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IN THE SUPREME COURT OF THE STATE OF IDAHO

* * * * *

SHAWN W. BAILEY,

Plaintiff/Appellant,

v.

PERITUS 1 ASSETS MANAGEMENT, LLC.,

Defendant/Respondent,

and

AMERICAN MEDICAL FILE, INC., a California Corporation; RONALD J. HELLER, an individual; DAVID J. DESMOND, an individual; WILLIAM R. ESPINOSA, an individual,

Defendants.

Supreme Court
Case No. 44357

* * * * *

APPELLANT'S BRIEF

Appeal from the District Court of the Fourth Judicial District for Ada County
Honorable Melissa Moody, District Judge, Presiding

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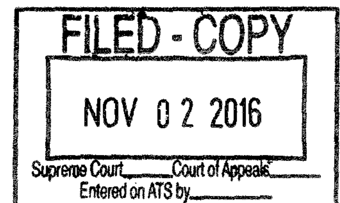

IN THE SUPREME COURT OF THE STATE OF IDAHO

* * * * *

SHAWN W. BAILEY, Plaintiff/Appellant, v. PERITUS 1 ASSETS MANAGEMENT, LLC., Defendant/Respondent, and AMERICAN MEDICAL FILE, INC., a California Corporation; RONALD J. HELLER, an individual; DAVID J. DESMOND, an individual; WILLIAM R. ESPINOSA, an individual, Defendants.	)	Supreme Court Case No. 44357

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Appeal from the District Court of the Fourth Judicial District for Ada County
Honorable Melissa Moody, District Judge, Presiding

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I.

STATEMENT OF THE CASE

A. NATURE OF THE CASE

This is a breach of contract dispute primarily concerning the interpretation of the Statute of Frauds original obligation exception Idaho Code § 9-506(2) and the "Main Purpose Rule." Bailey contends the trial court erred when it found as a matter of law that the contractual arrangement was intended to be a guaranty. Bailey contends AMF and Peritus were joint debtors in a surety relationship.

B. COURSE OF PROCEEDINGS

Bailey filed a complaint for breach of written and oral contracts and intentional infliction of emotional distress claims against his employer, a start-up company, American Medical File, Inc. (hereinafter referred to as "AMF"), Peritus I Asset Management, LLC (hereinafter referred to as "Peritus"), the company financing the start-up AMF, and Ronald J. Heller, David J. Desmond, and William R. Espinosa, individuals and officers of AMF and Peritus. The Defendants all filed motions to dismiss based on the pleadings. The Court dismissed the intentional infliction of emotional distress claim on the pleadings and dismissed the contract claims against the individual defendants finding the individuals signed the contracts "as representatives of Peritus I Asset Management and/or members of the Board of Directors of American Medical File." (R, pp. 000048 – 49.)

This dispute was set for trial to commence July 19, 2016. A Notice of Bankruptcy filing by AMF was filed with the Court May 26, 2015, and therefore all claims against AMF were stayed. Peritus filed its Motion for Summary Judgment March 21, 2016, claiming "Bailey's claim that Peritus promised to pay wages owed by AMF does not satisfy the Statute of Frauds." (R, p. 00268) Bailey filed an Affidavit of Shawn Bailey and a Memorandum of Law Opposing Summary Judgment contending, "the Statute of Frauds does not apply to original obligations per I.C. § 9–506 and the "Main Purpose Rule" adopted by the Idaho Supreme Court. (R, pp. 000281-284). On May 11, 2016, Bailey filed a Motion to Amend Complaint attaching a proposed Amended Complaint which specifically plead I.C. § 9–506(2). (R, pp. 000331-352.)

After a hearing May 19, 2016, the Court entered an Order Granting Summary Judgment to Peritus (R, pp. 000362-372) and an Order Denying Motion for Leave to Amend the Complaint (R, pp. 999373-376) on the basis that the contract was a guaranty and that the Statute of Frauds precluded recovery against Peritus. A Judgment was entered June 14, 2016. Bailey filed a Notice of Appeal July 22, 2016 (R, p. 000383).

C. CONCISE STATEMENT OF FACTS

1. The Three Parties to the Written and Oral Contracts.

(a) AMF

American Medical File (herein referred to as "AMF") was incorporated in California November 7, 2001 by Joel Rayden and Scot Anderson for the purpose of

developing personal health record (PHR) software for use in the medical and health insurance industries. (See Aff. Of Shawn Bailey, para. 15 – 17, R, p. 000307).

In 2004 a few of Peritus' clients became interested in investing in AMF so Peritus formed a limited partnership entity as a vehicle to invest in AMF. Peritus formed the Peritus Global Opportunity Fund Limited Partnership which invested $6.45 million in AMF in addition to a "bridge loan." When AMF defaulted by failing to repay the bridge loan in 2005 the Peritus Fund (hereinafter referred to as "PGO Fund") foreclosed and became the owner of a majority of AMF stock. (See Aff. of Ronald Heller, para. 4, R, p. 000224.)

In 2008 the PGO Fund stopped investing in AMF and dissolved. The AMF shares held by the PGO fund were distributed on a pro-rated basis back to the Peritus clients. (See Aff. of Ronald Heller, para. 5, R, p. 000224.)

After December 31, 2008, Peritus itself began making direct loans to fund AMF. (Aff. of Ron Heller, para. 6, R, p. 000224.) Between August 4, 2008, and September 12, 2011, Peritus loaned AMF at least $842,350.00. Bailey was personally aware of the cash Peritus supplied to AMF to pay overhead expenses on a monthly basis. Peritus employees told Bailey at times Peritus was making loans and at other times buying stock. Bailey did not see any formal loan agreements and none were produced by Peritus in this litigation to Bailey's knowledge. (Aff. of Shawn Bailey, para. 21, R, pp. 000309-10.)

