

April 2021

Corporations and Agency

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Recommended Citation

William E. Brayshaw, Corporations and Agency, 42 Denv. L. Ctr. J. 152 (1965).

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II. CORPORATIONS AND AGENCY

A. CORPORATIONS—COURT REJECTS THE SEC STANDARD FOR INCLUSION OF STATEMENTS IN PROXY SOLICITATIONS

Perhaps the most interesting corporate law case in Colorado was decided in the Federal District Court. *Western Oil Fields, Inc. v. McKnab*¹ dealt with the rights of a group of shareholders of an unlisted stock to include certain statements in a proxy solicitation. The corporate management brought an action based on state law for protective orders against a group of shareholders alleging that certain statements were included in proxy solicitations which were in part "untrue, incomplete, misleading, full of innuendoes and the same amount to either actual or constructive fraud made in conflict with the fiduciary obligation to the other shareholders"² and which may have deceived the other shareholders as to the true facts surrounding the controversy. The management asked that the annual meeting date be postponed, all proxy solicitations be cancelled, and that the court restrain solicitation of proxies which do not relate facts constituting a fair statement surrounding the matter. In denying the requested relief the district court, Arraj, J., said:

It is essential to the plaintiff's case that the accused statements be significant and material, in the sense that they influenced or reasonably could have influenced, shareholders to give their proxy in a situation where they would not have done so had the alleged fraudulent statement or statements not been made.³

No testimony was presented to indicate that anyone who had executed a proxy had been misled. In addition, the court said that it would be impossible for it to supervise further solicitations.

The Colorado Supreme Court has not expressed, as yet, an opinion on this point but the rule adopted here is in line with the cases on proxy solicitation decided in other states under state laws.⁴ *In re R. Hoe & Co.* presents a statement of the judicial attitude—"A certain amount of innuendo, misstatement, exaggeration and puffing must be allowed as a natural by-product of a bitter cam-

² *Id.* at 163.

³ *Id.* at 166.

⁴ *Willoughby v. Post*, 182 F. Supp. 496 (S.D.N.Y. 1960), *modified* 277 F.2d 149 (2d Cir. 1960); *Textron v. American Woolen Co.*, 122 F. Supp. 305 (D. Mass. 1954); *Mason v. Basic Properties, Inc.*, 230 N.Y.S.2d 560 (Sup. Ct. 1962); *Dal-Tran Service Co. v. Fifth Avenue Coach Lines, Inc.*, 14 App. Div. 2d 349, 220 N.Y.S.2d 549 (Sup. Ct. 1961); *Shora v. Great Sweet Grass Oils Ltd.*, 205 N.Y.S.2d 98 (Sup. Ct. 1960); *In re R. Hoe & Co.*, 137 N.Y.S.2d 142 (Sup. Ct. 1954); *In re Zickl*, 73 N.Y.S.2d 181 (Sup. Ct. 1947).

⁵ *In re Hoe*, *supra* note 4, at 147; see ARANOW & EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 435 (1957).

paign."⁵ The attitude exemplified in these cases quite possibly is an aspect of the old common law that is not easily forgotten.

The interesting aspect of *Western Oil Fields* is that, in the attempt to determine the standard to govern proxy solicitation statements for unlisted securities, the plaintiffs cited many cases dealing with Securities and Exchange Commission proxy rules, but the court looked elsewhere for guidance.⁶ Under the Securities and Exchange Act of 1934⁷ the Securities and Exchange Commission was authorized to set certain standards for proxy solicitation for unlisted securities. This authorization was implemented by section 14a of the Securities and Exchange Commission rules which does establish a definite criterion for stockholder protection, but so far this has not been extended beyond those persons listed in the regulation.⁸

Thus, *Western Oil Fields* is another example of the reluctance of courts to adopt the standard established by the Securities and Exchange Commission for proxy solicitation.⁹

Where do these decisions leave the investor? The considerations of corporate democracy and adequate disclosure which fostered enactment of this federal proxy regulation would certainly seem to be applicable in protecting unlisted securities.¹⁰ The number of investors holding unlisted securities is substantial¹¹ and these stockholders have no chance to take part in management or learn about the conduct of management apart from the proxy.

The lack of measures to deal with the reluctance to provide

¹ 232 F. Supp. 162 (D. Colo. 1964).

⁶ 232 F. Supp. 162, 164; see *Bresnick v. Home Title Guar. Co.*, 175 F. Supp. 723 (S.D.N.Y. 1959) discussed in *Standards of Disclosure in Proxy Solicitation of Unlisted Securities*, 1960 DUKE L.J. 623, 635.

⁷ 48 Stat. 895 (1934), 15 U.S.C. § 78(N) (1958).

⁸ 17 C.F.R. § 240.14a-2: "Sections 240.14a-1 to 240.14a-11 apply to every solicitation of a proxy with respect to securities listed and registered on a national securities exchange, whether or not trading in such securities has been suspended" These rules have been extended beyond those securities listed on national exchanges but the extension would not necessarily cover the situation in *Western Oil Fields*. For a short summary of the operation of the Securities Exchange Commission proxy rules see Hopper, *The Securities and Exchange Commission as it Affects the General Practitioner*, 36 COLO. L. REV. 36, 60 (1963). For a study of the administration of proxy rules see Mehren & McCarroll, *The Proxy Rules: A Case Study in the Administration Process*, 29 LAW & CONTEMP. PROB. 728 (1964).

⁹ The opportunity to adopt this standard in state decisions has been presented to other courts and summarily rejected, e.g., *Bresnick v. Home Title Guar. Co.*, 175 F. Supp. 723 (S.D.N.Y. 1959).

¹⁰ See Bernstein & Fischer, *The Regulation of the Solicitation of Proxies: Some Reflections on Corporate Democracy*, 7 U. CHI. L. REV. 226 (1940); 5 FLETCHER, CYCLOPEDIA ON CORPORATIONS § 2052.1 p. 212 n. 64 (Revised volume 1952).

