

NO. 32160

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

CHARLESTON, WEST VIRGINIA

**RICHARD F. FRYE,**

Plaintiff below, APPELLEE,

v.

CIRCUIT COURT HAMPSHIRE COUNTY  
CIVIL ACTION NO. 02-C-78

**RICHARD L. FRYE and  
CHARLES E. FRYE FARMS, INC.**

Defendants below, APPELLANTS.

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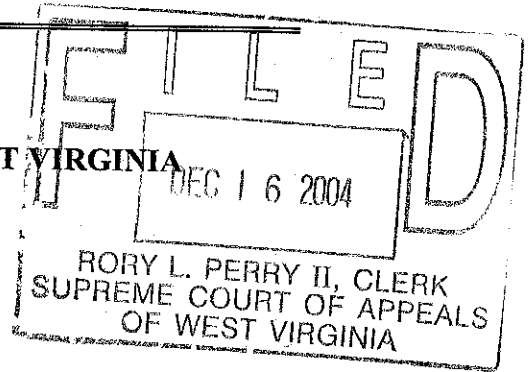
**BRIEF OF APPELLANTS**

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**BRIEF OF THE APPELLANT**

**TO: THE HONORABLE JUSTICES OF THE SUPREME COURT OF APPEALS  
OF WEST VIRGINIA**

**I. NATURE OF PROCEEDING AND RULING BELOW**

Appellants respectfully represent unto the Court that they are prejudiced and aggrieved by the final judgment of the Circuit Court of Hampshire County, West Virginia. The adverse judgment against Appellants is set forth in a "Bench Trial Order" in this civil action dated November 6, 2003.

The trial court ruled that (1) one hundred and twenty (120) shares of stock in Charles E. Frye Farms, Inc., represented by stock certificates numbers 11 and 13, dated January 25, 1998, each for sixty (60) shares, were properly and validly issued to Appellee, Richard F. Frye and his mother, Linda B. Frye; and (2) that Appellee paid \$292,896.70 as consideration for the purchase of the stock represented by certificates numbers 11 and 13.

Appellants challenge the ruling of the trial court as being contrary to the evidence presented at the trial of the case and contrary to the law of this jurisdiction. Rulings by the trial court that determined the ownership of farm equipment/personal property are not part of this appeal.

The original papers in this case, together with a transcript of all proceedings had with exhibits and documents admitted and all of the rulings and decisions of the Circuit Court of Hampshire County upon which Appellants rely for a reversal of the judgment complained of herein were filed with the Petition for Appeal and are part of the record

in this appeal.

## II. STATEMENT OF FACTS

### Background of Stock Ownership

It is undisputed Charles E. Frye, Farms, Inc. was incorporated in 1961 under the laws of the State of West Virginia and the corporate charter authorizes the issuance of seven hundred (700) shares of capital stock. A copy of the By-Laws of the corporation was filed at trial as Plaintiff's Exhibit 1. From its inception, the corporation has been a family farming operation.

The original stock issue is discussed in the trial transcript but is not relevant to the matters in issue in this case. In 1997 the issued and non-issued stock of the corporation was as follows:

--Charles E. Frye, Jr.	60
--Clara Brill	60
--Charlotte Bradfield	60
--Mary Hoke	60
--Dorothy F. Novak	60
--Richard L. Frye	60
--Richard L & Linda Frye	170
--Richard F. Frye	60 ( <i>Explained below</i> )
--Treasury or non issued stock	110
Total	<u>700</u> (590 issued and 110 non-issued)

As set forth above, in 1997, Charles E. Frye, Jr., owner of sixty (60) shares, Clara Brill, owner of sixty (60) shares, Charlotte Bradfield, owner of sixty (60) shares, and Mary Hike, owner of sixty (60) shares, (total of 240 shares) instituted civil suit for dissolution of the corporation. Unable to agree upon the value of the assets of the corporation, all assets were by agreement of the shareholders and Order of the Court

sold at public auction in December, 1997. Charles E. Frye Farms, Inc., through its remaining shareholders purchased the major corporate assets at the public auction for the total consideration of approximately \$850,000.00. Based thereon, each of the 590 issued shares had a value of approximately \$1,440.00 per share in 1997. After the payment of all costs and expenses of the 1997 civil action and the costs of sale of the corporate assets, the four (4) exiting shareholders received approximately \$81,500.00 each or a total of approximately \$326,000.00. All stock owned by the exiting shareholders (240 shares), were purchased by the corporation and thereafter designated as treasury stock.

Approximately three years prior to the 1997 dissolution suit, at a meeting of shareholders on November 9, 1994, the minutes reflect that upon motion of Appellant, Richard L. Frye, (seconded by Dorothy Novak) the shareholders present agreed to gift sixty (60) shares of stock in the corporation to Appellee, Richard F. Frye "for his many years of work and improvements he has done for the farm," effective December 31, 1994.

By certificate dated December 31, 1994, the corporation by its officer issued certificate No. 9 for sixty (60) shares to Appellee, Richard F. Frye. By the value established at the 1997 sale, the sixty (60) shares had a value of approximately \$1,440.00 per share, or a total value of approximately \$86,400.00. The validity of certificate No. 9 is *not* at issue in this appeal but is relevant to subsequent issues of certificates No. 11 and 13 to Appellee, Richard F. Frye, as hereinafter discussed.

