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COMMERCIAL LAW

OVERVIEW

The cases examined in this survey article involve various facets of the Tenth Circuit's decisions in the area of commercial law. The most significant case handed down in this area was one in which the court mounted an attack against the Federal Reserve Board's attempt to impermissibly aggrandize its jurisdiction through an expanded definition of a "bank."

Another significant commercial law decision held that standby letters of credit, representing primary obligations of the issuing bank, fall within the Federal Deposit Insurance Act's definition of a "deposit" and thus constitute insured deposits. During the past survey period, the Tenth Circuit's emphasis also became more pronounced in focusing on the substance rather than the form of commercial transactions. Its refusal to exalt form over substance was illustrated not only in a case involving a commercial lending transaction, but also in a consumer credit transaction. Additionally, the court announced an expanded "likelihood of confusion" test in a trademark infringement case. Finally, this article includes a synoptic survey of opinions handed down in the area of bankruptcy law.

I. NONBANK BANKS: *DIMENSION FINANCIAL CORP. V. BOARD OF GOVERNORS*

In *Dimension Financial Corp. v. Board of Governors*,[1] the Tenth Circuit prohibited the Federal Reserve Board (Board) from improperly altering its definition of "demand deposit" and "commercial loan" as a vehicle for expanding the parameters of its jurisdiction. These definitional changes were made in Regulation Y,[2] promulgated under the Bank Holding Company Act (Act).[3] The Board's expanded definitional and jurisdictional regulation would have included limited-service financial institutions, known as nonbank banks, within the Act's definition of a "bank," thereby allowing the Board to regulate such institutions' expansion and growth.

1. 744 F.2d 1402 (10th Cir. 1984), *cert. granted*, 105 S. Ct. 2137-38 (1985) [*Editors Note*: Subsequent to the submission of this survey article, the United States Supreme Court affirmed the Tenth Circuit decision in Board of Governors v. Dimension Financial Corp., 106 S. Ct. 681 (1986).].

2. 12 C.F.R. § 225 (1985).

3. 12 U.S.C. §§ 1841-50 (1982). The Act constitutes a comprehensive federal framework for the supervision and regulation of bank holding companies. A "bank holding company" is a company which controls a "bank." 12 U.S.C. § 1841(2)(l) (1982). The Act vests broad regulatory authority in the Board over such companies "to restrain the undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit." S. REP. No. 1084 91st Cong., 2d Sess. 24, *reprinted in* 1970 U.S. CODE CONG. & AD. NEWS 5519, 5541.

A. *Background*

The scope of the Board's regulatory power is limited by the Act's definition of the word "bank." This definition has been narrowed by several statutory changes since the Act's inception.[4] Since 1970, however, the Act has defined a "bank" as any institution that: "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."[5] Since this narrowed definition requires the presence of both the demand deposit and commercial loan elements, many nonbank banks[6] fall outside the Act's jurisdiction and the Board's control. In an attempt to bring these nonbank banks within its purview, the Board redefined both components of the Act's definition of a "bank" by amending Regulation Y.[7] The revised regulation broadened the definition of "demand deposit" to include deposits, like NOW accounts, which "as a matter of practice" are payable on demand.[8] Additionally, Regulation Y expanded the definition of "commercial loan" to include such items as money market and interbank transactions.[9]

B. *The Tenth Circuit Decision*

In *Dimension*, the revised Regulation Y was challenged through a petition for review of the Board's changes. The Tenth Circuit, Chief Judge Seth writing, set aside both the demand deposit and the commercial loan elements of the Board's amended regulation.[10] The court did

4. The original 1956 Act simply defined a bank as "any national banking association or any state bank, savings bank, or trust company." 12 U.S.C. § 1841(c) (1964) (amended 1966). Congress amended that statutory definition in 1966, and a "bank" was then defined as an institution that accepted deposits which "the depositor has a legal right to withdraw on demand." *See* S. REP. No. 1179, 89th Cong., 2d Sess. 7, *reprinted in* 1966 U.S. CODE CONG. & AD. NEWS 2385, 2391. In 1970, the Act was further amended to exclude all institutions which did not "engage in the business of making commercial loans." 12 U.S.C. § 1841(c) (1982).

5. 12 U.S.C. § 1841(c) (1982).

6. The term "nonbank banks" generally refers to an entity that is considered a bank under some criteria but does not satisfy both elements of the Act's definition. Nonbank banks fall under the regulatory power of the Comptroller of the Currency, not the Federal Reserve Board. *See* C. GOLEMBE & D. HOLLAND, FEDERAL REGULATION OF BANKING 83-84 (1983). *See generally* Lobell, *Nonbank Banks: Controversy Over a New Form of Consumer Bank*, 39 BUS. LAW. 1193 (1984) (discussing nonbank banks and their relationship to the Bank Holding Company Act); Note, *The Demise Of The Bank/Nonbank Distinction: An Argument For Deregulating The Activities Of Bank Holding Companies*, 98 HARV. L. REV. 650 (1985) (discussing the regulation of bank holding companies and how nonbank banks avoid these regulations).

7. 12 C.F.R. §§ 225.2(a)(1)(A), (B) (1985). The Federal Reserve Board amended Regulation Y under section 2(c) of the Act. 12 U.S.C. § 1841(c) (1982). *See generally* Loeser, *Bank Holding Company Regulation: The Federal Reserve Board's Recent Revision Of Regulation Y*, 101 BANKING L.J. 525, 542-44 (1984) (discusses the changes to the definition of "demand deposit" and "commercial loan").

8. 12 C.F.R. § 225.2(a)(1)(A) (1985).

9. 12 C.F.R. § 225.2(a)(1)(B) (1985). A commercial loan is "any loan other than a loan to an individual for personal, family, household, or charitable purposes" including "the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments." *Id.*

10. *Dimension*, 744 F.2d at 1411.

not discuss the changed demand deposit definition, however, as it had already been considered in an earlier Tenth Circuit opinion.[11] Thus, the court focused solely on the Board's new and changed view of what constitutes a "commercial loan" under the Act, and in particular, the inclusion of money market and interbank transactions under the Board's new definition.

In concluding that the Board's new definition of "commercial loan" was not consistent with the purpose of the Act, the Tenth Circuit addressed the following considerations: (1) the term's general meaning as used in business and in regulatory agencies, including the Board's usage; (2) the Board's purpose for the definitional changes; (3) the legislative history of the Act; and (4) the Board's authority under the Act to promulgate rules and regulations.[12]

In examining the general meaning of the term "commercial loan," the court concluded that the new definition was adopted without reference to the actual meaning of the term. It first noted that the Board's changed definition was a departure from the term's prevailing usage employed by businesses, by Congress, and by other regulatory agencies.[13] Furthermore, the court found that the common understanding of the term reflected the Board's own definition before 1982.[14] Only after 1982 did the Board begin to alter its position that money market and interbank transactions qualified as commercial loans.[15]

Next, the Tenth Circuit examined the Board's purpose for effectuating the changes. It determined that the Board altered the "commercial loan" definition solely to implement a new Board policy; to halt the fast-paced changes occurring in businesses providing financial services.[16] The Board considered it necessary to bring nonbank banks under its

11. *See* First Bancorporation v. Board of Governors, 728 F.2d 434 (10th Cir. 1984). In *First Bancorporation*, the court stated that the statutory definition of demand deposit was a deposit giving the depositor "a *legal right* to withdraw on demand." *Id.* at 436 (quoting 12 U.S.C. § 1841(c) (emphasis added)). The court disagreed with the Board's determination in that case that NOW accounts are demand deposits within the meaning of the Act. The court stated that since the lending institution reserves the legal right to demand prior notice of withdrawal, it is not a bank under the Act. *First Bancorporation*, 728 F.2d at 436. *See also* Note, Eleventh Annual Tenth Circuit Survey: Administrative Law, 62 DEN. U.L. REV. 17-18 (1985) (discussing changed definition of "demand deposit").

12. *Dimension*, 744 F.2d at 1404-11.

13. *Id.* at 1404-06. The Comptroller of the Currency and the FDIC both took positions contrary to the Board. *Id.* at 1410.