Bailey estimated AMF's "burn rate" of funds was approximately $40,000.00 per month for employees, rent, consultants, and other operating expenses. Although not all bills got paid, Peritus raised substantial sums of money, largely from its clients, to pay AMF overhead. (Aff. of Shawn Bailey, para. 20, R, p. 000309 and Exhibit "C," R, pp. 000319-321.)

AMF filed bankruptcy and the Court in this case was notified May 26, 2015 (R, p. 00004.)

(b) PERITUS

Peritus is an investment advisory company that provides investment management services to investors. Peritus advises clients on investment opportunities and is paid a fee for its advice and for managing client investments. (Aff. of Ronald Heller, para. 3, R, p. 000224).

Peritus employee R. J. Dundas worked for both Peritus and as the "AMF pro tem CEO" when he recruited Bailey to work at AMF in late 2005. (R, p. 000305, Aff. of Shawn Bailey, para. 9.) Bailey met with Peritus employees R. J. Dundas, David Desmond, and Tim Gramatovich in Santa Barbara, California for his job interview in February 2006. Bailey received a job offer March 10, 2006, to work at AMF. The job offer was made by Ronald J. Heller as President of Peritus I Asset Management, LLC, Managing Director Peritus Global Opportunity Fund, LP, and David Desmond as Chief Operating Officer Peritus I Asset Management, LLC. (R, pp. 000315 – 16) (R, p. 000306, para. 13.) While Bailey was employed at AMF, AMF business generated

revenues of only $2,500.00 per month. Peritus made loans and invested client money into AMF to meet its financial obligations (estimated to be $37,500.00 per month. $40,000.00 per month overhead less $2,500.00 per month AMF revenue.) (R, p. 000308, para. 18 and 19.) Over time, Peritus failed to make contributions to AMF to pay Bailey's salary. By late July or early August 2011, Bailey was owed $95,000.00 in back pay. (R, pp. 000308-309, para. 19 and 20.) Bailey quit working for AMF in late July 2011 due to the $95,000.00 in back pay. Peritus officers Ronald Heller and David Desmond contacted Bailey and requested him to return to work. Bailey told them he would not return to work until he received a written contract signed by Peritus in which Peritus was obligated to fund Bailey's salary at AMF. Bailey was provided a written contract of employment signed by Ronald J. Heller, President of Peritus I Asset Management, LLC, and David Desmond, Chief Operating Officer of Peritus I Asset Management, LLC. (R, pp. 000325-26.) In Bailey's opinion, the contract was drafted by Heller and Desmond. (R, p. 000311, para. 25.) Based upon all of the circumstances surrounding the creation of the contract including the discussions, the prior letter offer of employment (2006), Peritus' history of funding AMF operations (2004 – 2011), and the written employment contract provided to Bailey in 2011, Bailey understood Peritus was obligated to fund Bailey's compensation. Bailey would not have returned to work at AMF without the written contract signed by the Peritus officers. (R, p. 000311, para. 25 – 26.)

(c) BAILEY

In late 2005 Bailey was employed at Saint Alphonsus Regional Medical Center and was tasked with the responsibility to convert patient health records (PHR's) from paper files to secure online patient health records. While at St. Alphonsus, Bailey recommended the purchase of the AMF software system. St. Alphonsus was one of the pioneers in using the AMF PHR system. (R, pp. 000304-305). As a result of that experience with AMF, Bailey eventually received an offer of employment from Ronald J. Heller, President of Peritus I Asset Management, LLC and David J. Desmond Chief Operating Officer of Peritus I Asset Management, LLC. (R, p. 000306, para. 13 and Ex. "A", R, pp. 000315-16). Bailey worked at AMF from April 1, 2006, until he left March 20, 2013 as a result of missed compensation payments between October 31, 2012 and March 20, 2013. (R., p. 000312, para. 27 – 28.) Bailey contends he is entitled to $40,119.05 for payments missed after January 1, 2012, plus $300,000.00 in severance benefits under the written contract. (R, p. 000313.)

2. AMF and Peritus Were Jointly Obligated to Pay Bailey.

Although AMF was a separate corporation from Peritus, it is clear Peritus was the source of funding and managing the start-up venture. Peritus created the PGO Fund in 2004 which invested $6.45 million in AMF and extended a "bridge loan" in an unknown amount. After the PGO Fund was dissolved in 2008, Peritus continued to loan money to AMF.

> 6. After the PGO Fund dissolved, Peritus began loaning funds to AMF. Those loans, along with loans from other

> non-Peritus sources, are reflected in financial reports prepared by AMF's outside accountant. (Aff. of Ronald Heller, R, p. 000224, para 6 and Exhibits "A" and "B" attached (R, pp. 000228 – 252.))

The balance sheet Heller submitted shows AMF's long term liabilities totaling $15,076,946.88. Peritus clients invested $6,950,000.00 through the PGO Fund Peritus created and then dissolved. Peritus itself shows $811,852.06 loaned on the balance sheet as of September 30, 2011 (R, p. 000246). Bailey claims Peritus was "managing AMF" when he became employed at AMF and that in 2006 Peritus committed to "fund the expansion of AMF after April 1, 2006," and that between April 2007 and October 10, 2011, "Peritus was solely responsible for raising funds from investors to finance the business." (R, p. 000308)

Bailey's understanding of the Peritus commitment to fund and manage AMF is corroborated by the written letters sent to Bailey from Peritus. His initial employment offer dated March 10, 2006, was only signed by Ronald Heller and David Desmond in their Peritus and/or PGO capacities. (R, pp. 000315-16)

After Bailey quit in July 2011 due to non-payment of his salary, Heller and Desmond contacted Bailey requesting him to return to work. In the conversations preceding the written letter contract Bailey claims:

> 23. I was contacted by Ron Heller and Dave Desmond of Peritus and they requested I return to work. I told them I would not return to work until I received a written contract signed by Peritus in which Peritus was obligated to fund my salary.