After the issuance of the sixty (60) shares of stock to Appellee in 1994 and the purchase of stock from exiting shareholders in 1997, ownership of stock in the corporation was as follows:

--Dorothy F. Novak	60
--Richard L. Frye	60
--Richard L & Linda Frye	170
--Richard F. Frye	60
--Treasury or non issued stock	350
Total	<u>700</u> (350 issued and 350 non-issued)

Stock Issuances in Dispute

Appellants contend the 350 shares set forth above are the only lawful issued stock of the corporation and expressly contest the authority, legitimacy and consideration allegedly paid for the issuance of certificates Nos. 11 and 13. Certificate No. 11 bears the names of Linda B. Frye or Richard F. Frye, J/T, for sixty (60) shares and stock certificate No. 13, bears the names of Richard F. Frye or Linda B. Frye, Joint Tenant, for sixty (60) shares. Both certificates are dated February 25, 1998. (Emphasis added).

Appellee's contention that the shares represented by the two certificates were purchased from the 350 treasury or non-issued stock was not substantiated by the corporate records or trial testimony. In fact, no corporate records were introduced at trial to confirm the authority to issue stock certificate No. 11 or No. 13. It was conceded by all witnesses at trial that there had not been any meetings of shareholders or directors from 1996 until the filing of this civil action in 2002. (Emphasis added). There were not a single document presented at trial purporting to be minutes or agreements in lieu of meetings, or other writings even suggesting the authority to issue any stock to Appellee between 1996 and 2002. (Emphasis added).

The bylaws of Charles E. Frye Farms, Inc. was introduced into evidence as Plaintiff's Exhibit 1. Article IV, Section 3 of the by-laws of the corporation states, inter alia, regarding the duties of the secretary – treasurer, as follows:

“He shall sign all stock certificates with the president and such other papers pertaining to the corporation as he may be authorized or directed to do by the board of directors.” (Emphasis added).

Article VII, Section 3 of the by-laws of the corporation provides specifically that “The initial issue of common stock may be controlled by the stockholders at any annual meeting (Emphasis added) to determine whether or not it is deemed advisable to issue additional common stock to enlarge the operation of the corporation or, if it is deemed advisable, to issue additional common stock for the benefit of the corporation.”

There was little or no conflict in the trial testimony disputing the operations of the corporation between 1996 and 2000 were strictly by informal actions. The last corporate minutes in 1996, designated Appellant, Richard L. Frye as president of the corporation and Linda B. Frye (then wife of Appellant, Richard L. Frye) as secretary of the corporation.

Thus, the obvious query presented: “Why did stock certificates No. 11 and 13 bear the admitted signature of Richard L. Frye, as president?” Appellant, Richard L. Frye testified that in 1998 he distinctly remembers when exiting shareholders were being bought out, it was reported to him that some of the exiting shareholders had lost or misplaced their certificates. He signed blank certificates for the sole purpose of replacing lost or misplaced certificates for use by exiting shareholders as duplicate certificates for to enable those shareholders to sell or liquidate their stock. Appellant, Richard L. Frye further testified that subsequently, he was informed the lost or misplaced certificates of exiting shareholders were located thereby eliminating the need for the use of the certificates signed in blank and intended for use as duplicates only.

This contention by Appellant that he signed the certificates in blank to replace lost certificated was not something he dreamed up for the trial of this case. He contended exactly the same thing in divorce mediation before mediator, Patrick Henry, in 2001, as admitted by his ex-wife, Linda B. Frye. *See Designated Record*, Volume I of II, Page 132, lines 5-9. The testimony of Linda B. Frye following the admission to the effect there were no blank certificates in the stock book in 2001 served to prove absolutely nothing since the certificates in dispute (dated February 25, 1998) had obviously been filled in prior thereto.

Appellant, Richard L. Frye, emphatically denied certificates Nos. 11 and 13 were ever intended or authorized to be issued to Appellee or to Appellee and his mother, Linda B. Frye, individually or jointly, and that he did not learn of the existence of the issued shares until June, 2000, when the marriage of Linda B. Frye and Richard L. Frye began to disrupt. *See Transcript of Bench Trial, August 27, 2003*, at Volume II of II, pp. 41; 15-24 and pp. 42; 1-23. Shareholder, Dorothy F. Novak and sister of Appellant, Richard L. Frye, also testified she was never consulted regarding the issuance of the shares and did not know of their issuance until she was so informed in June, 2000, by her brother. *See Transcript of Bench Trial, August 27, 2003*, at Volume I of II, pp. 138; 16-24 and pp. 139; 1-5.

Appellee, Richard F. Frye, and Appellee's mother, Linda B. Frye, contradicted the testimony of Appellant, Richard L. Frye by testifying certificates Nos. 11 and 13 were signed and delivered to Appellee on February 28, 1998, as a result of informal actions by the officers. Appellant, Richard L. Frye, absolutely denied the certificates were signed on said date by any informal authority and contends the testimony of his

disgruntled son, Appellee, Richard F. Frye, and ex-wife, Linda B. Frye was self-serving and not credible. It is to be noted that prior to trial, Linda B. Frye, the ex-wife of Appellant, Richard L. Frye, had been paid in full for her substantial holdings of corporate stock in the family farm by way of the property division in the divorce case.