14. *Id.* at 1405-06. In 1972, 1976, and 1981 the Board rendered opinions or gave advice that money market funds, certificates of deposit, bankers' acceptances, broker call loans, and commercial paper were not commercial loans. *Id.* at 1405.

15. The consistent position of the Board abruptly halted in December of 1982, when it announced that the Dreyfus Corporation's proposed purchase of a state bank would be considered a purchase of a "bank" under the Act because the Act's term "commercial loans" included the purchase of "commercial paper, bankers' acceptances, and certificates of deposit, the extension of broker call loans, the sale of federal funds, the deposit of interest bearing funds and similar lending vehicles." *Id.* at 1406. The Federal Deposit Insurance Corporation (FDIC) disagreed with the Board's change of position and permitted the acquisition of the bank. *Id.*

16. *Id.* at 1405-06.

jurisdiction to accomplish this goal.[17] The court was severe in its criticism of the Board's actions,[18] finding that the redefinition and expansion of jurisdiction would cause extensive and disruptive changes in other agencies and in businesses providing financial services to the public.[19] In short, a pervasive restructuring of this country's financial system would occur.

The court also analyzed the Act's legislative history, which revealed that Congress intended to exclude from Board regulation those institutions whose only commercial credit activity is the purchase of money market or interbank transactions.[20] Finally, the court examined the Board's authority under the Act to make regulations[21] and held that the Act constricts the subject matter of the Board's functions basically within the confines of "anticompetitive considerations."[22] The court recognized the narrow scope of the statute and its clearly specified purpose and analyzed the Board's concomitant operation within these limitations. It held that such proposed action requires a congressional change in the agency's jurisdiction, and the Board could not *sua sponte* exercise powers not provided for or denied by Congress.[23] Thus, the Board's power is narrowly confined within the limits set by Congress. Regardless of the perceived need for change, such changes are for Congress and not for the Board to implement.

C. *Conclusion*

The Tenth Circuit was justified in prohibiting the Board from broadening its sphere of influence through the expansion of a definition. This decision's impact reaches far beyond the setback to the Board in curtailing nonbank banks' commercial activities. In demanding that

17. The Board's departure from the accepted meaning of a commercial loan was to provide, via an expansion of jurisdiction, a "regulatory device to change the course of the development of financial institutions which had taken place in conformance with the Act as construed by the Board from the outset." *Id.* at 1407.

18. "In short, the new definition has nothing to do with the original meaning of the term . . . but instead was a device to accomplish an end—a change in the Board's jurisdiction." *Id.* at 1405.

19. The court viewed the proposed changes as causing

> divestitures of old acquisitions, sale of assets, [and] changes in permitted uses of excess funds by state chartered and other institutions. It [would] also . . . have a drastic impact on many other types of business arrangements and on the way business [is] conducted, [and] who could insure deposits and changes in regulatory authority from states to the "fed."

Id. at 1406.

20. *Id.* at 1408.

21. 12 U.S.C. § 1844(b) (1982) authorizes the Board "to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and to prevent evasions thereof."

22. *See, e.g.*, Western Bancshares, Inc. v. Board of Governors, 480 F.2d 749, 753-54 (10th Cir. 1973) (The 1970 amendments were designed to protect against noncompetitive practices; no "public good" provisions were included.).

23. *Dimension*, 744 F.2d at 1409. *See also* Patagonia Corp. v. Board of Governors, 517 F.2d 803 (9th Cir. 1975) (FDIC not empowered to alter the definition of "subsidiary," the scope of which Congress carefully considered); Garvey v. Freeman, 397 F.2d 600 (10th Cir. 1968) (power of agencies to carry on government activities is circumscribed by the authority granted) (quoting Stark v. Wickard, 321 U.S. 288, 309-10 (1944)).

agencies not broadly interpret their mandate from Congress, this decision will remind the agencies to remain within the confines of their rulemaking authority. This decision also illustrates the Tenth Circuit's refusal to renounce its responsibilities by chanting an indiscriminate litany of deference to agency expertise. The Federal Reserve Board's attempted four-fold division of this country's tripartite political structure was thus effectively arrested as was the peril to this nation's financial structure.

II. Standby Letters of Credit: *Philadelphia Gear Corp. v. Federal Deposit Insurance Corp.*

In *Philadelphia Gear Corp. v. Federal Deposit Insurance Corp.*,[24] the Tenth Circuit addressed another federal agency attempt to alter a definition in a statute it was delegated to administer. In this case, however, the agency, the Federal Deposit Insurance Corporation (FDIC), attempted to refine a definition to exclude certain transactions, whereas in *Dimension*, the Federal Reserve Board attempted to broaden a definition to include certain entities.

A. *The Facts*

This case arose out of the 1982 failure of the Penn Square Bank in Oklahoma City. The plaintiff, Philadelphia Gear, was a trade supplier that furnished equipment to Orion Manufacturing Corporation (Orion), a Penn Square customer. Upon Orion's application, Penn Square issued an irrevocable standby letter of credit for the benefit of Philadelphia Gear in April of 1981.[25] The letter of credit provided that drafts drawn upon it must be accompanied by certain requisite documents.[26]

On July 5, 1982, the Comptroller of the Currency declared Penn Square insolvent and appointed the FDIC as receiver.[27] Two days later—seventeen days after the insolvency—Philadelphia Gear presented to the receiver drafts for payment on the letter of credit totaling $724,728.50. Philadelphia Gear then received a formal notice from Penn Square's liquidator stating that the receiver disaffirmed any and all obligations under the letter of credit and also stating that it would not honor any drafts thereon. The liquidator then returned the unpaid

24. 751 F.2d 1131 (10th Cir. 1984), *cert. granted*, 106 S. Ct. 245 (1985).

25. *Id.* at 1133. The letter of credit was issued on April 23, 1981, for $145,200 and expired August 1, 1982. That same day, Orion executed an unsecured note for $145,200 in favor of Penn Square as security for the letter of credit.

26. *Id.* The letter of credit required that drafts drawn upon it must be accompanied by Philadelphia Gear's signed statement showing that they had invoiced Orion and that the invoices remained unpaid for at least 15 days. Copies of all invoices were also required. These invoices were to be verified for authenticity with Orion before payment. A few days later, the letter of credit was amended by deleting the statement about verifying invoices and the following language was added: "This credit shall be automatically reinstated from time to time for any sum or sums up to $145,000 upon presentation of described documents. This credit and all reinstatements are irrevocable and shall expire on August 1, 1982." *Id.*

27. *Id.*

drafts.[28]

Philadelphia Gear, as beneficiary, sought to enforce the standby letter of credit by suing the FDIC in its corporate capacity as insurer for $100,000 in deposit insurance proceeds. The company also sued the FDIC in its official capacity as receiver for Penn Square for the letter of credit's total uninsured outstanding balance of $624,728.50.[29] The Oklahoma federal district court rendered judgment in favor of Philadelphia Gear on all of the issues dealing with deposit insurance, and in favor of the FDIC in its capacity as receiver on the question of the total value of the letter of credit.[30]

B. *The Tenth Circuit Decision*

The FDIC presented three legal issues in its appeal to the Tenth Circuit.[31] The first issue considered by the court was whether the standby letter of credit issued by Penn Square represented a "deposit" within section 1813(*l*)(1) of the Federal Deposit Insurance Act and was thus a deposit insured by the FDIC.[32] The FDIC argued that the letter of credit failed to meet two elements of the statutory definition: (1) it was not issued in exchange for "money or its equivalent," and (2) it was not a letter upon which the bank is "primarily liable." The agency contended that the "money or its equivalent" element of the definition was unsatisfied because no advance was made on Orion's promissory note. Since Philadelphia Gear did not present the requisite documents enumerated in the letter of credit before Penn Square's insolvency, the FDIC argued that Orion's note was nonnegotiable because it represented only a contingent obligation.[33]

The Tenth Circuit rejected this argument, stating that the negotiability of an instrument must be determined from the face of the instrument[34] and that the negotiability of Orion's note was not predicated on the presentation of documents under the letter of credit.[35] Thus the court affirmed the district court's holding that the transfer qualified as

28. *Id.* at 1134.
29. *Id.* at 1133.
30. *Id.*
31. A fourth issue was presented in this case. As cross-appellant, Philadelphia Gear claimed that the district court erred in construing the amount of the letter of credit as the aggregate sum of $145,200 rather than the $724,628.50. The Tenth Circuit found that the district court properly determined the total value of the letter of credit by construing an ambiguous clause against its drafter, Philadelphia Gear. *Id.* at 1139-50. Further discussion of this issue is beyond the scope of this article.
32. 12 U.S.C. § 1813(*l*)(1) (1982) defines a deposit as:

> [T]he unpaid balance of money or its equivalent received or held by a bank in the usual course of business and . . . which is evidenced by . . . a letter of credit . . . on which the bank is primarily liable: *Provided*, that, without limiting the generality of the term "money or its equivalent," any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for . . . a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable . . . .

33. *Philadelphia Gear*, 751 F.2d at 1134. *See* U.C.C. § 3-104(1)(B) (1978).
34. 751 F.2d at 1134. *See* U.C.C. § 3-105(2)(a) (1978).
35. 751 F.2d at 1134. *See* U.C.C. § 3-105(1)(d) (1978).

one in which "money or its equivalent" was issued in exchange for the promissory note. Since Penn Square had agreed to make funds available for the benefit of Orion, and in return Orion had executed a promissory note obligating it to repay advances made by the bank, the court found that a commercial transaction had occurred.[36]

The FDIC also argued that a second element of section 1813(*l*)(1)'s definition was not met since the letter of credit in issue was not one on which the bank was "primarily liable." The agency maintained that the section's language referring to letters of credit on which the bank is primarily liable was intended to refer to commercial letters and not to standby letters of credit such as the one issued by Penn Square.[37]

In support of this position, the FDIC contended that a standby letter of credit is essentially a guaranty of the account party's performance because the issuing bank's obligation is triggered only in the event that the account party defaults on the underlying contract.[38] The agency argued that such letters were not within the ambit of a national bank's authority to act as a guarantor of another party's debts.[39]

The Tenth Circuit rejected this contention and refused to defer to the FDIC's interpretation.[40] The court noted that the agency's position was inconsistent with federal regulations promulgated by the Comptroller of the Currency[41] and with the prior position taken by the FDIC.[42] The court compared standby letters of credit with a surety's contract guaranteeing a principal's debt,[43] but differentiated the two on the grounds that a bank issuing a standby letter of credit assumes signifi-

36. 751 F.2d at 1134.

37. *Id.* at 1135. Generally, the key document presented under a letter of credit is a certificate of default by the customer on the underlying obligation. For a discussion of the similarities and differences between a commercial and a standby letter of credit, see B. CLARK, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS, § 8.2, at 8-5 (rev. ed. 1981). This argument was based on the assertion that the agency assisted in drafting a significant portion of the statute in question and is charged with administering its provisions.

38. 751 F.2d at 1136.

39. *Id. See* First Empire Bank-New York v. FDIC, 572 F.2d 1361, 1367 (9th Cir.) (recognizing the rule that national banks are not authorized to enter into guarantees), *cert. denied*, 439 U.S. 919 (1978); 12 U.S.C. § 24 (1982).

40. The FDIC asserted that deference is often given to an agency's interpretation of a statute it administers, especially if Congress has expressly delegated authority to an agency to elucidate a specific provision of the statute. Since the court found no evidence that Congress explicitly delegated authority to the FDIC to refine the definition of deposit and since the agency had not acted as if it possessed such authority, the court refused to give the FDIC interpretation substantial deference. Instead, the court examined three factors in giving weight to the agency's interpretation of section 1813(*l*)(1): the agency's thoroughness, the validity of its reasoning, and consistency with its other pronouncements. 751 F.2d at 1135.

41. *Id.* at 1136 (quoting 12 C.F.R. § 7.7016 (1985)). 12 C.F.R. § 7.7016 states that "[a] national bank may issue letters of credit permissible under the Uniform Commercial Code or the Uniform Customs and Practice for Documentary Credits to or on behalf of its customers. The Uniform Commercial Code contemplates that banks may issue standby letters of credit."

42. *See, e.g.*, FDIC v. Freudenfeld, 492 F. Supp. 763, 767 (E.D. Wis. 1980) (A standby letter of credit is not a guaranty according to the FDIC.).

43. 751 F.2d at 1136.

cantly less conditional liability than does a surety. Unlike an ordinary guarantor who in many instances will be able to assert "real defenses,"[44] the liability of a bank issuing a standby letter of credit is nearly absolute;[45] it must pay claims against the letter even if the account party has legal defenses for nonpayment. Thus, the court held, as it has previously done under different facts,[46] that standby letters of credit represent primary and not secondary obligations of the issuing bank.

The FDIC also contended that the federal deposit insurance fund is structured to exclude standby letters of credit from the scope of section 1813 (*l*)(1)'s definition of deposit. It reasoned that Congress had established specific guidelines to be applied in determining the proper assessment amount each member bank should contribute to the insurance fund, which amount was predicated on the amount absolutely due upon a bank's failure.[47] Since an issuing bank's liability under a standby letter of credit relies upon the account party's default on its contract with the letter's beneficiary, such liabilities are contingent. It was never Congress' intention that "the FDIC attempt to evaluate and assess the risks associated with such contingent liabilities."[48]

This contention was curtly dismissed by the Tenth Circuit. It found no language in either the statute or its legislative history that would limit the definition of a deposit to exclude standby letters of credit.[49] The court held that these instruments were thus within the statutory definition of a "deposit," and that letters of credit constitute insured deposits.

The second issue considered by the court was whether Philadelphia Gear, as beneficiary of a standby letter of credit, was the insured depositor entitled to recover the deposit insurance proceeds. Since records of the insolvent bank are conclusive as to a claimant's entitlement to deposit insurance,[50] the FDIC argued that the drafts presented two days and seventeen days after Penn Square's insolvency were unrecorded contingent liabilities at the time of insolvency.[51]

In deciding that Philadelphia Gear was the insured depositor, the

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44. *Id. See* U.C.C. § 3-415, comment 1 (1978).

45. *Philadelphia Gear*, 751 F.2d 1136; *see also* J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 18-2 (2d ed. 1980). *Compare* U.C.C. § 3-415 (1978) (simple contract defenses are afforded an ordinary guarantor) *with* U.C.C. § 5-114 (1978) (issuance of a letter of credit has obligations not exclusively contractual in nature to beneficiary).

46. *See* Fidelity Bank v. Lutheran Mutual Life Insurance Co., 465 F.2d 211, 213 (10th Cir. 1972) (bank primarily liable on letter of credit issued to assure compliance with conditions of a loan commitment); *see also* Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, 707 F.2d 680, 682 (2d Cir. 1983) (bank's obligation to the beneficiary is primary, direct and independent of any claims arising in the underlying sale transaction).

47. *See* 12 U.S.C. § 1817 (1982).

48. 751 F.2d at 1137.

49. *Id.* (citing 12 U.S.C. § 1813(*l*)(1) for the definition of "deposit," and 12 U.S.C. § 1813(a)(1) which includes within the definition of a deposit, "a letter of credit . . . on which the bank is primarily liable.")). *See generally* 1950 U.S. CODE CONG. & AD. NEWS 3765-3779.

50. *See* 12 U.S.C. § 1822(c) (1982); 12 C.F.R. § 330.1(b) (1985) (records of the closed bank decide claimants).

51. 751 F.2d at 1138.

Tenth Circuit adopted the Ninth Circuit's approach on the issue by stating three conditions which must be met before drafts presented after insolvency are claims reimbursable through insurance proceeds.[52] First, the claims must be in existence prior to insolvency and not dependent on obligations arising after insolvency. Second, the total liability must be certain when the beneficiaries sue the bank's receiver. Finally, the claims must be made in a timely manner, before assets are distributed from the receivership estate.[53] Applying the Ninth Circuit test, the court held Orion's default, at least as to the claims presented two days after the receiver took over the bank, occurred before the insolvency and were provable claims.[54] Since the court believed that Philadelphia Gear, as beneficiary, was the only party permitted to make a demand on the issuing bank for amounts under the letter of credit, logically it should be considered the depositor in the event the issuing bank became insolvent.[55] Therefore, the court held that Philadelphia Gear was the "depositor" for purposes of entitlement to the insurance proceeds.