¹¹ CCH FED. SEC. L. REP., Special Report No. 902 p. 5 (5 June 1963).

shareholders with some needed protection is indeed a gap in the law, which should be filled legislatively or judicially. Colorado has no statute. Other state statutes dealing with the matter are few and generally not as comprehensive as the SEC laws.¹² The solution, at least for the present, would seem to lie with judicial recognition of a state standard based on or equivalent to the Securities and Exchange Commission proxy rules—"one whose violation is most likely to shock the chancellor's conscience in any event—and thus obtain the advantage of emancipation from whatever bothersome restrictions may still surround traditional concepts of fraud in the particular state."¹³

B. CORPORATIONS—COMMON LAW CONCEPT OF FRAUD IS ADOPTED AS THE BASIS FOR A CLAIM FOR MISREPRESENTATION IN SALE OF SECURITIES

Nichoalds v. McGlothen,¹⁴ a Tenth Circuit Court of Appeals case, dealt with fraud in the purchase and sale of securities. Nichoalds, who was the principal officer of two different corporations, the Compass and Trilon corporations, was conducting financing operations for Compass through Trilon. Loans were made by Trilon for operating expenses of a ranch, located in Montana. This ranch was an asset of Compass. Nichoalds, in advertising the Compass property for sale at a price of \$89,000, represented that Compass had adequate money to pay all expenses. He also represented that the listed encumbrances were the only ones outstanding against the property. McGlothen, the plaintiff, offered \$15,000 for a one-half interest in the Compass Corporation, consisting of 8,000 shares of stock, and was accepted. Thereafter, McGlothen learned that there was an unlisted loan on the property and that certain assets of Compass were pledged to secure that loan. Then McGlothen learned that Compass did not have sufficient cash to pay operating expenses. He brought this action asking for a rescission of the agreement and for a return of the purchase price and damages. In affirming the district court decision granting the plaintiff's request for rescission, Kerr, J., said for the Tenth Circuit: "We think the evidence and legal principles support only one conclusion, namely, that Nichoalds concealed from McGlothen material facts which equity and good

¹² Loss, *The SEC Proxy Rules and State Law*, 73 HARV. L. REV. 1249 (1960). See J. I. Case Co. v. Borak, 377 U.S. 426 (1964) where a federal court allowed a private remedy based on a violation of rule 14a; *Private Actions and the Proxy Rules: the Basis and Breadth of the Federal Remedy*, 31 U. CHI. L. REV. 328 (1964).

¹³ Loss, *The SEC Proxy Rules and State Law*, 73 HARV. L. REV. 1249, 1264 (1960).

¹⁴ 330 F.2d 454 (10th Cir. 1964).

conscience required him to disclose fully and honestly"¹⁵ citing *Morrison v. Goodspeed*.¹⁶ The court also indicated, alternatively, that in the instant case the nondisclosure would be actionable notwithstanding a lack of intent to commit a fraud where the remedy sought is rescission.¹⁷

The application of *Morrison* to this set of facts to establish fraud is well settled in Colorado,¹⁸ and in itself is not particularly noteworthy. However, a point of importance concerning this case is that the plaintiff might have been able to base his claim under a federal law.

The Securities and Exchange Act of 1934 contains a provision in section 10b¹⁹ controlling purchase and sale of securities. With this basic provision the Securities and Exchange Commission has enacted Rule X-10B-5,²⁰ which makes it unlawful to practice fraud in the purchase and sale of securities in interstate commerce or on national security exchanges. *Kardon v. National Gypsum Co.*²¹ in 1946 held that a civil remedy is implied in this provision. Other courts have indicated that the facts upon which an action may be brought under section X-10B-5 have been liberalized compared to those required at common law.²² In an action for damages under X-10B-5, all the plaintiff need do is prove damage and a misstatement or omission of a material fact, and if he asks merely for rescission, he need not show damage.²³

There has been some dispute in past cases concerning the extent of the protection offered by X-10B-5. Some courts have limited

¹⁵ *Id.* at 457.

¹⁶ 100 Colo. 470, 68 P.2d 458 (1937).

¹⁷ 330 F.2d 454, 457 (10th Cir. 1964); see the district court opinion at 212 F. Supp. 757, 761 (D. Colo. 1962).

¹⁸ *Bell Press, Inc. v. Phillips*, 147 Colo. 461, 364 P.2d 398 (1961); *Ginsberg v. Zaga*, 126 Colo. 536, 251 P.2d 1080 (1952); *cf. Leece v. Griffin*, 150 Colo. 132, 371 P.2d 264 (1962).

¹⁹ 48 Stat. 891 (1934), as amended 15 U.S.C. § 78 (1946).

²⁰ 17 C.F.R. § 240.10b-5: "It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national security exchange,

(a) To employ any device, scheme, or artifice to defraud.

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase and sale of any security."

²¹ 69 F. Supp. 512 (E.D. Pa. 1946); 73 F. Supp. 798 (E.D. Pa. 1947) (on the merits); 83 F. Supp. 613 (E.D. Pa. 1947) (request for additional findings of fact and law).

²² See *The Prospects for Rule X-10B-5: An Emerging Remedy for Defrauded Investors*, 59 YALE L. REV. 1120 (1950).

²³ *Id.* at 1131, and cases cited therein.

this protection to only those over-the-counter securities or listed securities traded on organized security markets.²⁴ However, by the clear weight of authority the coverage is extended to any purchaser of securities.²⁵ There has also been some division of authority on whether a civil liability could be created by a statute not containing express provision for civil liability; however, *Kardon* and other cases have inferred liability.²⁶

The last problem that McGlothen would encounter in bringing an X-10B-5 suit would be to place the transaction in interstate commerce. Although the case does not discuss this point, it would seem that because Compass was located in Montana and McGlothen brought his action in Colorado, some interstate transaction occurred. The courts have generally been very liberal in this regard so long as the transaction was connected with interstate commerce.²⁷

C. CORPORATIONS—RETURN RECEIPT FROM REGISTERED LETTER MUST BE RECEIVED BY SECRETARY OF STATE BEFORE SUBSTITUTED SERVICE OF PROCESS ON A FOREIGN CORPORATION WILL SATISFY DUE PROCESS

*Leach v. Farnsworth & Chambers Co.*²⁸ is a federal district court case which construed Colorado law pertaining to jurisdiction over foreign corporations. Plaintiff Leach filed a motion with the district court requesting an order allowing service of process on defendant, a foreign corporation not qualified to do business in

²⁴ The argument is based on the fact that the preamble to the Act of 1934 has language which could be inferred to so limit the coverage of X-10B-5. See 48 Stat. 881 § 2 (1934), 15 U.S.C. § 78(b) (1946).