There is strong evidence Linda B. Frye took advantage of the certificates signed in blank by her husband and issued them to her son and herself. Appellant, Richard L. Frye, testified he confronted his son in the farm shop sometime around Labor Day, 2000, and stated to Appellee, Richard F. Frye: "You stole a hundred and twenty shares of stock from me, the corporation, or whoever it may be." to which Appellee responded by saying "I did not have anything to do with that. My mother (Linda B. Frye) did that." (Emphasis added) See *Designated Record*, Volume II of II, Page 44, Lines 16-24. Independent witness, Ronald Kline, who had helped on the family farm for some 18 was present in the farm shop during the conversation and verified, Appellee, Richard F. Frye, stated, "...he didn't do it...he said his mother did it," referring to the issuance of the stock. (Emphasis added) See *Designated Record*, Volume II of II, Page 159, Lines 13-22.

Appellee also contented that since the prior issuance of stock to him represented by certificate No. 9, was initially issued by informal actions, the issuance of certificates No. 11 and 13 for sixty (60) shares each should be treated in the same fashion. However, the records and testimony clearly show that certificate No. 9 was issued as a result of minutes of a shareholders' meeting dated May 20, 1994. (Plaintiff's Exhibit 16.) Although the issuance of certificate No. 9 may not have been in strict accordance with the by-laws of the corporation or the general laws of this jurisdiction, the issuance of certificate No. 9 was subsequently ratified by all shareholders and approved by the Court

in the 1997 dissolution case wherein Appellee, Richard F. Frye was expressly determined to be the owner of sixty (60) shares by virtue of certificate No. 9.

By analysis, the issuance of certificates No. 11 and 13 did not have any such characteristics of legitimacy. There were not any shareholders or director meetings; there were not any minutes; there were never any actions taken with formality or appearance of formality; there was not any subsequent ratification or acquiescence; and there was never a determination of the value of the stock by shareholders. (Emphasis added).

The extremely significant value of the one hundred and twenty (120) shares lends support to Appellant, Richard L. Frye's testimony that he never intended for certificates No 9 and No 11 to be issued to Appellee, or to Appellee and his mother, Linda B. Frye. The value of the stock as determined by the public auction sale in 1997 was approximately \$1,440.00 per share. Therefore, the value of the shares in 1997 was approximately \$172,800.00. Due to the upward spiraling values of real estate in the area, the uncontested testimony of Appellee was that the stock shares have at least doubled in value since 1997 and each share was most likely worth \$3,000.00, or more. By calculation, the one hundred and twenty (120) shares alleged to have been distributed currently have a value of \$360,000.00 and represents approximately 25% of all issued shares of the corporation.

#### Disputed Consideration Alleged Paid

Should the Court adopt any theory under which the issuance of the one hundred and twenty (120) share might have been properly issued, Appellants vehemently contested the payment of the consideration as alleged by Appellee. It was undisputed the exiting shareholders in 1997 were paid for their collective 240 shares through loans

secured by shareholders on behalf of the corporation at Capon Valley Bank in the amount of \$325,000.00. However, the repayment of the \$325,000.00 in loans and the source of the funds used to repay the loans is the most critical determination. Appellee contends his repayment of the loans at Capon Valley Bank represent the consideration paid for the stock issued to Appellee by certificates No. 11 and No. 13.

Appellee's contentions were not born out by the evidence presented. Specifically, Plaintiff's Exhibit 6 was a check written to Capon Valley Bank for \$106,920.16. However, it was conceded by Appellee's witnesses, that \$100,000.00 of that amount came from shareholder, Dorothy F. Novak and her husband in the form of two checks. See Transcript of Bench Trial, August 27, 2003, at Volume I of II, pp. 100; 18-24 and pp. 139; 1-5. (Further discussions of the details of the \$100,000.00 are set forth below). It was likewise verified that \$92,000.00 received from the sale of corporate timber was applied to the loans at Capon Valley Bank. If the \$100,000.00 and \$92,000.00 payments had been properly credited by the trial court, the principal balance of the original corporate debt would have been reduced to about \$133,000.00 – not \$292,896.70 – the amount credited to Appellee for payments on the debts by the trial court.

The documents introduced by Appellee in support of his claim for payments on the corporate debts clearly failed to show proof of payments by a preponderance of evidence. Exhibit 6, the above mentioned check in the amount of \$106,920.16 included \$100,000.00 received from shareholder, Dorothy F. Novak and her husband in the form of two checks. Other exhibits introduced by Appellee were copies of certificates of deposit, checks, bank deposit slips but checks were not present to verify the balances were paid on the corporate debts. (Emphasis added). For example, Exhibit 12 was a

check for \$17,500.00 written to Capon Valley Bank referencing a payment on note 300171. But it was dated 4-5-99, approximately 14 months after the stock issuance on February 25, 1998. (Emphasis added). Exhibit 14 was a check for \$24,927.00 to Capon Valley Bank referencing a payment on note for "C.E. Frye Farms, Inc." But it was dated 11-23-99, or approximately 20 months after the stock issuance on February 25, 1998. (Emphasis added). Even though the trial court included the \$17,500.00 check and the \$24,927.00 check as part of its erroneous \$292,896.70 credit for purchase of stock, when confronted with the matter, Appellee, Richard F. Frye, took the laughable position he was entitled to even more stock for the funds credited after the stock issuances. *See Designated Record*, Volume I of II, Page 232, Lines 2-10. Such assertions by Appellee cast serious doubts on his credibility regarding all of the unlikely occurrences to which he testified.

