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American Vending Services, Inc. v. Morse: The Problem of Defective Incorporation in Utah

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American Vending Services, Inc. v. Morse: The Problem of Defective Incorporation in Utah

I. INTRODUCTION

As a general rule, individuals are personally liable for the liabilities that flow from their business dealings. The protection of the corporate shield, however, is an exception to this rule. It protects shareholders from being personally liable for the liabilities of the corporation. In order to invoke this protection the corporation must be formed and maintained with the proper formalities. When these formalities are not precisely adhered to in formation, no corporation exists, and consequently, there is no corporate shield for shareholders.

In an attempt to protect shareholders who inadvertently fail to comply with the formalities of incorporation, the common law developed the doctrines of de facto corporations and corporation by estoppel,1 which, when applicable, protected shareholders and third parties dealing with defectively formed corporations.

Over the years the application of the doctrines of de facto corporations and corporation by estoppel has become one of the most confusing areas of the law. In response, many states, including Utah, have adopted the Model Business Corporation Act, or similar legislation that attempts to create a bright-line rule regarding corporate formation and shareholder liability. In the wake of this legislation, there still remains confusion about whether the doctrines of de facto corporations and corporation by estoppel are completely dead or are still applicable in limited circumstances.

American Vending Services, Inc. v. Morse2 is the first case in which Utah courts have addressed the effect of the Utah Business Corporation Act on these doctrines. This note distinguishes the facts and the holding of Morse from other factual situations involving these doctrines that will arise.

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under the Act and offers suggestions about how the doctrine should be applied.

This note begins with a summary of the facts of Morse and the Utah Court of Appeals’ reasoning. It then traces the background of the doctrines of de facto corporations and corporation by estoppel at common law and how these doctrines led to the drafting of the Model Business Corporation Act. Next, the note analyzes the decision of the court of appeals, concluding that the court correctly found that the Utah Business Corporation Act eliminated the doctrine of de facto corporations. It concludes, however, that while the court reached the right result with respect to corporation by estoppel, the court’s language eliminating the doctrine in all circumstances is too broad and if followed would limit the court’s ability to prevent injustice. Finally, this note articulates a test by which courts can apply the Utah Business Corporation Act where applicable and still use the doctrine of corporation by estoppel to prevent injustice.

II. American Vending Services, Inc. v. Morse

A. The Facts

Douglas M. Durbano and Kevin S. Garn3 purported to enter into a contract on behalf of American Vending Services, Inc. (American Vending) with Wayne L. and Dianne L. Morse to buy a car wash. At the time the parties executed the contract, the articles of incorporation for American Vending had not been filed, although Mr. Durbano had received permission from the Utah Division of Corporations to use the name American Vending Services, Inc. Twice prior to the execution of the contract, Mr. Durbano had tried to file the articles, but they had been returned because of name conflicts. The articles of incorporation for American Vending were finally filed several weeks after the contract had been signed.

Although American Vending operated the car wash for three years, it experienced financial troubles from the very start. It failed to make any payments to the Morses on the balance owing under the sales contract. American Vending eventually defaulted on its debt obligation to its bank, and the bank foreclosed on the car wash.

3. Ironically, both men were licensed lawyers. Morse, 881 P.2d at 918.
The Morses sued American Vending, as well as Mr. Durbano and Mr. Garn personally. The trial court dismissed the Morses' claim against Mr. Durbano and Mr. Garn, finding that American Vending was a de facto corporation and thus the individuals could not be personally liable. The court entered judgment in favor of the Morses in the amount of $76,832 on their claim against American Vending, but they have been unable to collect on the judgement because American Vending has no income or assets. On appeal the Utah Court of Appeals reversed the trial court's ruling that Mr. Durbano and Mr. Garn were not personally liable, holding that, following the passage of the Utah Business Corporation Act, the doctrines of de facto corporations and corporation by estoppel were no longer viable in Utah.

B. The Reasoning of the Utah Court of Appeals

1. De facto corporations

Interpreting two sections of the Utah Business Corporation Act, sections 16-10-51 and 16-10-139, the court concluded that the doctrine of de facto corporations was no longer a viable doctrine in Utah. Section 51 provided that a corporation cannot exist until the certificate of incorporation is issued:

> Upon the issuance of the certificate of incorporation, the corporate existence shall begin, and the certificate of Incorporation shall be conclusive evidence that all conditions precedent

4. *Id.*
5. *Id.*
6. *Id.* at 919.
7. *Id.* at 927.
8. The Utah Business Corporation Act has been repealed and replaced by the Revised Utah Business Corporation Act, which was adapted from the Revised Model Business Corporation Act. The sections of the Utah Revised Act that are relevant to the issues of de facto corporations and corporation by estoppel are §§ 16-10a-203 to 204. Section 16-10a-203(1) provides in relevant part: “A corporation is incorporated, and its corporate existence begins, when the articles of incorporation are filed by the division . . . .” *Utah Code Ann.* § 16-10a-203(1) (Supp. 1994).

