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COMMERCIAL AND CORPORATE LAW

OVERVIEW

During the survey period, the Tenth Circuit Court of Appeals analyzed a variety of issues within the scope of commercial and corporate jurisprudence. The court considered tort claims arising from competitive takeover bids,[1] the applicability of "force majeure" clauses,[2] and the preemptive nature of federal copyright statutes.[3] In the sphere of corporate governance, the Tenth Circuit discussed piercing the corporate veil,[4] and post-dissolution liability for criminal acts committed by corporations and partnerships.[5] Cases in the banking area resulted in a discussion regarding the subtle distinctions between a bank and a "non-bank" bank,[6] and limitations on the use of the *ultra vires* defense by bank officers.[7] This article will examine these significant Tenth Circuit decisions.

I. CLAIMS OF TORTIOUS INTERFERENCE WITH CONTRACT AND WITH PROSPECTIVE BUSINESS ADVANTAGE PROVIDE NO PROTECTION TO TAKEOVER BIDDERS OUTDONE BY COMPETITIVE TENDER OFFERS

R-G Denver, Ltd. v. First City Holdings of Colorado, Inc.,[8] involved competing efforts to purchase the assets of the Denver Real Estate Investment Association ("DREIA"), a business trust with assets consisting of real and personal property.[9] R-G Denver was a limited partnership formed for the purpose of acquiring the assets of DREIA. First City Holdings was a corporation that owned, together with other parties, approximately six percent of DREIA's stock.[10] Like R-G Denver, First City Holdings was interested in taking control of DREIA.[11]

A. *Factual Background*

On July 17, 1980, R-G Denver entered into a contract with DREIA to purchase DREIA's assets for $42,540,000.[12] The value of this offer to

1. R-G Denver, Ltd. v. First City Holdings of Colorado, Inc., 789 F.2d 1469 (10th Cir. 1986).
2. International Minerals and Chem. Corp. v. Llano, Inc., 770 F.2d 879 (10th Cir. 1985).
3. Ehat v. Tanner, 780 F.2d 876 (10th Cir. 1985), *cert.denied*, 107 S. Ct. 86 (1986).
4. Inryco, Inc. v. CGR Bldg. Sys., 780 F.2d 879 (10th Cir. 1986); and McCulloch Gas Transmission Co. v. Kansas-Nebraska Natural Gas Co., 768 F.2d 1199 (10th Cir. 1985).
5. United States v. Mobile Materials, Inc., 776 F.2d 1476 (10th Cir. 1986).
6. Oklahoma Bankers Ass'n v. Fed. Reserve Bd., 776 F.2d 1446 (10th Cir. 1986).
7. Ries Biologicals, Inc. v. Bank of Santa Fe, 780 F.2d 888 (10th Cir. 1986).
8. 789 F.2d 1469 (10th Cir. 1986).
9. *Id.* at 1471.
10. *Id.*
11. *Id.* at 1472.
12. *Id.* at 1471.

DREIA shareholders was $32.00 per share, with a possibility for $34.00 per share if certain conditions were met.[13]

The agreement specifically required: 1) that a majority of DREIA shareholders approve the takeover at a meeting called for that purpose; 2) that DREIA pursue favorable tax rulings from the Internal Revenue Service; and 3) that DREIA consult with R-G Denver's counsel when preparing the necessary proxy materials.[14] If shareholder approval was not obtained by October 15, 1980, the contract provided that either party could terminate the agreement by providing written notice; otherwise, termination would automatically occur on December 31, 1980.[15]

On August 12, 1980, First City Holdings filed a Schedule 13D[16] with the Securities and Exchange Commission, indicating that it had acquired over five percent of DREIA's common stock and that it might be interested in obtaining control of DREIA or its assets. On September 15, 1980, First City Holdings informed DREIA of its intention to make a tender offer at $35.00 per share.[17] First City Holdings withdrew its tender offer on September 18, 1980, but two weeks later offered $36.00 per share for DREIA's assets with terms similar to those proposed by R-G Denver.[18] In light of these developments, the DREIA trustees concluded that updated proxies should be solicited. The October fifteenth shareholders' meeting was therefore adjourned to a later date (January 6, 1981), and no vote was taken on the pending R-G Denver proposal.[19]

Shortly thereafter, First City Holdings increased its offer to $37.15 per share.[20] Proxies were again sent out, the DREIA board announced its support for this new offer, and, at a price of $37.15 per share, First City Holdings was able to acquire nearly 80% of the outstanding DREIA shares.[21] Then, at the rescheduled shareholders' meeting on January 6, 1981, First City Holdings, now in control of DREIA, abstained from voting on R-G Denver's proposed acquisition. As a result, that plan was not approved.[22]

In its suit, R-G Denver first asserted that First City Holdings tortiously interfered with a contract by making bad faith tender offers for the sole purpose of manipulating the fiduciary duties of DREIA's trustees.[23] The trial court,[24] relying on *Great Western Producers Cooperative v.*

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13. *Id.*
14. *Id.*
15. *Id.* at 1472.
16. *Id.* A Schedule 13D is required to be filed with the Securities and Exchange Commission when any entity acquires more than 5% beneficial ownership of a company. The schedule must be filed within 10 days of the acquisition and a copy must be given to the issuer. 15 U.S.C. § 78(m)(d)(1) (1982).
17. *R-G Denver*, 789 F.2d at 1472.
18. *Id.*
19. *Id.* at 1473.
20. *Id.*
21. *Id.*
22. *Id.* Also at that meeting, DREIA, controlled by First City Holdings, paid $200,000 to R-G Denver as a mutual release of liability.
23. *Id.* For a general discussion of tender offer litigation, see Loewenstein, *Tender Offer Litigation and State Law*, 63 N.C.L. REV. 493 (1985).

Great Western United Corp.,[25] held that there was no breach of agreement where a contractual duty became inconsistent with fiduciary duties, regardless of tortious interference.[26]

R-G Denver's second cause of action was a claim for tortious interference with prospective business and economic advantage.[27] R-G Denver asserted that First City Holdings' actions were in bad faith and that the "now you see it, now you don't" tender offer was made with the express intent of preventing the October fifteenth shareholder vote.[28] The trial court, granting summary judgment in favor of First City Holdings, reasoned that First City Holdings' actions were within the bounds of proper competition.[29]

B. *The Tenth Circuit Decision*

Judge Cook,[30] writing for the Tenth Circuit, affirmed the trial court's decision. The court enumerated five elements necessary to prove a claim of tortious interference with a contract:

> (1) an existing valid contract between plaintiff and a third party; (2) knowledge by the defendant of this contract, or knowledge of facts which should lead him to inquire as to the existence of same; (3) intent by the defendant to induce a breach of contract by the third party; (4) action by defendant which induces a breach of the contract; and (5) damage to the plaintiff.[31]

The Tenth Circuit found that the instant case failed to meet all of these elements and that the DREIA trustees had a clear fiduciary duty to inform their shareholders of the competing offers from First City Holdings.[32]

Additionally, the Tenth Circuit noted that their decision was based

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24. The United States District Court for the District of Colorado, Judge John P. Moore presiding.

25. 200 Colo. 180, 613 P.2d 873 (1980). In *Great Western*, the board of directors of a sugar-refining corporation, organized under Delaware law, entered into an agreement with a group of sugar beet producers for the sale of Great Western's wholly owned subsidiary. Under the agreement, Great Western was obligated to use its "best efforts" to obtain shareholder approval of the sale. Although the Colorado Supreme Court held that under Delaware law the "best efforts" obligation required Great Western to make a "reasonable, diligent and good-faith effort" to secure shareholder approval, the "best efforts" clause did not bind the board to continue recommending approval of the sale in the face of escalating sugar prices. Approval of the sales agreement under these improved circumstances would be detrimental to the shareholders, and accordingly, Great Western was not sanctioned for eventually ceasing its efforts to obtain shareholder approval. *Id.* at 180-84, 613 P.2d at 874-76.

26. *R-G Denver*, 789 F.2d at 1473.

27. *Id.* at 1475-76.

28. *Id.* at 1476.

29. *Id.* at 1476-77.

30. Honorable H. Dale Cook, Chief Judge, United States District Court for the Northern District of Oklahoma, sitting by designation. Other members of the court were Circuit Judges Barrett and Anderson.

31. *R-G Denver*, 789 F.2d at 1474 (citing Control, Inc. v. Mountain States Tel. & Tel. Co., 32 Colo. App. 384, 513 P.2d 1082 (1973)).

32. *Id.* at 1474-75.

on prior case law. In an affirmation of the trial court's holding, Judge Cook cited *Great Western Producers Cooperative v. Great Western United Corp.*,[33] where the Colorado Supreme Court held that there is no breach of an agreement where a board of directors prioritizes its fiduciary duties over its contractual obligations.[34] The Tenth Circuit further reasoned that the R-G Denver/DREIA agreement was not breached by the failure of the shareholders to conduct a vote on October 15, 1980. The shareholder approval was merely a prerequisite to be satisfied before the contemplated transaction could take place. Accordingly, it did not carry the same consequences as an unfulfilled promise.[35]

R-G Denver's second claim — tortious interference with prospective business and economic advantage — also fell on deaf ears. This claim was supported by the assertion that First City Holdings' privilege to compete was lost by its wrongful and improper conduct. The tort of interference with a prospective business advantage has been previously established.[36] However, under these circumstances, the court simply did not believe that First City Holdings' *sole* purpose was wrongful, in bad faith or improper.[37]

The Tenth Circuit further found that the only breach which may have been induced was the failure of the shareholders to vote at the October fifteenth meeting.[38] However, that vote was not required regardless of intervening events. Shareholder approval was a condition, not a promise. Therefore, no actual breach — whether induced or not — occurred.[39] The summary judgment of the district court was affirmed.

C. *Analysis*

This decision upholds the basic principles of the free enterprise system. Once a tender offer is made, the target company is essentially placed upon an auction block. Shareholders are given the option of choosing between bidders, and the board of directors has a fiduciary

33. 200 Colo. 180, 613 P.2d 873 (1980).