²⁵ *E.g.*, *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 830 (D. Del. 1947).

²⁶ *Nemitz v. Cunny*, 221 F. Supp. 571, 573 (N.D. Ill. 1963); *Rosen v. Albern Color Research, Inc.*, 218 F. Supp. 473, 476 (E.D. Pa. 1963); *Beury v. Beury*, 127 F. Supp. 786, (S.D.W. Va. 1954). In *Beury* the court said:

The only reasonable construction of this statute (X-10B-5) is that it confers exclusive civil jurisdiction on federal courts to entertain only those actions which involve some right of recovery which goes beyond those common law rights which might have been fully adjudicated and enforced by appropriate action in a state court . . . before the Securities Exchange Act of 1934 was passed. 127 F. Supp. at 790.

See also *Fratt v. Robinson*, 203 F.2d 627, 635 (9th Cir. 1953), where, in citing 53 C.J.S. *Limitations of Actions* § 83(a) (1948) with approval, the court said: ". . . the phrase 'liability created by statute' or 'liability created by law' within the meaning of such a statute, has been held not to include or extend to actions arising under the common law." The law review article cited at note 22 *supra* raises some additional objections to an action based on X-10B-5. For additional discussion and some answers to those objections, see *Securities Regulation—Civil Liability Under Rule X-10B-5 for Fraud in the Purchase or Sale of Securities*, 52 MICH. L. REV. 893 (1954).

²⁷ *Fratt v. Robinson* 203 F.2d 627 (9th Cir. 1953); *Northern Trust Co. v. Essaness Theatres Corp.*, 103 F. Supp. 954 (N.D. Ill. 1952).

²⁸ 231 F. Supp. 157 (D. Colo. 1964).

Colorado, in accordance with Colo. Rev. Stat. §31-9-19(3) (1963).²⁹ Service was made on the Secretary of State, and the defendant moved to dismiss on the ground of denial of due process as guaranteed by the Colorado and federal constitutions because of lack of notice. The court first ruled that *Erie R.R. v. Tompkins*³⁰ required *only* a consideration of constitutionality under the Colorado constitution.³¹ In sustaining defendant's motion to dismiss, the court relied on a Colorado case dealing with service of process on non-resident motorists, *Clemens v. District Court*.³² Thus, the question to be dealt with here is whether *Clemens* can be applied to *Leach*.

In *Clemens*, the Colorado Supreme Court was dealing with the non-resident motorist statute³³ which is identical to that for non-resident corporations in the requirement for the Secretary of State to give notice to a prospective defendant. Both allow certification of service after a registered letter is sent to the last known address of the defendant, but require no return receipt before entry of a certificate of service. The court in *Leach* held the following language in *Clemens* to compel its decision:

Here, proceeding under the statute, service was had on two defendants; one received notice, the other did not. Though the

²⁹ In the 1963 edition of COLO. REV. STAT. § 31-35-19(3) was changed to § 31-9-19(3):

(3) If any foreign corporation shall hereafter transact business in the state without having qualified to transact business, it shall be deemed that such corporation has designated and appointed the secretary of state as an agent for process upon whom may be served any process from a court of record in any civil action arising out of any act or omission of such corporation within this state. When any civil action is commenced, the court upon verified motion giving the last known address of such corporation, and stating facts showing transaction of business within this state may ex parte authorize service to be made upon the secretary of state. Service shall be made by delivering two copies of the process, complaint, motion and order of court, with a fee of five dollars which shall be taxed as part of the cost of the proceeding, to the secretary of state, his assistant, or deputy. Notice of such service and a copy of each instrument so served shall forthwith be sent by the secretary of state by registered mail addressed to the defendant at its last known address with return receipt requested. Promptly after such mailing the secretary of state shall file with the clerk of the court a certificate showing such mailing. Service shall be complete on the day the certificate is filed with the clerk of the court.

³⁰ 304 U.S. 64 (1938).

³¹ 231 F. Supp. 157, 159 (D. Colo. 1964). See COLO. CONST. art II, § 25, "No person shall be deprived of life, liberty or property, without due process of law."

³² 390 P.2d 83 (Colo. 1964).

³³ COLO. REV. STAT. § 13-8-3 (1963), formerly § 13-8-3 (1953):

Service shall be made by delivering two copies of the process, complaint, motion and order of court to the secretary of state Notice of such service and a copy of each instrument so served shall forthwith be sent to the secretary of state by certified or registered mail, addressed to the defendant at his address given in the order of court, with return receipt requested. Promptly after such mailing the secretary of state shall file with the clerk of the court a certificate showing such mailing. Service shall be complete thirty days after service of process on the secretary of state as provided in this section.

effectiveness of procedures prescribed for getting notice to defendants should not be finally adjudged on results attained in an isolated case, the result here attained does cast grave doubt on the effectiveness of the methods provided and pursued.

Procedures only fifty percent effective cannot be held as reasonably calculated to bring notice to the defendant or to constitute due process.³⁴

In arriving at the *Clemens* decision the Colorado court relied on both federal and state concepts of the requirements of due process.³⁵

The general rule on requirement of notice to satisfy due process was stated in *Hess v. Pawloski*³⁶ and has been interpreted to mean that such service must be reasonably calculated to apprise the defendant of the action against him.³⁷ The cases have not been in accord as to what can be interpreted as reasonable notification as to both non-resident motorists and to foreign corporations;³⁸ however a case decided in the Federal District Court of Maryland, *Speir v. Robert C. Herd & Co.*,³⁹ offers a compelling analysis.

In *Speir* the defendant corporation challenged the validity of service of process made under a Maryland statute which required that a registered letter be sent to defendant, but did not require a

³⁴ *Clemens v. District Court*, 390 P.2d 83, 90 (Colo. 1964).