> Utah Code Ann. § 16-10a-204 (Supp. 1994) provides: “All persons purporting to act as or on behalf of a corporation, knowing there was no incorporation under this chapter, are jointly and severally liable for all liabilities created while so acting.”

Under the Revised Act, the analysis and conclusions of this note remain the same. See infra note 41 (discussing the impact of the Revised Act on the doctrine of de facto corporations) and note 62 (discussing the impact of the Revised Act on the doctrine of corporation by estoppel).
required of the incorporators have been complied with and the
corporation has been incorporated under this act, except as
against this state in a proceeding to cancel or revoke the
certificate of incorporation or for involuntary dissolution of
the corporation.\(^9\)

The court also relied upon section 139, which provided: "All
persons who assume to act as a corporation without authority
so to do shall be jointly and severally liable for all debts and
liabilities incurred or arising as a result thereof."\(^10\) In inter-
preting the meaning of these sections, the court relied on the
comments to the Model Business Corporation Act, from which
sections 51 and 139 were adopted. These comments expressly
state that the provisions were "designed to prohibit the applica-
tion of any theory of de facto incorporation."\(^11\)

Relying on the plain meaning of sections 51 and 139, as
well as the comments to the Model Business Corporation Act,
the court found that the trial court erred in concluding as a
matter of law that American Vending was a de facto corpo-
ration.\(^12\) In reaching this conclusion, the court distinguished
*Vincent Drug Co. v. State Tax Commission*,\(^13\) decided four
years after the enactment of the Utah Business Corporation
Act. In *Vincent Drug* the Utah Supreme Court applied the doc-
trine of de facto corporations but did not mention the Act. The
court reasoned that *Vincent Drug* was distinguishable on its
facts and that it had been implicitly overruled.\(^14\) The court
also cited with approval cases from other jurisdictions in which
courts had not found *Vincent Drug* persuasive on the issue of

\(^10\) Id. § 16-10-139.
\(^11\) MODEL BUSINESS CORP. ACT ANN. § 146 cmt., at 908 (1971); see also id.
§ 56 cmt., at 206 (stating that "a de facto corporation cannot exist under the Mod-
el Act").
\(^12\) American Vending Servs., Inc. v. Morse, 881 P.2d 917, 935 (Utah App.
\(^13\) 407 P.2d 683 (Utah 1965).
\(^14\) The court cited Gillham Advertising Agency, Inc. v. Ipson, 567 P.2d 163
(Utah 1977) (holding that the president of a non-existent corporation was personal-
ly liable for the debt of the corporation), and Loveridge v. Dreagoux, 678 F.2d 870
(10th Cir. 1982) (holding that a president and secretary of a corporation who
signed debentures for the corporation two days before the corporation came into
existence were personally liable), as support that *Vincent Drug* had been implicitly
overruled. See also Thompson & Green Mach. Co. v. Music City Lumber Co., 683
S.W.2d 340, 344 (Tenn. Ct. App. 1984) (holding that *Vincent Drug* is unpersuasive
for the proposition that a de facto corporation can exist under the Model Business
Corporations Act).
whether a de facto corporation could exist under the Model Business Corporation Act.¹⁵

2. Corporation by estoppel

The Utah Court of Appeals was unanimous in its decision that the doctrine of corporation by estoppel did not apply to the facts in Morse. The court was not unanimous, however, on whether the Utah Business Corporation Act precluded applying the doctrine of corporation by estoppel in every circumstance.¹⁶ The majority stated that the language of sections 51 and 139 prohibits the application of the doctrine of corporation by estoppel in every situation, while the minority would allow the doctrine to be applied in limited circumstance where "both parties reasonably believed they are dealing with a corporation and neither party has actual or constructive knowledge that the corporation does not exist."¹⁷ The court's statements concerning the applicability of the doctrine of corporation by estoppel to facts different than those presented in Morse, however, should be viewed as dicta since the facts in that case did not encompass every situation in which the doctrine could be applied.