34. *R-G Denver*, 789 F.2d at 1475 (relying on the analysis in *Great Western*, 613 P.2d at 878).

35. *Id.* at 1474.

36. *Id.* at 1476. *See* Dolton v. Capitol Federal Sav. and Loan Ass'n, 642 P.2d 21 (Colo. App. 1981). *See generally* Comment, *Interference with a Prospective Business Relationship: An Old Tort for the New Marketplace*, 35 BAYLOR L. REV. 123 (1983).

Colorado courts have adopted the RESTATEMENT (SECOND) OF TORTS § 768(1) (1977), which provides in pertinent part:

> (1) One who intentionally causes a third person not to enter into a prospective contractual relation with another who is his competitor . . . does not interfere improperly with the other's relation if
> (a) the relation concerns a matter involved in the competition between the actor and the other and
> (b) the actor does not employ wrongful means and
> (c) his action does not create or continue an unlawful restraint of trade and
> (d) his purpose is at least in part to advance his interest in competing with the other.

37. *R-G Denver*, 789 F.2d at 1477.

38. *Id.* at 1474.

39. *Id.*

duty to inform the shareholders of all offers. The current trend of "shark repellents"[40] and "poison pills"[41] may inhibit the initial offeror, but for a company that wants to deter takeovers, once the initial offer is made, there is nothing to prevent it from winding up on the auction block, thereby allowing shareholders to take advantage of the highest offer.[42]

The principle of free market competition in tender offers was also upheld by the Second Circuit Court of Appeals, in *Hanson Trust PLC v. SCM Corp.*[43] SCM, a prime target for a takeover, became the subject of a bidding contest. SCM sought a preliminary injunction barring purchasers, their officers, agents, and employees from acquiring shares in SCM and also from exercising any voting rights with respect to shares previously acquired.[44]

The Second Circuit acknowledged the legislative intent of the Williams Act,[45] which was to avoid favoring either existing corporate management or outsiders seeking control through tender offers. The Second Circuit stated that: "In this context the preliminary injunction, which is one of the most drastic tools in the arsenal of judicial remedies, must be used with great care, lest the forces of the free-marketplace, which in the end should determine the merits of take over disputes, are nullified."[46]

II. THE DISTINCTION IN APPLICABILITY BETWEEN "FORCE MAJEURE" AND ADJUSTMENT CLAUSES WHEN SUPERVENING GOVERNMENTAL REGULATIONS AFFECT PERFORMANCE UNDER A CONTRACT

In *International Minerals and Chemical Corp. v. Llano, Inc.*,[47] the Tenth

40. The expression "shark repellent" refers to the defensive tactic employed by some vulnerable companies whereby stock repurchase programs are implemented in order to strengthen the control of friendly shareholders. T. HAZEN, THE LAW OF SECURITIES REGULATION 380 (1985). *See, e.g.*, LTV v. Grumman Corp., 526 F. Supp. 106 (E.D.N.Y. 1981) (corporation and pension plan made market purchases of more than 1 million shares of corporation's own stock in a single day to prevent tender offeror from acquiring majority control).

41. The term "poison pill," used to describe the most recent defensive mechanism in the arsenal of corporate take over weapons, refers to preferred stock or warrants, issued by the board of directors without shareholder approval. These new securities have the common characteristic that the rights of their holders are materially increased if any person acquires more than a certain fraction of the corporation's common shares. R. HAMILTON, CORPORATIONS 834 (3d ed. 1986); *see, e.g.*, Moran v. Household Int'l Inc., 500 A.2d 1346 (Del. 1985).

42. In a less positive vein, an argument could be made that this decision seems to encourage non-disclosure of takeover offers and negotiations in an era where disclosure has previously been encouraged, if not required. *See* Michaels v. Michaels, 767 F.2d 1185 (7th Cir. 1985); Levinson v. Basic, Inc., 786 F.2d 741 (6th Cir. 1986); *see also* NEW YORK STOCK EXCHANGE COMPANY MANUAL § 202.05 (1983); AMERICAN STOCK EXCHANGE GUIDE § 401 (1983); NASD MANUAL Schedule D, Part II.

43. 774 F.2d 47 (2d Cir. 1985).

44. *Id.* at 50.

45. 15 U.S.C. § 78n(d)(1), (6) (1982).

46. *Hanson Trust*, 774 F.2d at 60.

47. 770 F.2d 879 (10th Cir. 1985).

Circuit reversed the district court and remanded with directions to allow a buyer, under a "take or pay" natural gas requirements contract, the protection of a payment-adjustment clause when the contract's "force majeure" clause was deemed inapplicable due to the lack of timely notification to the seller. The buyer had raised the "force majeure" defense when subsequently-enacted state environmental regulations resulted in modification to the buyer's mine processing facility.[48]

A. *Factual Background*

International Minerals and Chemical Corporation ("IMC") operated a potash mine and processing facility near Carlsbad, New Mexico.[49] Llano supplied IMC with the natural gas required to operate the mine's processing facility.[50] Under the contract, IMC was obligated to take, at a minimum, a daily average of 4800 million Btu's of Llano's gas.[51] IMC was further committed to pay for this minimum amount of gas, whether it was accepted or not.[52] The contract also contained a "force majeure" clause, which provided for certain unexpected exigencies.[53]

At the commencement of the contract, emissions from IMC's mine were not regulated. However, in December 1978, the New Mexico Environmental Improvement Board promulgated Regulation 508,[54] which limited emissions from potash processing equipment. Compliance was required "as expeditiously as practicable, and not later than December 31, 1982."[55] Following extensive study and testing, IMC determined that its best hope for compliance with Regulation 508 was to experiment with a "salting out process"[56] which required less gas consumption. Llano was notified that IMC's gas consumption would be 50 to 60 percent of normal usage during the testing period.[57] However, this notification did not inform Llano that the reduction was in response to environmental regulations, or that the reduced gas consumption might

48. *See generally* J. Becker, *Force Majeure and State Intervention in U.S. Law*, INT'L BUS. LAW, 283-86 (June 1985). *See also* Note, *Force Majeure Clause as Defense In Gas Delivery Contract*, 112 PUB. UTIL. FORT. 60 (July 21, 1983).

49. *International Minerals*, 770 F.2d at 881.

50. *Id.*

51. *Id.*

52. *Id.* at 881-82. This is a typical "take and or pay" provision used throughout the natural gas industry. The purpose is to compensate the seller for being ready to deliver at all times, frequently at the exclusion of other customers. *Id.*; *see also* Utah Int'l, Inc. v. Colorado-Ute Elec. Ass'n, 425 F. Supp. 1093 (D. Colo. 1976) ("take or pay" coal purchase contract); Mobile Oil Corp. v. Tennessee Valley Auth., 387 F. Supp. 498 (N.D. Ala. 1974) ("take or pay" electricity contract).

53. *International Minerals*, 770 F.2d at 882, 885. The "force majeure" clause provided that either party would be excused from performance if failure or delay in performance was occasioned by events such as fire, flood, acts of God, or the interference of civil and/or military authorities. The party seeking to be excused from performance was required to provide immediate notice of all pertinent facts and to take reasonable steps to prevent the problem. Further, the seller was to be entitled to six months' notice before the buyer could be excused. *Id.*

54. *Id.* at 883.

55. *Id.*

56. *Id.*

57. *Id.*

become permanent due to a "force majeure" situation.[58]

IMC was in compliance with Regulation 508 on March 20, 1981, twenty-three months before the regulation deadline. As a result, during the last eighteen months of the contract, IMC did not accept its minimum obligation of gas from Llano.[59]

IMC sought relief in the form of a declaratory judgment, hoping to release the company from the contractual obligation to pay for the unused natural gas. Llano counterclaimed for the amount due under the contract, $3,564,617.12.[60] The trial court found that IMC was liable to Llano for the full value of the gas not accepted, despite the fact that Llano had been able to sell the gas elsewhere for a higher price than IMC's purchase price.[61] The trial court reasoned that the U.C.C. doctrine of impossibility/impracticability, as codified in N.M. STAT. ANN. § 55-2-615 (1978),[62] was not applicable in this case because, by its terms, it applies only to sellers.[63] Additionally, the trial court based its decision on Official Comment 9,[64] which limits the section's applicability to buyers, "where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption."[65] The trial court also held that the "force majeure" clause could not excuse the buyer's contractual obligation unless Regulation 508 absolutely prohibited IMC's daily purchase of 4800 million Btu's of gas.[66]

B. *The Tenth Circuit Decision*

The Tenth Circuit rejected IMC's argument for relief based upon the "force majeure" clause. The court predicated its decision on two factors: first, IMC's notice to Llano, stating its intention to decrease consumption, was inadequate because no explanation of the environmental issues was included; and second, Regulation 508 did not, in and of itself, constitute an obstacle to IMC's ability to pay.[67]

However, the Tenth Circuit found relief on another basis, allowing

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58. *Id.* at 884.
59. *Id.*
60. *Id.* at 881.
61. *Id.* at 884.
62. N.M. STAT. ANN. § 55-2-615 (1978), titled "Excuse by failure of presupposed conditions," provides in pertinent part:

> Except so far as a seller may have assumed a greater obligation and subject to the preceding section . . . on substituted performance:
> (a) Delay in delivery or nondelivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made, or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid; . . .

