1972

J. B. Walker And Mary Goff Walker v. Rocky Mountain Recreation Corporation, A Utah Corporation (Formerly Old Mill, A Utah Corporation) And J. Douglas Bowers : Appellant's Brief

IN THE SUPREME COURT OF THE STATE OF UTAH

J. B. WALKER and MARY GOFF WALKER,

Plaintiffs-Respondents,

vs.

ROCKY MOUNTAIN RECREATION CORPORATION, a Utah Corporation (Formerly Old Mill, a Utah Corporation) and J. DOUGLAS BOWERS,

Defendants-Appellants.

Appeal from District Court
Honorable James E.
Appellants

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Defendants-Appellants.

Case No. 12,864

APPELLANT'S BRIEF

STATEMENT OF THE KIND OF CASE

Suit by promoters and former officers against corporation for balance claimed to be due for cancellation of lease between promoters and corporation. Current officers defend on basis of self-dealing, breach of fiduciary duty, unconscionability, failure to obtain stockholder ratification, and illegal sale of corporate office.

DISPOSITION IN LOWER COURT

District Court granted summary judgment in favor of promotors and former officers and against the corporation for $14,800.00 due plus a penalty of $10,200.00 (81% penalty).

RELIEF SOUGHT ON APPEAL

Defendant Rocky Mountain Recreation Corporation seeks an order vacating the summary judgment and remanding the case for trial on the merits after reasonable time for discovery.

STATEMENT OF FACTS

Walkers who were the owners of the "Old Mill" propery (R. 52, 67) Bowers, who was in the securities business (R. 69) Gilbert, a contractor (R. 69) and Wray, an accountant (R. 69) promoted and organized Old Mill Corporation and sold a public offering of its stock (R. 64-71). Prior to organizing the corporation Mrs. Walker leased the "Old Mill" property to Bowers (R. 54-63), and shortly after forming the corporation assigned that lease to the corporation (R. 27). All four of the promoters were officers and directors of the corporation (R. 69) until June 23, 1971, when Walker allegedly ceased to be a director (R. 37, 52).

Under the terms of the 5 year lease Old Mill Corporation was obligated to pay $67,080 plus a percentage of gross sales to Walker and was obligated to expend $50,000.00 on capital improvements to the leased property, for a minimum total rental of $117,080.00 (R. 52-63). The "Old Mill" property was unusable because of lack of sewer, water, etc. & needed repairs and was never used by the corporation except to list it asn a asset in the as-by the corporaton except to list it as an asset in the offering circular (R. 46, par. 4). Old Mill Corporation was unable to pay the lease agreement obligations and was in default from the inception of the lease. (R. 53)

Only $1,000.00 cash was invested by the promoters (R. 70), and stock of $10,000.00 was issued to Bowers in exchange for assignment of some earnest money receipts and of $20,000.00 was issued to Walker in exchange for assignment to the corporation of the said lease agreement with Walker, and $9,000.00 of stock as issued to Gilbert in exchange for contractors services of an indefinite nature to be performed by him in the future. (R. 65-70). The record does not disclose what happened to the funds received from selling stock to the public. Approximately 250 persons are stockholders of said corporation. (R. 46, Par. 3)

Shortly after Walker ceased to be a director (R. 37, 42), the Bowers entered into a contract on behalf of Old Mill (R. 82-83) wherein Old Mill agreed to pay $16,800.00 to Walker in exchange for cancellation of Walkers original lease with Bowers, which had been assigned to Old Mill Corporation, and 8 days later the Board of Directors of Old Mill Corporation, consisting of Bowers, Wray and Gilbert (R. 37, 52), ratified the said agreement (R. 74). Two days later the Board of Directors, still consisting of Bowers, Wray and Gilbert, allegedly adopted a resolution for Old Mill Corporation to indemnify Bowers against liability on the Walker transactions and for Old Mill Corporation to defend and to finance the defense of all such litigation. (R. 40-44). Almost immediately thereafter the entire Board of Directors resigned (R. 37, 42) in favor of a new group who purchased their offices in the corporation and took over corporate management.

Two Thousand Dollars was paid on the $16,800.00, however after new management learned of the circum-

stances surrounding the execution of the Walker agreement they refused to pay the remaining $14,800.00 (R. 45-47), and this lawsuit was commenced.