III. BACKGROUND

A. De Facto Corporations at Common Law

At common law, corporations could be either de jure or de facto.¹⁸ A de jure corporation is one that has been created as the result of compliance with all of the constitutional or statutory requirements of a government entity.¹⁹ At common law,


¹⁶. The concurring opinion contains the view of the majority on the corporation by estoppel issue. Morse, 881 P.2d at 927-29 (Garff, J., concurring).

¹⁷. Morse, 881 P.2d at 925.


¹⁹. Harris, 309 So. 2d at 117.
the doctrine of de facto corporations was created to protect individuals from personal liability when they were conducting business before the corporate formalities were complete.20 A de facto corporation could be brought into being when it could be shown that 1) the state had a statute which authorized incorporation, 2) a colorable attempt had been made to incorporate under the statute, and 3) actual corporate action had been taken.21 In addition, the incorporators were, in some jurisdictions, required to have acted in good faith in claiming to be a corporation.22 When these elements were met, a de facto corporation was created that, for all intents and purposes, had the same rights and privileges as a de jure corporation.23

B. Corporation by Estoppel at Common Law

The doctrine of corporation by estoppel was applied when the elements of a de facto corporation could not be met, yet equity demanded that, because of their actions, parties be barred from denying the existence of the corporation.24 As the doctrine developed, corporation by estoppel became one of the most confusing areas of corporate law, and many courts had trouble defining and applying the doctrine.25 Many courts have failed to recognize that the term "corporation by estoppel" is a misnomer.26 Unlike a de facto corporation, no corporation is deemed to exist.27 Further, there is no estoppel in the general sense because in many situations there is no reliance.28

21. See, e.g., Robertson v. Levy, 197 A.2d 443, 445 (D.C. 1964); 8 WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 3761 (perm. ed. rev. vol. 1992); see also Harris, 309 So. 2d at 117.
22. See, e.g., Robertson, 197 A.2d at 445.
23. See id. The only situation where a de facto corporation does not have all of the rights of a de jure corporation is in a quo warranto proceeding brought by the state against the corporation. See id.
24. See Bradley, supra note 18, at 524-27, 529-30 (discussing the background and development of corporations by estoppel); Yates, supra note 18, at 1258-61 (discussing the development and application of the doctrine of corporation by estoppel); Ziegler, supra note 18, at 1123-25 (discussing the traditional common law rule of corporation by estoppel).
26. See Willis v. City of Valdez, 546 P.2d 570, 574 (Alaska 1976); Robertson, 197 A.2d at 445; Ziegler, supra note 18, at 1123 ("A 'corporation by estoppel' is not really a corporation.").
27. See, e.g., Childs v. Philpot, 487 S.W.2d 637, 641 (Ark. 1972); Robertson, 197 A.2d at 445.
28. See Robertson, 197 A.2d at 445.
Instead, the doctrine of corporation by estoppel is applied when the court finds that, because of the agreements or conduct of the parties, it would be inequitable to allow the parties to deny the existence of the corporation. Thus, the entity could not conduct business as a legal entity, nor could it continue conducting business once the defective incorporation became known.

C. The Model Business Corporation Act

In response to widespread criticism of the confusing and arbitrary state of the law of defective incorporation, the drafters of the Model Business Corporation Act attempted to clarify when corporate existence begins. Two sections of the Model Act, sections 56 and 146, have substantially changed the way the courts have applied the common law corporation doctrines.

First, section 56 provides that corporate existence cannot begin until the certificate of incorporation is issued. Section 56 provides:

Upon the issuance of the certificate of incorporation, the corporate existence shall begin, and such certificate of incorporation shall be conclusive evidence that all conditions precedent required to be performed by the incorporators have been complied with and that the corporation has been incorporated under this Act, except as against this State in a proceeding to cancel or revoke the certificate of incorporation or for involuntary dissolution of the corporation.

29. Typical conduct that may result in the application of corporation by estoppel is signing a contract with an entity acknowledging it as a corporation before it has been incorporated. See, e.g., Arbo Corp. v. Aidan Mktg./Distribution, Inc., 639 F. Supp. 1512 (D. Minn. 1986); Southern-Gulf Marine Co. No. 9 v. Camcraft, Inc., 410 So. 2d 1181 (La. Ct. App. 1982), cert. denied, 412 So. 2d 1115 (La. 1982).


31. See Robertson, 197 A.2d at 445 n.6 (citing commentators and other authorities critical of the doctrine of de facto corporations); Ziegler, supra note 18, at 1137-38 (describing this area of the law as "in a hopeless state of confusion" and then describing the effect of the Model Business Corporation Act).