The third issue the court considered was whether prejudgment interest should be assessed against the FDIC in its capacity as insurer on the $100,000 deposit insurance proceeds. The Tenth Circuit reversed the district court on this issue by holding that prejudgment interest should not be awarded.[56] The court noted that although the FDIC has the capacity to sue and be sued,[57] it did not necessarily follow that this waives the sovereign immunity doctrine on claims for prejudgment interest. An express waiver of sovereign immunity is necessary.[58] Even though Congress expressly recognized that delays would occur in paying some insurance claims,[59] no express waiver of its immunity to prejudgment interest was present.[60]

C. *Conclusion*

Since bank insolvency is of increasing concern, this case gives some indication of how beneficiaries of standby letters of credit can minimize the adverse effects such bank failures can cause their business dealings. By structuring letters of credit to be negotiable on their face, beneficiaries can better insulate their financial transactions from being uninsured, contingent obligations.

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52. First Empire Bank-New York v. Federal Deposit Ins. Corp., 572 F.2d 1361, 1367-69 (9th Cir.), *cert. denied*, 439 U.S. 919 (1978).
53. 751 F.2d at 1138.
54. *Id.*
55. *Id.*
56. *Id.*
57. 12 U.S.C. § 1819 (1982).
58. 751 F.2d at 1138.
59. 12 U.S.C. § 1821(f) (1982).
60. 751 F.2d at 1139.

III. Statutory Disclosure Requirements of Creditor Status: *Eustace v. Cooper Agency, Inc.*

A. *The Facts*

In *Eustace v. Cooper Agency, Inc.*,[61] the plaintiff, Sadie Eustace, entered into an installment credit contract with Bogue Brothers, an appliance dealership, for the purchase of a washer and dryer. This contract was assigned to the Cooper Agency, a financing entity which purchased acceptable security agreements and sales contracts from Bogue Brothers.[62] Eustace brought this action against Bogue Brothers and the Cooper Agency under the Truth in Lending Act[63] (TILA) and Federal Reserve Board Regulation Z.[64] She alleged that the defendants failed to comply with statutory and regulatory requirements by not disclosing the creditor status of Cooper Agency in the credit contract.[65]

The district court initially held that Eustace failed to establish that Cooper Agency was a "creditor" as defined by the TILA. Consequently, the installment contract's failure to identify Cooper Agency's creditor status was immaterial and did not constitute a violation of the TILA.[66]

B. *The Tenth Circuit Decision*

On appeal, the Tenth Circuit reversed the district court, holding that the Cooper Agency was a "creditor" under the TILA[67] and Regulation Z[68] since credit had been extended. Several features of the Cooper

61. 741 F.2d 294 (10th Cir. 1984).
62. *Id.* at 297-98.
63. 15 U.S.C. § 1601-1667(e) (1982).
64. 12 C.F.R. § 226 (1985).
65. *Eustace*, 741 F.2d at 294-95. The complaint alleged that the defendants failed: (1) to identify both creditors in the transaction; (2) to make the disclosures using the prescribed terminology; (3) to make all required disclosures clearly, conspicuously and in meaningful sequence; and (4) to make all required disclosures on one side of the page. Also, the complaint alleged that improper additional information was disclosed. In short, the alleged violations appear to be technical ones.
66. *Id.* In this case, the court applied the law relevant at the time the transaction arose. The definition of "creditor" and the notification requirements have since been modified. The court stated, however, that the same result would occur if the most current law was applied. *Eustace*, 741 F.2d at 300 n.1. *See also* S. Rep. No. 536, 97th Cong., 2d Sess. 71, *reprinted in* 1982 U.S. Cong. Ad. News 3054, 3125 (amended section 1602(f) excludes "arrangers of credit" except for those who regularly extend commercial credit.); Griffith, *Recent Developments in the Effort to Simplify Truth in Lending*, 19 Tulsa L.J. 30, 56-58, 62-67 (1983) (comparing new and old versions of the Act). *Compare* 15 U.S.C. § 1602(f) (1976) (creditor is person who regularly extends consumer credit which is payable in more than four installments) *with* 15 U.S.C. § 1602(f) (1982) (creditor is person who regularly extends consumer credit which is payable in more than four installments *and* is the person to whom the debt is initially payable on the face of the instrument). *Compare* 12 C.F.R. §§ 226.1-1002 (1970) *with* 12 C.F.R. §§ 226.1-.29 (1985).
67. The Act, as cited in *Eustace*, provided in pertinent part:

> The term "creditor" refers only to creditors who regularly extend, or arrange for the extension of, credit which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required, whether in connection with loans, sales of property or services, or otherwise.

15 U.S.C. § 1602(f) (1976) (current version at 15 U.S.C. § 1602(f) (1982)).
68. Regulation Z, as cited in *Eustace*, provided in pertinent part:

> (5) "Creditor" means a person who in the ordinary course of business regularly

Agency's relationship with Bogue Brothers caused the court to characterize it as an entity extending credit. First, a dealer financing agreement existed under which Cooper Agency agreed to purchase acceptable sales contracts and security agreements from Bogue Brothers. Second, Bogue Brothers agreed to prepare such contracts on forms furnished by and satisfactory to the Cooper Agency. Third, Bogue Brothers assigned all of its installment contracts to financing entities, sixty-five percent of which were assigned to Cooper Agency.[69] Finally, there were no more than two or three contracts which Bogue Brothers requested Cooper Agency to return and which Cooper Agency did not purchase.[70] Therefore, in light of all these facts, the court found Cooper Agency to be a "creditor" for purposes of TILA disclosure requirements. The court's finding of an actual extension of credit was bolstered by the fact that Cooper Agency gave no prior approval to the buyer's credit application since it had recourse against Bogue Brothers.[71]

Addressing the second issue, which was contingent on finding that Cooper Agency was a creditor, the court held that the failure to so identify the Cooper Agency in the installment credit contract was not a mere technical violation of the Act, but instead warranted relief to the debtor as provided for under the Act. The TILA requires that each creditor must be clearly identified[72] and that the failure to do so imposes liability under the Act.[73]

The court found that the contract failed to identify Cooper Agency as a creditor based on two circumstances. First, although Eustace's copy of the contract stated that "[t]he foregoing security is hereby assigned

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> extends or arranges for the extension of consumer credit or offers to extend or arrange for the extension of such credit, which is payable by agreement in more than four installments, or for which the payment of a finance charge is or may be required, whether in connection with loans, sales of property or services, or otherwise.

12 C.F.R § 226.2 (1980) (current version at 12 C.F.R. § 226.2 (1985)).

69. 741 F.2d at 298. Additionally, Bogue Brothers had been doing business with the Cooper Agency for 10 years and was its largest source of business. *Id.* at 298.

70. *Id.*

71. The court noted the difference between this transaction and similar cases decided in other circuits. *See also* Ford Motor Credit Co. v. Cenance, 452 U.S. 155, 156-60 (1981) (per curiam). In *Cenance*, the dealer first submitted the buyer's credit application to the Ford Motor Credit Company (FMCC) for approval. It was only after the dealer was notified that the buyer passed FMCC's credit check, that the dealer and buyer executed a retail installment contract. FMCC then repurchased the installment contract without recourse against the dealer. *Cenance*, 452 U.S. at 155-57. There was no need for Cooper Agency, on the other hand, to give prior approval to the buyer's credit application since Cooper Agency purchased contracts with recourse against Bogue Brothers. The prior approval/recourse distinction was deemed to be of secondary significance by the Tenth Circuit. *Cf. Eustace*, 741 F.2d at 298; Boncyk v. Cavanaugh Motors, 673 F.2d 256 (9th Cir. 1981). And in Joseph v. Norman's Health Club Inc., 532 F.2d 86, 90 (8th Cir. 1976), the court stated:

> In interpreting the Act, the Federal Reserve Board and the majority of courts have focused on the substance, rather than the form, of credit transactions, and have looked to the practices of the trade, the course of dealing of the parties, and the intention of the parties in addition to specific contractual obligations.

