

1992

# H and B Carriers and Capital General Corporation v. Utah Securities Division and the Department of Business Regulation : Brief in Opposition to Certiorari

Utah Supreme Court

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920180

IN THE UTAH SUPREME COURT

In the Matter of the Following  
Issuers, their Securities,  
Affiliates or Successors,  
and/or Entities subsequently  
organized by them, including  
H & B Carriers, Inc., et al.,  
Capital General Corporation,  
Petitioners and Appellants

**vs.**

Utah Securities Division, and  
the Department of Business  
Regulation,  
Respondents and Appellees.

**BRIEF IN OPPOSITION TO PETITION  
FOR WRIT OF CERTIORARI**

CASE # 920180-SC

CASE # 910196-CA

RULE 29 PRIORITY # 13

Brief in Opposition to Petition for Certiorari Review  
of a Decision of the Utah Court of Appeals  
Dated February 10, 1992

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**FILED**

MAY 8 1992

CLERK SUPREME COURT  
UTAH

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## STATEMENT OF THE CASE

### NATURE OF THE CASE, COURSE OF PROCEEDINGS, AND DISPOSITION IN LOWER COURT:

This case involves an order by the Securities Advisory Board of the Utah Division of Securities (the "Division") that affects trading in the stock of approximately forty-seven (47) corporations formed by the Petitioner, Capital General Corporation ("CGC"). That Order was challenged by CGC in a District Court proceeding. Judge Russon dismissed the District Court case and awarded Rule 11 sanctions (in the amount of \$1395) against CGC on the grounds that CGC's claims were barred by the doctrine of collateral estoppel. The District Court found that the parties and the issues were identical in this case and in the case of Capital General Corporation v. Utah Department of Business Regulations, Securities Division, 777 P.2d 494 (Utah App. 1989) (hereinafter referred to as the "Amenity" case because of the name of the corporation whose stock was at issue in that case), which was fully and finally litigated. The case was then appealed to the Utah Court of Appeals, which upheld both the Division's actions and the District Court's dismissal and sanctions award. See, In re H & B Carriers, et al., Capital General Corporation v. Department of Business Regulations, Utah Securities Division, 180 Utah Adv. Rep. 23 (Utah App. Feb. 10, 1992). A Petition for Rehearing was Filed by CGC on February 24, 1992, and was denied on March 9, 1992. CGC then filed its Petition for Writ of Certiorari on April 8, 1992.

### Statement of the Facts:

During 1986, Capital General Corporation created at least forty-seven (47) "shell" corporations<sup>1</sup>, including Amenity, Inc. (which is the subject of the Amenity case), H & B Carriers, Inc. (originally known as "Y Travel," which is the lead corporation on the full caption of the present case), and some forty-five (45) others (which are all named in, and affected by, the present case). None of the forty-seven corporations registered their stock with the Division. CGC then gave small portions of the stock in each corporation to a large number of recipients, with CGC retaining the overwhelming majority of the stock in each shell corporation. The effect of these gifts was to make each shell corporation into a *de facto* publicly held corporation, bypassing various state and federal securities laws pertaining to registration of initial public offerings, and making the shell corporations much more valuable.<sup>2</sup>

The Division found that CGC's gifts were not "good faith gifts" within the meaning of the Utah Securities Act, which excludes good faith gifts from the definition of offers and sales of securities, because the intent in making the gifts was to

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<sup>1</sup>A "shell" corporation is one that has substantially no assets and conducts substantially no business.

<sup>2</sup>Publicly held shell corporations can be sold for significant amounts of money because they can be merged with operating businesses that are not publicly held corporations in such a way that the resulting entity is a publicly held corporation that bears the name of the operating business. This technique, known as a reverse merger, allows an operating business to become a public corporation without going through the federal and state registration requirements for an initial public stock offering. For example, Amenity, Inc., which was originally capitalized by CGC for \$2,000, was sold in a reverse merger for \$25,000.

circumvent the disclosure requirements of the Utah Securities Act.<sup>3</sup> The Division also found that CGC's gifts were "for value" because the value of shell corporation stock held by CGC greatly increased as a result of giving away a small portion of the stock in each corporation. Based upon those findings, and pursuant to Utah Code Annotated section 61-1-14(3), the Division ordered that none of the corporations could claim any transactional exemptions from the Utah Securities Act's registration requirements.<sup>4</sup> In other words, before anybody could trade any stock belonging to any one of the forty-seven corporations, that corporation would have to register its stock with the Division.<sup>5</sup>

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<sup>3</sup>CGC argues that there is evidence of subjective good faith because CGC's president testified at the administrative hearing that, on an unknown date, he talked to an unknown person at the Utah Division of Securities and made a general inquiry as to whether people who give gifts of stock need to register the gifts. He did not disclose any details about CGC's plan, its scope or nature, or the fact that the goal of the gifts was to create *de facto* public corporation. The Utah Court of Appeals found that "[b]ecause this evidence is so general, vague and uncorroborated, it has little weight or relevance." 180 Ut. Adv. Rep. at 24.