International Minerals, 770 F.2d at 885 n.2. For a discussion of § 2-615 of the U.C.C., see Prance, *Commercial Impracticability: A Textual and Economic Analysis of Section 2-615 of the Uniform Commercial Code*, 19 IND. L. REV. 457-95 (1986).
63. *International Materials*, 770 F.2d at 885 n.2.
64. N.M. STAT. ANN. § 55-2-615 (Official Comment 9, 1978).
65. *International Minerals*, 770 F.2d at 884.
66. *Id.*
67. *Id.* at 885.

protection for IMC under the "minimum bill" or payment-adjustment provision of the contract. This clause provided that, "in the event the buyer is *unable* to receive gas as provided in the Contract for any reason *beyond the reasonable control* of the parties, then an appropriate adjustment in the minimum purchase requirements . . . shall be made."[68] Having determined this provision to be applicable, the court then defined the issue as: "[d]id the promulgation of Regulation 508 constitute an event beyond the reasonable control of IMC that rendered IMC 'unable' to receive its minimum amount of gas under the contract?"[69]

The Tenth Circuit, in this circumstance, defined "unable" as being synonymous with "impracticable," thereby allowing the court to take advantage of common law and statutory interpretations of "impracticability."[70] In *Wood v. Bartolino*,[71] the New Mexico Supreme Court, relying on the RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981),[72] described the doctrine of impracticability as applying when "the promised performance was . . . [made] impracticable owing to some extreme or unreasonable difficulty, expense, injury or loss."[73] The unanticipated circumstances must make performance "vitally different from [the original] contemplation of both parties."[74] The critical issue in applying the doctrine of impracticability, as determined by the Third Circuit's holding in *Gulf Oil Corp. v. Federal Power Commission*,[75] is "whether the cost of performance has in fact become so excessive and unreasonable that the failure to excuse performance would result in grave injustice."[76]

The RESTATEMENT (SECOND) OF CONTRACTS § 264 (1981), and § 55-2-615 N.M. STAT. ANN., also allow for performance to be excused when made impracticable by required compliance with a supervening governmental regulation. This principle was illustrated in *Kansas City, Missouri v. Kansas City, Kansas*,[77] where the district court held that the obligation of one city to accept another city's sewage was excused by the enactment of the Federal Water Pollution Control Act.[78]

The Tenth Circuit found that there was "no technically suitable way for IMC to comply"[79] with the environmental regulation without decreasing gas consumption, and therefore the payment-adjustment provision of the contract was properly triggered. The court said that the adjustment clause should result in a minimum bill to IMC, based upon

68. *Id.* at 886 (emphasis in original).
69. *Id.*
70. *Id.*
71. 48 N.M. 175, 146 P.2d 883 (1944).
72. RESTATEMENT (SECOND) OF CONTRACTS § 261 comment d (1981). For a general discussion on the doctrine of impracticability, see D. Jacobs, *Legal Realism or Legal Fiction? Impracticability Under the Restatement (Second) of Contracts*, 87 COM. L. J. 289-98 (1982).
73. *Wood*, 146 P.2d at 886.
74. *Id.* (quoting 6 WILLISTON ON CONTRACTS § 1931 (1938)).
75. 563 F.2d 588 (3d Cir. 1977), *cert. denied*, 434 U.S. 1062 (1978).
76. *Id.* at 599.
77. 393 F. Supp. 1 (W.D. Mo. 1975).
78. *See also* City of Vernon v. City of Los Angeles, 45 Cal. 2d 710, 290 P.2d 841 (1955).
79. *International Minerals*, 770 F.2d at 886-87.

the difference between IMC's minimum purchase obligation and the value of the gas actually accepted.[80]

Llano argued that there was no supervening impracticability because IMC was in final compliance with Regulation 508 long before the required date. Llano contended that IMC should have delayed compliance in order to take and use the gas as required by the contract.[81] The court emphatically rejected this argument, first on public policy grounds, and second "as a matter of law, [declaring that] government policy need not be explicitly mandatory to cause impracticability."[82]

C. *Analysis*

In *International Minerals*, the court implicitly balanced the enforceability of commercial contracts against the public need for environmental regulation. IMC was required by law to meet the standards of Regulation 508 and as a good corporate citizen it endeavored to abide by the law. If the court had additionally required IMC to fulfill its previous contractual obligations, the costs involved would have made compliance with this type of governmental regulation an even more difficult pill for the corporation to swallow.

It is important for the drafters of commercial contracts to include both a "force majeure" clause and a payment-adjustment clause. These clauses should be skillfully drafted in light of the contract they support, the intentions of the contracting parties, and with a wary eye toward unexpected future exigencies. The terms of the "force majeure" clause, if triggered, will be strictly construed. If the "force majeure" clause is deemed inapplicable, then the outcome of any dispute may likely be determined by the underlying adjustment clause.

The actions of the corporation after execution of the contract, and after some exigency has arisen, is also critical. IMC's mistake was in its failure to fully notify Llano as to the reasons for its reduction in consumption. As a result, the adjustment clause was triggered instead of the "force majeure" clause. In the final analysis, however, equity was served. IMC was not required to pay for gas which Llano never delivered and, in fact, sold elsewhere.

The applicability of a "force majeure" clause was similarly examined by the Second Circuit, in *Phillips Puerto Rico Core, Inc. v. Tradax Petroleum, Ltd.*[83] There, the Coast Guard's detention of a cargo ship did not frustrate the purpose of the contract, nor did it prevent the buyer from carrying out his obligation. The seller's only obligation was to deliver the goods to the carrier; any event that occurred after delivery to the cargo ship was of no concern to the seller. Here, as in the *International Minerals* decision, the "force majeure" clause did not excuse performance.

80. *Id.* at 887.
81. *Id.*
82. *Id.*
83. 782 F.2d 314 (2d Cir. 1985).

III. Preemption by Federal Copyright Laws

In *Ehat v. Tanner*,[84] the Tenth Circuit upheld the efficacy of 17 U.S.C. § 301(a),[85] the federal copyright preemption statute, and denied relief to an individual whose action was based on state common law claims. The court reasoned that the common law rights were equivalent to "exclusive rights" within the scope of the federal copyright statutes, and were thus preempted.

A. *Factual Background*

Ehat was a scholar doing post-graduate research on the history of the Church of Jesus Christ of the Latter-Day Saints (the LDS Church).[86] In the process of his research, Ehat took quotes from and made written notations on the William Clayton Journals.[87] Ehat gave this information to a colleague. The materials were surreptitiously taken from the colleague's office, copied and returned.[88] One of the unauthorized copies was obtained by the Tanners, who blacked out Ehat's comments, reproduced the journal quotes and sold them to the public.[89]

Ehat's suit was based on a claim under the federal copyright statutes, and on state common law claims for unfair competition and unjust enrichment.[90] The trial court granted summary judgment for the defendants on the claim under the federal copyright statutes.[91] However, a bench trial was conducted on Ehat's state common law claims and Ehat prevailed.[92] The Tanners appealed and the Tenth Circuit reversed.

B. *Legal Background*

The Copyright Act of 1976[93] amended federal copyright law to preempt state law. The amendment was intended to prevent "the States from protecting . . . [a work] even if it fails to achieve federal statutory copyright because it is too minimal or lacking in originality to qualify, or

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84. 780 F.2d 876 (10th Cir. 1985), *cert. denied*, 107 S. Ct. 86 (1986).

85. 17 U.S.C. § 301(a) (1982) provides:

> On and after January 1, 1978, all legal or equitable rights that are equivalent to any of the exclusive rights within the general scope of copyright as specified by section 106 in works of authorship that are fixed in a tangible medium of expression and come within the subject matter of copyright as specified by sections 102 and 103, whether created before or after that date and whether published or unpublished, are governed exclusively by this title. Thereafter, no person is entitled to any such rights or equivalent right in any such work under the common law or statutes of any State.

86. *Ehat*, 780 F.2d at 877.

87. William Clayton was the private secretary to Joseph Smith, the first president of the LDS Church. The journals were maintained by Clayton between 1842 and 1846. *Id.* at 877 n.1.

88. *Id.* at 877.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. Copyright Act of 1976, 17 U.S.C. §§ 301-305, *et seq.* (1982); *see supra* note 85.

because it has fallen into the public domain."[94] In *Compco Corp. v. Day-Brite Lighting, Inc.*,[95] the Supreme Court established that a state law forbidding others to copy an article "unprotected . . . by a copyright . . . would interfere with the federal policy, found in art. I, section 8, cl. 8, of the Constitution, and in the implementing federal statutes, of allowing free access to copy whatever the federal patent and copyright laws leave in the public domain."[96]

In *Harper & Row, Publishers, Inc. v. Nation Enterprises*,[97] the Second Circuit held that 17 U.S.C. § 301 preempted state common law or state statutory claims when two conditions were present. First, the work in question must be within the scope of the "subject matter of copyright" as defined in 17 U.S.C. §§ 102 and 103;[98] and second, the rights granted under state law must be equivalent to any exclusive rights within the scope of federal copyright as provided in 17 U.S.C. § 106.[99] Relying on the parameters of *Compco* and *Harper & Row*, Judge Seymour rendered the opinion for the Tenth Circuit.[100]

C. *The Tenth Circuit Decision*

Applying the criteria set forth under section 301, the court determined that Ehat's work was within the subject matter of the copy-

94. *Ehat*, 780 F.2d at 877 (quoting H.R. REP. No. 1476, 94th Cong., 2d Sess. 131, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 5659, 5747).

95. 376 U.S. 234 (1964).

96. *Id.* at 237; *see also* Suid v. Newsweek Magazine, 503 F. Supp. 146 (D.D.C. 1980).

97. 723 F.2d 195 (2d Cir. 1983), *rev'd on other grounds*, 471 U.S. 539 (1985).

98. Copyright protection is afforded to "works of authorship," including:

> (1) literary works; (2) musical works, including any accompanying words; (3) dramatic works, including any accompanying music; (4) pantomimes and choreographic works; (5) pictorial, graphic, and sculptural works; (6) motion pictures and other visual works; and (7) sound recordings.

17 U.S.C. § 102 (1982). In addition, 17 U.S.C. § 103(a) (1982) provides:

> The subject matter of copyright as specified by section 102 includes compilations and derivative works, but protection for a work employing preexisting material in which copyright subsists does not extend to any part of the work in which such material has been used unlawfully.

17 U.S.C. § 103(b) (1982) sets forth that:

> The copyright in a compilation or derivative work extends only to the material contributed by the author of such work, as distinguished from the preexisting material employed in the work, and does not imply any exclusive right in the preexisting material.

99. 17 U.S.C. § 106 (1982) states:

> [T]he owner of copyright under this title has the exclusive rights to do and to authorize any of the following: (1) to reproduce the copyrighted work in copies or phonorecords; (2) to prepare derivative works based upon the copyrighted work; (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending; (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly; and (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly.

