

1991

Jerrold L. Davis v. Heath Development Company : Brief of Appellant

Utah Supreme Court

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UTAH SUPREME COURT

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JERROLD L. DAVIS dba JERRY DAVIS AND
ASSOCIATES,

Plaintiff-Respondent,

vs.

HEATH DEVELOPMENT COMPANY, a Corporation
dba PIONEER TRAILER PARK, SANDRA H.
FLINDERS, KATHRYN B. HEATH, DOROTHY
A. HOUSELY, BONNIE J. BRINTON, HELEN
YOUNG, MARY FRANCIS BENNION, LAWRENCE
T. HEATH, CAROLYN H. MARLER, NANCY
H. FERRIN,

Defendants-Appellants.

DOROTHY A. HOUSELY AND BONNIE J. BRINTON,

Cross-Complainants-Respondents,

vs.

HEATH DEVELOPMENT COMPANY, a corporation,
dba PIONEER TRAILER PARK,

Cross-Defendant-Appellant.

BRIGHAM YOUNG UNIVERSITY
J. Reuben Clark Law School

Case No. 14549

BRIEF OF APPELLANT

An Appeal from the Judgment of the District Court of the Third
Judicial District, The Honorable G. Hal Taylor, Judge

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FILED

JUN 28 1976

Clerk, Supreme Court, Utah

SUPREME COURT

OF THE

STATE OF UTAH

JERROLD L. DAVIS dba JERRY DAVIS AND
ASSOCIATES,

Plaintiff-Respondent,

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vs.

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dba PIONEER TRAILER PARK,

Cross-Defendant-Appellant.

APPELLANTS BRIEF ON APPEAL

STATEMENT OF THE KIND OF CASE

This is an action by plaintiff real estate broker to recover a real estate commission, and by cross-complainants for specific performance of an earnest money agreement. The suit was against Heath Development Company, a corporation, it having been stipulated prior to trial that the actions against the individual defendants be dismissed with prejudice.

DISPOSITION IN THE LOWER COURT

After a trial before the Honorable G. Hal Taylor sitting without a jury, the court found for the plaintiff and for the cross-claimants and entered judgment for the real estate commission and an order of specific performance of the earnest money agreement.

RELIEF SOUGHT ON APPEAL

Appellants seek to have the judgment of the District Court reversed.

STATEMENT OF FACTS

The defendant Heath Development Company is a Utah Corporation, its only asset being the Pioneer Trailer Park located at 937 South State in Salt Lake City, Utah. (T. 447). It is a close family corporation having a total of nine stockholders at the time of these transactions. Five of the nine stockholders serve on the Board of Directors.

In recent years the corporation has listed the Pioneer Trailer Park for sale with various realtors for the sum of \$400,000.00 (T. 402). On a prior occasion an oral offer of \$325,000.00 had been made, but not accepted by the corporation. (T. 403). On November 13, 1973 Dorothy A. Housely, a director in the company, (T. 402), and the manager of the Pioneer Trailer Park, (T. 402), signed a listing with the plaintiff

real estate broker for the sales price of \$400,000.00. (T. 402). Thereafter on November 19, 1973, six of the stockholders of the company signed a document purporting to ratify the original listing agreement signed by Dorothy A. Housely. (T. 319).

Pursuant to the listing agreement, plaintiff attempted to sell the Pioneer Trailer Park but was unsuccessful. (T. 322). Without any encouragement from plaintiff, and without any solicitation or effort on plaintiff's part, Dorothy A. Housely, the same person who signed the listing agreement, decided that she would like to purchase the trailer park. (T. 323). After conferring with the plaintiff and with her sister and brother-in-law, Bonnie and Elmer Brinton (Bonnie also being a stockholder and director) an Earnest Money Offer was prepared on January 12, 1974, wherein Dorothy and Bonnie offered to purchase the trailer park for \$250,000.00. (T. 325).