32. See Bradley, supra note 18, at 532-36 (discussing the history and the impact of the Model Act); Yates, supra note 18, at 1261-64 (discussing the reasons for and the drafting of the Model Act).

33. MODEL BUSINESS CORP. ACT ANN. § 56. Section 56 is enacted nearly verbatim at UTAH CODE ANN. § 16-10-51 (repealed 1992). See supra note 9.
The comments to this section eliminate any ambiguity about the drafters' intent. They state that "[u]nder the unequivocal provisions of the Model Act, any steps short of securing a certificate of incorporation would not constitute apparent compliance. Therefore a de facto corporation cannot exist under the Model Act."  

Second, section 146 indirectly addresses the issue of defective incorporation by providing that individuals who act on behalf of a non-existent corporation are not protected by the corporate shield and therefore may be personally liable. Section 146 provides: "All persons who assume to act as a corporation without authority so to do shall be jointly and severally liable for all debts and liabilities incurred or arising as a result thereof." As with section 56, the comments reflect the drafters' attempt to avoid ambiguity about the effect of section 146 on the doctrine of de facto corporation: "This section is designed to prohibit the application of any theory of de facto incorporation." In 1961 the Utah Legislature adopted the Model Business Corporation Act, including sections 56 and 146, without substantial modification.

IV. ANALYSIS OF AMERICAN VENDING SERVICES v. MORSE  

A. De Facto Corporations

The Utah Court of Appeals correctly found that a de facto corporation cannot exist under the Utah Business Corporation Act. In its common law application, the doctrine of de facto

34. MODEL BUSINESS CORP. ACT ANN. § 56 cmt., at 205.  
35. See, e.g., Larry E. Ribstein, Limited Liability and Theories of the Corporation, 50 Md. L. Rev. 80, 121-22 (1991) (stating that § 146 led to results that were surprising in the context of the parties' intentions).  
36. MODEL BUSINESS CORP. ACT ANN. § 146.  
37. Id. § 146 cmt., at 908.  
38. UTAH CODE ANN. § 16-10-51 (repealed 1992). See supra note 9 and accompanying text for the text of this section.  
39. Id. § 16-10-139.  
40. Id. §§ 16-10-1 to 141.  

Under the Revised Utah Business Corporation Act de facto corporations are also impossible. The beginning point for corporate existence, however, is different. Under the Utah Business Corporation Act, corporate existence begins when the certificate of incorporation is issued. UTAH CODE ANN. § 10-16-51 (repealed 1992). Under the Revised Act, however, the "corporate existence begins, when the articles of incorporation are filed by the division." Id. § 16-10a-203(1).
corporations actually creates a corporation that is entitled to all of the benefits and rights of a de jure corporation. 42 Under the Utah Business Corporation Act, a corporation does not, and cannot, exist until the issuance of the certificate of incorporation. 43 As the comments to the Model Business Corporation Act point out, this provision makes the creation of a de facto corporation impossible. 44 This conclusion has been reached by the majority of courts which have addressed the issue. 45

The elimination of de facto corporations is sound public policy. This area of the law had become too confusing and unpredictable; therefore, to stabilize business transactions, it was necessary to develop a clear rule defining when corporate existence begins. 46 Further, because the corporate shield is provided at the sufferance of the state, it should only offer protection to those who have technically availed themselves of this privilege by fulfilling the state's requirements for incorporating. Historically, the allowance of a de facto corporation was thought to be fair because it protected incorporators who, although they had not incorporated correctly, expected to have the protection of a corporation. 47 This policy of protecting individuals, however, should be balanced with the policy that individuals should be responsible for their own actions and commit-