See infra note 103; *see also* Schuchart & Assoc. v. Solo Serve Corp., 540 F. Supp. 928 (W.D. Tex. 1982); I.M. NIMMER, NIMMER ON COPYRIGHTS § 1.01[B] at 1-19 (1985).

100. Seymour, Circuit Judge, authored the opinion for the three-judge panel including Chief Justice Holloway and Judge Babcock.

right,[101] and that the state common law rights asserted by Ehat and the exclusive rights encompassed by the federal copyright laws were equivalent.[102] Accordingly, Ehat's claims were denied.

In its decision, the court cited the federal copyright law, specifically 17 U.S.C. §§ 106(1) and (3), which create an exclusive right to the owner of the copyright " 'to reproduce the copyrighted work' " and " 'to distribute copies' " to the public for sale.[103] However, the court noted that Ehat's materials had not been copyrighted, nor was his claim based upon any deprivation of rights in the works as "physical matter and property."[104] Instead, Ehat's claims were for *damages* flowing from Tanners' reproduction and distribution.[105] The court intimated that had Ehat's cause of action been based on a state law claim of conversion — i.e., to recover for the physical deprivation of his notes — the result may have been different.[106]

D. *Conclusion*

Federal copyright law will preempt any state common law or statutory claims which may fall within the "exclusive rights" scope of the copyright law. One must carefully structure claims to be outside of this scope when attempting to utilize state statutory or common law and, even then, the likelihood for a successful outcome is uncertain.

IV. CORPORATE GOVERNANCE

A. *Piercing the Corporate Veil*

During the survey period, the Tenth Circuit reviewed two cases regarding piercing of the corporate veil. In *McCulloch Gas Transmission Co. v. Kansas-Nebraska Natural Gas Co.*,[107] the Tenth Circuit refused, in an alter ego situation,[108] to pierce the corporate veil absent a showing that failure to do so would "defeat public convenience, justify wrong, protect

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101. *Ehat*, 780 F.2d at 878. "Literary works, including compilations and derivative works, are within the subject matter of copyright if they are original works of authorship fixed in any tangible medium of expression." *Id.*; *see supra* note 98.

102. *Ehat*, 780 F.2d at 878.

103. *Harper & Row*, 723 F.2d at 200.

> When a right defined by state law may be abridged by an act which, in and of itself, would infringe one of the exclusive rights, the state law in question must be deemed preempted . . . . Conversely, when a state law violation is predicated upon an act incorporating elements beyond mere reproduction or the like, the rights involved are not equivalent and preemption will not occur.

Id.

104. *Ehat*, 780 F.2d at 878.

105. *Id.* The court's view of Ehat's claim was based in part on the $960 damages awarded (improperly) by the trial court. This amount represented the Tanners' profit from distribution of the copies. *Id.*

106. *Id.*

107. 768 F.2d 1199 (10th Cir. 1985).

108. The alter ego doctrine fastens liability on the individual who uses a corporation merely as an instrumentality to conduct his or her personal business, and such liability arises from fraud or injustice perpetrated on persons dealing with the corporation. The corporate form may be disregarded only where equity so requires. 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41 (1983 & Supp. 1986).

fraud, or defend crime."[109] In *Inryco, Inc. v. CGR Building Systems, Inc.*,[110] the Tenth Circuit reached the opposite result and allowed a creditor to pierce the corporate veil of an under-capitalized corporation.

1. *McCulloch Gas Transmission Co. v. Kansas-Nebraska Natural Gas Co.* - The Alter Ego Situation

a. *Factual Background*

The *McCulloch* suit was the result of an alleged breach of a gas purchase contract. In 1969, McCulloch Gas entered into a 20-year contract with Northern Utilities.[111] The contract contained a "take or pay" clause which eventually came into dispute.[112] In August 1974, Northern Utilities assigned the contract to Northern Gas. One month later, Kansas-Nebraska Natural Gas Company acquired all the stock of Northern Utilities and Northern Gas. It is not disputed that Kansas-Nebraska is the alter ego of its wholly owned subsidiaries, Northern Utilities and Northern Gas.[113] In 1982, McCulloch Gas brought this breach of contract action against Kansas-Nebraska and Northern Gas. The trial court,[114] relying on the alter ego relationship, pierced the corporate veil of the wholly owned subsidiaries of Kansas-Nebraska.[115]

b. *The Tenth Circuit Decision*

The Tenth Circuit, in an opinion written by Judge Russell,[116] reversed, holding that alter ego status alone is insufficient for piercing the corporate veil. Instead, the court set forth a two-prong test. In addition to a finding of alter ego — the first prong — the Tenth Circuit, relying on *Langdon v. Lutheran Brotherhood*,[117] established a second prong requiring a showing that failure to pierce the corporate veil would "defeat public convenience, justify wrong, protect fraud, or defend crime."[118] The instant case gave no indication that McCulloch would suffer any hardship by a failure to pierce the corporate veil.[119] Therefore, the case was reversed and remanded.

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109. *McCulloch*, 768 F.2d at 1199, 1200.

110. 780 F.2d 879 (10th Cir. 1986).

111. *McCulloch*, 768 F.2d at 1200.

112. *Id.*

113. *Id.*

114. The United States District Court for the District of Wyoming.

115. *McCulloch*, 768 F.2d at 1200.

116. Sitting by designation, the Honorable David L. Russell, United States District Judge for the Northern, Eastern and Western Districts of Oklahoma. Other members of the panel included Chief Justice Holloway and Judge McKay.

117. 625 P.2d 209, 213 (Wyo. 1981).

118. *McCulloch*, 768 F.2d at 1200 (citing Langdon v. Lutheran Bhd., 625 P.2d 209 (Wyo. 1981)). The court in *Langdon* quoted 1 W. FLETCHER, *supra* note 108. *See also* Wyoming Constr. Co. v. Western Casualty and Sur. Co., 275 F.2d 97 (10th Cir.), *cert. denied*, 362 U.S. 976 (1960); State v. Nugget Coal Co., 60 Wyo. 51, 144 P.2d 944 (1944).

119. *McCulloch*, 768 F.2d at 1201.

c. *Analysis*

Generally speaking, courts are extremely reluctant to pierce the corporate veil.[120] The general rule, subject to various exceptions, has been that a corporate entity will be recognized, not disregarded.[121] This theory will govern as long as it is utilized for *legitimate* purposes.[122] In the past, the alter ego theory has been employed where the corporate entity was used as a subterfuge.[123] In *McCulloch*, the Tenth Circuit has maintained the traditional reluctance to pierce the corporate veil by establishing an additional requirement of showing that if the corporate veil is not pierced, the result will "defeat public convenience, justify wrong, protect fraud, or defend crime."[124] The protective corporate shield, absent this showing, remains resilient.

2. *Inryco, Inc. v. CGR Building Systems, Inc.* - Notification of Partnership's Creditors Required Upon Incorporation.

In contrast to the result reached in *McCulloch Gas*, the Tenth Circuit's *Inryco* decision allowed a creditor to pierce the corporate veil of an under-capitalized corporation, thereby exposing the shareholders to liabilities which they had incurred earlier as partners in a prior general partnership.

a. *Factual Background*

CGR was originally formed in May of 1980, as a general partnership.[125] The partnership's primary business was selling building supplies. Soon after starting operations, CGR became a dealer for products supplied by Inryco.[126]

The original CGR partnership interests were evenly divided in thirds among the Reiman family and two other partners.[127] Inryco extended credit to CGR based upon the financial strength of the partners, with particular reliance on the Reimans. In 1982, the other two partners withdrew from CGR.[128] CGR then incorporated with little change in operation; the same personnel, letterhead, logo and accounts were employed by the new corporation.[129] Additionally, at the time of incorpo-

120. H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS 344, 346 (3d ed. 1983).
121. United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (E.D. Wis. 1905).
122. Cataldo, *Limited Liability with One-Man Companies and Subsidiary Corporations*, 18 LAW & CONTEMP. PROBS. 473, 480-82 (1953).
123. *McCulloch*, 768 F.2d at 1200 (quoting 1 W. FLETCHER, *supra* note 108). *See generally* Lopez, *The Alter Ego Doctrine: Alternative Challenges to the Corporate Form*, 30 U.C.L.A. L. REV. 129 (1982); Note, *Piercing the Corporate Veil: The Alter Ego Doctrine Under Federal Common Law*, 95 HARV. L. REV. 853 (1982).
124. *McCulloch*, 768 F.2d at 1200.
125. *Inryco*, 780 F.2d 879, 880 (10th Cir. 1986).
126. *Id.* at 881.
127. *Id.*
128. *Id.*
129. *Id.*

ration, CGR had serious cash flow problems[130] and some corporate formalities were not observed. Adequate books of accounts were not maintained and the board of directors' meetings and shareholder meetings were not held.[131] Moreover, although CGR had been instructed to discuss all credit-related matters with a Mr. Petrie of Inryco, he never received notice of CGR's incorporation.[132]

By 1983, CGR owed Inryco $40,000, of which $25,000 was incurred after incorporation.[133] Inryco brought suit to collect this debt,[134] naming CGR Building Systems, Inc. and its three shareholders, the Reimans, as defendants. There was no dispute that the Reimans were personally liable for that part of the debt incurred under the general partnership.[135] However, in addition to that amount, Inryco contended that the CGR corporate veil should be pierced, and that the Reimans should also be liable for the $25,000 debt incurred after incorporation.[136] The trial court agreed with Inryco's contentions and entered judgment accordingly.[137] The Reimans and CGR appealed.

b. *The Tenth Circuit Decision*

The Tenth Circuit, in an opinion by Circuit Judge William E. Doyle,[138] affirmed the trial court decision. Relying on Wyoming case law, the Tenth Circuit set forth a variety of factors to be considered when determining the propriety of piercing the corporate veil. The court said that each determination should be made on a case by case basis in light of the particular facts presented therein.[139] The separate corporate identity will be disregarded, if necessary, to promote public policy, to further justice, or to prevent unjust or inequitable consequences.[140] The court noted that actual corporate fraud is not required; however, gross undercapitalization or complete domination of corporate affairs by individual shareholders will greatly increase the possibility of the corporate veil being pierced.[141] On this basis, the Tenth Circuit

130. *Id.* At incorporation, CGR "had approximately $1,500 in its checking account, owned no assets of significant value, and had accounts payable far in excess of the combined value of its assets." *Id.* at 882.