On that date the plaintiff's agent, Mason Rankin, telephoned the President of the corporation, Kathryn D. Heath, to arrange a directors' meeting for presentation of the offer. (T. 326). The meeting was scheduled for the next afternoon at the home of Kathryn D. Heath. (T. 326). Those present at the directors' meeting on January 13, 1974, at which the offer was presented, included: Kathryn D. Heath, President, Director and owner of 20% of the common stock; Essie Heath

(since deceased), Secretary, Director and owner of 20% of the common stock; Dorothy A. Housely, Director and owner of approximately 20% of the common stock; Bonnie Brinton, Treasurer, Director and owner of approximately 20% of the common stock; the plaintiff and plaintiff's agent, Mason Rankin (T. 325-330).

Of the four directors present it was the first time that any of them had actually received a written offer to purchase the sole asset of the corporation. (T. 426-7). Mr. Rankin went through the offer of purchase at least twice, and insisted that the property was only worth \$250,000.00 rather than the \$400,000.00 that it was listed at and that they would not receive a better offer. (T. 448-450). This meeting lasted for about two hours. (T. 390). Essie Heath, the secretary of the corporation, was so confused by the offer she couldn't even write it in the minutes and asked one of the purchasers to write the terms of the offer in the minute book which Mrs. Housely did. (T. 414).

The plaintiff and his agent were aware that they were dealing with a corporation and with the sale of corporate property. (T. 348-349). The plaintiff and his agent were both duly licensed and knowledgeable in the real estate business. (T. 385-386). Neither plaintiff nor his agent gave any instructions to the directors on how to sign the Earnest

Money document. (T. 506). All signatures are in a personal capacity and nothing on the document purports to bind the corporation. (T. 471-472; and T. 519).

The Articles of Incorporation call for five directors with the qualification that each hold one full share of common stock. (Exhibit 5-P). The fifth director, Sandra Flinders, held less than one full share of stock. (P. 352). However, the other stockholders had continuously and unanimously elected her a director and authorized her to function as vice president since 1964. (T. 487-488). The Articles of Incorporation provide that a majority of the directors shall constitute a quorum and the act of the majority of the quorum shall be the act of the corporation. (Exhibit 5-P).

The Earnest Money Agreement signed January 13, 1974, was further conditioned upon the buyer's obtaining financing. (Exhibit 3-P). The buyers did not qualify for financing on their own. (T. 382-383). On or about March 15, 1974, after two months of trying to obtain financing, the plaintiff through his agent Mason Rankin presented an offer to purchase the trailer park to Dorothy A. Housely and Bonnie Brinton for \$400,000.00. (T. 375). Bonnie Brinton and Dorothy A. Housely were directors of Heath Development Company at this time and did not disclose this offer to anyone else in the corporation. (T. 476). Hugh Wayman, the new purchaser, agreed to co-sign

for Mrs. Housely's and Mrs. Brinton's financing on the original purchase agreement. (T. 382-383). The lending institution agreed to make the loan with Hugh Wayman being responsible for repayment (T. 382-383).

On April 9, 1974, Mason Rankin took a warranty deed to the home of Kathryn D. Heath for her signature. (T. 452). The proposed deed was from the corporation to Dorothy Housely and Bonnie and Elmer Brinton. The deed did not contain the name of Hugh Wayman nor did Mason Rankin tell Mrs. Heath anything about Mr. Wayman. (Exhibit 7-P). Mrs. Heath refused to sign the deed. (T. 454). On April 11, 1974, the plaintiff presented another Earnest Money Agreement and Offer to Purchase directly to the corporation from Hugh Wayman for \$400,000.00. (T. 521). After counterproposals between Hugh Wayman and the corporation, no agreement was reached. Suit was filed by plaintiff for a real estate commission on the Earnest Money Agreement of January 13, 1974, and a cross-claim was filed by Dorothy Housely and Bonnie Brinton for specific performance under the \$250,000.00 Earnest Money Agreement of January 13, 1974.