72. 12 C.F.R. § 226.8 (1985).

73. 12 C.F.R. § 226.6 (1985).

under the terms of the Seller's Recourse, recommendation, Assignment and Guaranty on the reverse side hereof unless otherwise indicated,"[74] her copy did not contain, on the reverse side, such quoted language or a statement that the contract was assigned to the Cooper Agency. Second, although the contract copy did contain a reference to the Group Creditor Life Policy pursuant to the agency agreement of Cooper Agency, this statement was found not to be sufficiently clear to identify Cooper Agency as a creditor.[75] Despite the fact that Eustace acknowledged that she was making payments directly to the Cooper Agency, the Tenth Circuit held that even a showing of actual knowledge does not excuse a creditor's failure to comply with the mandatory disclosure requirements, or prevent recovery under the mandatory remedial provisions of the Act and the regulations.[76]

The court concluded that since the contract did not clearly notify Eustace of the assignment to the Cooper Agency or its status as a creditor, the mandatory disclosure requirements of TILA were not met.[77]

C. *Conclusion*

According to *Eustace*, a loose interpretation of "creditor" will be applied to those who regularly extend credit. Not only will a financing entity be regarded as a "creditor" when it gives prior approval to credit transactions without recourse, the entity will also be regarded as a "creditor" when it gives no prior approval but has recourse. Additionally, the argument that a financing entity such as the Cooper Agency has in effect accepted a *fait accompli* by merely accepting an assignment of a completed agreement without prior approval will not be accorded much deference. Once a financial entity falls within the definition of a creditor, fastidious compliance with the consumer credit rules is mandated. This holding should not be affected by applying current consumer credit law. *Eustace* highlights that what appears to be a mere oversight will not necessarily be regarded as a mere technical violation which requires no remedy.

IV. Trademark Infringement and the "Likelihood of Confusion" Test: *Amoco Oil Co. v. Rainbow Snow*

In *Amoco Oil Co. v. Rainbow Snow*,[78] the Tenth Circuit court expanded and clarified the "likelihood of confusion" test to be applied in a trademark infringement case.[79] In this case, Amoco Oil Company

74. *Eustace*, 741 F.2d at 300.
75. *Id.* (citing Boncyk v. Cavanaugh Motors, 673 F.2d 256, 260 (9th Cir. 1981)).
76. 741 F.2d at 301.
77. *Id.* (citing Ford Motor Co. v. Cenance, 452 U.S. 155 (1981)).
78. 748 F.2d 556 (10th Cir. 1984).
79. *Id.* at 557-58. The provisions of 15 U.S.C. § 1114(1) (1982) govern the trademark infringement determination. That section imposes liability for the "use in commerce [of] any reproduction, counterfeit, copy, or colorable imitation of a registered mark . . . *likely to cause confusion*, or to cause mistake, or to deceive . . . ." *Id.* (quoting 15 U.S.C. § 1114(1) (1982) (emphasis added)). This "likelihood of confusion" test was also deemed

(Amoco) appealed the district court's denial of its motion for a preliminary injunction prohibiting the appellee's use of the name "Rainbow Snow" to describe his snow cone business.[80]

A. *The Facts*

In 1976, Amoco created the Rainbow Oil Company division (Rainbow Oil) to operate self-service gas stations in Salt Lake City, Utah. Since that time, Rainbow Oil has operated exclusively under the "Rainbo" trademark,[81] and this mark appears on service station signs.[82] The Rainbo stations have sold convenience foods since 1976, and in 1980 ice slush drinks were introduced at two Rainbow stations.[83]

During the summer of 1982, Van Leeuwen operated a snow cone business in the Salt Lake City area under the name of Rainbow Snow, Inc.[84] The snow cones were sold from booths displaying the name "Rainbow Snow" beneath a rainbow logo.[85] Some of these booths were in close proximity to Rainbo stations.[86]

In December of 1982, Amoco filed suit against Van Leeuwen, seeking injunctive relief and alleging that use of the "Rainbow Snow" mark constituted trademark infringement.[87] In its decision, the Utah federal district court initially noted the general rule regarding likelihood of confusion; would an ordinary consumer likely be confused as to the source of the product.[88] It then applied the factors enumerated in the Restatement of Torts[89] to determine if there was a likelihood of confusion. Its conjunctive application of these two legal standards led the district court to focus solely on the issue of confusion as to source. Implicit in its decision was the conclusion that confusion was unlikely because pro-

applicable to Amoco's pendent state claims of infringement under UTAH CODE ANN. § 70-3-13 (1953); its claim of false designation of origin, 15 U.S.C. § 1125(a) (1976); and its common law claims of unfair competition and deceptive trade practices, Amstar Corp. v. Domino's Pizza, Inc., 615 F.2d 252, 258 (5th Cir. 1980).

80. *Amoco*, 748 F.2d at 557.

81. Amoco registered its "Rainbo" service mark and trademark with the United States Patent Office in 1978 and with the State of Utah in 1982. *Id.*

82. The word "Rainbo" appears in white letters against a black background and below a red-orange-yellow-blue truncated rainbow logo. *Id.*

83. *Id.*

84. *Id.* During the summer of 1981, Van Leeuwen sold snow cones from two stands in the Salt Lake City area under the name "Sno Shop," and in October 1981, he reserved the name "Rainbow Snow" with the State of Utah as the name for his expanded snow cone business.

85. The Rainbow Snow booths are blue with a 180-degree, red-orange-yellow-green rainbow appearing on the upper half of the booth, and the name "Rainbow Snow" appears in white below the rainbow. *Id. See supra* note 82.

86. *Id.* at 557. Some Rainbow Snow booths were located adjacent to Rainbo stations, while others were within a few blocks.

87. *See supra* note 79.

88. The district court stated the rule as follows: "[i]t is the generally accepted rule that a designation is confusingly similar to a trade-mark if an ordinary prospective purchaser, exercising due care in the circumstances, is likely to regard it as coming from the same *source* as the trade-marked article." *Amoco*, 748 F.2d at 558 (quoting Avrick v. Rockmont Envelope Co., 155 F.2d 568, 572 (10th Cir. 1946) (emphasis added)).

89. RESTATEMENT OF TORTS § 729 (1938). The RESTATEMENT factors are:

spective purchasers would not believe that Rainbow Snow cones originated with the Rainbow Oil Company.[90] The district court determined that Amoco had established none of the four prerequisites to the issuance of a preliminary injunction,[91] and thus denied the motion. Amoco appealed this adverse decision to the Tenth Circuit.[92]

B. *The Tenth Circuit Decision*

In short, the Tenth Circuit held that the district court erred when it "limited its inquiry to the issue of confusion of *source*, and did not consider potential confusion which might result from a belief in *common sponsorship or affiliation*."[93] The Tenth Circuit agreed that the factors enumerated in the Restatement should be applied,[94] but stated that the district court considered those factors in too narrow a context.[95]

The Tenth Circuit considered only whether Amoco had shown a substantial "likelihood of success on the merits,"[96] and premised Amoco's ability to establish this prerequisite on its demonstrating a substantial likelihood that it would prevail on the issue of likelihood of con-

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(a) the degree of similarity between the designation and the trade-mark or trade name in
(i) appearance;
(ii) pronunciation of the words used;
(iii) verbal translation of the pictures or designs involved;
(iv) suggestion;
(b) the intent of the actor in adopting the designation;
(c) the relation in use and manner of marketing between the goods or services marketed by the other;
(d) the degree of care likely to be exercised by purchasers.

90. 748 F.2d at 559.

91. To obtain a preliminary injunction the moving party has the burden of establishing:

"(1) substantial likelihood that the movant will eventually prevail on the merits; (2) a showing that the movant will suffer irreparable injury unless the injunction issues; (3) proof that the threatened injury to the movant outweighs whatever damage the proposed injunction may be cause the opposing party; and (4) a showing that the injunction, if issued, would not be adverse to the public interest."