³⁵ *Hess v. Pawloski*, 274 U.S. 352 (1927); *McDonald v. Mabee*, 243 U.S. 90 (1917); *Grote v. Rogers*, 158 Md. 685, 149 Atl. 547 (1930); *Kurilla v. Roth*, 132 N.J.L. 213, 38 A.2d 862 (1944).

³⁶ 274 U.S. 352 (1927).

³⁷ *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 318 (1950); *International Shoe Co. v. Washington*, 326 U.S. 310, 320 (1945); RESTATEMENT (SECOND), CONFLICT OF LAWS § 75 (Tent. Draft no. 3, 1956):

Notice and Opportunity to Be Heard. A state cannot exercise judicial jurisdiction over a person, who is subject to its jurisdiction, unless a reasonable method of notification is employed and unless he is afforded a reasonable opportunity to be heard. *Comment: e. Actual knowledge of proceedings not required.* It is not necessary that the defendant should have received actual knowledge of the action in which the judgment is rendered. It is sufficient that the steps taken to give him notice of the action and an opportunity to be heard satisfy the requirements of the rule of this section.

³⁸ *Sugg v. Hendrix*, 142 F.2d 740 (5th Cir. 1944) (statute required return receipt, held valid); *Clawson v. Central Nebraska Packing Co.*, 219 F.Supp. 1 (D. Ind. 1963); *Kohler v. Derderian*, 187 F.Supp. 173 (S.D.N.Y. 1960); *Allison v. Montgomery Ward*, 159 F.Supp. 550 (D.N.H. 1957); *Bucholz v. Hutton*, 153 F.Supp. 62 (D. Mont. 1957); *Powell v. Knight*, 74 F.Supp. 191 (E.D. Va. 1947); *Harrison v. Matthews*, 235 Ark. 915, 362 S.W.2d 704 (1962); *Boise Flying Serv. v. General Motors Acceptance Corp.*, 55 Idaho 5, 36 P.2d 813 (1934); *Fidelity & Casualty Co. of New York v. Cross*, 127 Miss. 31, 89 So. 780 (1921) (dealing with an insurance company); *Levitt v. Colonial Boat Works, Inc.*, 70 N.J. Super. 555, 176 A.2d 48 (1961); *National Mfg. Corp. v. Buffalo Metal Container Corp.*, 204 Misc. 269, 126 N.Y.S.2d 755 (1953); *State v. Ford Motor Co.*, 208 So. C. 379, 38 S.E.2d 242 (1946). *Cf.*, *Maston v. Desormeau Dairy-Vend Serv., Inc.*, 11 App. Div. 2d 860, 203 N.Y.S.2d 343 (1960); *Parr v. Leal*, 290 S.W.2d 536 (C.C.A. Tex. 1956).

³⁹ 189 F.Supp. 432 (D. Md. 1960). See *Gkiafif v. Steamship Yiosonas*, 221 F.Supp. 253 (D. Md. 1963); *Maryland Nat'l Bank v. Shaffer Stores Co.*, 240 F.Supp. 775, 785 (D. Md. 1965) (where the court rejects *Leach*).

return receipt.⁴⁰ The defendant argued that due process was not satisfied without the requirement of a return receipt, as evidenced by the non-resident motorist statutes in effect in Maryland which did require the receipt. The court rejected the defendant's argument and held the statute to be valid. It relied on several cases, including some cited in *Clemens*, for the point that a corporation is not the same as a non-resident individual. The court generally followed the theory that a corporation should be aware of the statutory requirements of a state in which it does business and should keep current a certification of its address so that, in the event an action is brought against it, notification will occur.⁴¹ The possibility that the address of the corporation may be unknown should not affect validity, because lack of an address is the exceptional case and constitutionality is decided on the basis of normal circumstances.⁴²

⁴⁰ ANN. CODE OF MARYLAND art. 23 § 96(d) (1957):

If any corporation of this state, or any foreign corporation required by any statute of this state to have a resident agent or any foreign corporation subject to suit in this state under § 92 of this article (1) has not a resident agent, . . . such corporation shall be conclusively presumed to have designated the Commission as its true and lawful attorney authorized to accept on its behalf service of process.

ANN. CODE OF MARYLAND art. 23 § 98 (1957):

When service of process upon any corporation of this state or upon any foreign corporation is made by leaving copies of the process in the office of the Commission as provided in this subtitle:

(a) *In general*—It shall be the duty of the Commission forthwith to record the day and hour of such service and to forward by registered mail one copy of the process with a notice of such service, addressed to such corporation at its mailing address, if it has a mailing address, if it has a mailing address on file with the Commission, or if it has not a mailing address on file with the Commission, addressed to it at its principal office, if it has a principal office, or, if it has neither a mailing address on file with the Commission nor a principal office, addressed to it in care of the secretary of state or the corresponding official of the state or place under the statute or common law of which it was formed or is existing, if known to the Commission: and

(b)

⁴¹ 189 F.Supp. at 435. The *Speir* court cited *Wuchter v. Pizzutti*, 276 U.S. 13, 20 (1927):

The cases, in which statutes have been upheld providing that nonresident corporations may properly be served by leaving a summons with a state official, where the corporation has not indicated a resident agent to be served, are not especially applicable to the present statute Such corporations may be properly required to accept service through a public officer as a condition of their doing business in the state. Their knowledge of the statutory requirement may perhaps prompt frequent inquiry as to suits against them . . . ;

and *Grote v. Rogers*, 158 Md. 685, 149 Atl. 547 (1930) for the proposition that "A foreign corporation is expected to protect itself by keeping up to date the certification of its mailing address."

⁴² *Speir v. Robert C. Herd & Co.*, 189 F.Supp. 432, 435 (D. Md. 1960). *American Land Co. v. Zeiss*, 219 U.S. 47, 67 (1911), "The criterion is not the possibility of conceivable injury but the just and reasonable character of the requirements, having reference to the subject with which the statute deals."