42. See Robertson v. Levy, 197 A.2d 443, 445 (D.C. 1964); Fletcher, supra note 21; Ziegler, supra note 18, at 1123.
44. Id. § 56 cmt., at 205.
45. See, e.g., Bowers Bldg. Co. v. Altura Glass Co., 694 P.2d 876, 878 (Colo. Ct. App. 1984); Robertson, 197 A.2d at 446; Don Swann Sales Corp. v. Echols, 287 S.E.2d 577, 578 (Ga. Ct. App. 1981); Timberline Equip. Co. v. Davenport, 514 P.2d 1109, 1110-11 (Or. 1973); Thompson & Green Mach. Co. v. Music City Lumber Co., 683 S.W.2d 340, 344 (Tenn. Ct. App. 1984); see also Fletcher, supra note 21, § 3762.10 (discussing the impact of the Model Business Corporation Act on the common law); Alexander H. Frey, Legal Analysis and the "De Facto" Doctrine, 100 U. Pa. L. Rev. 1153, 1178 (1952) (arguing, before the Model Business Corporation Act was adopted, that the doctrine of de facto corporation should be eliminated); Mark E. Noennig, Note, The De Facto Corporation Doctrine in Montana, 39 Mont. L. Rev. 305, 308-310 (1978) (discussing how the Model Business Corporation Act's elimination of de facto corporations solves some of the problems created by the common law "nullity" approach); Yates, supra note 18, at 1261 (discussing the impact of the Model Act on the doctrine of de facto corporations); Ziegler, supra note 18, at 1137-38.
46. See, e.g., Ziegler, supra note 18, at 1137 (stating that this area of the law was "in a hopeless state of confusion").
47. American Vending Servs., Inc. v. Morse, 881 P.2d 917, 920-21 (Utah App. 1994), cert. denied, No. 940470 (Utah Jan. 10, 1995); Ziegler, supra note 18, at 1121 (stating that de facto corporations developed to meet the demands of equity and to protect those who had acted in good faith).
ments. In balancing these two policies, the protection of the corporate shield should be provided only to those who have properly met the state’s requirements of incorporation. Under the Utah Business Corporation Act, the requirements are straightforward and easy to satisfy. Negligent or ignorant individuals should not be shielded from the effects of their actions or bargains if they have not acted with sufficient care to meet the requirements of the statute. The Utah Business Corporation Act balances both of these interests and establishes a bright-line rule that makes it easy for even the least sophisticated individuals to know when they, or those they are dealing with, are protected by the corporate shield.

B. Corporation by Estoppel

Although the Utah Court of Appeals reached the correct result on the facts of Morse, its conclusion that the doctrine of corporation by estoppel is totally eliminated by the Utah Business Corporation Act is not well reasoned and is bad policy. As is explained in the following sections, the court’s analysis was too broad because the Act does not require the court’s conclusion. Instead, the court should have recognized that, although the doctrine is not applicable in all of the factual scenarios where it was applicable under the common law, circumstances exist under which it may still be applied to prevent injustice.

48. Under the Revised Utah Business Corporation Act, there is no possibility that the corporation will not be properly formed as a consequence of a mistake made by the state. Under the Revised Act, the corporate existence begins when the articles of incorporation are “filed.” Utah Code Ann. § 16-10a-203(1). This is an improvement from the Utah Business Corporation Act, which provided that the corporate existence began when the certificate of incorporation was issued by the state, which increased the possibility that the corporation would not come into existence because of a mistake on the part of the state. Id. § 16-10-51.

49. See infra notes 71 and 76 and accompanying text.

50. See, e.g., Arbo Corp. v. Aidan Mktg./Distribution, Inc., 639 F. Supp. 1512, 1514 (D. Minn. 1986) (holding that while the Model Business Corporation Act does eliminate de facto corporations, it does not necessarily affect the viability of an estoppel defense); see also William L. Stocks, Note, Corporations—De Facto Corporations—Estoppel—Model Business Act, 43 N.C. L. Rev. 206, 210 (1964) (arguing that the Model Business Corporation Act does not require the elimination of corporation by estoppel); Yates, supra note 18, at 1263-64 (stating that under the Model Act the status of the doctrine of corporation by estoppel is unclear).
1. Corporation by estoppel and de facto corporations are separate and distinct doctrines

The first important distinction the court of appeals failed to make is that the doctrines of de facto corporations and corporation by estoppel are separate and distinct. The doctrine of de facto corporations has the effect of actually creating a legal entity, while corporation by estoppel simply bars a limited number of persons from denying the corporate existence in resolving a specific dispute. Corporation by estoppel is an equitable principle which estops parties from denying the existence of a corporation, for the purpose of one lawsuit, where the parties have dealt with the association as a corporation or have acknowledged the association as a corporation.

Historically, many courts have failed to recognize the difference between the two doctrines. Even courts which have addressed the viability of these doctrines under the Model Act have failed to recognize them as distinct doctrines. This confusion has sometimes led the courts to treat the two doctrines as if they serve the same purpose and thus both could be eliminated by the same logic. The better-reasoned view, however, is that these doctrines serve separate and distinct purposes, and therefore, the elimination of de facto corporations by the Model Business Corporation Act does not necessarily eliminate the doctrine of corporation by estoppel.