The court found that the listing agreement was valid and that the plaintiff secured and presented an offer to purchase the Pioneer Trailer Park for \$250,000.00 from a ready, willing and able buyer and that the offer was accepted by

the corporation. (R. 275-279). Based on these findings, the court entered judgment for plaintiff for the real estate commission in the amount of \$15,000.00 with interest at 6% per annum from April 10, 1974, for a total to date of entry of judgment, of \$16,650.00. Also the court awarded attorney's fees of \$5,000.00 with interest at 6% per annum on the attorney's fees from April 10, 1974, until the date of judgment. (R. 280-281). Further, the court ordered specific performance on the cross-claim ordering the corporation to convey the property to directors Dorothy Housely and Bonnie Brinton and awarded attorney's fees of \$7,500.00. (R. 294-297).

ARGUMENT

POINT I

THE EARNEST MONEY AGREEMENT OF JANUARY 13, 1973 WAS NEVER SIGNED OR ACCEPTED BY A PROPERLY CONSTITUTED QUORUM OF HEATH DEVELOPMENT COMPANY AND THE CONTRACT CREATED IS VOIDABLE.

The Articles of Incorporation of Heath Development Company provide that "three members of the Board of Directors shall constitute a quorum and shall be authorized to transact business and exercise the corporate powers of the corporation". Article X, Articles of Incorporation. Section 16-10-34, Utah Code Annotated 1953 provides that, "The act of a majority of the directors present at a meeting at which a quorum is present shall be the act of the Board of Directors". Applying this

statute in the Heath Development Company situation would mean that if there is a quorum of three directors present, that the vote of two of the directors could bind the corporation.

Of the five directors in Heath Development Company, four attended the meeting at which the Earnest Money Agreement was presented. Two of the directors were purchasers on the Earnest Money Agreement and thus were personally interested in having the corporation agree to the offer or purchase, leaving only two disinterested directors. The question of considering interested directors for purposes of quorum requirements is discussed in 2 Fletcher Cyclopedia Corporation, Sec. 426 at P. 280 as follows:

"Although, there is at least some authority which recognizes an interested director's eligibility for quorum purposes, the majority and better view is that a director who is disqualified by reason of personal interest in the matter before a directors' meeting loses, pro hac vice, his character as a director, and he cannot be counted for the purpose of making out a quorum."

The Utah Supreme Court adopted the majority view that interested directors cannot be counted for quorum purposes in the case of Rocket Mining Corporation vs. Rulan J. Gill, 25 Utah 2d 434, 483 P. 2d 897 (1971). In this case the court determined that there was a "properly constituted board of four directors" and that only one of the directors had a

personal interest in the matter before the board. The court held that:

"In reference to the question as to whether there was a proper quorum to transact business, Sec. 16-10-38, UCA 1953 provides that such a quorum shall consist of a majority of the number of directors fixed by the Bylaws or . . . stated in the Articles of Incorporation . . . we accept the proposition advocated by the plaintiffs that in matters where a director has an interest adverse to the corporation he cannot participate to bind the corporation."

The court concluded that because one of the directors received a direct benefit he was disqualified from participating in the action of the board and could not be counted for quorum purposes.

This rule was followed again by the Utah Supreme Court as expressed in the dicta of Branch vs. Western Factors Inc., 28 Utah 2d 361, 502 P. 2d 570. In Branch, the court referred to an 1898 Utah case, Singer vs. Salt Lake Copper Manufacturing Company, 17 Utah 143, 53 P. 1024, in which a director voted in favor of a transaction between himself and the corporation. The court stated that "there were present at the meeting four of the five directors so there was a quorum excluding the interested director".

