

STATE OF MICHIGAN
COURT OF APPEALS

MARCIA GUSTAFSON and CARL
GUSTAFSON,¹

UNPUBLISHED
July 7, 2000

Plaintiffs-Appellants/Cross-
Appellees,

v

No. 218024
Ogemaw Circuit Court
LC No. 95-000959-CZ

STEVEN R. GOULD, PAMELA K. GOULD,
JAMES I. LUDLOW, and RUTH L. LUDLOW,

Defendants,

and

BERNARD M. BLUMENSTEIN, PEGGY
BLUMENSTEIN, MICHAEL B. KAY, and KIM L.
KAY,

Defendants-Appellees/Cross-
Appellants,

and

KROSSWINDS KAMPGROUND AND RESORT,
INC., and FIRST NATIONAL BANK OF
GAYLORD,

Defendants.

¹ Plaintiffs' counsel has advised the Court that Carl Gustafson has died. If the estate intends to pursue the claims at issue, a substitution of parties must be filed. MCR 2.202(A).

Before: Meter, P.J., and Griffin and Talbot, JJ.

PER CURIAM.

This case arises out of plaintiffs' purchase of shares in Krosswinds Kampground and Resort, Inc., from defendants Gould, Ludlow, Blumenstein, and Kay. Plaintiffs appeal as of right the trial court's grant of summary disposition in favor of defendants on plaintiffs' claims of misrepresentation, stock fraud, and violations of the Uniform Securities Act, MCL 451.501 *et seq.*; MSA 19.776(101) *et seq.* Defendants Blumenstein and Kay cross appeal the trial court's award of mediation sanctions. We affirm in part, reverse in part, and remand for further proceedings.

Plaintiffs first argue the trial court erred in granting summary disposition on their claims of misrepresentation, stock overvaluation, watered stock, and misrepresentation based on the language in an addendum to their offer to purchase. A trial court's decision regarding a motion for summary disposition is reviewed *de novo*. *Spiek v Dep't of Transportation*, 456 Mich 331, 337; 572 NW2d 201 (1998); *M&D, Inc v W B McConkey*, 231 Mich App 22, 26; 585 NW2d 33 (1998).

We conclude that the trial court neither erred in summarily disposing of plaintiffs' claims of misrepresentation, arising apart from the addendum, nor erred in granting summary disposition of plaintiffs' claims of share overvaluation and watered stock. However, the trial court did err in granting summary disposition to defendants on plaintiffs' "blurb" theory.

Misrepresentation Claims

A claim of innocent misrepresentation is shown if a party to a contract detrimentally relies on a false representation in such a manner that the injury suffered by that party inures to the benefit of the party who made the representation. *Novak v Nationwide Mut Ins Co*, 235 Mich App 675, 688; 599 NW2d 546 (1999); 2 Restatement, Torts, § 552C. Similarly, a suit alleging negligent misrepresentation requires proof that a party justifiably relied to his detriment on information provided without reasonable care by one who owed the relying party a duty of care. 2 Restatement, Torts, § 552; *Law Offices of Lawrence J Stockler, PC v Rose*, 174 Mich App 14, 33; 436 NW2d 70 (1989).

Plaintiffs acknowledged in judicial admissions that defendants made no misrepresentations, therefore summary disposition of these claims was not in error. These answers to requests for admissions are entitled to be treated as conclusive judicial admissions pursuant to MCR 2.312; *Radtke v Miller, Canfield, Paddock & Stone*, 453 Mich 413, 420; 551 NW2d 698 (1996). Plaintiffs' admissions bar the claims of innocent and negligent misrepresentations because both require evidence that a party made a false representation.

Further, plaintiffs provided insufficient evidence to create an issue of fact that defendants were liable as the principals of an agent who made misrepresentations. The authority of an agent to bind a principal may be either actual or apparent. *Meretta v Peach*, 195 Mich App 695, 698; 491 NW2d 278 (1992). Because the Blumensteins and Kays did nothing in plaintiffs' presence, only the doctrine of implied authority, which rests on acts and conduct of the alleged agent that are known and acquiesced

to by the alleged principal, may serve as a basis for vicarious liability here. See *Auto-Owners Ins Co v Michigan Mut Ins Co*, 223 Mich App 205, 216; 565 NW2d 907 (1997); *Weller v Speet*, 275 Mich 655, 659; 267 NW 758 (1936). However, the only acts of Steven Gould that were allegedly acquiesced to by defendants were Gould's phone calls to defendants while in plaintiffs' presence. We conclude Gould's phone calls to defendants while in plaintiffs' presence are insufficient to create implied authority because there is no evidence of defendants' side of the conversations nor any record of what was actually said to Gould. See *Shinabarger v Phillips*, 370 Mich 135, 136-137; 121 NW2d 693 (1963).

Claims of Improper Stock Valuation and Watered Stock

The trial court did not specifically rule on plaintiffs' claims that the corporation's shares were overvalued and watered down. However, plaintiffs' allegations relating to the overvaluation are essentially a restatement of their misrepresentation claims. Further, plaintiffs' complaint cannot be read to include a claim for watered stocks. Watered stock is stock issued for less than par value or for no consideration. Fletcher, *Cyclopedia of the Law of Private Corporations*, § 5199 (1995). Watered stock is recorded as paid for, but has in fact been given for less than its value. *Loud v Solomon*, 188 Mich 7, 13; 154 NW 73 (1915); *Clark v Airavada Corp*, 12 F Supp 2d 1114, 1119 n 5 (D Nev, 1998). Plaintiffs' complaint does not state a claim for watered stock because it makes no allegations related to stock that was issued but not paid for, and those are not the facts in this matter.