51. See, e.g., Arbo Corp., 639 F. Supp. at 1514; Robertson v. Levy, 197 A.2d 443, 445 (D.C. 1964) (discussing the separate functions of the two doctrines); Ziegler, supra note 18, at 1124-25 (discussing the overlap between the doctrines of de facto corporations and corporation by estoppel but recognizing the majority rule that the two doctrines are separate).
52. See Childs v. Philpot, 487 S.W.2d 637, 641 (Ark. 1972); Ziegler, supra note 18, at 1124 (discussing the limitations on the doctrine of corporation by estoppel).
53. See, e.g., James v. Unknown Trustees, 220 P.2d 831, 835 (Okla. 1950) (stating that the doctrine of corporation by estoppel may not be invoked unless the corporation has at least a de facto existence).
54. See Robertson, 197 A.2d at 447 (stating that the doctrines of de facto corporations and corporation by estoppel are independent, but holding that the Model Act leads to the elimination of both doctrines by creating a bright-line rule concerning the beginning of corporate existence); Thompson & Green Mach. Co. v. Music City Lumber Co., 683 S.W.2d 340, 345 (Tenn. Ct. App. 1984) (following Robertson and holding that the Model Business Corporation Act eliminated both de facto corporations and the doctrine of corporation by estoppel).
55. See Arbo Corp. v. Aidan Mktg./Distribution, Inc., 639 F. Supp. 1512, 1514 (D. Minn. 1986) (holding that the elimination of de facto corporations does not necessarily eliminate the doctrine of corporation by estoppel); Willis v. City of Valdez, 546 P.2d 570, 574 (Alaska 1976) (holding that because doctrine of corporation by
The separate purposes served by these two doctrines were indirectly recognized by the drafters of the Model Business Corporation Act. The drafters commented in two places that their intention was to eliminate the doctrine of de facto corporations, but they did not ever mention its companion doctrine—corporation by estoppel. This omission is significant because it must be assumed that the drafters intentionally excluded it from the comments, and therefore did not intend for the Model Act to eliminate corporation by estoppel. Many courts have, with little explanation of their reasoning, concluded that the Act eliminated corporation by estoppel as well as de facto corporations. Other courts, however, have recognized the separate nature and purpose of the two doctrines, and have therefore held that it is possible for the principle of corporation by estoppel to continue to exist although de facto corporations are eliminated. In Morse, Judge Greenwood found the argument that corporation by estoppel could continue to exist under the Model Business Corporation Act more persuasive. In her concurring opinion she argued that there was no basis in the comments to the Model Business Corporation Act to support the position that the Model Act eliminated corporation by estoppel. Recognizing the different purposes served by corporation by estoppel, she argued that the doctrine should still be applicable in limited circumstances. While her suggested estoppel is concerned with the acts of the parties, and doctrine of de facto corporations is concerned with the legality of the corporation, corporation by estoppel is an independent doctrine and is applicable where a de facto corporation cannot be established).

56. See supra notes 34 and 37.
57. See Booker Custom Packing Co. v. Sallomi, 716 P.2d 1061, 1063 (Ariz. Ct. App. 1986) (holding that an argument similar to corporation by estoppel is precluded by the Model Business Corporation Act without directly addressing the issue of corporation by estoppel under the Act); Robertson, 197 A.2d at 447; Thompson & Green Mach. Co., 683 S.W.2d at 345.
58. See Arbo Corp., 639 F. Supp. at 1514 (holding that although the Model Business Corporation Act eliminated de facto corporations it does not eliminate the estoppel defense); Stocks, supra note 50, at 210 (criticizing Robertson for holding that the Model Business Corporation Act eliminated corporation by estoppel and arguing that the elimination of corporation by estoppel would result in injustice).
60. The majority criticizes Judge Greenwood's analysis because she relied upon Harry Rich Corp. v. Feinberg, 518 So. 2d 377 (Fla. Dist. Ct. App. 1987), in which corporation by estoppel was recognized by statute. The majority fails to recognize that the Florida statute at issue in that case simply recognized the distinction that exists at common law. Just because the distinction was recognized by
exceptions may have been too limited, it is significant that she recognized that the Utah Business Corporation Act did not eliminate the doctrine altogether.

The language of the Utah Business Corporation Act dealing with when corporate existence begins simply is not applicable to the doctrine of corporation by estoppel. The doctrine of corporation by estoppel does not purport to actually create a corporation; no corporation comes into existence under the doctrine. Therefore, the Court of Appeals' reasoning that the Act's language must eliminate the doctrine is erroneous.