An example of application of the majority rule is the Colorado case of Colorado Management Corporation vs. American Founders Life Insurance Company, 359 P. 2d 665 (Colo. 1961). In the Colorado case only six of eight board members of plaintiff

were in attendance. Of the six present, three were directors of another corporation and considered to be interested in the matter before the board. The bylaws of the plaintiff corporation provided that five directors would constitute a quorum. In determining that the three disinterested directors did not constitute a quorum, the court held at page 667 as follows:

"A director cannot with propriety vote in the board of directors upon a matter affecting his own private interest anymore than a judge can sit in his own case; and any resolution passed at a meeting of the directors which a director having a personal interest in the matter voted would be voidable at the instance of the corporation, without regard to its fairness, provided the vote of such director was necessary to the result. It follows that a director of a corporation cannot be counted in determining the existence of a quorum when the transaction under consideration is one in which the director has a personal interest adverse to that of the corporation." Citations omitted.

It would follow that in the case before the court that a proper disinterested quorum of directors never considered the Earnest Money Agreement and the action taken was not binding on the corporation. Of the four directors present at the meeting where the offer was considered, two directors wanted to purchase the sole asset of the corporation. Their offer of purchase was \$150,000.00 below what these same two directors agreed to list the property for, three months earlier. The conflict created by their personal interest is obvious.

The following cases are representative of the majority rule that interested directors are not to be considered for quorum purposes: Goldie vs. Cox, 130 F. 2d 695; Kerbs vs. California Eastern Airways, Inc. (Del), 90 A. 2d 652; Whicher vs. Delaware Mines Corp., 52 Idaho 304, 15 P. 2d 610, 616; Alward vs. Broadway Gold Mining Company, 94 Mont. 45, 20 P. 2d 647; Adams vs. Mid-West Chevrolet Corp., 198 Okla. 461, 179 P. 2d 147; Oregon, Rugger vs. Mt. Hood Elec. Co., 143 Ore. 193, 20 P. 2d 412; Duncan vs. Ponton (Tex. City App.), 102 S.W. 2d 517; Hein vs. Gravelle Farmers' Elevator Co., 164 Wash. 309, 2 P. 2d 741.

POINT II

THE TRANSACTIONS OF INTERESTED DIRECTORS ARE VOIDABLE AT THE OPTION OF THE CORPORATION AND MAY BE SET ASIDE WITHOUT SHOWING ACTUAL INJURY.

There is no question that all of the parties involved knew that they were dealing with a corporation and with corporate property. (T. 348-349). The majority rule, followed by Utah as expressed in Branch vs. Western Factors, Inc., 28 Utah 2d 361, 502 P. 2d 570 (1972) is that a contract "made by the corporation with its officers are not void per se, but at most voidable merely at the election of the corporation or its representatives within a reasonable time." It is also stated in the Branch case that "a director occupies a fiduciary relationship to his corporation and his personal dealings with the corporation may be avoided unless good faith and fairness

are shown".

This implies that the burden of showing good faith is on the interested director. Without the showing of good faith the contract will be set aside. In the case of Sweeney vs. Happy Valley, Inc., 18 Utah 2d 113, 417 P. 2d 126, a transaction of a corporation with some of its directors was examined. The court agreed with the proposition that "when a fiduciary deals for his own interest with the beneficiary, in case any question arises such dealings should be scrutinized with great care, and the burden is upon him to show good faith in the transaction". The cross-claimants failed to introduce any tangible evidence concerning the true value of the property involved or to try and establish the fairness of the transaction. On cross examination concerning how the purchase price of \$250,000.00 was arrived at, Mrs. Housely stated that "it was what we thought we had the possibility of getting a loan on and it was worth offering to see if they would accept" (T. 403-404). Thus the primary concern of the interested directors was on how much money they could borrow as individuals and not necessarily what the true value of the trailer park was.

The case of Runswick vs. Floor, 116 Utah 91, 208 P. 2d 948 (1949) follows the majority position that "so long as corporate officers act fairly and in good faith, they are not precluded from dealing or contracting with the corporation

merely because they are its officers". However, when this situation exists the contract will be valid:

"Provided they act in good faith and provided there is a quorum of directors on the other side of the contract, so that the vote of the interested director is not necessary to the adoption of the measure; and even in the latter case the contract is good in law."