The Corporate Defendant obtained a copy of the complaint from Bowers who had been served (R.79) and answered on Jan. 25, 1972. Thirteen days later (Feb. 7, 1972) Walkers moved for summary judgment (R. 51-75) which was scheduled for hearing nine (9) days later on Feb. 16, 1972, (R. 49). Defendant filed a timely affidavit in opposition to summary judgment (R. 45-47), however summary judgment was granted (R. 22-23, 48). Defendant's motion for a new trial or to correct findings, conclusions and judgment (R. 20-21) was denied (R. 8), and this appeal was taken.

ARGUMENT

POINT I

THE COURT LACKED JURISDICTION TO GRANT SUMMARY JUDGMENT BECAUSE OF INSUFFICIENT NOTICE

Rule 56(c), RCP, pertaining to a motion for summary judgment, provides in part as follows:

> "The motion shall be served at least 10 days before the time fixed for hearing. . . ."

Rule 6(e), URCP, provides as follows:

> "Whenever a party has the right or is required to do some act or take some proceedings within a prescribed period after the service of a notice or other paper upon him and the notice or paper is served upon him by mail, 3 days shall be added to the prescribed period."

The motion for summary judgment (R. 51-75) was mailed by counsel for Plaintiffs on February 7, 1972, (R. 49-50), which is only 9 days before the hearing of that motion on February 16, 1972, (R. 22-23, 48). The time required for notice of a motion for summary judgment is 10 days (Rule 56(c), URCP, supra) plus an additional 3 days because that notice was mailed (Rule 6(e), URCP, supra), for a total of 13 days. Acordingly the notice of hearing fixed the date of the hearing 4 days short of the required time and precluded the Court for hearing the matter and from awarding summary judgment at that hearing. Defendant might not object so much to the shortness of the notice of hearing of that motion, however when viewed in light of the shortness of time since the filing of the complaint (Jan. 12, 1972) (R. 80), since the filing of Defendant's answer (Jan. 25, 1972), (R. 76-77), it is obvious that Defendant was not given a reasonable opportunity to interview witnesses, obtain affidavits, submit interrogatories, take depositions, and to otherwise prepare to defend this lawsuit. The above quoted rules were adopted to protect against such summary disposition of litigation and should be strictly enforced.

POINT II

DEFENDANT WAS DENIED PROCEDURAL DUE PROCESS BY BEING DENIED A REASONABLE OPPORTUNITY TO PREPARE FOR TRIAL AND TO ENGAGE IN DISCOVERY PROCEDURE.

Only 13 days elapsed between the mailing by Defendant of its answer to Plaintiff and the filing of Plaintiff's

motion for summary judgment (R. 75-77). Rule 1, URCP, provides in part as follows:

> ". . . . They shall be liberally construed to secure the just, speedy, and inexpensive determination of every action."

Rules 26-37, URCP, provide for discovery through interrogatories, requests for admissions, depositions, production of documents, etc., which obviously contemplates that a reasonable time will be allowed for such procedures. Even if interrogatories had been submitted with the answer the Plaintiffs would not have been required to answer those interrogatories until 5 days after hearing of the motion for summary judgment. The management of the Defendant corporation was only in office for a short time before commencement of this lawsuit and accordingly was quite unfamiliar with the transactions out of which the claim of Plaintiff's arose and was at a disadvanatage in not having readily available facts with which to properly defend this lawsuit. (R. 76-77; 20-21).

POINT III

THE COURT ERRED IN AWARDING JUDGMENT FOR A PENALTY OF $10,200.00 FOR NON-PAYMENT OF A $14,800.00 OBLIGATION (81%)