On the basis of the comparison of *Leach* and *Speir*, it would seem that the Colorado Federal District Court has made an unnecessary extension of the requirements of due process for service of process on foreign corporations.⁴³

D. CORPORATIONS—SALES IN THE STATE BY A LOCAL DISTRIBUTOR OF A FOREIGN CORPORATION AMOUNT TO DOING BUSINESS IN THE STATE

The case of *American Type Founders Co. v. District Court of the City and County of Denver*,⁴⁴ decided in the Colorado Supreme Court prior to both *Leach* and *Clemens*, questioned the application of the statute⁴⁵ which was declared void in *Leach*. American Type Founders, a foreign corporation, had sold some printing equipment through a local distributor who was located in Denver. Suit was brought against American Type Founders for breach of this contract. The same statute, Colo. Rev. Stat. § 31-9-19(3) (1963), was used to obtain service of process. Founders filed a motion to dismiss for lack of jurisdiction on the ground that the corporation was not, in fact, transacting business without having qualified to transact business as provided by the statute.⁴⁶ The supreme court affirmed the district court's denial of the motion. In so holding, the supreme court reaffirmed the long-established precedent that the requirements of this statute are "doing business" in the state.⁴⁷ As authority for this point, the court has continually relied on *International Shoe Co. v. State of Washington*.⁴⁸ *American Type Founders* is of inter-

⁴³ The *Speir* case must be distinguished from cases similar to *State of Washington v. Superior Court*, 289 U.S. 361, 366 (1933), where the Court upheld the constitutionality of a statute that did not require notice to be sent to a foreign corporation saying:

the fact that appellant qualified to do business in the state and complied with the registration statute also distinguishes cases of attempted service on a state official pursuant to a statute with which the defendant corporation had never complied, and where at the time of suit it had removed from the state and was transacting no business.

In *Leach* and *Speir* neither defendant corporation had complied with the state statutes, the former not having qualified to do business, the latter having not made a proper appointment of an agent.

⁴⁴ 389 P.2d 85 (Colo. 1964).

⁴⁵ COLO. REV. STAT. § 31-9-19(3) (1963).

⁴⁶ *Ibid.*

⁴⁷ *Bay Aviation Serv. Co. v. District Court*, 149 Colo. 542, 370 P.2d 752 (1962); *Norton v. Dartmouth Skis, Inc.*, 147 Colo. 436, 364 P.2d 866 (1961); *Hibbard, Spencer, Bartlett & Co. v. District Court*, 138 Colo. 270, 332 P.2d 208 (1958). Compare *Focht v. Southwestern Skyways, Inc.*, 220 F.Supp. 441 (D. Colo. 1963), *aff'd* in *Cessna Aircraft Co. v. Focht*, 336 F.2d 603 (10th Cir. 1964).

⁴⁸ 326 U.S. 310 (1945).

est, recalling that it preceded the *Clemens* and *Leach* decisions, because of the definite possibility that the next time the supreme court is presented with this problem it may declare the statute void, on the strength of *Leach*.⁴⁹

E. AGENCY—INSURERS OWE NO DUTY TO THEIR AGENTS TO ACT WITH CARE TO PREVENT LAPSE OF INSURANCE POLICIES IN WHICH THE AGENT HAS AN INTEREST

In *Berenbeim v. Maccabees*,⁵⁰ the court ruled on the question of the duty of an insurer with respect to commissions due its agents on renewals of insurance policies.

Plaintiff Berenbeim was a district manager for the defendant insurer and in the course of his employment he wrote insurance policies for various individuals. Berenbeim's contract provided that he was to have "certain vested commissions upon termination of employment. Those commissions were a percentage of the premiums paid by the policyholders . . ." ⁵¹ regardless of whether he was currently employed by defendant Maccabees. Berenbeim was terminated for cause and he brought this action contending, in part, that Maccabees "negligently, carelessly and recklessly failed to send out notices of premiums due, failed to take proper steps to keep policies of insurance in force in which the plaintiff had an interest."⁵² The trial court sustained Maccabees' motion for a summary judgment. On appeal, the Colorado Supreme Court affirmed. Moore, J., said on this point, quoting the assertion of Maccabees, "defendant had and

⁴⁹ If the Colorado Supreme Court does overrule *American Type Founders*, the enactment of a new statute would obviously be necessary. Of important consideration in this regard is the fact that Colorado has seen fit only to enact a "doing business" statute. The decisions of the United States Supreme Court in *Hanson v. Denckla*, 357 U.S. 235 (1958); *McGee v. International Life Ins. Co.*, 355 U.S. 220 (1957); *International Shoe Co. v. State of Washington*, 326 U.S. 310 (1945) indicate that a state may enact "minimum contacts" statute which would considerably extend the state's power to obtain personam jurisdiction. In light of the fact that in *Clemens v. District Court*, 390 P.2d 83 (Colo. 1964), the court saw fit to place emphasis on the minimum contacts basis it is suggested that Colorado place itself among those states which have extended the embrace of jurisdiction without violating due process. See Kurland, *The Supreme Court, The Due Process clause and the in Personam Jurisdiction of State Courts—From Pennoyer to Denckla: a Review*, 25 U. CHI. L. REV. 569 (1958). See Colo. Sess. Laws 1965, ch. 119 in which COLO. REV. STAT. 37-1-26, -27 (1963) was enacted providing a method of service of process of foreign corporations requiring personal service. Effective date is May 10, 1965. And see Colo. Sess. Laws 1965, ch. 109 in which COLO. REV. STAT. 31-9-19(3) was amended to require return receipt.

⁵⁰ 392 P.2d 172 (Colo. 1964).

⁵¹ Brief for Defendant, pp. 19-20, *Berenbeim v. Maccabees*, 392 P.2d 172 (Colo. 1964).

⁵² 392 P.2d at 173 (Colo. 1964).

has no duty toward plaintiff with respect to the manner in which defendant conducts its own business.’⁵³

The case presents an interesting question concerning the rights of an insurance agent to commissions on renewals of policies which he has previously written. More specifically, can an employer negligently and recklessly act to deprive his employee of this right? This specific point had not been considered in Colorado prior to this time.

The general rule with respect to commissions on renewals is that they must be provided for by the express terms of the contract including the right to renewals on termination of employment; the employee's rights to these commissions will not be found to be merely implied.⁵⁴ On this point Berenbeim qualified because of the express provision in his contract, but failed in his claim because the company had no duty to secure renewals of the policies. With no renewals, there could be no commissions.

⁵³ *Id.* at 174.