* * * *

> 24. Attached as Exhibit "E" (and also attached to the Complaint) is the written and signed contract Peritus provided to me which they represented fulfilled my demand for a binding contract from Peritus to ensure payment of my salary. I understood I was an employee of the start-up company AMF but that Peritus was obligated to fund my employment by virtue of the contract Peritus President, Ronald Heller and Peritus COO, David Desmond, signed . . . . (R, p. 000310)

As stated in Bailey's affidavit, Bailey's understanding of the contract making AMF and Peritus joint obligors is entirely consistent with the course of conduct after April 1, 2006, the verbal discussions and the written correspondence and contracts signed by AMF, Peritus, and Bailey. Bailey contends the arrangement does not fall within the Statute of Frauds because of the "Main Purpose Rule" and I.C. § 9-506(2) "surety exception" to the Statute of Frauds.

II.

ISSUES PRESENTED ON APPEAL

1. Bailey contends the trial court erred when it denied Bailey's motion to amend his complaint to specifically allege the "Main Purpose Rule: and I.C. § 9-506(2) surety exception to the Statute of Frauds affirmative defense.

2. The trial court misinterpreted the Statute of Frauds "Main Purpose Rule."

3. The trial court misinterpreted I.C. § 9-506(2) surety exception.

III.

ATTORNEY FEES ON APPEAL

This is a commercial transaction. The prevailing party shall be entitled to an award of attorney fees per I.C. § 12-120(3). Mickelsen Construction, Inc. v. Horrocks, 154 Idaho 396, 299 P.3d 203, 212 (2013).

IV.

STANDARD OF REVIEW

The Supreme Court reviews a grant of summary judgment under the same standard the district court used in relying on the motion. Peritus had the burden to prove there was no genuine issue of any material fact and is entitled to judgment as a matter of law. Wright v. Ada County, Docket No. 42999 (2016 Opinion No. 74). The Supreme Court exercises free review over issues of law. Buckskin Properties, Inc. v. Valley County, 154 Idaho 486, 490, 300 P.3d 18, 22 (2013).

Where the evidence is all in the form of depositions, affidavits, and documents, the trial court's findings of fact are not binding on the Supreme Court. D & M Development Company v. Sherwood and Roberts, Inc., 92 Idaho 200 at 204 (1969).

In every contract there are both express and implied terms.

> In every contract there exist not only the express promises set forth in the contract but all such implied provisions as are necessary to effectuate the intention of the parties, and as arise from the specific circumstances under which the contract was made.
>
> Davis v. Professional Business Services, 109 Idaho 810 at 813 (1985).

In this case the agreement of the parties is established by conduct, oral promises and written documents as well as the financial circumstances of AMF and Peritus. A review of all evidence by the trier of fact is warranted to establish intent.

> This Court has consistently held that it cannot make the contract for the parties, and that it is only when interpretation of ambiguous terms of a contract is required, are questions of fact presented for determination.
>
> Minidoka Co. v. Krueger, 88 Idaho 395, 416 (1965).

The written contract at issue in this case as well as the course of performance establishes a joint obligation by AMF and Peritus to pay Bailey. AMF and Peritus signed the contract,. Peritus admits both Peritus and AMF supplied funds to pay Bailey throughout the course of their relationship. There is no evidence of a "guaranty relationship."

> The main distinction between a contract of guaranty and a contract of suretyship is that a surety is typically jointly and severally liable with the principal obligor on an obligation to which they are both bound, while a guarantor typically contracts to fulfill an obligation upon the default of the principal obligor. Restatement (Third) of Suretyship and Guaranty § 1, cmt. C. (1996).
>
> Valley National Bank v. Greenwich Ins. Co., 254 F.2d 448 at 453 (S.D.N.Y 2003.)

V.

LEGAL ARGUMENT

A. AMENDMENT OF COMPLAINT.

Procedurally this case is similar to Mickelsen Construction, Inc. v. Horrocks, 154 Idaho 396, 299 P.3d 203 (2013) where the Plaintiff argued on appeal that I.C. § 9-

506(2) applied as an exception to the Statute of Frauds. However, in the complaint, Mickelsen had claimed Horrocks' promise to pay Mickelson was a "guaranty." The Supreme Court ruled the two concepts were "mutually exclusive" and disallowed the argument noting:

> If a plaintiff facing a motion for summary judgment decides it has alleged the wrong claim for relief or wants to raise another claim, the plaintiff must amend its complaint. Because Mickelsen Construction did not do so in this case, its argument that Ms. Horrocks was not a guarantor but instead was a principal debtor cannot be considered on appeal.
>
> Mickelsen Construction, Inc. v. Horrocks, 154 Idaho 396 at ____, 299 P.3d 203 at 212. (2013)

Unlike Mickelsen, Bailey followed the precise procedure set forth by this Court in Mickelsen. After Peritus filed its Summary Judgment Motion relying on Bailey's general allegation of a "guarantee" (R, 00012, para. 11), Bailey filed a motion to amend his complaint to raise the I.C. § 9-506(2) surety defense to the Statute of Frauds. (See R, p. 000338, para. 12, and R, p. 000341, para. 26, 29, and R, p. 000341 para. 30 – 32.) Therefore, Bailey timely raised the original obligation "surety" claim and "Main Purpose Rule" issues. Bailey contends a guaranty and surety arrangement are oftentimes confused and are generally similar according to many legal scholars. The initial pleading error should not prevent the court from deciding a dispute on the merits.