The Walker agreement which is the subject matter of this lawsuit provides for a $25,000.00 judgment in the event that Old Mill Corporation failed to pay $16,800.00 within the times required under the terms of this contract (R. 82-83). Two Thousand Dollars of that obligation was paid leaving an unpaid balance of $14,800.00. The Court

enforced that unconscionable penalty provision (R. 22-23, 48) notwithtanding the obvious unfairness of the agreement and the obvious self dealing by corporate officers (R. 45-47; 76-77). Defendant was entitled to a jury trial and/or to trial by a court of equity concerning the unconscionable and/or inequitable nature of and enforceability of that penalty. The net effect of enforcement of the penalty was to require payment of 81% additional by reason of the delay in payment, clearly a penalty. That exclusive measure of damages for detention of money is interest. Croft v. Jensen, 86 U. 13, 40 P.2d 198 at page 202. Where, as in our case, a contract calls for payment of money, an agreement to pay a sum certain in case of default is usually construed as an agreement for a penalty, and not liquidated damages. Reed v. Armstrong, 312 P.2d 77, 6 U. (2d) 291. A provision for a penalty in the event of a breach of contract is unenforceable. Russell v. Ogden Union Railway & Depot Company, 247 P.2d 257, 122 U. 107.

An issue of fact as to whether the provision for payment of the additional $10,200.00 is a penalty or a provision for liquidated damages, which issue precludes summary judgment.

POINT IV

PLAINTIFFS' CLAIM ARISE FROM AN ILLEGAL SALE OF SUBSTANTILLY ALL OF THE ASSETS OF THE CORPORATE DEFENDANT AND IS UNENFORCEABLE

Utah Corporation law provides elaborate safeguards against sale by officers or directors of substantially all of the assets of a corporation, including the following requirements imposed by 16-10-74, UCA, 1953:

(a) A resolution of board of directors recommending the sale and directing submission thereof to a vote of the shareholders.

(b) A written notice to each shareholder of the time and place of the meeting of shareholder, stating that one of the purposes of that meeting is to consider the proposed sale of assets.

(c) Affirmative vote of a majority of all outstanding shares of stock of the corporation.

In our case the officers and directors wholly failed to comply with any of the above mentioned requirements. Bowers as president entered into a contract for disposition of substantially all of the assets of the corporate defendant Sept. 1, 1971, (R. 43-43), which agreement was ratified 8 days later (R. 74) by the board of directors (with Bowers voting although the contract relieved him of personal liability to Walkers). The Board of Directors had no power to enter into a contract to dispose of said assets, but only the power to recommend sale to the stockholders as provided by 1-10-74, UCA, 1953. No notice was ever sent to stockholders and no stockholders meeting was ever held to act upon the proposed sale of assets (R. 74)

In the event that Plaintiffs contend that the Walker contract did not result in disposition of substantially all of the assets of the Corporate Defendant within the mean-

ing of 16-10-74, UCA, 1953, then an issue of fact exists concerning that matter which requires a trial, and accordingly requires reversal of the summary judgment and remanding of the matter for trial.

POINT V

DISPUTED ISSUES OF FACT PRECLUDED GRANTING SUMMARY JUDGMENT

The corporate Defendant admits the agreement which is the subject matter of this lawsuit was executed by former officers and that if that agreement is enforceable it is indebted to Plaintiffs in some amount, however the pleadings, affidavits and other documents on file in this case contain disputed issues of fact which entitle the Corporate Defendant to a trial, including but not limited to the following:

1. Dispute as to whether the Walker agreement which is the subject matter of this lawsuit constituted a disposition of subtantially all of the assets of the corporation within the meaning of 16-10-74, (UCA, 1953, and thereby required the affirmative vote of a majority of the outstanding stock at a meeting called for that purpose. See disscussion under point IV above.

2. Dispute as to whether the 81% penalty imposed by contract upon Defendant for delay in payment constituted enforceable liquidated damage clause or prohibited penalty provision. See discussion under point III above.

3. Dispute as to whether the disclosure in the prospectus (R. 64-71) of self-dealing, unconscionable contracts between the corporation and its officers and direc-

tors, issuance of stock without reasonable consideration, etc. is sufficient to insulate those officers and directors from the usual corporate liability for such transactions, particularly where the record fails to disclose ratification or approval of those transactions by the stockholders of the corporation and repudiation by new officers after learning of self-dealing. It should also be remembered that the only purported adoption by the corporation of the Walker lease contract before the court at the time that the summary judgment was granted was the statements in the affidavit of Walker to the effect that the lease had been listed as an asset in the offering circular (R. 53). See also statement of facts on page 4 above for details concerning the unconscionable lease agreement, issuance of stock for inadequate consideration, and the agreement to pay $16,800.00 to terminate that lease agreement.