⁵⁴ *Aronoff v. Carraher*, 146 Colo. 223, 361 P.2d 354 (1961), citing *Corpus Juris Secundum* with approval said:

A renewal agreement whereby a contract of insurance may be continued in force after its expiration, is in itself a contract of insurance. It has been generally held that a renewal is in effect a new contract of insurance, for the period of time covered by such renewal, at least in the sense that it is subject to the laws in force at the time it is effected, and at least where there is no provision in the original policy for its renewal. 146 Colo. at 228.

Massachusetts Bonding and Ins. Co. v. Board of County Comm'rs, 100 Colo. 398, 68 P.2d 555 (1937), citing *Corpus Juris* with approval saying:

A renewal of a fidelity policy or bond constitutes a separate and distinct contract, for the period of time covered by such renewal, unless it appears to be the intention of the parties, as evidenced by the provisions thereof, that such policy or bond and the renewal thereof shall constitute one continuous contract. 100 Colo. at 401.

Pruitt v. Southern Underwriters, 83 So.2d 115 (Fla. 1955), "the agent has no vested rights in commissions on renewal premiums . . . and his right to be paid commissions on renewals must be based entirely upon the terms of the contract;" *Barr v. Sun Life Assur. Co. of Canada*, 200 So. 240 (Fla. 1941):

[T]he great weight of authority holds that the agent has no vested rights in commissions on renewal premiums and that his right to be paid commissions on renewal premiums must be based entirely upon the terms of the contract and even where a contract provides for commissions on renewal premiums the contract is construed to require the payment of such commissions only as long as the employee continues as the agent of the company and, unless otherwise provided in the contract, he is entitled to no commissions on renewals made after the termination of his employment as Agent. 200 So. at 243.

Stevenson v. Brotherhoods Mut. Benefit, 317 Mich. 575, 27 N.W.2d 104 (1947): "[T]he right of an insurance agent to commissions on renewal premiums depends upon the contract existing between the agent and the insurance company."; *Cortina v. General Ins. Co. of America*, 40 Misc. 2d 916, 244 N.Y.S.2d 343 (1963); *Underwood v. Greenwich Ins. Co.*, 161 N.Y. 413, 55 N.E. 936 (1900); 4 COUCH, INSURANCE § 26:400—11 (2d ed. 1960).

The contentions of the parties would be easily solved had the contract required Maccabees to obtain renewals, for there is ample authority to support an action based on negligence when there is a duty involved.⁵⁵ However, in insurance contracts as between the insured and insurer, the general rule is that unless the contract contains an express provision for such renewal, it terminates on expiration of the period of the original contract,⁵⁶ and before there is renewed coverage a new contract must be agreed upon. The cases do not speak of a duty upon the insurer actually to attempt to obtain a renewal; in fact, in *Berenbeim* it appeared that the insurance agent—Berenbeim himself, if still employed—had the duty to obtain the renewal.⁵⁷

Notwithstanding the fact that there might not have been a duty on the part of the insurance company to obtain renewals, there is at least one decision which indicates the insurance agent may maintain an action for relief for a lapse caused by the insurer.⁵⁸ The best

⁵⁵ *Lembke Plumbing and Heating v. Hayutin*, 148 Colo. 334, 366 P.2d 673 (1961), (Defendant negligently installed some pipes which broke, causing damage to plaintiff's house. The contract imposed no duty to use care, however, "the duty upon Lembke was even more fundamental, to-wit: the common law obligation to exercise due care, caution and skill resting on all persons and in all undertakings when the rights of others are involved. Although this duty may not be contractual, the law allows no vacuum and imposes the duty." 148 Colo. at 337); *Dean v. Hershowitz*, 119 Conn. 398, 177 Atl. 262, 266 (1953) (A duty arises where "in the performance of some act within the scope of that relationship, unless he uses proper care, is likely to do injury to the person, property, or rights of the other."); *Douglas v. United States Fid. & Guar. Co.*, 81 N.H. 371, 127 Atl. 708, 711 (1924) (So far as an obligation to use care is concerned, it is imposed by law upon all who undertake a service); *Burnham v. Stillings*, 76 N.H. 122, 79 Atl. 987 (1911) (It is not usual to express this duty in the contract.); *Lewis v. Scott*, 54 Wash. 2d 851, 341 P.2d 488 (1959); 38 AM. JUR. *Negligence* § 20 p. 662 (1941):

Accompanying every contract is a common-law duty to perform with care, skill, reasonable expedience, and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of contract. In such a case, the contract is mere inducement creating the state of things which furnishes the occasion of the tort. In other words, the contract creates the relation out of which grows the duty to use care.

⁵⁶ *Metts v. Central Standard Life Ins. Co.*, 142 Cal. App. 2d 445, 298 P.2d 621 (1956); *Rosin v. Peninsular Life Ins. Co.*, 116 So. 2d 798 (Fla. 1960); *McGregor v. Inter-ocean Ins. Co.*, 48 Wash. 2d 268, 292 P.2d 1054 (1956). Compare *Hutchinson v. Metropolitan Life Ins. Co.*, 293 S.W.2d 307 (Mo. 1956).

⁵⁷ Brief for Defendant, pp. 20-21, *Berenbeim v. Maccabees*, 392 P.2d 172 (Colo. 1964).

⁵⁸ *Hahn v. North American Life Ins. Co.*, 13 Hun. 195 (N.Y. 1878). Plaintiff was employed by defendant as a general agent to solicit insurance and collect premiums. The agreement provided that he was to receive compensation on premiums, regardless of whether or not he continued working for the company, so long as they should be paid to the company. Plaintiff claims damages caused by the defendant in processing policies obtained by the plaintiff to be transferred to other companies, or causing them to lapse, thus depriving the plaintiff of his right to commissions upon renewal premiums. The court allowed the plaintiff to recover on those policies which the defendant caused to be transferred or lapse.

expression on the point is in *Ensign v. United Pac. Ins. Co.*⁵⁹ where the court stated in a strong dictum that an agent could recover commissions lost by an arbitrary cancellation of a policy by the insurer. This dictum was quoted with approval in the United States Court of Appeals for the Tenth Circuit in deciding an appeal from a Colorado Federal District Court case, *Sterling Colorado Agency, Inc. v. Sterling Ins. Co.*⁶⁰ *Sterling* suggests that facts sufficient to evidence bad faith on the part of the insurer toward the insurance agent would be adequate to give the agent a claim for renewals lost.⁶¹