Not to belabor the issue, but Bailey contends this Court should reconsider its wording in Mickelsen which results in illogical pleading requirements for claimants asserting breach of contract claims. Bailey contends his original pleading properly set

forth a breach of contract cause of action which is all that is required in a complaint. A copy of the written contract was attached and incorporated in the complaint. It is illogical to require a claimant to assert in its complaint an exception to an affirmative defense. The Statute of Frauds is an affirmative defense. See I.R.C.P. 8(c)(1)(P).

> (C.) Affirmative defenses.
>
> (1) In general. In responding to a pleading, a party must affirmatively state any avoidance or affirmative defense, including;
>
> (P) statue of frauds;

In the event a defendant raises the Statute of Frauds affirmative defense, all parties are on notice of that issue. Either party can thereafter address the affirmative defense in a summary judgment motion where an exception will undoubtedly arise. It is illogical to require a plaintiff to assert in a complaint an exception to an affirmative defense when the claimant contends the Statute of Frauds does not apply. Again, the Statute of Frauds is an affirmative defense, a burden on the defendant. It has always been Bailey's position that the written, signed contract is outside the Statute of Frauds. The promise by Peritus to pay was an enforceable oral agreement to which the Statute of Frauds does not apply.

Further, a party may specifically and expressly make inconsistent claims like surety vs. guaranty. Inconsistent pleadings are allowed by Supreme Court rule.

> I.R.C.P 8(d)(3) Inconsistent claims or defenses. A party may state as many separate claims or defenses as it has, <u>regardless of consistency</u>. (Emphasis added.)

To be clear, when I drafted the complaint claiming that "Peritus would guarantee payment of Bailey's salary" on or about April 12, 2007, the word "guarantee" was used as a synonym of "assurance." Further, it referred to a 2007 oral agreement, not the written 2011 agreement and the oral "assurances" which are the subject of this lawsuit. Counsel respectfully requests the Court to reconsider the intent of "notice pleading." The Statute of Frauds issue is an affirmative defense that must be raised by the Defendant. If the defense does not raise the defense it is waived. Requiring the claimant to raise the affirmative defense and then also raise the defense that the Statute of Frauds does <u>not</u> apply creates an unfair burden on the Plaintiff. In effect it requires the Plaintiff to raise an affirmative defense that the Plaintiff contends does not apply.

B. <u>THE PROMISE OF PERITUS DOES NOT FALL WITHIN THE STATUTE OF FRAUDS PURSUANT TO THE "MAIN PURPOSE RULE</u>."

The "Main Purpose Rule" is a universally accepted rule of law. When an oral promise is made by a "third party" to pay a creditor of the original promisor in order to advance the economic interest of the third party, the promise is not within the Statute of Frauds. This has been the law in the U.S. since at least 1891 and is still the law as reflected by the Restatement of Contracts (Second).

> §116 Main Purpose: Advantage to Surety.
> A contract that all or part of a duty of a third person to the promise shall be satisfied is not within the Statute of Frauds as a promise to answer for the duty of another if the consideration for the promise is in fact or apparently desired by the promisor <u>mainly for his own economic advantage</u>, rather than in order to benefit the third person.
>
> Restatement (Second) of Contracts § 116 (1981).

The Restatement explains the rationale for the rule which is perfectly rational and logical. If a third person makes a promise for his own benefit, he really isn't a "third person" because he has a financial benefit not unlike the primary debtor.

> a. Rationale. This section states what is often called the "main purpose" or "leading object" rule. Where the surety-promisor's main purpose is his own pecuniary or business advantage, the gratuitous or sentimental element often present in suretyship is eliminated, the likelihood of disproportion in the values exchanged between promisor and promise is reduced, and the commercial context commonly provides evidentiary safeguards. Thus, there is less need for cautionary or evidentiary formality than in other cases of suretyship.
>
> Restatement (Second) of Contracts § 116 a. Rationale.

The "Main Purpose Rule" has been recognized in America since at least 1891 when the U.S. Supreme Court addressed the Statute of Frauds and "Main Purpose Rule" in Davis v. Patrick, 141 U.S. 479, 12 S. Ct. 58 (1891) which involved a factual scenario very similar to this case. Patrick, the creditor, agreed to continue hauling ore under a contract with the Flagstaff Mining Company (the primary debtor). Davis (the third party promisor) was owed money by the Flagstaff Mining Company and wanted the ore converted to money so his debt would also get paid by the Flagstaff Mining Company. Consequently, Davis orally promised Patrick to "guaranty him to be paid."

> Q: What did he say in that connection to A.S. Patrick about continuing on in the hauling of the ores?
>
> A: He required him to continue in the hauling of the ores. He requested him to do it.

> Q: In response to Mr. Davis to that request, what did Mr. Patrick say?
>
> A: He said to Mr. Davis if he would guaranty him to be paid he would continue to work, and Davis said he would see him paid.
>
> Davis v. Patrick, 141 U.S. 479 at 486 (1891).

The U. S. Supreme Court ruled under the "Main Purpose Rule," the oral promise did not fall within the Statute of Frauds. The facts showed Patrick was motivated to help his own financial and economic interest.