Claims Arising Out of the Addendum

In the addendum to the offer to purchase stock, each defendant agreed to the following statement, which plaintiffs term the "blurb":

K. Financial statements supplied pursuant to this agreement are prepared in accordance with generally accepted accounting principles and that [sic] all documents, including, but not limited to, financial statements, tax returns etc., furnished to the purchaser for review are complete and accurate in all respects.

We conclude that, under the reasoning of *First State Savings Bank of Muskegon Heights v Dake*, 250 Mich 525; 231 NW 135 (1930), plaintiffs stated a valid cause of action arising out of the addendum language and that questions of fact precluded the court's summary disposition of the claim. In *First State*, a corporation seeking a line of credit provided a financial statement of the defendant, a corporate officer, who co-signed notes to be used as collateral for the loan. *Id.* at 525-526. The defendant prepared a list of assets and liabilities, showing a net worth of \$40,279 and the bank issued the line of credit. *Id.* at 526. On his financial statement, the defendant averred that he "maintains and guarantees that said statement is in all respects true and correct; and you may consider said statement as to the pecuniary responsibility of the undersigned as continuing to be true and correct until written notice of a change is given you by the undersigned." *Id.* at 528. It was ultimately determined that the notes were worthless. *Id.* The bank sued the defendant for fraud and misrepresentation, stating that the financial statement was false because it did not accurately value certain property or list outstanding

obligations. *Id.* at 526-527. The Supreme Court agreed, stating that this financial statement was a continuing representation of the defendant's responsibility. *Id.*

First State is persuasive authority that the Blumensteins and Kays may be subject to liability under plaintiffs' "blurb" theory. Defendants specifically attested to the accuracy of the financial documents and plaintiffs averred that they relied on these statements. The parties agree the appraisals provided by the bank were not accurate. While defendants did not prepare these documents, they personally stated they were correct. Based on the evidence presented to the trial court at the time of defendants' motion, the trial court erred in summarily disposing of plaintiffs' claims arising out the addendum language.

Claims Arising Out of the Uniform Securities Act

Next, plaintiffs argue the trial court erred in summarily disposing of plaintiffs' claims arising out of the Michigan Uniform Securities Act, MCL 451.501 *et seq.*; MSA 19.776(101) *et seq.* We conclude the trial court erred in disposing of these claims because questions of fact exist regarding whether the stocks and the transactions were required to be registered under the act or were exempt from registration.

The Michigan Uniform Securities Act provides for the registration of certain securities, brokers, and transactions. The act is designed to protect the public against fraud and deception in the issuance, sale, exchange, or disposition of securities. It is intended to protect investors, not persons engaged in commercial loan transactions. *Noyd v Claxton, Morgan, Flockhart & VanLiere*, 186 Mich App 333, 338; 463 NW2d 268 (1990), *People v Breckenridge*, 81 Mich App 6, 16; 263 NW2d 922 (1978). The act provides it is unlawful for a person or corporation to make misrepresentations in connection with a sale of securities. MCL 451.501; MSA 19.776(101).

The act further mandates no securities may be sold unless they and the transaction are registered or exempt from registration. MCL 451.701; MSA 19.776(301). These exemptions are found in MCL 451.802(a); MSA 19.776(402)(a). The stock of the Krosswinds Corporation does not appear to fall within any of the exemptions from registration. Further, defendants rely on only one exemption excusing registration of the transaction, MCL 451.802(b)(9); MSA 19.776(402)(b)(9). The statute places the burden of proving the exemption of a security or transaction on the party claiming it. MCL 451.802(c); MSA 17.996(402)(c). However, even securities and transactions exempted from registration are not exempt from the anti-fraud provisions of the act. Author's comment, 7B Uniform Laws Annotated, 1985, § 402, p 603; *Pratt v Kross*, 555 P2d 765, 771 (Or, 1976). Further, the act provides for civil liability and rescission of sales made in violation of the registration requirements or based on misrepresentation. MCL 451.810; MSA 19.776(410).

In *Sparling Plastic Industries, Inc v Sparling*, 229 Mich App 704, 709; 583 NW2d 232 (1998), a group of investors purchased all the outstanding stock in the plaintiff corporation. Neither the securities, nor the sale, were registered under the Uniform Securities Act and the purchaser later sued the seller to rescind the sale based on this nonregistration. *Id.* at 710. This Court ruled the seller had

the burden of showing an exemption applied and the seller failed to meet this burden; therefore, the purchasers were entitled to rescind the transaction. *Id.* at 711-712.

We conclude the trial court erred in granting summary disposition of plaintiffs' claims arising out of the Uniform Securities Act because questions of fact exist regarding whether the securities and the transaction were exempt from registration. If the securities or transaction were obligated to be registered under the act, plaintiffs are entitled to rescind the purchase pursuant to MCL 451.810; MSA 19.776(510); *Sparling, supra*.

Mediation Sanctions

In their cross appeal, defendants argue the trial court erred in reducing the requested mediation sanctions by deducting attorney fees associated with attorney travel time and counsel's representation of other defendants during a portion of the proceedings. In view of our partial reversal, the order granting mediation sanctions in favor of defendants is vacated and the cross appeal is dismissed as moot.

Affirmed in part, reserved in part, and remanded for further proceedings. We do not retain jurisdiction. Plaintiffs, being the prevailing parties, may tax costs pursuant to MCR 7.219.

/s/ Patrick M. Meter
/s/ Richard Allen Griffin
/s/ Michael J. Talbot