131. *Id.* at 881.

132. *Id.*

133. *Id.*

134. The suit was filed in the United States District Court for the District of Wyoming, Chief Judge Clarence A. Brimmer, Jr.

135. *Inryco*, 780 F.2d at 881.

136. *Id.*

137. *Id.* at 880. Inryco was awarded $39,999.76 by the trial court. *Id.*

138. Sitting as member of a three-judge panel comprised of Judge Barrett, Judge McWilliams and Judge Doyle.

139. *Inryco*, 780 F.2d at 881 (citing Yost v. Harpel, 674 P.2d 712 (Wyo. 1983); Opal Mercantile v. Tamblyn, 616 P.2d 776 (Wyo. 1980)).

140. *Yost*, 674 P.2d at 712; AMFAC Mechanical Supply Co. v. Federer, 645 P.2d 73 (Wyo. 1982); *Opal Mercantile*, 616 P.2d at 776; Peters Grazing Ass'n v. Legerski, 544 P.2d 449 (Wyo. 1975), *reh'g denied*, 546 P.2d 189 (Wyo. 1976).

141. *AMFAC Mechanical Supply*, 645 P.2d at 79; State v. Nugget Coal Co., 144 P.2d 944 (Wyo. 1944); Caldwell v. Roach, 44 Wyo. 319, 12 P.2d 376 (1932). For a succinct analysis of *AMFAC Mechanical Supply*, see Note, *A Prima Facie Case for Piercing the Corporate Veil*,

determined that the trial court was correct in piercing the corporate veil.[142]

CGR had asserted that since notice of the incorporation was conveyed to Inryco's sales agent, Mr. Reedy, the corporate veil should not be pierced, because Reedy's knowledge should be imputed to Inryco.[143] At the time, however, Reedy was also a CGR shareholder.[144] Although a general rule of agency law provides that the knowledge of an agent may be imputed to his principal,[145] where an agent is found to have engaged in transactions which are adverse to the principal, knowledge or notice will not be imputed.[146] Reedy, with financial interests of his own, failed to communicate notice of CGR's incorporation to Inryco and, accordingly, the court did not impute notice.[147]

c. *Analysis*

During the process of incorporating, and subsequent to actual incorporation, it remains of the utmost importance to strictly observe all corporate formalities and to be adequately capitalized.[148] Additionally,

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AMFAC Mechanical Supply Co. v. Federer, 645 P.2d 73 (Wyo. 1982), 18 LAND & WATER L. REV. 823 (1983).

142. *Inryco*, 870 F.2d at 882.

143. *Id.*

144. *Id.* at 883.

145. W. SEAVEY, AGENCY 174 (1964); *see* Commercial Bank & Trust Co. v. Hauf, 32 Wyo. 127, 230 P. 539 (1924). Generally speaking, corporations will be bound by knowledge acquired by, or notice given to, its agents or officers which is within the scope of their authority. American Standard Credit v. National Cement Co., 643 F.2d 248 (5th Cir. 1981); Ritchie Grocer Co. v. Aetna Casualty & Sur. Co., 426 F.2d 499 (8th Cir. 1970).

146. *Inryco*, 780 F.2d at 883 (citing *Commercial Bank*, 32 Wyo. at 129, 230 P. at 540); *see also* SEAVEY, *supra* note 145, at 184.

147. *Inryco*, 780 F.2d at 883.

148. Provisions for adequate capitalization and the observance of proper corporate formalities will minimize the probability that the corporate entity will be disregarded. The following checklist, recommended by David H. Barber in his article entitled "Piercing the Corporate Veil," may assist the practitioner in maintaining a corporation's limited liability:

a. *At the time of incorporation*:
(1) file articles of incorporation with the proper state and local authorities;
(2) issue stock, providing certificates to all shareholders of record;
(3) provide at least the minimum capital required by law and make sure that all subscribed shares are actually paid for;
(4) establish a separate bank account in the corporation's name.

b. *After incorporation*:
(1) hold the annual shareholders' meetings;
(2) hold regular meetings of the board of directors (also include a non-shareholder on the board);
(3) keep accurate records of all such meetings;
(4) do not commingle corporate and personal funds;
(5) document all loans to the corporation by the shareholders — show the purpose for the loan and the reason that funds were not obtained from outsiders;
(6) if possible, pay regular dividends which represent a reasonable return on investment;
(7) always use the corporation's name in dealing with the public and require that authorized parties sign all documents as agents for the corporation, stating their relationship to the corporation.

c. *Capitalization*:
(1) document the reason for selecting a given capital structure, including any comparable businesses studied (and past operating experience, if the entity was established prior to incorporation);

when transforming a partnership to a corporation, proper notice to all creditors is imperative.[149] Failure to give notice of the incorporation can expose individuals to personal liability, thereby defeating one of the primary advantages of incorporation.

Other circuits have also dealt with this issue recently. The Eighth Circuit, in *Kapp v. Naturelle*,[150] considered a fact pattern where partners in a partnership became the shareholders in a subsequent corporation, and no notice of the incorporation was provided to the partnership's creditors. The business carried on as it had as a partnership and maintained its original name, but with the addition of the word "company."[151] In *Kapp*, the corporate veil was pierced and the individual shareholders were estopped from denying personal liability.[152] The Seventh and Sixth Circuits have reached similar decisions.[153] Therefore, the Tenth Circuit's *Inryco* decision follows precedent from the other circuits dealing with similar issues.

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(2) provide a fixed maturity date and reasonable interest rate for any loan made to the corporation by a shareholder;
(3) prior to incorporation, discuss the range of contemplated activities and specifically evaluate the reasonable risks of torts liability associated with the business, document reasons for selection of the amount of liability insurance, and consult a competent insurance broker for advice in assessing the risks and getting insurance;
(4) provide all contracting parties with accurate financial data prior to any contractual agreements;
(5) maintain a balance between debt and equity which is in line with the debt-equity ratio of other businesses of the same type.

d. *Other factors*:
(1) avoid diversion of corporate assets or funds to shareholders, parent corporations, or related entities for other than corporate uses;
(2) do not allow any shareholders or agents of the corporation to represent that they will be personally responsible for the obligations of the corporation;
(3) do not establish a separate corporation for conducting a single business venture (particularly one with high risk) unless adequate capital or insurance is provided for the venture;
(4) make the names of all shareholders available to those who deal with the corporation.

Barber, *Piercing The Corporate Veil*, 17 WILLAMETTE L. J. 371, 402-03 (1981).

149. *See infra* notes 150-52 and accompanying text. *See generally* 8 FLETCHER CYC. CORP. §§ 4019-20 (1966).

150. 611 F.2d 703, 709 (8th Cir. 1979).

151. *Id.* at 705-06.

152. *Id.* at 709.

153. Kingsberry Homes v. Corey, 457 F.2d 181 (7th Cir. 1972); Northway Lanes v. Hackley Union Nat. Bank and Trust Co., 464 F.2d 855 (6th Cir. 1972); *see also* Melikian v. Corradetti, 791 F.2d 274 (3d Cir. 1986), where the Third Circuit upheld the sufficiency of a complaint which expressly alleged that corporate officers, through their single economic enterprise, used a corporate form to defraud other parties to a contract for the sale of corn. The case, which involved fraudulent misrepresentations of the corporation, resulted in the piercing of the corporate veil and held the corporation's principals to be liable on a judgment against the corporation for breach of the contract. *Id.* at 281. *Cf.* Kashi v. Gratsos, 790 F.2d 1050, 1056-57 (2d Cir. 1986) (principals held individually liable where they participated in using corporation to perpetrate fraud while disregarding usual corporate formalities).

B. *Criminal Liability of Corporations and Partnerships for Acts Committed Prior to Dissolution*

The case of *United States v. Mobile Materials, Inc.*[154] presented the sole issue of whether dissolved corporations and partnerships may be prosecuted for crimes committed prior to dissolution.

1. Factual Background

Mobile Materials, Inc. had been in the Oklahoma highway construction business since 1967.[155] The Philpot brothers were the sole shareholders, directors and officers of the corporation.[156] Additionally, these two brothers did business as Mobile Materials Company, a general partnership.[157] Both the corporation and the partnership were dissolved in 1982, after Mobile was served with a subpoena *duces tecum* issued by a grand jury investigating bid-rigging on Oklahoma highway construction projects. In August of 1984, the grand jury returned indictments against the partnership and corporation, and against one of the Philpot brothers.[158] The indictments included violations of the Sherman Anti-Trust Act,[159] the mail fraud statute[160] and the fraud and false statement statute.[161]

Mobile moved to dismiss the charges on grounds that the companies had been formally dissolved before the indictments were returned. The district court,[162] relying on *United States v. Safeway Stores*,[163] dismissed the action against both companies on grounds that criminal proceedings cannot be maintained against Oklahoma corporations and partnerships which have been dissolved prior to indictment.[164]

In *Safeway Stores*, the Tenth Circuit held that criminal prosecutions were not encompassed by a California statute, similar to the Oklahoma statute at issue in this case, which allowed for the continuation of a corporation after dissolution "for the purpose of prosecuting and defending actions."[165] In *Safeway Stores*, the court also determined that the criminal prosecution exception was permissible under the corporate dissolution statutes of Nevada and Delaware.[166] Two subsequent cases, *United States Vanadium Corp. v. United States*[167] and *United States v. Line Material Co.*,[168] had upheld the *Safeway Stores* decision, thereby abating

154. 776 F.2d 1476 (10th Cir. 1986).
155. *Id.* at 1477.
156. *Id.*
157. Mobile Materials Company leased heavy equipment to Mobile Materials, Inc. *Id.*
158. *Id.*
159. 15 U.S.C. §§ 1-7 (1982 & Supp. 1986).
160. 18 U.S.C. § 1341 (1982).
161. 18 U.S.C. § 1001 (1982).
162. The United States District Court for the Western District of Oklahoma.
163. 140 F.2d 834 (10th Cir. 1944).
164. *Mobile Materials*, 776 F.2d at 1477.
165. *Safeway Stores*, 140 F.2d at 837.
166. *Id.* at 838.
167. 230 F.2d 646 (10th Cir. 1956) (criminal action abated upon dissolution).
168. 202 F.2d 929 (6th Cir. 1953) (criminal action abated upon dissolution). *But see*

criminal action against corporations upon dissolution.