F. AGENCY—SERVANT RETURNING FROM A MEAL WHILE TRAVELING FOR HIS MASTER IS DOING AN ACT WITHIN THE SCOPE OF HIS EMPLOYMENT

Hynes v. Donaldson,⁶² decided in the Colorado Supreme Court, presents an interesting determination of the extent of "scope of employment" with respect to agents while traveling for their principals. Donaldson was an employee of the defendant corporation and had served for several years in the New Mexico area. On trips out of town he was paid a per diem plus mileage. In 1959 Donaldson was advised of his impending transfer to the corporation's Denver office and, to enable him to make an easier transition, he was directed to go to Denver and discuss prospective business, familiarize himself

⁵⁹ 107 Utah 557, 155 P.2d 965 (1945). Plaintiffs were non-exclusive agents of the defendant, employed to solicit and submit applications for insurance on various classes of risks. Plaintiff had earlier written a policy of insurance with A and now A desiring a new rate, because of changed conditions, contacted a broker who in turn contacted plaintiff. The insured had desired to get the coverage immediately, but plaintiff was slow in acting, therefore the defendant wrote the policy through another agent.

In holding for the defendant, the court said:

Respondent [defendant] could not, of course, by arbitrary action cancel the policy with the object of preventing the collection of premiums by plaintiffs and securing thereby an advantage to itself. Nor, . . . could it arbitrarily refuse quotation to an agent of a proper rate and secure the insurance through another at such rate, at least where the business contact with the insured had been originally made by the agent. *To do so would evidence a lack of fair dealing which would deprive appellants of the contemplated fruits of their contract with respondent.* But neither may the agent through lack of diligence on his part chance the loss of such business by the insurer and still be entitled to the benefits accruing as a result of the diligence of another. This is precisely what appellants demand. 155 P.2d at 967. (Emphasis added.)

Ensign was quoted with approval in *Sterling Colo. Agency, Inc. v. Sterling Ins. Co.*, 266 F.2d 472 (10th Cir. 1959) where the court said:

It is true that an insurer cannot by arbitrary action cancel a policy to prevent collection of renewal premiums by the agent . . . ; or to force the agent to accede to improper demands, . . . or otherwise interfere in business which it has promised the agent in order to defeat his rights. Such activities have been found to be violative of the implied covenant of good faith between principal and agent. 266 F.2d at 474.

⁶⁰ 266 F.2d 472 (10th Cir. 1959).

⁶¹ *Id.* at 474.

⁶² 395 P.2d 221 (Colo. 1964).

with the area, and search for a home for his family. When he arrived in Denver he was housed in a motel which had been rented for him by the defendant corporation. The day on which the accident in question occurred Donaldson breakfasted with an official of the corporation and then spent some time looking for a house. That evening he dined with a corporate official and discussed corporate business. On the way back to his motel, an automobile accident occurred in which he injured the plaintiff, Hynes. Hynes brought this action against the corporation, Donaldson's principal. The trial court granted defendant corporation's motion for summary judgment but the supreme court, in an opinion by Frantz, J., reversed, holding that:

An employee who, in following his master's instructions, is away from home or the headquarters of his employment . . . which makes it impossible to return home each night must of necessity eat and sleep in various places to carry on the business of his master. Under the circumstances we hold that a servant while lodging in a public accommodation, preparing to eat, or while going to or returning from a meal, is performing an act necessarily incident to his employment.⁶³

Finally, the court held that whether the facts of this case brought Donaldson within this rule was a jury question.

The basis of affixing liability on the master for the acts of his servant is the doctrine of *respondeat superior*. The master is liable when he has placed his servant, over whom he has the right to control, in such a position as to cause injury to third parties.⁶⁴ The periods during which the master has this right to control and direct the agent are said to be within the "scope of employment."⁶⁵ In addition, the courts have extended liability for acts of the servant which are incidental to the scope of employment, those acts which the master could have reasonably anticipated as probable in view of the terms of the employment.⁶⁶ Colorado has generally recognized these principles as evidenced by the cases cited in *Hynes*.⁶⁷

⁶³ *Id.* at 223.

⁶⁴ *Foerker v. Nicholson*, 41 Colo. 12, 92 Pac. 224 (1907), The court quotes *Quarman v. Burnett*, 6 M W 497, 151 Eng. Rep. 509 (Ex. 1840):

[T]he master is responsible for the acts of his servant; and that person is undoubtedly liable, who stood in the relation of master to the wrongdoer — he who had selected him as his servant, from the knowledge of or belief in his skill and care, and who could remove him for misconduct, and whose orders he was bound to receive and obey; . . . 41 Colo. at 13.

⁶⁵ *Id.*

⁶⁶ *Miller v. Teche Lines, Inc.*, 175 Miss. 351, 167 So. 52 (1936).

⁶⁷ *Sayers v. Nuckolls*, 3 Colo. App. 95, 32 Pac. 187 (1893). A case in which an action was brought when an alleged agent shot and killed the plaintiff's husband as he trespassed on defendant's land. However, no employment was shown between defendants and the alleged agent, even though the land did belong to these defendants.

The issue presented in *Hynes* was whether the accident occurred at a time when Donaldson's acts were within the master's right to control him either directly or incidentally. The question here is particularly difficult because on the day in which the accident occurred Donaldson was looking for a possible residence for his family in the event he was moved to Denver. Granted, Donaldson was in Denver by order of his master, but it would seem that at least while Donaldson was looking for a home he was beyond the scope of employment.⁶⁸

The difficulty arises because in support of its decision, the court places much emphasis on the fact that the accident occurred after Donaldson had eaten his evening meal, citing three travelling sales-

In denying the plaintiff relief the court announced the rule that "there must be an employment — the relation of master and servant must exist; that the wrong of the servant was incidental to or in the line of his employment and within the authority given." 3 Colo. App. at 102. The wrong committed was not an incident to the employment but the criminal act of a confederate; In *Cooley v. Essridge*, 125 Colo. 102, 241 P.2d 851 (1952), the defendant employer was doing some construction work and had entered into a contract with the plaintiff whereby the latter agreed to furnish equipment and operators, and pay all expenses of his operation. Defendant also hired one Berglin to see that dirt was deposited correctly and see that plaintiff did his work. Subsequently Berglin was employed by the plaintiff to put in some overtime; the wages for this period were to be paid by plaintiff. On the day the accident occurred one of plaintiff's operators didn't appear. Berglin didn't contact the defendant but employed one Ferrel to help with some machinery. Ferrel drove the machine up a hill and due to his acts it was damaged.