These later two checks clearly demonstrate that the Appellee and/or Appellee and his mother, Linda B. Frye, after the fact of issuance of the stock, assembled any and all documents that might remotely suggest payment of the corporate debts. Not a single document introduced as alleged proof of payment contained any notation, indication, verification or even suggestion that the amount of funds thereon were ever intended for stock purchases. (Emphasis added). Certainly, the proof of having funds or the depositing of funds cannot be substituted for verification or proof of what the funds may have been used for in the absence of checks or other documentary proof.

As for the principal balance in corporate debt owed to Capon Valley Bank of \$133,000.00 (\$325,000.00 less \$192,000.00) more or less, neither the corporate records

maintained by Linda B. Frye as secretary/treasurer, nor any evidence introduced at trial by Appellee, substantiated when or from what source these funds were derived.

Appellant, Richard L. Frye, testified, and it was not denied, that he fully entrusted his then wife, Linda B. Frye, and his son, Appellee, Richard F. Frye, to manage his personal funds and those of the corporation from farming operations. He made no effort to track the funds and could not say with certainty as to where funds were deposited or the purposes for which they were expended. *See Transcript of Bench Trial, August 27, 2003*, at Volume II of II, pp. 33; 18-22 and pp. 47; 16-24. Nevertheless, the most credible evidence indicating the source of the funds used to pay the note balances of approximately \$133,000.00 is set forth in the income tax returns of Richard L. Frye and Linda B. Frye for 1997 and 1998.

The 1997 and 1998 joint tax returns of Richard L. Frye and Linda B. Frye verify that substantial personal assets of the Appellant and his then spouse, consisting of certificates of deposit, stocks, bonds and other accounts were liquidated during the very same time period the loans to Capon Valley Bank were being repaid. Conceding exact calculations were not possible, the joint income tax return of Richard L. Frye and Linda B. Frye for 1997 shows interest income of \$30,082.00, which was substantially reduced to \$8,517.00 in 1998, clearly verifying the sale of substantial interest producing assets. Likewise, the parties' 1997 joint shows dividend income of \$5,586.00 and the 1998 joint return shows dividend income was reduced to \$1,700.00, again clearly verifying the sales of dividend producing assets. No comparable evidence exists as to the Appellee's returns.

Shareholder Gift of \$100,000.00 and Corporate Timber Sale

Based upon the sworn testimony of shareholder, Dorothy F. Novak during the time the corporate assets were being sold in 1997, she and her husband agreed to contribute \$100,000.00 to assist in buying the corporate farm. (Designated Record, Volume I of II, page 137, lines 3-8 and lines 14-16.) Checks were written by Mrs. Novak's husband, Fred Novak in the amounts of \$45,000.00 and \$55,000.00, respectively, and were actually made payable to "Richard and Linda Frye" even though Mrs. Novak stated the checks were made to only one person. Appellants contends a check intended as a gift to a nephew or to a mother and a son, as is contended by Appellee, would certainly not be written in such a form. When asked directly if she ever intended the funds to be a gift to Appellee, Mrs. Novak stated, "Absolutely not because we were in the process of purchasing the farm." Examination of the checks disputes the Appellee's contention that the funds were intended as a gift to Appellee or anyone else. There was no designation as a "gift", but rather the memorandum section of both checks contained the notation of "INV." See Defendant's Exhibit 1, and *Designated Record*, volume II of II, Page 14, Lines 4-13. These notations corroborated the testimony of shareholder, Dorothy F. Novak, she and her husband were "investing" in saving of the family farm.

Notwithstanding the sworn testimony of Dorothy F. Novak, the source of the funds, and the examination of the two checks totaling \$100,000.00, the trial court ruled accepted the self-serving testimony of Appellee that the \$100,000.00 was intended as a gift to him and applied the sum to the alleged stock purchase. The trial court likewise

failed to credit the sale of \$92,000.00 in corporate timber sales to the debts owed to Capon Valley Bank resulting in a unjustified credit to the debt.

#### Effect of Rulings by Trial Court

The effect of the trial court's rulings has drastically changed the percentage of ownership in the family corporation. Specifically, after the return of the 240 shares to treasury stock from the former shareholders, the percentage interest of all remaining shareholders increased proportionately in the corporation. Prior to the alleged purchase of the 120 shares, Appellee owned 60 of 590 total shares issued, or slightly over 10% of the issued stock. After the 240 shares of stock were purchased and returned as treasury stock, Appellee owned 60 of 350 total shares issued and his interest increased to slightly over 17% of the issued stock. As a result of the trial court's ruling, Appellee would own a total of 180 of 470 total shares issued or over 38% of all issued and outstanding stock. Obviously, the percentage ownership of Appellant, Richard L. Frye and minority shareholder, Dorothy F. Novak decreased accordingly. This is very significant given the substantial infusion of funds by Dorothy F. Novak.