2. The Tenth Circuit Decision

In an opinion by Circuit Judge John P. Moore, the Tenth Circuit reversed, holding that *Melrose Distillers v. United States*,[169] overruled *Safeway Stores*. In *Melrose*, the Supreme Court resolved the discrepancies among the circuits and expanded the Maryland and Delaware statutes to allow for the continued existence of dissolved corporations so that criminal actions, pending under the Sherman Anti-Trust Act, could proceed.[170] It specifically rejected the Tenth Circuit's interpretation of the California statute discussed in *Safeway Stores*.[171] Mobile argued that *Melrose* should not be dispositive because that indictment was handed down *prior* to dissolution; in *Safeway Stores* and the instant case, the indictments were handed down *following* dissolution. In spite of this distinction, the Tenth Circuit found *Melrose* to be controlling and held that the indictment against Mobile must stand.[172] The pivotal inquiry, according to the court, is whether a statute implies "sufficient vitality" to post-dissolution corporate life to subject that corporation to criminal prosecution.[173] The language of the statute in question provided sufficient vitality.[174]

The Tenth Circuit justified expansion of the statute by interpreting "actions," as it appears in the statute,[175] to include criminal prosecution. It also noted that the Oklahoma statute provided for service of process on dissolved corporations.[176] Accordingly, the court reasoned that the corporation could be criminally prosecuted.

Moreover, the court determined that the timing of the indictment was not a deciding factor in the *Melrose* case.[177] As additional support, the Tenth Circuit relied on *Wewoka Petroleum Corp. v. Gilmore*,[178] where

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United States v. P.F. Collier & Son Corp., 208 F.2d 936 (7th Cir. 1953) (reaching the opposite result).

169. 359 U.S. 271 (1959).

170. *Id.* at 273-274.

171. *Mobile Materials*, 776 F.2d at 1478. "If *Safeway Stores* retains any vitality, it is limited to the proposition that corporate existence following dissolution must be determined under state law." *Id. Safeway Stores* has also been rejected in several other cases. *See* United States v. BBF Liquidating, Inc., 450 F.2d 938 (9th Cir. 1971) (per curiam), *cert. denied*, 405 U.S. 1065 (1972); United States v. San Diego Grocers Ass'n, 177 F. Supp. 352 (S.D. Cal. 1959).

172. *Mobile Materials*, 776 F.2d at 1478. *Cf.* United States v. 2.61 Acres of Land, 791 F.2d 666 (9th Cir. 1985) (where the court held that a delinquent corporation could not bring suit, could not defend a legal action, and could not appeal an adverse ruling. However, once the corporate powers were reinstated, the corporation's existence was again recognized and it was then permitted to defend such an action).

173. *Mobile Materials*, 776 F.2d at 1479.

174. OKLA. STAT. tit. 18, § 1.188 (1981) provides that the corporate form remains intact: "[F]or the purpose of winding up its affairs, prosecuting and defending actions by or against it, and enabling it to collect and discharge obligations."

175. *Mobile Materials*, 776 F.2d at 1478 n.5.

176. *Id.* at 1479 (citing Okla. Stat. tit. 18, § 1.198b (1981)).

177. *Id.* at 1476.

178. 319 P.2d 285 (Okla. 1957).

the Oklahoma Supreme Court refused to dismiss a civil action which was filed after the corporation dissolved.

One of the last factors cited by the Tenth Circuit in the *Mobile Materials* opinion was that of policy rationale. Noting that the Mobile indictment was "not entirely unanticipated" and that dissolution was not prevented by the threat of criminal prosecution,[179] the court concluded that it would not be equitable to immunize a corporation from criminal action by simply allowing dissolution.

3. Conclusion

One "escape hatch" of corporate liability, under Oklahoma law, has been closed by this case: a corporation can no longer hide behind dissolution when seeking protection from criminal prosecution.[180] Furthermore, it is apparently irrelevant whether the indictment is handed down before or after dissolution.[181]

The Tenth Circuit's *Mobile Materials* decision should assist law enforcement personnel and prosecutors in their pursuit of corporate criminals. To rule otherwise would probably create an atmosphere where corporate criminals could advantageously rely upon the convenience of dissolution any time they sought to avoid responsibility for their illegal corporate acts.

V. BANKING

A. *"Bank" vs. "Nonbank Bank": Acquisition of a "Nonbank Bank" by an Out-of-State Holding Company Under the Bank Holding Company Act*

The Bank Holding Company Act of 1956 ("BHCA")[182] was enacted to regulate federally chartered banks, so as to prevent the concentration of commercial banking activities and to separate banking from commerce.[183] Among other things, the BHCA restricts the type of out-of-state subsidiaries which a bank holding company may own. In *Oklahoma Bankers Association v. Federal Reserve Board*,[184] the Tenth Circuit examined the subtle parameters governing a bank holding company's acquisition of out-of-state subsidiaries.

1. Factual Background

The BHCA prohibits a bank holding company from acquiring a

179. *Mobile Materials*, 776 F.2d at 1480-81.

180. For a historical perspective on the evolution of corporation liability, *see* Brickley, *Corporate Criminal Accountability: A Brief History and an Observation*, 60 WASH. U.L.Q. 393-423 (1982).

181. *Mobile Materials*, 776 F.2d at 1481.

182. Bank Holding Company Act of 1956, 12 U.S.C. §§ 1841-50 (1982).

183. Wilshire Oil Co. v. Board of Governors, 668 F.2d 732 (3d Cir. 1981); *see also* S. REP. No. 1095, 84th Cong., 1st Sess. 2 (1955), *reprinted in* 1956 U.S. CODE CONG. & AD. NEWS 2482, 2483.

184. 766 F.2d 1446 (10th Cir. 1985).

bank located in any state outside of the bank holding company's principal place of business.[185] Citicorp, the intervenor in this case, met the definitional requirements for a bank holding company as set forth under the BHCA.[186] With its principal place of business located in New York, Citicorp sought to acquire an inactive Oklahoma trust company for the purpose of operating subsidiary offices in Tulsa and Oklahoma City, Oklahoma.[187] The subsidiaries were to be known as Citicorp Savings and Trust Company ("CSTC") and were to be managed from the offices of Citicorp's existing consumer finance subsidiary, Citicorp Person to Person, in New York.[188]

In March 1983 Citicorp filed, with the Federal Reserve Board of New York, its application to purchase the inactive Oklahoma trust company.[189] Through CSTC, Citicorp proposed to offer de novo services, consumer and commercial lending and thrift deposits.[190] However, in an effort to avoid being categorized as a "bank" under the BHCA, Citicorp sought "nonbank bank" status and submitted an application which expressly stated that demand deposits or other transactional accounts would *not* be accepted at CSTC.[191]

The Oklahoma Bankers Association petitioned the Federal Reserve Board in opposition to the Citicorp proposal, but the Board approved Citicorp's application nonetheless, finding that CSTC's limited industrial banking functions fell within the definition of a "nonbank bank"

185. 12 U.S.C. § 1842(d) (1982). The statute provides that:

> [N]o application . . . shall be approved under this section which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside the State in which the operations of such bank holding company's bank subsidiaries were principally conducted on July 1, 1966, or the date on which such company became a bank holding company, whichever is later, unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication. [T]he State in which the operations of a bank holding company's subsidiaries are principally conducted is that State in which total deposits of all such banking subsidiaries are largest.

186. A "bank holding company" is defined as "any company which has control over any bank . . . ." 12 U.S.C. § 1841(a)(1) (1982). A company is deemed to have control over a bank if (1) it has the power, directly or indirectly, to vote 25 per centum or more of any class of the bank's stock; (2) it controls — in any manner — the election of a majority of the bank's directors; or (3) the Board determines that it exercises a controlling influence over the bank's management or policies. 12 U.S.C. § 1841(a)(2)(A)-(C) (1982).

187. *Oklahoma Bankers*, 766 F.2d at 1448.

188. *Id.*

189. *Id.*

190. *Id.* The charter for one of Citicorp's proposed acquisitions listed industrial banking services which included the:

> making or acquiring of loans and other extensions of credit, secured or unsecured, for consumer and other purposes; the sale of credit related life and accident and health insurance by licensed agents or brokers, as required; the issuing of thrift certificates and thrift passbook certificates; [and] the sale of consumer oriented financial management courses.

48 FED. REG. 14,756 (1983). "Thrift certificates" are defined as "fixed time certificates, redeemable only after a minimum maturity period." *Oklahoma Bankers*, 766 F.2d at 1448.