In denying plaintiff a recovery the court said:

There is no competent evidence in the record to support a finding that Berglin was acting within the scope of his employment when he undertook the matters of which the complaint is here made resulting in plaintiff's damages. *The things which Berglin undertook to do were not for Edna's (defendant's) benefit but for plaintiff's advantage, and were matters which were exclusively for plaintiff's benefit.* They amounted to a willful trespass and were unlawful; and, as we have said, Edna (defendant) is not liable therefor in the absence of express authorization. 125 Colo. at 114. (Emphasis added.)

Gibson v. Dupree, 26 Colo. App. 324, 144 Pac. 1133 (1914), was a case where the plaintiff, while riding a bicycle, was struck by an auto driven by N. The auto was kept by the employers of N subject to a bailment for E. N had been forbidden to take any auto out of the garage except upon call of the owner. The accident occurred while N was returning from having a battery charged. Caring for batteries was a part of his duties but he had no authority to use the auto. In holding the employers liable for N's tort the court said: "Such disobedience in using the automobile for such purpose has relation merely to the manner in which the act (going and returning with the battery) was performed. The masters are liable for injury caused by the disobedience of the servant in so using the automobile." 26 Colo. App. at 328.

⁶⁸ Admittedly this house-hunting occurred while Donaldson was employed by the defendant but there was no control exercised by defendant nor was there benefit to him apart from the fact that Donaldson's family would have a place to live upon arrival in Denver. For cases holding this activity beyond the scope of employment see *Gibbons & Reed Co. v. Howard*, 129 Colo. 262, 269 P.2d 701 (1954); *Cooley v. Essridge*, 125 Colo. 102, 241 P.2d 851 (1952); *Marron v. Helmecke*, 100 Colo. 364, 67 P.2d 1034 (1937); see *Tregellas v. American Oil Co.*, 188 A.2d 691 (Md. 1963); *Porter v. Jack's Cookie Co.*, 106 Ga. App. 497, 127 S.E.2d 313 (1962); *McClellan v. Chicago Great W. Ry.*, 3 Ill. App. 2d 235, 121 N.E.2d 337 (1954); *Loos v. Boston Shoe Co.*, 123 Cal. App. 2d 564, 266 P.2d 884 (1954); *SEAVEY, LAW OF AGENCY* § 83B (1964), "It is only during the period in which the servant has duties that the employer is liable for his unauthorized conduct." At p. 141.

men cases as authority for the point that the meal was incidental to the scope of employment.⁶⁹ But in each one of these cases the travelling salesman had caused some injury, either while performing or after having performed a service for his master. In *Hynes*, Donaldson was eating a meal after having performed an act for himself and apparently on a day during which he could look for a home. It may be argued that the dinner was eaten with an official of the defendant corporation, but the court does not limit the decision to that set of facts.⁷⁰ The apparent basis of the holding of the case is the sole fact that a meal was eaten while Donaldson was in Denver by order of the master.⁷¹ But, as illustrated in the travelling salesmen cases, the meal must be related to some act done for the master. This decision is puzzling because surely the court does not mean that any meal that Donaldson eats while in Denver is incidental to his employment, but the import of the court's words would seemingly lead to that conclusion.

This decision should be limited to the facts of this case because an adoption of a liberal interpretation of *Hynes* will bring an unreasonable broadening of the scope-of-employment concept.

In 1964 there were no partnership cases interpreting Colorado law which would require a discussion in this review.

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⁶⁹ *Brunk v. Hamilton*, 334 Mo. 517, 66 S.W.2d 903 (1933). In this case defendant's agent was a travelling salesman employed to procure sales over a large area. He fixed his own hours. On the day the accident occurred, the agent was driving a company car, he had left his base to sell various products and on the return he stopped at one town to have dinner. After dinner and on the way back to his base the accident happened. Defendant argued that the agent was no longer working for him when the accident occurred. In rejecting the defendant's argument the court said: "Such activities or suspensions of activity are necessary concomitants of the employment." 66 S.W.2d at 907. The court also dealt with the question of stopping for dinner as being within the scope of employment, saying: "Cessation of work for eating, drinking, and other like necessities are necessary incidents of employment, and an employee so engaged does not sever his relation from his work, nor does he do so by going to or from his places of work."; 66 S.W.2d at 907. *Ryan v. Farrell*, 208 Cal. 200, 280 Pac. 945 (1929): Here the agent was also a travelling salesman who had gone into his territory to solicit some customers for his master, the defendant Rex. On the return trip he injured the plaintiff. In holding that the plaintiff was entitled to a new trial the court said: "An employee who has gone on an errand on behalf of his master does not cease to be acting in the course of his employment at the moment he starts upon the return trip after having performed the errand." 280 Pac. at 946; *May v. Farrell*, 94 Cal. App. 703, 271 Pac. 789 (1928), on identical facts with the *Ryan* case, discussed above, the court said, in holding the agent's acts were within the scope of employment, "it being sufficient . . . that he was engaged in acts contributing to the service . . ." 271 Pac. at 794.

⁷⁰ *Hynes v. Donaldson*, 395 P.2d 221, 223 (Colo. 1964), "[P]reparing to eat or returning from a meal . . ."

⁷¹ *Cunningham v. Union Chevrolet Co.*, 177 Tenn. 214, 147 S.W.2d 746 (1941). The mere fact that the injury complained of was caused by negligence of the servant in the performance of an act which, taken per se, was within the scope of his employment, will not impose a liability upon the matter, if the act was merely incidental to the servant's attempt to perform an act entirely beyond the scope of his authority.