### III. ASSIGNMENT OF ERRORS

- A. The Trial Court Erred in Ruling the 120 Shares of Stock represented by Certificates Numbers 11 and 13 were properly and lawfully issued
- B. The Trial Court Erred in Ruling Appellee paid \$292,896.70 for the 120 Shares of Stock represented by Certificates Numbers 11 and 13
  - 1. Failure of Consideration
  - 2. Impossibility of Payment of Consideration
- C. The Trial Court Erred in Granting Appellee \$100,000.00 Credit for Funds Gifted to the Corporation by Shareholder, Dorothy F. Novak
- D. The Trial Court Erred in Failing to Credit the \$92,000.00 for Sale of Corporate Timber to the Notes at Capon Valley Bank resulting in an Unjustified Credit to Appellee
- E. The Trial Court Erred in Granting Appellee Credit for Additional Payments for Stock Purchase

#### IV. TABLE OF AUTHORITIES

- Thurmond, et al. v. Paragon Colliery Co., et al, 82 W.Va. 49 (1918)
- Howard v. Taum, et al, 81 W.Va. 561 (1918)
- Kearneysville Creamery Co. v. American Creamery Co., 103 W.Va. 259, 137 S.E. 217 (1927)
- First Nat. Bank v. Tri-State Equipment. et al, 108 W.Va. 686, 152 S.E. 635 (1930)
- Michie's Jurisprudence, Corporations, Sec. 44.
- Mosell Realty Corp. v. Schofield, 183 Va. 782, 33 S.E.2d 774 (1945)
- Stevens v. Davison, 59 Va. (18 Gratt.) 819 (1868).
- Hodges Realty v. John Smiley's Motel, Inc. 183 W.Va. 328; 395 S.E.2d 751 (1990).
- Manister v WEBCO Co., 262 S.E.2d 433 (1980)
- West Virginia Code 31D-2-205
- West Virginia Code 31D-2-205(b).

## **V. DISCUSSION OF LAW AND ARGUMENT**

### **A. THE TRIAL COURT ERRED IN RULING THE 120 SHARES OF STOCK REPRESENTED BY CERTIFICATES NUMBERS 11 AND 13 WERE PROPERLY AND LAWFULLY ISSUED**

First and foremost, since there was no written authority for issuance of the one hundred and twenty (120) shares of stock issued to the Appellant at anytime between 1996 and 2002, and authority was not given at a proper meeting of the directors' or at a shareholders' meeting, the issuance of those Charles E. Frye Farm, Inc., stock certificates No. 11 and No. 13 representing sixty (60) shares each, as stated above, was directly contrary to Article IV, Section 3 and Article VII, Section 3 of the By-Laws of the corporation.

Corporate law in West Virginia has always authorized or directed the adoption of bylaws for a corporation. The current law is set forth in West Virginia Code 31D-2-205. The statutes and case law have consistently stated the bylaws of a corporation may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with the law or the articles of incorporation. See West Virginia Code 31D-2-205(b). A person who becomes a stockholder subjects himself to the regulations and enforcement of the bylaws of the corporation. See Michie's Jurisprudences, Corporations, Sec. 44.

Therefore, issuance of shares in direct violation of corporate bylaws in and of itself renders those shares invalid.

Furthermore, stock certificates No. 11 for sixty (60) shares and stock certificate No. 13 for sixty (60) shares were not issued with sufficient corporate authority and legitimacy. When a private corporation has issued only part of its authorized capital stock

and desires to increase its capital stock, such decision to increase the issuance of capital stock is within the discretion of its board of directors who may issue additional stock at a price per share determined by a majority of the shareholders. In such cases, each shareholder has a right to purchase his pro rata share of such non issued stock that is offered for sale. Thurmond, et al. v. Paragon Colliery Co., et al, 82 W.Va. 49 (1918). See Howard v. Taum, et al, 81 W.Va. 561 (1918), where the Court reviewed a case where non issued stock was properly sold implicitly adopting the standards set forth in Thurmond case. Appellants insist the increase and issuance of such a large amount of capital stock, of substantial value, requires strict compliance with the requirements set forth in Thurmond.

Appellee, Richard F. Frye, contended that the prior issuance of stock by certificate No. 9 to him, although technically flawed, should somehow validate issuance of certificates Nos. 11 and 13. But as pointed out above, there were clear distinctions. The issuance of certificate No. 9 was subsequently ratified by all shareholders and further validated by rulings in the prior 1997 civil action. In Kearneysville Creamery Co. v. American Creamery Co., 103 W.Va. 259, 137 S.E. 217 (1927), the West Virginia Supreme Court held that where shareholders and officers participated in an informal meeting and thereafter executed an agreement, all were estopped to deny the legality of the meeting. As to certificates Nos. 11 and 13, there was no formal or informal agreement nor was there execution of any written agreement or memorandum ratifying the action. Under the holdings of Thurmond, the issuance of capital stock, that being certificates Nos. 11 and 13, without proper authority and void of an acquiescence or ratification by the shareholders cannot be valid. Thurmond, Supra.