191. *Oklahoma Bankers*, 766 F.2d at 1448.

under the BHCA.[192] Oklahoma Bankers brought this action after failing to convince the Board that its approval of Citicorp's application should be reversed. Citicorp joined as an intervenor.[193]

Oklahoma Bankers raised two primary objections to Citicorp's proposed acquisition and CSTC's designation as a "nonbank bank." First, the association alleged that CSTC was actually a bank under the BHCA, based upon a theory that characterized CSTC's thrift certificates as demand deposits.[194] Second, Oklahoma Bankers contended that since Oklahoma banking law permits trust companies to accept demand deposits, CSTC must necessarily be a bank under the BHCA.[195]

The BHCA defines a bank as "[1] an institution which makes commercial loans *and* [2] accepts 'deposits that the depositor has a legal right to withdraw on demand.' "[196] Oklahoma Bankers contended that the thrift deposit accounts offered by CSTC qualified as "demand deposits" under section 2(c), and that, accordingly, Citicorp should not be granted "nonbank bank" status.[197] Citicorp admitted that CSTC intended to make commercial loans, thereby fulfilling the first requirement of the BHCA's two-part "bank" definition. Accordingly, the primary issue became whether the thrift deposit accounts were deemed to be "demand deposits" as argued by Oklahoma Bankers. If this was the case, then the second criteria would also be fulfilled, and CSTC would be a "bank" under section 2(c).[198]

2. The Tenth Circuit Decision

Judge Seth, writing for the three-judge panel,[199] rejected the arguments raised by Oklahoma Bankers and affirmed the decision of the Federal Reserve Board.[200] The court noted that for the purposes of federal regulation Congress has narrowed the BHCA's original definition of a "bank,"[201] and that in recent years numerous institutions have qualified for "nonbank bank" status under the exceptions created by Congress.[202] The court stated that "[f]ederal law under the non-bank exception . . . expressly envisions the operation of industrial banks in

192. *Id.* at 1449.
193. *Id.* at 1446.
194. *Id.*
195. *Id.* at 1450 (citing OKLA. STAT. tit. 6, § 1001(A)(1) (1981)). Oklahoma Bankers raised this claim even though Citicorp's proposal stated that demand deposits would not be accepted by CSTC. *Id.* at 1448.
196. 12 U.S.C. § 1841(c) (1982) (emphasis added by the Tenth Circuit).
197. *Oklahoma Bankers*, 766 F.2d at 1449.
198. *Id.*
199. The panel included Judge Holloway, Judge McWilliams and Judge Seth.
200. *Oklahoma Bankers*, 766 F.2d at 1446.
201. On two occasions Congress has modified the definition of a "bank" under the Act. Originally, the definition included all national banks, state banks and savings banks. Act of May 9, 1956, ch. 240, § 2(c), 70 Stat. 133. The definition was narrowed in 1966 to govern only those domestic institutions which "[accept] deposits that the depositor has a legal right to withdraw on demand." Act of July 1, 1966, § 3, 80 Stat. 236, 237. The current definition was enacted in 1970. *See supra* note 196 and accompanying text; *see also Wilshire*, 668 F.2d at 733.
202. *Oklahoma Bankers*, 766 F.2d at 1449 (citing the Tenth Circuit's earlier decision in

Oklahoma by out-of-state bank holding companies."[203] The Tenth Circuit also affirmed the Board's finding that the limited functions of CSTC qualified it for "nonbank bank" status.[204]

The court specifically rejected Oklahoma Bankers' first contention,[205] and held that the thrift certificate deposits proposed by Citicorp to be offered by CSTC were *not* demand deposits under the BHCA.[206] "Demand deposits" are defined as those which "the depositor has a *legal right* to withdraw on demand."[207] Utilizing a theory similar to the one employed by the Federal Reserve Board, the court determined that CSTC's thrift deposits were not payable upon demand.[208] In *First Bancorporation v. Board of Governors*,[209] the Tenth Circuit reached a similar determination regarding interest-bearing "NOW" accounts.[210] The determinative factor in both *First Bancorporation* and *Oklahoma Bankers* is whether a restriction exists on the immediate withdrawal of a depositor's money.[211] In *First Bancorporation*, the restriction was statutory; in *Oklahoma Bankers*, it was contractual.

In *First Bancorporation*, Utah law specifically required industrial loan companies to reserve the right to demand notice from a depositor prior to withdrawal.[212] Oklahoma law, however, is silent on this issue, and Oklahoma Bankers contended that this loophole would allow depositors to make immediate, transactional-type withdrawals from the Citicorp subsidiaries. However, the court acknowledged that Citicorp's application expressly stated that CSTC's thrift certificate deposits would be governed by "specific, legally enforceable, contractual agreements" explicitly requiring depositors to provide CSTC with 14 or more days notice prior to withdrawal.[213] The court upheld the enforceability under Oklahoma law of this restrictive type of private contractual arrangement

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Dimension Fin. Corp. v. Board of Governors, 774 F.2d 1402 (10th Cir. 1984), *aff'd*, 106 S. Ct. 681 (1986)).

203. *Id.* at 1451. The court reviewed the legislative history of the Act and observed that the Senate Banking Committee chairman, Senator A. Willis Robertson, stated that a 1966 amendment to section 2(c) of the Act "clearly exclude[d] industrial banks" from definition as a "bank." 112 CONG. REC. 12386 (June 6, 1966) (statement of Sen. Robertson).

204. *Oklahoma Bankers*, 766 F.2d at 1449.

205. *See supra* text accompanying note 194.

206. *Oklahoma Bankers*, 766 F.2d at 1450.

207. *Id.* at 1449 (citing 12 U.S.C. § 1841(c) (1982) (emphasis added by the Tenth Circuit)).

208. *Id.* at 1450.

209. 728 F.2d 434 (10th Cir. 1984).

210. *Id.* at 435. "NOW" account is an acronym for "negotiable order of withdrawal" account. *Id.*

211. *Oklahoma Bankers*, 766 F.2d at 1449-50.

212. *First Bancorporation*, 728 F.2d at 436. *Accord*, Pennsylvania Bankers Ass'n v. Secretary of Banking, 481 Pa. 332, 392 A.2d 1319 (1978) (drafts were not "payable on demand" and not considered "checks" under the Uniform Commercial Code where NOW accounts, offered by savings bank, required depositors to give 14 day notice prior to withdrawal or payment of a draft); Savings Bank of Baltimore v. Bank Comm'r, 248 Md. 461, 237 A.2d 45 (1968) (accounts subject to withdrawal by check, which required 30 day notice prior to withdrawal, negated assumption that such accounts could be characterized as "demand deposits").

213. *Oklahoma Bankers*, 766 F.2d at 1449.

between a depositor and a financial institution,[214] and concluded that such an agreement would prohibit depositors from withdrawal upon demand.[215] Accordingly, the Tenth Circuit upheld the Board's finding that the thrift certificates were not demand deposits, and CSTC avoided being characterized as a "bank" under the BHCA.[216]

The court also rejected Oklahoma Bankers' second contention that since Oklahoma banking law permits trust companies to "receive deposits of trust monies"[217] which are withdrawable upon demand, a trust company such as CSTC is clearly a "bank" under the BHCA.[218] The court agreed that the Oklahoma trust charters sought by CSTC permitted traditional banking services to be offered,[219] and it acknowledged the opinion of the Oklahoma bank commissioner who characterized trust deposits as being withdrawable upon demand.[220] Despite these acknowledgments, the court stood by its previously stated pronouncement from *Dimension Financial Corp.*

> We no longer look to the possible powers an institution may exercise under a state charter but rather decide whether it meets both the deposit and commercial lending elements of the statutory test. An organization which has voluntarily limited its functions in order to conform to the Act's definition of a nonbank simply cannot use all the powers granted by a state charter.[221]

On its own initiative, Citicorp's CSTC application specifically refrained from including the full menu of traditional banking services,[222] thereby complying with the limitations imposed by the statute. In addition, the Tenth Circuit further noted that, despite the fact that the trust charter granted CSTC the power to offer traditional banking services, the approval of Citicorp's CSTC proposal by the Federal Reserve Board carried with it no right to exercise traditional banking power.[223] The Board's order allowed CSTC to operate as a "limited purpose industrial bank," restricted to the services permitted by nonbank banks.[224] Any violation of these restrictions or any alteration or expansion of CSTC's

214. *Id.* at 1449-50. The Oklahoma Supreme Court held in Duncan v. Anderson, 120 Okla. 194, 250 P. 1018, 1019 (1926), that a deposit "may be subject to any agreement which the depositor and the bank may make with respect to it."

215. *Oklahoma Bankers*, 766 F.2d at 1449-50.

216. *Id.* at 1450.

217. *Id.* (citing OKLA. STAT. tit. 6, § 1001(A)(1) (1981)).

218. *Oklahoma Bankers*, 766 F.2d at 1450.

219. *Id.* "The powers granted to trust companies by Oklahoma law are substantially similar to the powers granted banks." *Id. Compare* OKLA. STAT. tit. 6, § 402 (1981) *with* OKLA. STAT. tit. 6, § 1001 (1981) (Banks and trust companies are granted the same general powers under these statutes.).

220. *Oklahoma Bankers*, 766 F.2d at 1450.

221. *Id.* (citing *Dimension Fin. Corp.*, 774 F.2d at 1404). For a critical analysis of *Dimension* see Note, *Nonbank Banks: Who's Minding the Store?* 46 LA. L. REV. 1087 (1986); Comment, *Banking Law: A Bank is a Bank is a Bank*: Dimension Financial Services v. Board of Governors, 11 J. CORP. L. 277 (1986).

222. *See supra* text accompanying notes 190 and 191.

223. *Oklahoma Bankers*, 766 F.2d at 1450.

224. *Id.*

limited areas of operation, would result in an enforcement action by the Board.[225]

The court also considered and rejected Oklahoma Bankers' allegations that the services to be offered by CSTC failed to meet the BHCA's requirements of (1) being closely related to banking and (2) benefiting the public.[226] A list of activities deemed to be "closely related" to banking is codified at 12 C.F.R. § 225.4(a).[227] The Tenth Circuit found the services proposed by Citicorp to be within these statutory boundaries.[228] The court also determined that CSTC could "reasonably be expected to produce benefits to the public."[229] The court rejected Oklahoma Bankers' contention that Citicorp's sheer size alone could produce monopolistic tendencies that would be detrimental to the public good.[230] Moreover, this theory had been previously struck down in *Connecticut Bankers Association v. Board of Governors*.[231] Congress has not established aggregate size as a factor for the Board to weigh.[232] Instead, the court considered the public benefit issue within the scope set forth by Congress.[233] After weighing "public benefit factors such as 'greater convenience, increased competition, or gains in efficiency,' against 'possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices,' "[234] the Tenth Circuit agreed with the determination of the Federal Reserve Board that CSTC's operation in Oklahoma would benefit the public.[235]

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225. *Id.* Enforcement actions are brought under 12 U.S.C. § 1818(b)(3) (1982). "The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof." 12 U.S.C. § 1844(b) (1982); *see Wilshire*, 668 F.2d at 738 (discussion of enforcement considerations).