2. **Factual scenarios where corporation by estoppel should not be precluded by the Utah Business Corporation Act**

Since the Utah Business Corporation Act does not expressly eliminate the doctrine of corporation by estoppel, the court should have asked whether any provisions of the Act limit the doctrine's application. Section 139, which holds individuals liable for acts taken on behalf of a defectively formed corporation, limits the application of the doctrine in some—but not all—factual scenarios. There are scenarios where corporation by estoppel could be applied and would not be inconsistent with, or precluded by, section 139. Whether corporation by

statute in one state does not prevent the Utah courts from continuing to recognize the common law distinction in the absence of a statute, especially when there is nothing in the language of the Utah Act that would mandate that the doctrine be rejected. Indeed, the *Arbo Corp.* court, aided by the reporters' notes to the statute, recognized this very distinction where there was no language in the state statute recognizing the doctrine. *Arbo Corp.*, 639 F. Supp. at 1514. Regardless of the source of the idea, the Utah courts should continue to recognize the separate purpose of corporation by estoppel.

61. Section 51, which addresses when the corporation's existence begins, should not enter into the analysis of whether corporation by estoppel may apply, because corporation by estoppel does not rely on the fiction that a corporation has been created, but rather relies on equity, which requires that a party be estopped from denying the existence of the corporation in a particular situation.

62. Under the Revised Utah Business Corporation Act ("Revised Act"), which replaces the Utah Business Corporation Act ("Act"), the same procedure should be followed with nearly the same results. The doctrine of corporation by estoppel should remain applicable unless its application is precluded by the Revised Act. Under the Revised Act, corporation by estoppel will be applicable in more situations than it is under the Act. Under the Act, § 139 precludes the application of corporation by estoppel whenever its application would protect individuals who have acted on behalf of a non-existent corporation. *Utah Code Ann.* § 16-10-139 (repealed 1992). The Revised Act, however, adds a knowledge requirement to this provision and therefore would only preclude the application of corporation by estoppel when its application would protect individuals who have *knowledgeably* acted on
estoppel applies, therefore, must be determined on a case by case basis. The doctrine of corporation by estoppel was developed as a tool with which the court could combat injustice, and the doctrine’s complete elimination will result in great injustice.63

This analysis, however, is not as difficult as it may at first seem. According to one court, there are only five factual scenarios where corporation by estoppel could be applied.64 A review of these five scenarios demonstrates how the doctrine of corporation by estoppel should be applied as a tool to prevent injustice.

a. Scenario 1. A defectively formed corporation sues a third party and the third party is estopped from denying that the plaintiff is a corporation.65 An example of this scenario is Southern-Gulf Marine Co. No. 9 v. Camcraft, Inc.66 In Southern-Gulf, a shipbuilder contracted with an entity to build a vessel for a fixed price. The entity purported to be a corporation but in fact was not yet incorporated. Between the signing of the contract and the completion of the vessel, the vessel appreciated in price and consequently the shipbuilder refused to deliver the vessel to the corporation. The corporation’s suit against the shipbuilder was dismissed by the trial court, which found that there was no valid contract and thus no valid cause of action, based on the corporation’s lack of existence when the contract was executed. On appeal, the court reversed and found that because the shipbuilder contracted with the entity as a corporation, the shipbuilder was estopped from denying the entity’s corporate existence.

b. Scenario 2. A third party sues a defectively formed corporation and the defectively formed corporation is

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63. See Stocks, supra note 50, at 210; Ziegler, supra note 18, at 1145 (arguing that the courts need corporation by estoppel to moderate the rigid approach of the Model Act).


65. See Fletcher, supra note 21, § 3910 (discussing cases and corporation by estoppel under this factual scenario).

66. 410 So. 2d 1181 (La. Ct. App. 1982), cert. denied, 412 So. 2d 1115 (La. 1982). This case did not arise under the Model Business Corporation Act, but the facts of this case illustrate one factual situation where serious injustice will result if corporation by estoppel is eliminated.
estopped from denying that it is a corporation. 67 An example of this scenario is *United States v. Theodore.* 68 In this case a defectively formed corporation moved to dismiss an action against it by the Internal Revenue Service for failure to produce its corporate records used in the preparation of a tax return. The corporation argued that it could not be sued in its corporate capacity because it had never filed articles of incorporation as required by state statute. Further, the corporation argued that South Carolina had adopted the Model Business Corporation Act, which set the filing of the articles of incorporation as the beginning of corporate existence. The court found that the corporation had held itself out as a corporation to the public, to the government of South Carolina, and to the government of the United States and was therefore estopped from denying its corporate existence.