Had the President and Secretary signed the certificates at the same time and under the circumstances as contended by Appellee, (which has been emphatically denied by Appellant, Richard L. Frye) such action was outside the authority of the officers to act by informal or implied authority without proper consent by the board of directors and shareholders. The implied authority of officers of a corporation to act on behalf of the corporation is limited to ordinary corporate business. First Nat. Bank v. Tri-State Equipment. et al, 108 W.Va. 686, 152 S.E. 635 (1930). Any presumption on the part of the trial court that there was authority to execute the stock certificates in question based on the prior issuance of certificates simply does not apply here because there is positive evidence that a principal stockholder, Fern Novak, did not grant authority. Any ratification after the fact depends on actual and not constructive information to the board of directors and stockholders. First Nat. Bank v. Tri-State Equipment. et al. Infra. In Mosell Realty Corp. v. Schofield, 183 Va. 782, 33 S.E.2d 774 (1945), the Virginia Supreme Court held that even though the president, secretary and treasurer owned two-thirds of the capital stock, such ownership did not, in the absence of a statute, vest them with the authority to bind the corporation outside a formal stockholders' meeting. Where large amounts of spurious stock was issued, officers cannot deny ultra vires actions. Stevens v. Davison, 59 Va. (18 Gratt.) 819 (1868).

Here the trial court ignored the authorities and requirements for the valid and lawful increase of authorized capital stock and did so without Appellee or the court citing upon what legal authority the trial court relied in making its rulings.

**B. THE TRIAL COURT ERRED IN RULING APPELLEE  
PAID \$292,896.70 FOR THE 120 SHARES OF STOCK  
REPRESENTED BY CERTIFICATES NUMBER 11 AND 13**

It is not disputed in the testimony of the parties that in order to pay the exiting shareholders for 240 shares of stock in the corporation in 1997, Charles E. Frye Farms, Inc, by and through its remaining shareholders, borrowed approximately \$325,000.00 through notes at Capon Valley Bank. The trial court ruled in effect that Appellee repaid \$292,896.70 of the loans and such repayment represented compensation paid for the 120 shares of stock allegedly purchased.

### 1. FAILURE OF CONSIDERATION

The evidence is totally insufficient to hold that Appellee paid, directly or indirectly, any sum approaching the \$292,896.70 alleged, or any other significant consideration for the 120 shares of stock in Charles E. Frye Farms, Inc. A person asserting ownership in shares of stock in a corporation is not entitled to the receipt of such shares if it is determined that consideration was not given for the claimed interest in the corporation. Hodges Realty v. John Smiley's Motel, Inc. 183 W.Va. 328; 395 S.E.2d 751 (1990).

To his extreme detriment, Appellant trusted his then wife, Linda B. Frye, as secretary/treasurer, and his son, Appellee, Richard F. Frye to conduct the office and business matters of the three separate farming operations for Richard L. Frye, individually, Richard F. Frye, individually, and Charles E. Frye Farms, Inc. Appellant, Richard L. Frye, did not maintain the corporate records and accounts or have personal knowledge as to how or where income was deposited (Designated Record Volume II of II, page 47, lines 16-24; page 48, lines 1-2). The only bank account maintained exclusively by Appellant, Richard L. Frye, was an account used for the deposit of his disability income (Designated Record Volume II of II, page 46, lines 8-14). However, the

record clearly shows Appellant, Richard L. Frye, earned significant income from farm sales, e.g. \$26,100.00 in 1998, \$31,000.00 in 1999 and \$22,000.00 in 2000 (Designated Record Volume II of II, page 47, lines 9-13 and page 48, lines 2-4; also see tax returns filed). Since the funds were not elsewhere, Appellant assumed they were deposited in "Frye Farms" account which he believed to be owned by himself, Linda B. Frye and the Appellee. When Appellant attempted to obtain checks for "Frye Farms," he learned the account was in the name of Appellee. (Designated Record Volume II of II, page 48, lines 16-21). Thus, Appellant's income was being deposited into an account owned by Appellee, who in turn, used the funds to pay on the corporate debt and later claimed a his personal credits toward the stock purchases at issue. (Designated Record Volume II of II, page 48, lines 22-24).

For example, Plaintiff's Exhibit 10, a check for \$34,014.52 represents proceeds from the sale of steers. Of this amount, at least one-third constituted payment for steers owned by Appellant, Richard L. Frye, and one-third for the steers owned by Appellant, Charles E. Frye, Farms, Inc. Throughout the period Appellee claimed payments on the debts of the corporation the pattern was the same, i.e., Appellee deposited funds owned by others into his personal account, made payment on the notes owed to Capon Valley Bank and claimed the payments as consideration paid for stock purchases titled to he and his mother.

It should also be noted that none of the Appellee's personal or individual tax records reflect reporting of the alleged purchase of the stock by capital contribution or gift to the Internal Revenue Service, nor do the corporate records reflect any change in the corporation's capitalization or a reporting of such changes to the Internal Revenue

Service.

The court clearly erred in holding that Appellee paid the stated consideration under the principles set forth in Hodges Realty, Supra.