In the situation before the court there was not a disinterested quorum on the other side of the contract and thus there was no contract. Even if there had been a disinterested quorum on the other side, the contract is voidable on a showing of lack of fairness to the corporation.

As mentioned previously, since 1898 it has been the law in Utah that if a director deals with his corporation in entire good faith, fairness and honesty and the corporation is represented by other disinterested directors, then the transaction is valid. However, "where the corporation is represented in the transaction by interested directors or officers who deal with themselves the contract is voidable at the option of the corporation merely because of the relationship without proof of actual fraud or of actual injury to the corporation". 19 Am. Jur. 2d Corporations Sec. 1291. The law on this subject is stated further in Section 1291 of Am. Jur. as follows:

"Similarly, it is said that if a director places himself in a position in which he may be tempted by his own private interests to disregard those of the corporation, his transactions are voidable

at the option of the corporation and may be set aside without showing actual injury. It is clear that contracts between a corporation and its officers and directors are voidable for unfairness and fraud. In any event, the burden of proving the fairness of transactions between a corporation and its directors or officers is upon the directors and officers seeking to uphold its validity, and if they fail to do so, either the transaction may be set aside, or the corporation may affirm the transaction and hold the director or officer liable for profits received by him or for losses sustained by the corporation."

POINT III

THE DISTRICT COURT ERRED IN NOT ADMITTING EXHIBITS D 9 AND D 10.

Before the cross-claimants could prevail on their claim for specific performance the court was under an obligation to examine closely the fairness of the transactions. Defendants offered Exhibits D 9 and D 10 to show the lack of fairness in the transaction and the fair market value of the property involved as determined in an arms-length transaction.

Exhibit D 9 which was not admitted by the trial court is an Earnest Money Agreement dated and signed March 15, 1974 by and between the two interested directors as sellers and Hugh Wayman, an outsider, as purchaser. The total purchase price of \$400,000.00 or \$150,000.00 more than what the interested directors offered to purchase the same property for two months earlier. Max Engman, the banker, testified that the

purchasers on the January 13, 1974 Earnest Money Agreement did not qualify for financing. It was only after Hugh Wayman came into the picture that financing was obtainable. (T. 382-383). The interested directors testified that even though they were directors of the corporation, they did not intend at this time to inform anyone else in the corporation of the resale at \$150,000.00 profit and in fact, no one else was informed.

On April 9, 1974 the president of the corporation informed the plaintiff realtor that the corporation would not consummate the Earnest Money Agreement of January 13, 1974. Plaintiff's response was to submit another Earnest Money Agreement dated April 11, 1974 from Hugh Wayman as purchaser directly to the corporation for purchase of the same property for \$400,000.00. This document, Exhibit D 10, also not admitted by the trial court, was offered to establish the fair market value of the property involved as determined in an arms-length transaction. In Sweeney vs. Happy Valley, Inc., cited previously, the question of determining the fair market value of land was involved. The court held as follows:

"The rulings of the trial court reflect the correct view that in order for evidence concerning sales of other property to be admissible as bearing on the market value of the property in question, the test of comparability of the sales must be met: That the type of land, its location, its

uses, actual and potential, and the time and circumstances of the sale are sufficiently similar, that the price paid for the other property can fairly and reasonably be regarded as having probative value as to the worth of the property in question."

The documents offered and not accepted by the trial court meet the criteria of the Sweeney case. An examination of these two documents show the unfairness of the offer of January 13, 1974. There is no explanation for the increase in offering price by \$150,000.00 except that the higher offers are arms-length transactions not controlled by interested directors. Both subsequent offers should have been examined by the court in determining whether or not the interested directors contract was fair to the corporation.

POINT IV

THE PROVISIONS OF §16-10-74, U.C.A., (1953) WERE NOT COMPLIED WITH AND THE SALE OF THE CORPORATE ASSETS SHOULD BE SET ASIDE.

