---------------|----------|

EQUITY:

|                            |            |
|----------------------------|------------|
| Common Stock               | 25,000.00  |
| Preferred Stock            | 77,177.50  |
| Paid in Surplus            | 40,179.40  |
| Earned Surplus             | 2,934.68   |
| 1988 Operations (1,335.37) | 1,599.31   |
|                            | <hr/>      |
|                            | 145,733.21 |

INSURANCE INVESTMENT COMPANY  
STATEMENT OF PROFIT & LOSS  
YEAR - 1988

INCOME:

|                      |        |
|----------------------|--------|
| Interest Income      | 132.53 |
| Tax refund (State)   | 28.00  |
| Tax refund (Federal) | 103.00 |
|                      | <hr/>  |
|                      | 263.53 |

EXPENSES:

|                        |          |
|------------------------|----------|
| State Corporation Fees | 15.00    |
| Income Tax (State)     | 100.00   |
| Banking Expense        | 29.27    |
| C.P.A. Expense         | 989.63   |
| Interest Expense       | 465.00   |
|                        | <hr/>    |
|                        | 1,598.90 |