The law generally permits a corporation to adopt a promoters contract if that contract is beneficial, reasonable and made in good faith. Un. German Silver Co. v. Bronson, 102 A. 647; Fletcher, Cyc Corp., P. 808, Sec 208. An issue of fact exists as to the power of the Corporate Defendant to ratify or adopt the agreements in question in view of the questions concerning whether or not said contracts were (a) beneficial to the corporation, (b) reasonable in view of the circumstances, and (c) were made in good faith by the officers, directors and promoters.

4. Dispute as to whether the act of the corporation constituted a ratification of the Bower-Walker lease and of the later Bower-Walker agreement to which required

the corporation to pay $16,800.00 to Walker, particularly in view of the self-dealing by officers, directors and promoters, and purported ratification by board consisting only of those officers, directors and promoters.

Defendant's answer (R. 76-77) and affidavit in opposition to the motion for summary judgment (R. 45-47) created issues of fact concerning the foregoing matters and precluded awarding of summary judgment. A motion for summary judgment is, in effect, a demurrer to the contentions of the adverse party and states that, conceding the facts to be as claimed by the adversary, there is no basis for the other party to prevail in the lawsuit. Auto Lease Co. v. Central Mut. Ins. Co., 325 P.2d 264, 7 U.(2d) 366; Samms v. Eccles, 358 P.2d 344, 11 U.(2d) 289. Summary judgment should be granted only when, taking the view most favorable to the claims of the party against whom summary judgment is sought, and any proof that might be adduced thereunder, he could in no event prevail. Kidman v. White, 278 P.2d 898, 14 U.(2d) 142. If a dispute exists as to any issue of fact which would be determinative of rights of the parties, summary judgment should be denied. Transamerica Title Ins. Co. v. United Resources, Inc., 471 P.2d 165, 24 U.(2d) 346. Summary judgment is a drastic remedy and should be granted with reluctance. Housley v. Anaconda Co., 427 P.2d 870, 17 U.(2d) 420.

Issues of fact exist which preclude summary judgment and entitle the defendant to a trial.

SUMMARY

Summary judgment was improperly granted against defendant for balance claimed to be owed under terms of agreement between corporation and its officers, direcors and promoters for the following reasons:

1. Court lacked jurisdiction since hearing on motion for summary judgment was held 4 days before earliest time allowed by Rules 56(c) and 6(e), URCP. (Point I)

2. Hearing of motion for summary judgment filed 13 days after and heard 22 days after answer was filed denied procedural due process and denied Defendant a reasonable time to engage in discovery procedure and to prepare for trial, particularly where current officers had no knowledge concerning transactions between corporation and its prior officers, which transactions were the subject matter of suit. (Point II)

3. Issues of fact established by Defendant's answer (R. 76-77) and by affidavit in opposition to motion for summary judgment (R. 45-47) precluded summary judgment, including issues as to:

(a) Whether the transaction which was the subject matter of the lawsuit was void as a disposition of substantially all of the assets of the corporation without stockholder approval as required by 16-10-74, UCA, 1953. (Point IV).

(b) Whether the contract was unconscionable or otherwise void and unenforceable by reason of inclusion therein of a penalty of 81% of the obligation in the event of non-payment within the time specified, particularly in view of issues of fact concerning alleged self-dealing

corporate officers, directors and promoters in making that contract. (Point III)

(c) Whether or not the disclosures contained in the prospectus were sufficient to insulate the officers, directors and promoter from personal liability for their alleged self-dealing with and unconscionable contracts with corporation, particularly where the purported ratification was by a board of directors consisting of those persons.

This appears to be a classic case of promoters selling stock to the public, causing the corporation to enter into contracts with the promoters which are unfair to the corporation, then bailing out and leaving the stockholders with little or no assets. The new management seeks to prevent the former officers from taking further assets from the corporation, and to have those agreements declared void. To affirm the summary judgment would be to leave the stockholders who purchased stock in good faith without a remedy. Justice requires that they be given a reasonable opportunity to engage in discovery and to present their evidence at a trial. The summary judgment entered herein should be reversed and the case should be remanded for trial.

Respectifully submitted,

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