<sup>4</sup>Action was first brought with respect to Amenity, Inc., and then thereafter with respect to the remaining shell corporations in a separate case. The Amenity case remained at least one stage ahead of the other case (which is the case currently before the court).

<sup>5</sup>Contrary to CGC's assertion in its Petition, the Division's actions do not permanently prevent any stock from becoming fully alienable. All that is necessary is for the corporation in question to register its stock with the Division. Since CGC controls the overwhelming majority of the stock in the corporations at issue, it could easily elect boards of directors who would register each corporation. Naturally, the Division may condition registration on adequate disclosure and compliance with Utah blind pool laws, and may deny registration on the basis of fraud, etc. To date, however, none of the forty-seven corporations has attempted to register, although a successful registration would allow shareholders to sell their stock.

## ARGUMENT

The Utah Supreme Court has already denied a nearly identical petition for writ of certiorari, with respect to points I and II (of the current petition), in the Amenity case:

The Utah Court of Appeals handed down the Amenity decision on July 3, 1989. On August 1, 1989, CGC filed a petition for writ of certiorari. Certiorari was denied on September 12, 1989.<sup>6</sup> The petition raised the following point:

Point One: A Writ of Certiorari should be granted because the Court of Appeals decided a question of law in conflict with a prior decision of this court and construed the plain words of the controlling statute contrary to their usual and customary meaning.

This point is essentially identical to the first two points raised in the current petition:

Point I: A Writ of Certiorari should be granted because the Court of Appeals has ignored the clear meaning of a statute and thus sanctioned an invalid use of a statute.

Point II: A Writ of Certiorari should be granted to determine whether the decision of the Court of Appeals is in conflict with a prior decision of this Court, namely Andrews v. Chase, 89 Utah 51, 49 P.2d 938 (1935).

It would be anomalous if the Supreme Court were to grant certiorari in this case, after denying a certiorari petition from the same party, alleging the same errors and based upon the same facts. That is particularly true give the nature of the current Court of Appeals decision, which can be fairly summarized as follows: "This case is factually indistinguishable from Amenity,

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<sup>6</sup>The Supreme Court case number for the Amenity case is 890339-SC.

and therefore is bound by the Amenity decision as a matter of precedent." What CGC is challenging in its current petition is not really the current Court of Appeals decision (except in so far as it asserts that the present case is identical to Amenity), but rather the earlier Amenity decision.<sup>7</sup>

The doctrine of collateral estoppel, also known as issue preclusion, bars Capital General Corporation from relitigating the same issues that were decided against it in the Amenity case:

The Honorable Leonard H. Russon dismissed this case at the district court level because the doctrine of collateral estoppel bars Capital General Corporation from relitigating the issues decided against it in the Amenity case. The Court of Appeals chose not to directly address the issue in its opinion,<sup>8</sup> but this Court would have to address it if certiorari is granted.

Collateral estoppel, also known as issue preclusion, exists when there was a prior action where: (1) the issues are identical; (2) the judgment is final; (3) the issues were fully and competently litigated; and (4) the party precluded from

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<sup>7</sup>Indeed, the question of whether the Utah Supreme Court case of Andrews v. Chase, 89 Utah 51, 49 P.2d 938 (1935) applies was only analyzed in the Amenity decision. See, 777 P.2d at 497, n.3. The current Court of Appeals decision makes no reference at all to the Andrews case.

<sup>8</sup>The Court of Appeals assumed, *arguendo*, that collateral estoppel did not exist for purposes of analysis, probably because that court found it easier to base its decision on the grounds that Amenity is binding precedent. See, 180 Utah Adv. Rep. at 24. The issue remains, however, as a valid alternative theory on which to uphold the results reached by the Court of Appeals. Indeed, the Court of Appeals must have presumed the existence of collateral estoppel, because it upheld the District Court's award of Rule 11 sanctions, which was based upon collateral estoppel.

relitigating the issues was a party to the prior action. Madsen v. Borthick, 769 P.2d 245, 250 (Utah 1988); Trimble Real Estate v. Monte Vista Ranch, 758 P.2d 451, 454 (Utah App. 1988).