> While the original promisor was the mining company, and the undertaking was for its benefit, yet the performance of the contract inured equally to the benefit of Davis and the mining company. Performance helped the mining company in the payment of its debt to Davis, and at the same time helped Davis to secure the payment of the mining company's debt to him; and as the mining company was apparently destitute of any other property, and the payment of its debt to Davis, therefore, depended upon the continued and successful working of this mine . . . . He therefore, in any true sense of the term occupied not the position of a collateral undertaker, but that of an original promisor, and it would be a shadow on justice if the administration of the law relieved him from the burden of his promise on the ground that it also resulted to the benefit of the mining company, his debtor.
>
> Davis v. Patrick, 141 U.S. 479, 488-89 (1891) (Emphasis added.)

Idaho has adopted the Main Purpose Rule. The primary issue is to determine the motivation of the joint debtor.

> The Main Purpose Rule provides that where the promisor (the owner) "has for his object a benefit which he did not enjoy before his promise, which benefit accrues immediately to himself, his promise is original, whether made before,

> after, or at the time of the promise of the third party (the general contractor), notwithstanding that the "affect" is to promise to pay or discharge the debt of another. In order for the rule to apply, there must be consideration for the owner's promise and the consideration must be beneficial to him.
>
> Treasure Valley Plumbing & Heating, Inc. v. Earth Resources Co., Inc. 115 Idaho at 378-79.

Another explanation from another court which followed the Restatement of Suretyship and Guarantee makes the purpose of the rule even clearer.

> According to Rosewood, Caterpillar's promise falls outside the Statute of Frauds pursuant to the "Main Purpose" or "Leading Object" Rule. Under this rule, when the "Main Purpose" or "Leading Object" of the promisor/surety is to subserve or advance his own pecuniary or business interests, the promise does not fall within the statute. P. Alces, Law of Suretyship and Guarantee, sec. 4:19 (1996). As section 11 of the Restatement (Third) of Suretyship and Guaranty states: A contract that all or part of the duty of the principal obligor to the obligee shall be satisfied by the secondary obligor is not within the Statute of Frauds as a promise to answer for the duty of another if the consideration for the promise is in fact or apparently desired by the secondary obligor mainly for its own economic benefit, rather than the benefit of the principal obligor. Restatement (Third) of Suretyship and Guarantee, sec. 11(3)(c) at 42 (1996). See also, Restatement (Second) of Contracts, sec. 116 at 299 (1981).
>
> The reason for the "Main Purpose" or "Leading Object" Rule has been explained: "where the secondary obligor's main purpose is its own pecuniary or business advantage, the gratuitous or sentimental element often present in suretyship is eliminated, the likelihood of disproportion and the values exchanged between secondary obligor and obligee is reduced, and the commercial context commonly provides evidentiary safeguards. Thus, there is less need for cautionary or evidentiary formality than in other secondary obligations. Restatement (Third) of Suretyship and

> Guaranty, sec. 11, comment to Section (3)(c) at 49-50 (1996).
>
> See also Restatement (Second) of Contracts, sec. 116, comment a at 299 (1981); 72 Am Jur 2d Statute of Frauds sec. 134 at 658 (2001) ("Cases sometimes arise in which, although a third party is the primary debtor, the promisor has a personal, immediate, and pecuniary interest in the transaction, and is therefore himself a party to be benefited by the performance of the promisee. In such cases the reason which underlies and which prompted this statutory provision fails, and the courts will give effect to the promise.)"
>
> Rosewood Care Center, Inc. v. Caterpillar, Inc., 877 N.E. 2d 1091 at 1099. (Emphasis added.)

The Supreme Court of Illinois went on to state that the Main Purpose or Leading Object Rule set out in the Restatement has been part of Illinois law since 1873 and that a majority of jurisdictions have adopted this rule as well. Rosewood Care Center, Inc. v. Caterpillar, Inc., 877 N.E. 2d 1091 at 1099 – 1100.

In this case the evidence is undisputed that Peritus had a strong financial incentive to assist AMF by paying AMF's employee, Bailey. Peritus had advised Peritus clients to invest in AMF and Peritus itself loaned significant sums of money to AMF. Peritus may have been a stockholder although that issue is disputed. Peritus had a long history of raising money to capitalize AMF expecting the investment to succeed. Peritus was faced with losing its own money as well as its investors' money if its Chief Technology Officer left the company. Therefore, Peritus persuaded Bailey to continue working at AMF by acting as a surety in the transaction. It is highly unlikely Peritus was motivated to assist non-Peritus stockholders of AMF. There has been no evidence

submitted to support that claim. The only evidence shows Peritus was extremely involved in running and financing the operations of AMF to benefit Peritus and Peritus investors that relied on Peritus to invest and manage their money wisely and productively. This was not an isolated incident but a continuous course of action for at least six years. Peritus received the bargained for consideration of Bailey's time and expertise for six years. The terms of the contract cannot be disputed. Peritus was an original, primary promisor. The Statute of Frauds does not apply. At best there is an issue of fact for a jury to determine intent. Summary Judgment for Peritus must be reversed.

C. I.C. § 9-506(2) EXCEPTION APPLIES.

The trial court rejected Bailey's argument that I.C. § 9-506(2) applied and found the "original obligation exception does not apply as a matter of law." (R., p. 000370.) The Court went on to explain its reliance on Mickelsen Const., Inc. v. Horrocks, 154 Idaho 396, 299 P.3d 203 (2013) for the proposition that "the original obligation exception does not apply when the creditor contends that the original debtors are still liable on the debt" (R, p. 000370) quoting the Horrocks decision. Bailey acknowledges that finding accurately refers to the Horrocks decision. However, that finding in the Horrocks decision is not found in the express language of the statute or the law of surety. In fact, it is inconsistent with the law of surety and the statute. I.C. § 9-506(2) provides:

> 9-506. Original obligations – Writing not needed. – A promise to answer for the obligation of another, in any of the following cases, is deemed an original obligation of the promisor, and need not be in writing:

> 2. Where the creditor parts with value, or enters into an obligation in consideration of the obligations in respect to which the promise is made in terms or under circumstances such as to render the party making the promise the principal debtor, and the person in whose behalf it is made, his surety. (Emphasis added.)