Id. at 557 (quoting Lundgrin v. Claytor, 619 F.2d 61, 63 (10th Cir. 1980)).

92. Amoco appealed pursuant to 28 U.S.C. § 1292(a)(1) (1982).

93. 748 F.2d at 559 (emphasis added).

94. *Id.* at 558. For Tenth Circuit cases where the court has applied the RESTATEMENT criteria, see Beer Nuts, Inc. v. Clover Club Foods Co., 711 F.2d 934, 940 (10th Cir. 1983); Drexel Enterprises v. Richardson, 312 F.2d 525, 528 (10th Cir. 1962). Other courts have also used some formulation of this same test. *See, e.g.*, Soweco Inc. v. Shell Oil Co., 617 F.2d 1178, 1185 (5th Cir. 1980), *cert. denied*, 450 U.S. 981 (1981); McGregor-Doniger Inc. v. Drizzle Inc., 559 F.2d 1126, 1130 (2d Cir. 1979); AMF Inc. v. Sleekcraft Boats, 559 F.2d 341, 348-49 (9th Cir. 1979); Union Carbide Corp. v. Ever-Ready Inc., 531 F.2d 366, 381-82 (7th Cir.), *cert. denied*, 429 U.S. 830 (1976); Fotomat Corp. v. Cochran, 437 F. Supp. 1231, 1242 (D. Kan. 1977).

95. *Amoco*, 748 F.2d at 558-59. "[T]he Restatement factors should be considered not only in the context of confusion of source, but also in the context of confusion that results from a mistaken belief in common sponsorship or affiliation." *Id.* at 558. Implicit in this holding is that the district court failed to consider whether prospective purchasers would believe Rainbo and Rainbow Snow were somehow related to or affiliated with each other.

96. The court's sole concern with the first prerequisite to the issuance of a preliminary injunction was premised on its belief that the district court's determination that confusion was unlikely may have affected its resolution of the other three prerequisites. *Amoco*, 748 F.2d at 556, 559.

fusion.[97] In determining that the district court had placed too restrictive an interpretation on the confusion requirement, the Tenth Circuit remanded the case with instructions that the district court assess the likelihood of confusion which might result from a belief in common sponsorship or affiliation, and concomitantly consider the Restatement factors.[98]

The *Rainbow Snow* case cannot be read solely as a decision which aligned the Tenth Circuit with other circuit courts in giving the "likelihood of confusion" test a wider scope than simply an inquiry into confusion of source.[99] The question of confusion, whether of a sensory or conceptual nature,[100] or of source or affiliation, is determinative of an infringement claim, and the Tenth Circuit's decision indicates that the test involved in trademark infringement law is becoming both increasingly expansive and subjective.[101]

V. Bankruptcy Decisions

A. *The Effect of Primary Use of Collateral on Exemption and Lien Avoidance Status:* In re Reid

In *In re Reid*,[102] the Tenth Circuit considered whether certain paintings owned by the debtors were exempt from attachment under the personal property exemption categories described in the Oklahoma exemption statute[103] and the Federal Bankruptcy Code lien avoidance statute.[104] Both statutes require that items which fall within the exemption categories must be "held primarily for the personal, family or

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97. *Id.* at 558.

98. *Id.* at 559.

99. *See* Dallas Cowboys Cheerleaders, Inc. v. Pussycat Cinema Ltd., 604 F.2d 200, 204-05 (2d Cir. 1979); James Burrough Ltd. v. Sign of the Beefeater, Inc., 540 F.2d 266, 274 (7th Cir. 1976); *see also* Control Components, Inc. v. Valtek, Inc., 609 F.2d 763, 770 (5th Cir. 1980).

100. *See* Beer Nuts, Inc. v. Clover Club Foods Co., 711 F.2d 934, 940 (10th Cir. 1983) (similarity of sight, sound, and meaning must each be considered).

101. For an informative case discussing the general area of trademark infringement law, see Soweco, Inc. v. Shell Oil Co., 617 F.2d 1178 (5th Cir. 1980), *cert. denied*, 450 U.S. 981 (1981) *see also* Beer Nuts, Inc. v. Clover Club Foods Co., 711 F.2d 934 (10th Cir. 1983) ("Beer Nuts" and "Brew Nuts"); Beatrice Foods Co. v. Neosho Valley Coop. Creamery Ass'n, 297 F.2d 447 (10th Cir. 1961) ("Meadow Sweet" and "Meadow Gold"); Nebraska Consol. Mills Co. v. Shawnee Milling Co., 198 F.2d 36 (10th Cir. 1952) ("Mother's Best" and "Mother's Pride").

102. 757 F.2d 230 (10th Cir. 1985).

103. Okla. Stat. tit. 31 § 1(A)(3), (7) (Supp. 1980). The pertinent portion of the Oklahoma exemption statute provides:

> [T]he following property shall be reserved to every person residing in the state, exempt from attachment or execution and every other species of forced sale for the payment of debts, except as herein provided:
>
> . . .
>
> (3) All household and kitchen furniture held primarily for the personal, family or household use of such person or a dependent of such person;
>
> . . .
>
> (7) All books, portraits and pictures, and wearing apparel, that are held primarily for the personal, family or household use of such person or a dependent of such person.

104. 11 U.S.C. § 522(f) (1982). Section 522(f) provides in part:

> Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a

household use" of the debtor.[105]

In *In re Reid*, the debtors, Wayne and Dorothy Reid, operated a family business which received fifteen religious paintings from a customer as payment for services rendered.[106] The Reids hung all fifteen paintings throughout their house. They then pledged these paintings to two banks as collateral for loans, the proceeds of which were used for business purposes. Both security agreements indicated, however, that the paintings were held primarily for personal, family and household use.[107] The Reids filed a voluntary bankruptcy petition approximately one year after the loans were made, and sought to exempt the paintings from attachment for payment of debts under the Oklahoma exemption statute.[108] One of the banks commenced this action in the bankruptcy court claiming that the paintings were not exempt under the Oklahoma statute and that the debtors could not avoid security interest liens on the property under the Federal Bankruptcy Code lien avoidance statute.[109]

The bankruptcy court found that the paintings were not exempt and the liens were not avoidable, because, under all the circumstances, the paintings were not held primarily for personal, family or household use.[110] Although the paintings were located in the debtors' home, the bankruptcy court found that their "most important use . . . [was] pledging them commercially for commercial loans."[111] The bankruptcy court asserted three reasons for its conclusion. First, the paintings were received by the Reids as a business entity and as payment on a series of commercial transactions. Second, the paintings were pledged as collateral for business loans shortly after the Reids received them and placed them in their home. Finally, the Reids themselves indicated in their list of assets that the paintings were a "unique collection" by not incorporating them into their general description of furniture, fixtures and ac-

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lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled . . . if such lien is —

(2) a nonpossessory, nonpurchase-money security interest in any —

(A) household furnishings, household goods . . . that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor.

105. OKLA. STAT. tit. 31, § 1(A)(3), (7) (Supp. 1980); 11 U.S.C. § 522(f)(2)(A) (1982). The debtor is allowed to choose between use of state or federal exemption provisions. *In re* Reid, 757 F.2d at 231 n.1; 11 U.S.C. § 522(b)(2)(A) (1982).

106. *In re* Reid, 757 F.2d at 231-32. The paintings were 200 to 300-year-old "classic religious paintings" valued at approximately $187,000. A credit of $125,000 was given to the customer's company accounts when the paintings were received. *Id.* at 232, 235.

107. *Id.* The Reids stressed the wording in the security agreements as strong evidence that the banks recognized the personal, family and household use of the paintings. *Id.* at 232. The Tenth Circuit never addressed the issue of whether the banks were required to adopt the characterization of the goods given in the security agreements furnished by them.

108. OKLA. STAT. tit. 31, § 1(A)(3), (7) (Supp. 1980). *See supra* note 103. Objections were filed by the trustee in bankruptcy and the two banks involved. *Reid*, 757 F.2d at 231.