There is no doubt as to requirements (2), (3) and (4). Amenity was fully, competently, and finally litigated, and Capital General Corporation, the sole appellant in this case, was the sole appellant in Amenity.<sup>9</sup> The only question is whether the issues in this case are the same as those in Amenity.

The Court of Appeals determined in Amenity that Capital General Corporation's scheme of "giving away" stock in order to create publicly held companies constitutes a sale of a security, 777 P.2d at 496-97; that Capital General Corporation failed to meet its burden of showing that its transfers were "good faith gifts," 777 P.2d at 498; that the Securities Advisory Board has statutory authority to deny or suspend secondary trading in the unregistered stock held by Capital General Corporation, 777 P.2d at 498-99; and that the case of Andrews v. Chase is not applicable. Those are the same substantive and legal issues raised in this case.

Capital General Corporation has admitted that "the Amenity facts and the facts of the present case are identical in all respects, the basic difference being that Mr. Yeaman was unavailable to testify in the Amenity matter [on the issue of good

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<sup>9</sup>Much of CGC's petition is filled with expressions of concern for "innocent" shareholders, such as those who received "gifts" of stock in the various corporations. Interestingly, none of those shareholders, and none of the corporations that are directly affected by the Division's order, have ever chosen to get involved in this litigation. The only party on the petitioner's side is the petitioner itself.

faith] . . . ." See, Capital General Corporation's Memorandum in Support of Petition for Review, at 4.

Mr. Yeaman's testimony is irrelevant because it goes to the issue of good faith, an issue that was fully and finally litigated in Amenity.<sup>10</sup> The doctrine of collateral estoppel does not allow an issue to be relitigated simply because counsel wish to present different testimony in the second trial. The testimony presented by Mr. Yeaman is as relevant to the good faith issue in Amenity as it is to this case, and it was Capital General Corporation's burden to put that evidence on in the first case.<sup>11</sup> Capital General Corporation must raise new issues, not merely the specter of new testimony concerning already decided issues, in order to avoid collateral estoppel; with the exception of Point III, relating to the District Court's imposition of Rule 11 sanctions, Capital General Corporation has failed to raise a single issue that was not raised and resolved in the Amenity proceeding. Should certiorari

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<sup>10</sup>This case is so closely tied factually to the Amenity case that Amenity, Inc. is discussed at length in the Securities Advisory Board's Findings of Fact, Conclusions of Law and Recommended Order. Likewise, the Court of Appeals actually referred, in the Amenity decision, to the corporations whose stock is at issue in this case: "Additional evidence of CGC's economic self-interest and its lack of gratuitous intentions is shown by the fact that CGC *similarly converted at least thirty other private companies using the same method employed here.*" 777 P.2d at 498 (emphasis added).

<sup>11</sup>The fact that Mr. Yeaman was "unavailable" to testify in the Amenity case is irrelevant. Mr. Yeaman is the President of Capital General Corporation, and it was Capital General Corporation's responsibility to either ensure his availability, obtain a continuance, or introduce similar evidence from other witnesses. A failure to present all of your evidence in the first proceeding is no defense to a claim of collateral estoppel in a subsequent proceeding.

be granted, all aspects of this case, except for the Rule 11 sanctions issue, will have to be decided against Capital General Corporation on the basis of collateral estoppel. Since collateral estoppel would prevent the Court from reaching the merits of the Amenity decision, there is no benefit to granting a writ of certiorari.

Points I and II of the current petition do not raise the sort of "special and important reasons" required for a grant of certiorari under Utah Rule of Appellate Procedure 46:

Setting aside the problem of reaching the merits of CGC's arguments due to the collateral estoppel issue, CGC has failed to raise concerns sufficient to warrant a writ of certiorari. Rule 46 of the Utah Rules of Appellate Procedure state that a writ of certiorari "will be granted only for special and important reasons." The rule then goes on to give examples of such reasons.