In this case, Peritus made a promise to answer for the obligation of AMF as contemplated in the first paragraph of the statute. Under paragraph 2, the "creditor parts with value" phrase refers to Bailey's agreement to provide Chief Technology Officer services. "Under circumstances such as to render" (Peritus) the "principal debtor" and AMF "his" surety for Peritus. This statute clearly contemplates two obligors, both of whom are liable on the debt. Nowhere does the statute suggest the creditor can only pursue one obligor. That would defeat the purpose of the statute.

Given the factual scenario before this Court, I.C. § 9-506(2) clearly applies. For six years Peritus had been supplying AMF around $37,500.00 per month in funding to pool with revenue from AMF of $2,500.00 per month to pay AMF's $40,000.00 per month overhead expense. Clearly, Peritus was always the "principal debtor" and the only way Peritus would get the money back is when AMF became successful and repaid Peritus out of its increased revenues and profits. The concept the statute "does not apply when the creditor contends that the original debtors are still liable on the debt" has no support from a reading of the statute. The statute clearly reflects an intention that both debtors would be liable. In a surety arrangement, Peritus can seek payment from AMF if Peritus pays the debt. In a surety arrangement, Bailey can seek payment

from both AMF and Peritus. They are joint debtors to Bailey. A more thorough discussion of surety law follows. The statute does not contain language supporting the Horrocks dicta relied upon by the trial court.

1. The Difference Between Surety and Guarantor.

After much research into the world of surety and guaranty, it is clear the two concepts are often confused and similar. This is an additional reason Bailey's original pleadings cannot be strictly adhered to where the two concepts are in play. A review of case law will show lawyers and lay people frequently confuse the two concepts. As stated by the First Circuit Court of Appeals in Rhode Island Hospital Trust National Bank v. The Ohio Casualty Insurance Company, 789 F.2d 74 (1st Cir. 1986):

> In fact, the terms "surety" and "guarantor" often are used interchangeably, reflecting their nearly identical characteristics. Restatement of Security sec. 82 (1941); (other citation omitted).
>
> Rhode Island Hospital Trust Nat'l Bank v. The Ohio Cas. Ins. Co., 789 F.2d 74 at 78 (1st Cir. 1986). (Emphasis added.)

In that case the 1st Circuit Court cited the primary differences between a surety and a guarantor. One of the easiest distinctions is that a surety typically signs the same contract as the principal debtor whereas a guarantor typically does not. A guarantor normally would enter into a separate contract based on separate consideration.

> A suretyship is a contractual arrangement in which one party, the "surety," agrees to back up the obligation of another, termed the "principal" or "principal debtor," the latter bearing the primary burden of performing for the creditor. The term "surety" is often used broadly to include all forms of suretyship, including the "guaranty." It also is used in a

> narrow sense to indicate a direct, primary obligation to pay someone else's debt, as distinguished from the secondary, collateral obligation of a "guarantor." The difference between the primary obligation of the surety and the secondary obligation of the guarantor is that the surety joins the original contract with the principal and may be sued as an unconditional promisor along with the principal; the guarantor's liability arises from an independent agreement and is expressly conditional upon default by the principal. (Citation omitted.) (Emphasis added.)
>
> Rhode Island Hospital Trust Nat'l Bank v. The Ohio Cas. Ins. Co., 789 F.2d 74 at 77-78 (1986).

It should be noted, AMF and Peritus each signed Bailey's employment contract. The Court specifically assumed Peritus signed the employment contract. (R, p. 000393.) The fact there was one contract signed by both is proof of a surety contract and joint obligation. This also proves it was not a guaranty. The fact there was one contract is a defining characteristic of an intent to be a "surety."

Other authorities are in accord. In Howell v. Commissioner of Internal Revenue, 69 F.2d 447 (8th Cir. 1934), the 8th Circuit Court of Appeals stated distinctions between suretyship, guaranty, and indemnity.

> There are recognized distinctions between suretyship, guaranty, and indemnity.
>
> A surety and guarantor are answerable for the debt, default, or miscarriage of another. Strictly speaking, the liability of a guarantor is secondary and collateral, and its enforcement depends upon certain conditions. The liability of a surety is original, primary, and direct. The surety is bound by the same agreement which binds his principal, while a guarantor is bound by his own independent undertaking. (Citation omitted.) In case of suretyship there is but one contract, binding the surety and the promisor, but in the case of a

guaranty there are two contracts, one binding the principal debtor, and one binding the guarantor.

Howell v. Comm. Of Internal Revenue, 69 F.2d 447 at 450 (8th Cir. 1934).

In Commercial Money Center, Inc. v. Illinois Union Insurance Company, 508 F.3rd 327 (6th Cir. 2007), the 6th Circuit determined a suretyship arrangement existed between Illinois Union Insurance Company and a leasing company which went bankrupt. Commercial Money Center, the Plaintiff sued Illinois Union Insurance Company alleging it was liable as a surety. The 6th Circuit addressed the issue of interpretation of contracts for purposes of determining whether a suretyship arrangement was made. The court found that where the contract is ambiguous, the court may resort to parol evidence to aid in the interpretation of the intent of the parties.