Section 16-10-74, Utah Code Annotated sets forth the procedure to be followed when a corporation sells all of its assets other than in the regular course of business. The first step is for the board of directors to "adopt a resolution recommending such sale". This recommendation of sale is then submitted "to a vote at a meeting of shareholders, which may be either an annual or a special meeting". The central feature of this statute is the right given to every shareholder to vote on

whether or not he wants to sell the corporate assets.

The Utah Supreme Court has considered the application of this statute in two prior cases. Neither case deals with the fact situation now before the court. The first case was Grover vs. Garn, 23 Utah 2d 441, 464 P. 2d 598 (1970). This was an action by a corporation to rescind a contract for the sale of land nearly a year after the deed had been delivered. Among other statements the Supreme Court stated that it was a "sham corporation" in which virtually all of the stock was owned by a husband and wife. It was also pointed out that the "sham corporation" had the assistance of counsel throughout the entire negotiation and sales process. A year after the deed had been delivered and a substantial payment received, a son who owned one share out of 100 shares issued, filed the action on behalf of the corporation for rescission under the technicalities of §16-10-74. The Supreme Court correctly ruled that the corporation could not now hide behind the formality of not having the sale approved by the stockholders.

The second case is similar to the first one. In U-Beva Mines vs. Toledo Mining Company, 24 Utah 2d 351, 471 P. 2d 867 (1970) U-Beva Mines attempted to void a lease with an option to purchase when the defendant was late with an \$87.00 tax payment. U-Beva set up the claim that its stockholders had not approved the lease and option and on that basis it should

be cancelled. It was pointed out that the lease had been in effect for some four years with substantial investment having been made by the lessee. The court stated "it would hardly seem to lie in the corporations mouth to assert invalidity of the lease under the statute after having received and kept monthly rentals for about four years".

Neither of these cases fit the fact situation now before the court. The only money which has changed hands is a \$500.00 earnest money deposit which was refunded. No final documents have been signed and no deeds delivered. The purchasers did not go into possession nor make improvements on the property. The corporation is not a sham corporation. The time period involved is a few months, not years as in the two cases mentioned. Indeed, it would seem that this is the very situation that §16-10-74 Utah Code Annotated was designed for. To hold otherwise would deny protection of the law to the minority stockholders who were not directors and present when the offer of January 13, 1974 was considered.

It is the general rule that this statute inures to the benefit of the shareholder and is not assertable by the corporation. When the corporation is taking a course of action consistent with what the minority shareholder would take, it would be an unnecessary act for a shareholder to assert this statute himself, 58 ALR 2d 784 (1958). On the basis of

§16-10-74 Utah Code Annotated, the decision of the District Court should be reversed and dismissed.

POINT V

THE DISTRICT COURT ERRED IN AWARDING INTEREST OF 6% PER ANNUM ON PLAINTIFF'S ATTORNEYS FEES FROM APRIL 10, 1974 UNTIL ENTRY OF JUDGMENT.

It is undisputed that plaintiff's agent contacted the president of defendant corporation on April 9, 1974 to inform her of the closing set for the next day. It was on this occasion that defendant's president informed plaintiff that the corporation would not consummate the transaction. Plaintiff was awarded attorney's fees of \$5,000.00 based on the listing contract of November 13, 1973.

Defendants maintain that it was error to award any attorney's fees in that there was no sale. Defendants claim that the error is compounded by awarding interest on the attorney's fee from the date of the alleged breach of contract. Plaintiff's counsel testified as to the amount of time involved but nothing was submitted as to when their services commenced or why interest on the full amount of the attorney's fees had been earned on the day of the alleged breach of contract. The award of attorney's fees to plaintiff's counsel should be disallowed and particularly the award of interest on the attorney's fees should be disallowed.

CONCLUSION

Based upon all of the arguments and authorities as cited herein, appellants respectfully request the court to reverse the judgment of the trial court.

Respectfully submitted,

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