109. *Id.*

110. *Id.* at 232. In the proceedings, the bankruptcy court assumed that the paintings fell within the personal property exemption categories described in the Oklahoma exemption statute and found that the creditors' security interests were nonpossessory, nonpurchase-money liens subject to 11 U.S.C. § 522(f) avoidance provisions. *Id.*

111. *Id.*

cessories.[112] The district court affirmed the judgment.[113]

On appeal, the issue before the Tenth Circuit was whether the bankruptcy court erred in finding that the paintings were not held primarily for personal, family or household use. The court stated that it was bound to accept the findings of the bankruptcy judge unless they were clearly erroneous.[114] The Tenth Circuit found that sufficient evidence was introduced in the bankruptcy hearing to support the bankruptcy court's findings that the paintings were received by the debtors as a business entity and not as individuals.[115] Next, the court held that the bankruptcy court, in finding that the most important use of the paintings was pledging them commercially for commercial loans,[116] was not required to adopt the characterization of the items given in the security agreement.[117] Finally, the court held that despite the location of the items in the debtor's home, the bankruptcy court could properly find that the paintings were primarily used for business rather than for household purposes, which was deemed to be a secondary use.[118] Thus, the Tenth Circuit agreed with and affirmed the lower court's decision that the paintings were not held primarily for personal, family or household use and did not fall within the exemption and lien avoidance

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112. *Id.* at 232, 235 n.6.

113. *Id.* at 232.

114. The Tenth Circuit concluded that the clearly erroneous standard of review is appropriate in a "core bankruptcy proceeding" under both the 1978 Bankruptcy Act and the Bankruptcy Amendments and Federal Judgeship Act of 1984. *Id.* at 234 n.5. The court stated that the bankruptcy case before them was a " 'core proceeding' because it involved the determination of 'exemptions from the property of estate,' defined as a 'core proceeding' under § 157(b)(2)(B) of the 1984 Act." *Id.* at 234 n.5; *cf.* 1616 Reminc, Ltd. Partnership v. Atchison & Keller Co., 704 F.2d 1313, 1318 (4th Cir. 1983) (use of clearly erroneous standard unconstitutional in *non-core* contexts).

115. 757 F.2d at 234. To support this finding, the court noted the following: (1) although the Reid's was a family-run business, some of the company employees were not members of the Reid family; (2) the Reids received the paintings as payment of debts owed the business; (3) "credit" was given to the customer's company accounts in the amount of $125,000 for the paintings; and (4) that the Reids were seeking to discharge in bankruptcy some of the costs incurred "in producing this $125,000 worth of work." *Id.* at 235.

116. *Id.* The Tenth Circuit also found that sufficient evidence supported the bankruptcy court's finding that the paintings' most important use was pledging them commercially for commercial loans, in that the paintings were pledged as collateral within a period of six days from the first installment and a period of a few months from the second installment. Additionally, Wayne Reid testified on numerous occasions that the loan proceeds were used exclusively for business purposes. *Id.* at 234-35.

117. *Id.* at 235. *See In re* Currie, 34 B.R. 745, 747-48 (Bankr. D. Kan. 1983) (evidence of actual use of collateral controlled over security agreement classification of collateral as consumer goods held for family, personal or household purposes); *In re* Noggle, 30 B.R. 303, 305, (Bankr. E.D. Mich. 1983) ("classification of property in a security agreement is not dispositive of questions dealing with whether the property may be claimed as exempt or whether a lien on such property may be avoided.").

118. *Reid,* 757 F.2d at 235 (quoting 3 COLLIER ON BANKRUPTCY ¶ 522/12 (15th ed. 1985) ("Presumably, those goods which are primarily for occupational use . . . do not fall within the [personal, family or household use] exemption, even though there may also be a secondary personal use.")); *see also* Security Building & Loan Ass'n v. Ward, 174 Okla. 238, 50 P.2d 651, 656 (1935) (even though goods may have characteristics of "household furniture," courts have held with practical unanimity that furniture devoted to commercial purposes does not fall within the exemption statute).

statutes.[119]

The test applied by the Tenth Circuit in denying exempt status to these items was that use controls over nature, characterization and location of the collateral. Thus, even though an item might fall within the applicable exemption categories of the statutes by virtue of its nature as personal property, it will not automatically be exempt by virtue of its classification as "household furniture even if the item is located in the home."[120] Neither will an item be automatically exempt by its characterization adopted by the parties to a security agreement. Although the paintings were "used" in the Reid's home as ornamentation, their incidental placement was not afforded much deference by the court. The "actual use" itself should be carefully scrutinized. The items must be held "primarily" for household or personal use. In looking at the "primary use" of the collateral, the court will consider such factors as the source of the collateral as well as its future use.

B. *Reopening of Bankruptcy Estate* SUA SPONTE: IN RE MULLENDORE

In *In re Mullendore*,[121] the court addressed the issue of whether it is an abuse of discretion for a bankruptcy judge to reopen an estate *sua sponte* for the purpose of ordering the debtor estate to pay fees to the referees' salary and expense fund.[122] In the original action, the district judge who handled the Mullendore bankruptcy proceeding did not assess a fee payable to this fund. The bankruptcy judge who replaced the then-deceased district judge closed the estate on July 17, 1979. After discovering that no charges were made or paid to the credit of the referees' fund, the bankruptcy judge reopened the estate on his own motion on November 7, 1979. The judge then ordered the debtor estate or the debtors to pay the amount of $14,256.06 to the clerk of the bankruptcy court for deposit into the referees' fund.[123] The Mullendores appealed the district court's affirmance of the bankruptcy court's order.

On appeal, the Tenth Circuit affirmed the district court's decision, beginning with the initial premise that a bankruptcy court is vested with the authority to exercise original jurisdiction to reopen estates if cause is shown.[124] The court then noted that although the duty to reopen an estate is a discretionary one in many instances, it in effect becomes an

119. *Reid*, 757 F.2d at 236.

120. *Id.*

121. 741 F.2d 306 (10th Cir. 1984).

122. *See* 11 U.S.C. § 68(c)(2) (1982) which states: "Additional fees for the referees salary and expense fund shall be charged, in accordance with the schedule fixed by the conference . . . of this Title."

123. *Mullendore*, 741 F.2d at 308 n.2.

124. *Id.* at 308. *See* 11 U.S.C. § 11(a)(8) (1982). The appellants cited *In re* Barlean, 290 F. Supp. 260 (D. Mont. 1968), for the proposition that "cause shown" refers to causes which, if known to the adjudicating authority, would have altered the decision or order. *See Mullendore*, 741 F.2d at 308 n.1. They argued that if the fee assessment matter had been reconsidered by the original district judge, the results would not have been different, and thus disputed the bankruptcy judge's decision to reopen the estate. The Tenth Circuit briefly distinguished the Mullendores' cited authority on the ground that the court in *Barlean* reached the correct result and, therefore, the motion to reopen was denied. The

affirmative duty of the court "whenever prima facie proof exists that the estate has not been fully administered."[125] In this case, the court found that the estate was reopened within a reasonable time to properly complete the administration of the estate. The Tenth Circuit thus held that the bankruptcy court did not abuse its discretion in reopening the estate *sua sponte* for the purpose of ordering the debtor estate to pay fees for the referees' fund.

In reaching this conclusion, however, the court cursorily bypassed the *sua sponte* initiation of the reopening.[126] Relying on rather scanty authority, the court noted in response to the Mullendores' contention that the bankruptcy judge had no authority to reopen the estate that " 'it has been suggested that perhaps the court could make a reopening order *sua sponte*.' "[127] The Tenth Circuit court bolstered its position by citing a Second Circuit opinion, *In re International Match Corp.*[128] That opinion held that where the referee in bankruptcy had fraudulently taken excess commissions in violation of a court order, it was proper for the court, upon the recommendation of a special master, to reopen the estate and to order the recovery of the sums involved.[129] The Tenth Circuit, however, failed to mark the distinction between reopening an estate on the recommendation of a master and reopening an estate by a bankruptcy judge *sua sponte*. The *sua sponte* reopening of an estate has thus materialized in the Tenth Circuit in those situations in which proper administration of an estate must be completed.