> To affirm we must find that the transaction as a whole unambiguously established a suretyship with Chase/Citi Bank as the intended obligee. Surety contracts are construed using the same rules that govern the interpretation of other contracts. (Citations omitted.) The language of the contract governs if it is clear and does not result in an absurdity; and the intention of the parties is to be ascertained, if possible, from the writing alone. See Cal. Civ. Code sec. 1638 and 1639. In discussing California law, this Court explained that a policy is ambiguous if its terms are reasonably susceptible of more than one construction, and that extrinsic evidence is admissible if it is "relevant to prove a meaning to which the language of the instrument is readily susceptible." (Citations omitted.) ("When a dispute arises over the meaning of contact language, the first question to be decided is whether the language is "reasonably susceptible" to the interpretation urged by the party. If it is not, the case is over.") (Citation omitted.)

Surety contracts and insurance contracts are conceptionally and legally distinct. The distinction, generally speaking, is that: an insurer undertakes to indemnify another "against loss, damage, or liability arising from an unknown or contingent event" whereas a surety promises to "answer for the debt, default, or miscarriage of another." The surety relationship is a tripartite one; it is a third party (the obligee), not the principal, who is protected, although the principal pays the premium. Furthermore, an insurer has no right of subrogation against its insured; a surety, on the other hand, is entitled to reimbursement by its principal. The fact that the endorsement purports to be part of an insurance policy providing collateral security insurance coverage is not dispositive, as no particular form of agreement is required to establish a suretyship as long as the agreement establishes the intention to create a surety contract. It is a substance of the transaction, not the form, that controls ("the existence of suretyship status depends upon the respective roles of the parties and the nature of the underlying transaction.")

The Restatement similarly provides that when the criteria for suretyship are fulfilled, the secondary obligor has surety status regardless of, among other things, the form of the transaction, the terms used to describe the secondary obligor or the secondary obligation, or whether the secondary obligation is conditional or unconditional. Restatement (Third) of Suretyship and Guaranty, sec. 13) affirming determination that agreement although styled as an insurance contract, was a contract of suretyship). The Restatement also explains that a secondary obligor has the status of a surety when:

(a) Pursuant to contract (the "secondary obligation"), an obligee has recourse against a person (the "secondary obligor") . . . with respect to the obligation (the "underlying obligation") of another person (the "principal obligor") to that obligee; and

(b) To the extent that the underlying obligation or the secondary obligation is performed, the obligee is not entitled to performance of the obligation; and

> (c) As between the principal obligor and the secondary obligor, it is the principal obligor who ought to perform the underlying obligation or bear the cost of performance. Restatement (Third) of Suretyship and Guar., sec. 1(a) (1996).
>
> Suretyship is described as involving a tripartite relationship consisting of a principal obligee who is owed a debt or duty; a principal obligor who is responsible for payment of the debt or performance of the duty; and a secondary obligor or surety who agrees to answer for the primary obligor's debt or duty. (Citations omitted.)
>
> Commercial Money Center, Inc. v. Illinois Union Ins. Co., 508 F.3d 327 at 338-39 (6th Cir. 2007). (Emphasis added.)

At issue in this lawsuit is whether the contract made between Peritus, AMF, and Bailey involves a surety relationship or a guarantee. Clearly, under Idaho law, a guarantee must be in writing and must contain a specific express promise of guarantee. A surety contract, by statute, need not be in writing. Therefore, determining whether the contract is a guaranty or surety, in the strict sense (a surety) is a critical issue.

In the Mickelsen Construction v. Horrocks opinion, this Court addressed a factual situation which was clearly a guarantee arrangement. In that case, Mickelsen Construction, Inc. entered into a contract with Accelerated Paving, Inc. whereby Mickelsen provided asphalt on an Accelerated Paving job site. Under the contract, Mickelsen was owed $34,980.00 which Accelerated had failed to pay. (Ms. Horrocks was not a party to that contract.) Mickelsen threatened to file a lien against the property where the work was done. Clearly, in this situation, Accelerated was the primary obligor and Mickelsen Construction was the obligee. At some later time, Ms.

Horrocks wrote a check in the amount of $34,980.00 payable to Mickelsen out of Ms. Horrocks' business account. There was no evidence suggesting Ms. Horrocks was motivated by anything other than a friendship with Accelerated Paving. The Idaho Supreme Court found that the alleged guarantee by Ms. Horrocks was not enforceable because the check was not adequate evidence of a guarantee as required by the Statute of Frauds. The Court stated:

> In this case, the only document that could constitute a note or memorandum signed by Ms. Horrocks was the check. The only writing on the check, other than the date, the payee, the amount, and Ms. Horrocks' signature, was "ACCEL" written on the memo line, which began with the word "For." That would indicate that the check was "for Accel," but nothing more. A guarantee is an undertaking or promise on the part of a guarantor which is collateral to a primary or principal obligation and binds the guarantor to performance in the event of non-performance of the principal obligor. The check does not show any intent by either of the defendants to be liable for the obligation of some other person or entity, it does not name or identify the person or entity that is primarily liable and it does not specify what obligation of that person or entity is allegedly being guaranteed. There is nothing on the check indicating that either Ms. Horrocks or Sun Shine Secretarial agreed to guarantee any obligation of Accelerated Paving to Mickelsen Construction. Therefore the alleged guarantee agreement is void.
>
> Mickelsen Construction, Inc. v. Horrocks, 154 Idaho 396 at ___________, 299 P.3d 203 at 209. (Emphasis added.)