226. *Oklahoma Bankers*, 766 F.2d at 1451-52 (citing 12 U.S.C. § 1843(c)(8) (1982)).

227. "Closely related" activities include:

> (1) Making or acquiring . . . loans and other extensions of credit . . . such as would be made, for example, by a mortgage, finance, credit card, or factoring company;
>
> (2) Operating as an industrial bank . . . in the manner authorized by State law so long as the institution does not both accept demand deposits and make commercial loans;
>
> (3) Servicing loans and other extensions of credit for any person; and
>
> (4) Acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business . . . .

12 C.F.R. § 225.4(a)(1)-(3), (9) (1983). The Federal Reserve Board's determination of which activities are "closely related" to banking is entitled to the "greatest deference." Board of Governors v. Investment Co. Inst., 450 U.S. 46, 56 (1981).

228. *Oklahoma Bankers*, 766 F.2d at 1450-51.

229. *Id.* at 1451 (quoting the statutory language of 12 U.S.C. § 1843(c)(8) (1982)).

230. *Id.* Citicorp is the second largest commercial banking organization in the United States, with total consolidated assets of $130.2 billion. The largest Oklahoma bank holding company has total consolidated assets of $3 billion. *Id.*

231. 627 F.2d 245 (D.C. Cir. 1980).

232. Western Bancshares, Inc. v. Board of Governors, 480 F.2d 749 (10th Cir. 1973).

233. *Oklahoma Bankers*, 766 F.2d at 1451.

234. *Id.* (citing 12 U.S.C. § 1843(c)(8) (1982)).

235. *Id.*

3. Conclusion

It may be argued, at least from the perspective of the Oklahoma Bankers Association, that the distinction between a "bank" and a "nonbank bank" is merely one of semantics. Although the BHCA was enacted, in part, to prevent the "concentration of commercial banking activities,"[236] the Tenth Circuit's decision does not appear to support this meritorious goal. By affirming the Federal Reserve Board's decision to allow Citicorp to offer numerous financial services in Oklahoma (albeit no transactional type accounts), the court has indeed created another participant in the local banking marketplace — the industrial bank operating as a nonbank bank.[237] Although Citicorp will not compete "service for service" with local Oklahoma banks,[238] several avenues of competition will be opened by Citicorp's entry into the marketplace, especially in the realm of consumer and commercial lending. Additionally, some deposits heretofore invested with local, small town banks will undoubtedly find their way to the coffers of Citicorp's CSTCs.

From the consumer's point of view, at least for the short term, the increased competition may be welcomed.[239] In the long run however, and from the perspective of the small town banker, the decision in *Oklahoma Bankers* poses a threat. It represents another hurdle for the local bank to overcome and thereby makes moot the lofty ideals of the BHCA.[240] In an era when rural small town banks are struggling to hold on — in the face of depressed oil prices and decreasing farm product prices — the Tenth Circuit's decision is likely to be viewed with skepticism by the small town banker in Oklahoma. To him, the distinction between "bank" and "nonbank bank" is irrelevant.

B. *Limitations on the Ultra Vires Defense*

1. *Ries Biologicals, Inc. v. Bank of Santa Fe*

In *Ries Biologicals, Inc. v. Bank of Santa Fe*,[241] the Tenth Circuit held that a bank may not employ the shield of the *ultra vires*[242] defense when its guarantee to pay the debts of a third party is made to benefit the pecuniary interests of the bank.

236. *See supra* note 183 and accompanying text.

237. For a critical discussion of the contradictory policy considerations surrounding nonbank banks, see Felsenfeld, *Nonbank Banks - An Issue in Need of a Policy*, 41 BUS. LAW 99-123 (1985).

238. *See supra* note 191 and accompanying text.

239. For an article illustrating the consumer advantages derived from nonbank banks, see L.A. Daily Journal, Jan. 23, 1986, at 1, col. 6. *Cf.* Victor, *Nonbank Bank Options Get Mixed Reviews*, Legal Times, June 10, 1985, at 2, col. 1.

240. *See supra* note 183 and accompanying text.

241. 780 F.2d 888 (10th Cir. 1986).

242. "Ultra vires" refers to acts beyond the scope or in excess of the legal power or authority vested in a corporation, an official, or a legislative body. BLACK'S LAW DICTIONARY 1365 (5th ed. 1979).

a. *Factual Background*

Ries Biologicals was a distributor of medical supplies.[243] One of Ries' customers, Dialysis Management Systems, Inc. ("DMS"), was a health care provider specializing in kidney dialysis.[244] During the time in question, DMS was experiencing financial problems and had outstanding loans with its bank, the Bank of Santa Fe, in excess of $620,000.[245] DMS was also delinquent on payments due to Ries. When DMS's outstanding balance with Ries reached $42,000, Ries notified DMS that all future orders to DMS would be shipped on a C.O.D. basis only.[246] A few months later, however, Mr. Levitt, a senior vice president for the Bank of Santa Fe, made an oral agreement with Ries to guarantee payment by the bank of all DMS orders approved by the bank in advance of shipment.[247] Relying on Mr. Levitt's oral guarantee, Ries resumed shipments of medical supplies to DMS. All orders were approved in advance and all invoices were sent directly to Mr. Levitt at the bank.[248]

Despite the oral guarantee and Ries' full compliance with Mr. Levitt's instructions, Ries was not paid in full for medical supplies shipped to DMS. Ries filed suit against the bank, and the trial court[249] entered judgment in favor of Ries for approximately $27,000, together with costs and attorneys' fees.[250] On appeal, the bank denied liability and asserted, among other things, that Ries' claim was barred by the New Mexico statute of frauds,[251] and that the oral guarantee of Mr. Levitt was void as an *ultra vires* act.[252]

b. *The Tenth Circuit Decision*

Judge Crow,[253] writing for the Tenth Circuit, affirmed the lower court decision.[254] The court held that the New Mexico statute of frauds did not prohibit Ries' recovery, despite the fact that an oral agreement

243. *Ries Biologicals*, 780 F.2d at 890.
244. *Id.*
245. *Id.* $500,000 of this amount was guaranteed by the Small Business Administration. However, the trial court found that the bank still had a substantial amount outstanding at great risk. *Id.* at 891.
246. *Id.* at 890.
247. *Id.*
248. *Id.*
249. The United States District Court for the District of New Mexico.
250. *Ries Biologicals*, 780 F.2d at 890.
251. The New Mexico statute of frauds provides that:
"[A] contract for the sale of goods for the price of $500 or more is not enforceable . . . unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought . . . ."
N.M. STAT. ANN. § 55-2-201 (1978).
252. In addition to its primary contentions, the bank also raised evidentiary and accounting issues. The Tenth Circuit quickly disposed of those issues. *Ries Biologicals*, 780 F.2d at 890-91.
253. Honorable Sam A. Crow, United States District Judge for the District of Kansas, sitting by designation. Other members of the panel were Judge Holloway and Judge Seth.
254. *Ries Biologicals*, 780 F.2d at 889, 892; *see also* Martin Roofing, Inc. v. Goldstein, 469 N.Y.S.2d 595 (1983) (enforceability of oral guarantees).

to guarantee the debts of a third party is not ordinarily enforceable.[255] The statute of frauds will not apply, the court said, where "the main object of the agreement is to serve pecuniary interests of the promisor."[256] In addition, the court relied on *Aragon v. Boyd*,[257] which held that full performance by one side is sufficient to satisfy the statute of frauds.

The bank also failed to escape liability under its *ultra vires* theory. The court refused to deny Ries' right to recovery on the bank's contention that Mr. Levitt's oral guarantee was a violation of the bank's statutory powers.[258] The court pointed out that "[t]he New Mexico Supreme Court has held that a bank may not avoid a guarantee as *ultra vires* where the transaction is for the bank's benefit in the furtherance of legitimate banking business."[259] The Tenth Circuit found that the Bank of Santa Fe's involvement in the activities of DMS was an effort to prevent bank losses which would result from a DMS failure. According to counsel for the Bank of Santa Fe, the bank would not have become so involved if no incidental benefit could be received.[260] Therefore, the court rejected the bank's attempt to avoid payment.

c. *Conclusion*

Ries Biological stands for the simple proposition that a bank may not hide behind an *ultra vires* defense when the bank's guarantee to pay the debts of a third party is made for the overall benefit of the bank.[261] Under the circumstances in *Ries Biologicals*, the outcome of this case is the only one which is equitable. To allow the Bank of Santa Fe the option of raising an *ultra vires* defense anytime a guarantee goes sour, would be to create havoc in the business marketplace. Similarly, suppliers like Ries should be entitled to rely on a bank's guarantee made by a senior vice-president. Banks must be cognizant of the guarantees they make, and the standards for extending those guarantees should be the same as for other banking agreements which are clearly not *ultra vires*.

Molly Myer

255. *Ries Biologicals*, 780 F.2d at 891. The rule was stated in Beacon Supply Co. v. American Fiber Corp., 75 N.M. 29, 35, 339 P.2d 927, 931 (1965), however, in *Beacon* no benefit was found for the promisor and that statute of frauds was enforced.

256. Abraham v. H.V. Middleton, Inc., 279 F.2d 107 (10th Cir. 1960). The pecuniary interests of the promisor, the Bank of Santa Fe, were significant. Only $500,000 of the $620,000 owed by DMS to the bank was guaranteed by the Small Business Administration. The remaining $120,000 was unsecured. Accordingly, the bank had a substantial interest in getting DMS back to profitability. *Ries Biologicals*, 780 F.2d at 891.

257. 80 N.M. 14, 450 P.2d 614 (1969).

258. *Ries Biologicals*, 780 F.2d at 891.

259. *Id.* (citing Ellis v. Citizen's Nat'l Bank of Portales, 25 N.M. 319, 183 P. 34 (1918)).

260. *Id.* at 891.

261. *Id.*