Next, the Mullendores contended that the bankruptcy judge erred in presuming that the earlier failure of the district judge to assess the fee was merely an oversight. The Tenth Circuit held that regardless of the reasons for the earlier failure of the district judge to assess these fees, fees for the fund are chargeable against each case in an arrangement confirmed under Chapter 11 of the Bankruptcy Act.[130] This statement withstood the Mullendores' further contention that no services were

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court concluded that in the appellant's situation the correct result was not reached by the adjudicating authority at the time he acted. *Id.* at 308.

125. *Mullendore*, 741 F.2d at 308 (citing *In re* Joslyn's Estate, 171 F.2d 159, 164 (7th Cir. 1948)).

126. *Mullendore*, 741 F.2d at 308. After stating that an "interested party" could reopen an estate, the court failed to determine whether the bankruptcy judge was such an interested party. Apparently, a bankruptcy judge would fall within the classification of an "interested party" when the referees' fund is the object to be benefited.

127. *Id.* at 308 (quoting 1 COLLIER ON BANKRUPTCY ¶ 2.50 (14th ed. 1976)).

128. 190 F.2d 458 (2d Cir.), *cert. denied*, 342 U.S. 870 (1951).

129. *Id.* at 460-61.

130. *Mullendore*, 741 F.2d at 309 (citing 11 U.S.C. § 68(c)(2) (1976), which states that "fees . . . shall be charged . . . against each [chapter 11] case . . ." (*see supra* note 122); 11 U.S.C. § 65 (1976), providing that the Judicial Conference of the United States is to determine "schedules of graduated additional fees to be charged . . . ;" and THE 1948 REPORT OF THE JUDICIAL CONFERENCE OF THE UNITED STATES 31, stating that "[a]dditional charges for the referees' salary and expense funds . . . shall be collected . . . in all straight bankruptcy cases . . ."). The additional charges for the referees' salary and expense fund in those Chapter 11 cases administered before a district court without a reference to a referee in bankruptcy appear to have been based on policy considerations of uniform costs of administration and for provision of funds necessary to maintain the referees' salary and expense fund.

performed by a referee sufficient to justify an assessment for the fund. The Tenth Circuit held that even in Chapter 11 cases administered without reference to referees, such fees are chargeable to the estate.[131] The court then stated that these fees must be paid in full unless they have been waived. Since there had been no waiver, and no deposit covering these fees had been made, the court found that the Chapter 11 arrangement had been erroneously confirmed.[132]

Finally the Mullendores contended that the discharge in bankruptcy released the former debtors in possession from any provable debt owed to the United States.[133] The court first stated than an unsecured debt includes within its confines unsecured priority debts, and that the fees for the referees' fund are such priority debts.[134] The Tenth Circuit found, however, that the requirement that such a debt must be provided for by the arrangement in order to be discharged by the confirmation of the arrangement had not been satisfied. " 'If a plan does not provide for the payment of some consideration for the modification or alteration of a creditor's rights, the debt owed to that creditor is not affected by the discharge which results from confirmation of the plan.' "[135] Since the district judge did not assess a fee payable to the referees' salary and expense fund, and the arrangement did not provide for the payment of such fees, the fees were not discharged by the confirmation of the arrangement.

The complete administration of an estate is the primary goal when an estate is reopened. *In re Mullendore* thus illustrates that the non-payment of fees for the referees' fund falls under the aegis of "cause shown" to enable a bankruptcy court to exercise its jurisdiction to reopen an estate.

C. *Bankruptcy Automatic Stay Protection:* Fortier v. Dona Anna Plaza Partners

In *Fortier v. Dona Anna Plaza Partners*,[136] the Tenth Circuit held that 11 U.S.C. § 362[137] stays litigation only against the debtor and affords no protection to solvent co-defendants of that debtor. In this case, shopping center buyers (the Fortiers) sued the developer-seller (Peterson) for damages in connection with the development, construction and sale of the Dona Anna Plaza Shopping Center.[138] In a suit brought in the

131. The appellants relied on 11 U.S.C. § 771 (1976) which states: "The confirmation of an arrangement shall discharge a debtor from all his unsecured debts and liabilities provided for by the arrangement, except as provided in the arrangement or the order confirming the arrangement, but excluding such debts as, under section 35 of this title, are not dischargeable."

132. *Mullendore*, 741 F.2d at 309-10.

133. 741 F.2d at 310.

134. *Id.* (citing 9 COLLIER ON BANKRUPTCY ¶ 9.32 (14th ed. 1976) and 11 U.S.C. § 104(a) (1976)).

135. 741 F.2d at 310 (quoting 9 COLLIER ON BANKRUPTCY ¶ 9.32 (14th ed. 1976)).

136. 747 F.2d 1324 (10th Cir. 1984).

137. 11 U.S.C. § 362 (1982).

138. 747 F.2d at 1328.

United States District Court for the District of New Mexico, the Fortiers alleged that Peterson was negligent in instructing his architect, Armstrong, to ignore certain parking lot design recommendations concerning soil conditions. Armstrong complicated the trial proceedings by filing for bankruptcy in the United States Bankruptcy Court for the Southern District of California five days before the trial was to begin. All pending proceedings against Armstrong were automatically stayed pursuant to 11 U.S.C. § 362.[139] The damage action was immediately removed by the Fortiers to the United States Bankruptcy Court for the District of New Mexico.[140] The next day, the Fortiers filed a complaint seeking relief from the automatic stay that became effective in the New Mexico bankruptcy court. The New Mexico bankruptcy judge lifted the stay and allowed the case to proceed. Thus, the case was transferred back to the New Mexico district court. The district court rendered judgment in favor of the Fortiers against Peterson and Armstrong.[141]

On appeal, Peterson contended that Armstrong's bankruptcy filing stayed the litigation against all parties and thus divested the district court of jurisdiction to hear the case.[142] The Tenth Circuit dismissed Peterson's contention, stating that the language of 11 U.S.C § 362 stays only proceedings "against the debtor," and that no language in the statute purports to extend the stay to causes of action against solvent co-defendants of the debtor.[143]

The court reasoned that it would be contrary to the legislative purposes underlying an automatic stay to extend stay protections to solvent co-defendants of the debtor.[144] Therefore, the Tenth Circuit refused to extend Armstrong's automatic stay to Peterson and joined other circuit courts in concluding that 11 U.S.C. § 362 stays litigation only against

139. *Id.* 11 U.S.C. § 362(a) (1982) provides in pertinent part:

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of —
>
> (1) the commencement or continuation . . . of a judicial . . . proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title . . . .

140. *Id.* The Fortiers' action was filed pursuant to 28 U.S.C. § 1478 (1982) and local Bankruptcy Rule 1-118.

141. 747 F.2d at 1328-29.

142. *Id.* at 1329. Peterson also argued that the New Mexico bankruptcy court had no jurisdiction to lift the stay since an automatic stay imposed by 11 U.S.C. § 362 must be obtained from the court in which the debtor filed his bankruptcy petition, in this case the California bankruptcy court. This argument was never addressed by the Tenth Circuit since the court found that an automatic stay applied "only to the debtor." *Id.* at 1329. Peterson raised four other arguments as well, but they are outside the scope of this article. *Id.* at 1325.

143. *Id.* at 1330. *See supra* note 139.

144. Since the legislative purpose for an automatic stay is to permit the debtor to reorganize his affairs without creditor harassment and to allow organized claim resolution, the court stated that it is not logical to extend the stay to solvent co-defendants. *Id.* at 1330.

the debtor.[145]

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145. *Id.* (citing Williford v. Armstrong World Indus., Inc., 715 F.2d 124, 126-27 (4th Cir. 1983); Wedgeworth v. Fibreboard Corp., 706 F.2d 541, 544 (5th Cir. 1983); Austin v. Unarco Indus., Inc. 705 F.2d 1, 4-5 (1st Cir.) *cert. dismissed*, 463 U.S. 1247 (1983); Pitts v. Unarco Indus., Inc. 698 F.2d 313 (7th Cir. 1983); Lynch v. Johns-Manville Sales Corp., 710 F.2d 1194 (6th Cir. 1983)). *See also In re* Convention Masters, Inc., 46 B.R. 339, 341 (Bankr. D. Md. 1985).