## 2. IMPOSSIBILITY OF PAYMENT OF CONSIDERATION

The ruling by the Court that Appellee paid approximately \$292,000.00 toward payment of the notes to Capon Valley Bank through his separate income, assets or funds allegedly gifted to Appellee by his mother, Linda B. Frye, is absolutely contrary to the evidence and simple math. During the very time the Appellee claims to have made the payments on the corporate notes (1998 and 1999), Appellee's tax returns conclusively show Appellee did not have any significant taxable income with which to make such payments. In fact, in reviewing Appellee's tax returns for a seven (7) year period prior to the trial of this case, Appellee's net farm loss was approximately \$26,000.00. To this amount depreciation of \$156,000.00 for the same period must be factored thereby generating non-cash expense of \$130,000.00 (\$156,000.00 less \$26,000.00). During the exact same time period, Appellee testified he had purchased or was in the process of purchasing 67 acres, known as the "Woodworth Place" valued by Appellee at \$180,000.00 and encumbered with a debt of \$82,000.00, and 140 acres, known as "Love Place" valued by Appellee at \$360,000.00 and subject to a debt of \$60,000.00. Appellee further testified he had acquired farm machinery, equipment and personal property at the estimated costs of \$175,000.00 to \$200,000.00. (Designated Record, Volume I of II, pages 210-223) Therefore, even if Appellee's financial resources are reviewed in their most favorable light, his debt service and purchase of farm machinery, equipment and personal property would have precluded any alleged payments on the debts owed to

Capon Valley Bank and credited by the trial court as being a portion of the consideration paid by Appellee for the purchase of 120 shares of stock.

Furthermore, Appellee verified he had no other sources of income and his wife's income as a teacher had never been used to purchase or pay for any corporate asset or to pay any corporate obligation. (Designated Record, Volume I of II, page 229, lines 22-24; and page 230, lines 1-8.)

Appellee expressly admitted that of all the documents and exhibits presented as proof of payment for debts of the corporation, not a single instrument presented in any way indicated or verified such payments made by Appellee were designated as payments for the purchase of stock in the corporation. (Designated Record, Volume I of II, page 230, lines 22-24 and page 231, lines 1-15.)

During the exact same period Appellee was amassing substantial wealth, his personal income tax returns reveal Appellee did not pay one single penny in federal or state income taxes.

The court should have concluded that with Appellee's limited disposal income, it was implausible that he could have contributed significantly toward the payment of the notes at Capon Valley Bank.

**C. THE TRIAL COURT ERRED IN GRANTING APPELLEE  
\$100,000.00 CREDIT FOR PAYMENT GIFTED TO THE  
CORPORATION BY DOROTHY F. NOVAK**

Based upon the sworn testimony of shareholder, Dorothy F. Novak, during the time the corporate assets were being sold in 1997, she and her husband agreed to contribute \$100,000.00 to assist in buying the corporate farm. (Designated Record, Volume I of II, page 137, lines 3-8 and lines 14-16) Checks were written by Mrs.

Novak's husband, Fred Novak for \$45,000.00 and \$55,000.00 respectively and were actually made payable to "Richard and Linda Frye" even though Mrs. Novak stated the checks were made to only one person. Appellants contend a check to a mother and a son, as alleged by Appellee, would certainly not be written in such a form. When ask if she ever intended the funds to be a gift to Appellee, Mrs. Novak stated "Absolutely not because we were in the process of purchasing the farm." Designated Record, Volume I of II, page 138, lines 9-12)

Notwithstanding the clear and unambiguous testimony of Dorothy F. Novak, the trial court ignored her testimony and gave full force and effect to the admissible but notably self-serving hearsay testimony of Appellee and his mother. The trial court ruled the \$100,000.00 was a gift to Appellee and therefore, Appellee was entitled to a corresponding credit toward the purchase of the 120 shares of stock. Such holding is clearly erroneous.

It is also abundantly clear in awarding Appellee an additional 120 shares of treasury stock without the participation, consent and approval of the minority shareholder, Dorothy F. Novak, the minority shareholder is extremely prejudiced. The court's approval of Appellee's receipt of the 120 shares substantially reduced the percentage ownership and corresponding value of the stock held by Dorothy F. Novak in the corporation. Specifically, the interest of Mrs. Novak in the issued shares prior to this civil action is easily computed at 17.1% (60 of 350 issued shares). By awarding Appellee an additional 120 shares of stock, the ownership of Dorothy F. Novak was reduced to 12.7% (60 of 470 issued shares). Such reduction in percentage ownership necessarily reduced the overall value of her stock by the same percentage. If, as testified

to by Appellee, the value of the corporation has doubled since the sale in 1997 from a sale price of \$850,000.00 to a current value of \$1,700,000.00, the 4.4% reduction (17.1% minus 12.7%) results in a reduction of the value of Mrs. Novak's stock by \$74,800.00, and such amount is in addition to the \$100,000.00 she and her husband contributed to the purchase of the stock from prior shareholders. The actions of the Court in approving the issuance of the 120 shares of stock effectively permits Appellee to manipulate the affairs of the corporation and ratifies actions of Appellee and Appellants that are not legally effective against a minority shareholder. In fact, neither Appellee nor Appellants could properly purchase the non-issued shares of stock without the participation of the minority shareholder, Dorothy F. Novak. Equity requires courts to protect the rights of a minority shareholder. Manister v WEBCO Co., 262 S.E.2d 433 (1980).