Clearly, the arrangement between Mickelsen, Accelerated Paving, and Horrocks was a guarantee arrangement as evidenced by the fact there were two separate contracts. First, there was the contract between Mickelsen and Accelerated Paving for

performance of the construction work. Secondly, there was a subsequent contract entered into between Ms. Horrocks and Mickelsen wherein Horrocks wrote a check in payment on behalf of the primary obligor, Accelerated. The obligation of Accelerated was primary and the obligation of Ms. Horrocks was, at best, "collateral." More importantly, there was no evidence Ms. Horrocks had a business interest in the construction contract. There was no indication of a joint obligation typical of a surety arrangement. Typically, in a surety arrangement the primary obligor and the surety would enter into the same contract promising performance to the obligee. Both parties would have a business or financial stake in performance of the underlying construction contract. The Mickelsen case is the perfect example of an oral guaranty that is void. The Bailey, AMF, Peritus contract is the perfect example of a surety contract. There was only one contract, Peritus had a direct financial interest with a primary obligation to pay, not collateral.

2. The Purpose of the Statute of Frauds.

It is important to keep in mind the primary purpose of the Statute of Frauds. The Statute of Frauds is intended to prevent fraud, not to perpetrate fraud. In certain circumstances it is advisable to have an agreement in writing to protect someone from rash or unwise decisions. The purpose of the Statute of Frauds is not to discourage oral agreements under the proper circumstances.

> The Statute of Frauds was first enacted in England in 1677. Considering modern rules of evidence and business practice, there are some who believe that insofar as applicable to facts similar to those here, such statute has

> outlived its usefulness. It is a two edged sword. It is argued that it may be used to perpetrate frauds as well as to prevent them. Under it a person may obtain to prevent them. Under it a person may obtain an oral promise to pay the debt of a third person and then resist payment on the ground that this promise is oral and therefore unenforceable under the Statute of Frauds. Because of this and other dangers, the courts of England and this country have sought to keep the Statute within its intended purpose.
>
> Gulf Liquid Fertilizer Co. v. Titus, 354 S.W.2d 378 at 382 (Tex. 1962).

The Supreme Court of Texas also addressed the specific rationale for requiring contracts to be in writing where a third party is promising to pay the debt of another.

> The Statute of Frauds suretyship provision applies when a creditor seeks to recover from a guarantor because of a third person's failure to perform. The provision discourages false allegations that a person promised to pay if the primary debtor could not. The provision also protects those closely associated with the principal debtor for making rash or emotionally driven promises before having any real opportunity for awareness of the nature and magnitude of the risks undertaken. The suretyship provision, however, is not intended to provide more certainty to the terms of an oral contract for the benefit of a third person. Nor is it intended to discourage oral promises to assume the debt of a third person.
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> Dynegy, Inc. v. Yates, No.11-0541 Supreme Court of Texas (Aug. 30, 2013).

VI.

CONCLUSION

The Idaho legislature contemplated that contracts to answer for the debt of another can either be written or oral depending on the circumstances.

I.C. §9-505 Certain agreements to be in writing.

> 2. A special promise to answer for the debt, default, or miscarriage of another, except in the cases provided for in section 9-506, Idaho Code.

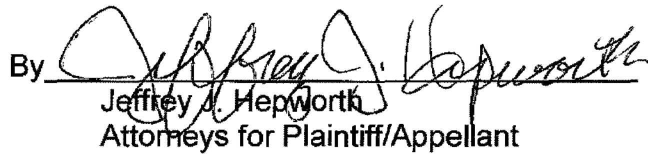
There is no dispute a guaranty contract must be in writing. I.C. § 9-506(2) provides the "surety" exception. A surety arrangement is similar to a guaranty in that they involve three parties, one obligee and two obligors. The difference between a surety and guarantor, both of whom are debtors, depends on the nature of their obligation. A surety is jointly and severally liable with the principal obligor. A guarantor only agrees to pay upon default of the principal obligor. In a surety arrangement the principal and surety typically sign the same agreement. A guarantor does not. The debt of a surety is original, primary, and direct. The liability of a guarantor is secondary and collateral, and its enforcement depends on certain conditions. Howell v. Commissioner v. Internal Revenue, 69 F.2d 447 (8th Cir. 1934).

The "Main Purpose Rule" provides that the oral promise of a third party to pay the creditor of an original debtor is outside the Statute of Frauds when the promise is motivated "mainly" for his own economic benefit. The two concepts of the surety exception and the "Main Purpose Rule" are both recognized under Idaho law. The rationale for the two concepts is similar. In both cases, the third party promise is motivated to benefit the third party economically. In this case AMF was a start-up company financed by Peritus or by Peritus clients on the advice of Peritus. Peritus had a long history of continuous investment of money in AMF. Peritus had a vested interest in making AMF successful in order to make Peritus and its clients' money. The course

of conduct, discussion , and writings all prove the arrangement was not a guaranty. Under a guaranty, the guarantor would only be expected to pay after AMF defaulted. Instead, the evidence shows Peritus was continuously investing money, from 2004 to 2012. This was not a guaranty arrangement and the Statute of Frauds does not apply.

DATED this 2nd day of November, 2016.

JEFFREY J. HEPWORTH, P.A.
& ASSOCIATES



By ______
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CERTIFICATE OF SERVICE

The undersigned, a resident attorney of the State of Idaho, with offices at 161 5TH Avenue South, Suite 100, Twin Falls, Idaho, certifies that on the 2nd day of November, 2016, he caused a true and correct copy of the APPELLANT BRIEF to be forwarded with all required charges prepaid, by the method(s) indicated below, to the following:

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Hand Delivered	X
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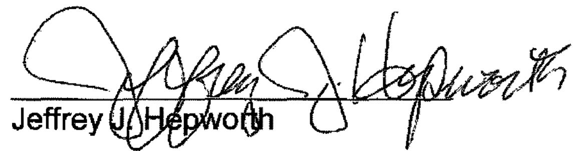

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