Point I of CGC's petition asserts that the Court of Appeals' reading of the Utah Securities Act is flawed in several respects, but it fails to assert that "the Court of Appeals has rendered a decision that has so far departed from the accepted and usual course of judicial *proceedings* . . . as to call for an exercise of the Supreme Court's power of supervision." Rule 46 (emphasis added). In essence, Point I is simply a dispute over the meaning of statutory provisions, which it says "clearly" mean one thing, but which the Court of Appeals (and the Division) say clearly mean something else. Actually, the Court of Appeals' decision in Amenity is decidedly pedestrian. All that it says is that sometimes transactions that appear to be gifts of securities really

should be deemed to be sales when the giver receives something of value as a result of giving the gift, and that the Division may deny a corporation access to any exemptions from stock registration requirements when it used such non-gifts as a means to evade the registration requirements of Utah law. Unless the Utah Supreme Court is intent on micro-managing the decisions of the Court of Appeals, it should leave such an unremarkable decision undisturbed.

Point II of the petition admittedly involves an allegation that the Court of Appeals decided Amenity in a way that is in conflict with a Utah Supreme Court opinion, namely Andrews. Even a cursory look at the Andrews case and subsequent legislation shows that Andrews both lacks precedential value and is factually distinguishable.

Andrews is a 1935 case that involved gifts of assessable stock, which the Utah Supreme Court held were gifts, and not sales. Since 1935 the legislature has enacted two relevant changes to the securities laws. One change was to explicitly call a purported gift of assessable stock an "offer or sale." See, Utah Code Ann. § 61-1-13(15)(c)(ii) (1989). The other change was to state that a "good faith gift" does not constitute an offer or sale. See, Utah Code Ann. § 61-1-13(15)(d)(i) (1989). Both changes occur in a portion of the Utah Securities Act that attempts to give examples of what is an offer or sale, and what is not. In essence, the legislature has said that some gifts are made in good faith, without reciprocal value to the giver, while other "gifts" are not made in good faith and are sales, a category that explicitly

includes gifts of assessable stock.

Even if Andrews retained any precedential value, the case is factually distinguishable. As the Court of Appeals noted in Amenity:

In Andrews, the gift of stock was made with the mere expectation of future, speculative benefits in the form of assessments the donees would voluntarily choose to pay. See Andrews, 49 P.2d at 942. Here, the disposition of the Amenity, Inc. shares created an immediate, actual benefit to CGC in that it now owned substantial shares in a public company which, but for the disposition, would be a private company.

Amenity, 777 P.2d at 497-498 n.3. In its petition, CGC argues that this is a specious distinction because creating a public company only creates a potential for benefit that depends "upon the further efforts of the givers (infusion of assets, work to make the company viable, etc.)." Petition, at 17. The facts of Amenity show that CGC's assertions are simply wrong. Amenity, Inc. was worth \$2,000 when it was first incorporated as a privately held shell corporation by the name of "Y Travel, Inc." Once Y Travel, Inc. became a *de facto* publicly held shell corporation it became a viable merger partner for a privately held business, without the infusion of any additional assets or work. In fact, such a merger took place to form Amenity, Inc., and CGC received \$25,000 for its stock in Y Travel, Inc.

Point III of the current petition, pertaining to the award of Rule 11 sanctions by the District Court, is based upon alleged error by the trial court, and not by the Court of Appeals, and is therefore not a valid independent basis for a certiorari petition:

The Court recently made the following remark in a footnote:

We take this opportunity to remind the bar that when exercising our certiorari jurisdiction granted by section 78-2-2(3)(a), we review a decision of the court of appeals, not of the trial court. . . . To restate the matter: We do not grant certiorari to review *de novo* the trial court's decision.

Butterfield v. Okubo, 184 Utah Adv. Rep. 27, 33 n.2 (Utah April 7, 1992) (citations omitted).

In the present case, the Court of Appeals applied an "abuse of discretion" standard, and found that the District Court did not abuse its discretion in awarding Rule 11 sanctions against CGC. In its petition, CGC has not argued that the Court of Appeals applied the wrong standard; rather, CGC has only argued that the District Court abused its discretion. This is nothing but an attempt to have this Court review the District Court's decision *de novo*, contrary to the language in Butterfield.

## CONCLUSION

The Utah Supreme Court should deny the writ of certiorari sought by Capital General Corporation.

RESPECTFULLY SUBMITTED this 8th day of May, 1992.

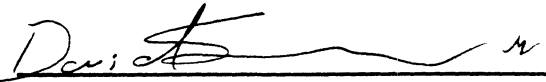
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## CERTIFICATE OF SERVICE

I hereby certify that on this 8th day of May, 1992, I caused to be mailed, postage prepaid, four true and correct copies of the foregoing Brief in Opposition to Petition for Writ of Certiorari to

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