**D. THE TRIAL COURT ERRED IN FAILING TO CREDIT THE \$92,000.00 FOR SALE OF CORPORATE TIMBER TO THE NOTES AT CAPON VALLEY BANK, RESULTING IN AN UNJUSTIFIED CREDIT TO APPELLEE**

Appellant, Richard L. Frye, testified that shortly after the purchase of stock from the exiting shareholders, there was a sale of corporate timber for \$92,000.00 and that those proceeds were applied to the corporate debts at Capon Valley Bank. (Designated Record Volume II or II, page 33, lines 13-24). It was not disclosed as to where or in what account the funds were deposited, but based upon the numerous payments from the "Frye Farms" account owned exclusively by Appellee (not to be confused with the Charles E. Frye Farms, Inc., corporate account), the circumstances suggest deposit was made into the "Frye Farms" account. Clearly, Appellee paid far more funds from that account than he could have possibly deposited from his limited sources of income.

**E. THE TRIAL COURT ERRED IN GRANTING APPELLEE  
ADDITIONAL CREDITS FOR PAYMENTS OF STOCK PURCHASE**

It is clear from the trial transcript and exhibits Dorothy F. Novak and her husband, Fred Novak gifted \$100,000.00 to the corporation for the purchase of the family farm that Appellee deposited into an account owned by him. It is equally clear \$92,000.00 was received for the sale of corporate timber and deposited by Appellee in the same fashion. Both receipts were corporate income and should have been credited to the corporation's payment of the notes owed to Capon Valley Bank and not to Appellee as consideration for the alleged stock purchase. If properly credited, the original notes in the amount of \$325,000.00 were reduced to approximately \$133,000.00.

Neither the corporate records maintained by Linda B. Frye as secretary/treasurer, nor any evidence introduced at trial by Appellee, clearly substantiates the source from which the \$133,000.00 in corporate debt was paid. Since the notes at Capon Valley Bank were paid in full, funds obviously were derived from somewhere. The most credible evidence shows the balance of approximately \$133,000.00 was paid by the liquidation of certificates of deposit, stocks, bonds and other accounts owned by Richard L. Frye and Linda B. Frye, then husband and wife. Although exact calculations are not possible the 1997 and 1998 joint tax returns of Richard L. Frye and Linda B. Frye verify that during the calendar year of 1998, when the loans to Capon Valley Bank were being repaid, substantial assets were liquidated by the parties. Specifically, the 1997 joint income tax return of Richard L. Frye and Linda B. Frye shows interest income on their investments of \$30,082.00, while the 1998 joint return shows interest income was reduced to \$8,517.00 as a direct result of the sales of interest producing assets. Likewise, the 1997 joint income tax return of Richard L. Frye and Linda B. Frye shows dividend income of

\$5,586.00 and the 1998 joint return shows dividend income reduced to \$1,700.00 as a direct result of the sales of dividend producing assets.

As further evidence of the source of funds, one of the deposit tickets set forth on Plaintiff's Exhibit 10 shows a deposit to the C. E. Frye Farm, Inc. Account on January 20, 1998, of \$123,100.84 for "CDS cashed." Since Appellee did not have any certificates of deposit and did not assert same at trial, the certificates cashed and deposited had to have been owned by Appellant, Richard L. Frye and his then wife, Linda B. Frye, or the corporation. Interpreting the deposit most favorable to Appellee, if the certificates were marital assets of Richard L. Frye and his then wife, Linda B. Frye, Appellee's mother could not have gifted Appellee more than one-half thereof, or a sum approximating \$61,550.42. At a value of \$2,880.00 per share, the stock to which Appellee would be entitled is 22 shares, even if the issuance of stock were otherwise valid.

The trial court totally failed to properly calculate and apply funds to their proper owners.

## **VI. CONCLUSION AND RELIEF SOUGHT**

The issuance of one hundred and twenty (120) shares of stock with an estimated value of \$360,000.00 in the family farm corporation to a disgruntled son and vindictive ex-wife under the facts of this case, cannot be valid in this jurisdiction when the issuance thereof is : (1) in direct violation of the bylaws of the corporation; (2) without shareholder or director meetings or corporate minutes or any other corporate authority from shareholders or directors; (3) without valuation of the stock by shareholders; (4) without knowledge of a minority shareholder; (5) without any subsequent ratification or

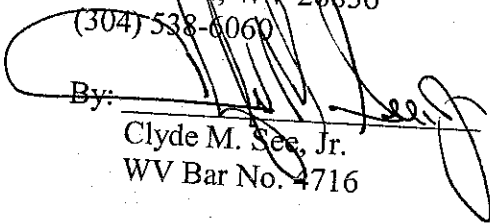
acquiescence by shareholders or directors of the stock issuance; and (6) without proof of payment of adequate or valuable consideration.

Appellants seek an order declaring the issuance of the one hundred and twenty (120) shares to Richard F. Frye and Linda B. Frye to be null and void; or in the alternative, an order declaring the correct number of shares to which Appellee is entitled as result of any financial contributions in the form of repayment of loans to the Capon Valley Bank as the Court may determine to be accurate based upon the evidence in the case; or in the alternative, an order reversing the decisions by the trial court the matters in dispute herein and remanding of the case to the Circuit Court of Hampshire County for a new trial.

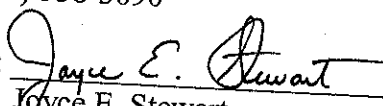
Respectfully submitted this the 15th day of December, 2004.

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