c. **Scenario 3.** A third party sues the defective corporation, and the incorporators who held the entity out as a corporation are estopped from denying the existence of the corporation. 69 An example of this scenario is *Peterson v. Baloun.* 70 In this case Mr. Peterson was enticed to invest in a mortgage company by his accountant, who was acting on behalf of the unincorporated entity that sold Mr. Peterson the investment. Mr. Peterson later sued the corporation for alleged violations of the securities laws. The corporation moved to have the suit dismissed, claiming that since it was not incorporated at the time it entered into the contract to sell the securities, it could not have been a party to the contract. The court found that because the accountant had purported to act on behalf of the corporation, the corporation could not deny its existence.

Under each of these first three scenarios, section 139 does not apply because the corporation is the party rather than the putative shareholders. If relief is to be provided under these scenarios, it must be provided by applying corporation by estoppel. Under these scenarios, applying corporation by estoppel is good public policy. The doctrine prevents the corporation or persons it contracts with from escaping liability or avoiding

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67. *See* FLETCHER, *supra* note 21, § 3930 (discussing cases and corporation by estoppel in this factual scenario).
69. *See* FLETCHER, *supra* note 21, § 3938 (discussing cases and corporation by estoppel under this factual scenario).
obligations based solely on the corporation's negligence in complying with the corporate formalities.\textsuperscript{71} Allowing parties to escape liability simply because they failed to follow the state's incorporation statutes provides an incentive not to complete the technical requirements of incorporation where being unincorporated works to a party's advantage in committing some mischief or fraud.

d. Scenario 4. Either a third party or the defective corporation is estopped from denying the existence of the corporation because of prior pleadings that the parties have made in the lawsuit.\textsuperscript{72} An example of this scenario is \textit{Spurlock v. Santa Fe Pacific Railroad},\textsuperscript{73} in which Spurlock, the owner of the surface estate, sued a railroad that owned the mineral estate, for conversion. Spurlock argued several theories, including that under the terms of the contract certain mineral rights were not severed from the surface estate, and that because of the railroad's failure regarding corporate formalities,\textsuperscript{74} the railroad was not a corporation, and therefore, could not own the mineral rights. The court found that Spurlock was estopped from denying the existence of the railroad as a corporation because Spurlock had pled that it was a corporation and, therefore, Spurlock had elected to treat the railroad as a corporation.\textsuperscript{75}

Under this scenario, section 139 may preclude the application of corporation by estoppel, but only if the case involves a person who has acted on behalf of a defectively formed corporation. If section 139 is not applicable, however, the application of corporation by estoppel is sound public policy. It prevents parties who know of the corporate defects and nevertheless assert the validity of the corporation from later denying the corporate existence when it becomes convenient to do so. The application of this rule should be flexible, however, to allow parties to

\textsuperscript{71} See Stocks, \textit{supra} note 50, at 210 (stating that the complete elimination of corporation by estoppel will result in injustice and illustrating the point with facts similar to scenario two); Ziegler, \textit{supra} note 18, at 1149-52 (discussing, in different terms, the same three factual scenarios and reaching the conclusion that corporation by estoppel should be applied).

\textsuperscript{72} See FLETCHER, \textit{supra} note 21, §§ 3944-3952 (discussing cases and corporation by estoppel under this factual scenario).


\textsuperscript{74} Spurlock's theory was that the railroad had de facto dissolved. While this is slightly different from the defectively formed situations, the application of corporation by estoppel would work the same.

\textsuperscript{75} \textit{Spurlock}, 694 P.2d at 314.
amend their complaints or abandon their suits without being estopped if they were unaware the corporation’s defects. This result provides an incentive for parties to take well-thought-out positions and encourages efficiency in the resolution of legal disputes.

e. Scenario 5. A third party sues the individuals behind the defective corporation but is estopped from denying the existence of the corporation. The Morse case is a classic example of this scenario. In an attempt to escape liability, the individuals behind American Vending Services Inc. wanted to estop the Morses from denying the existence of the corporation. Under these circumstances, section 139 provides that the individuals behind the entity are personally liable for acting on behalf of a non-existent corporation. Because section 139 is operable in this situation, it precludes the application of corporation by estoppel. This result is proper because if corporations by estoppel were applied, the doctrine would enable individuals to escape liability simply by their own negligence or bad faith. This outcome is consistent with the common law principle that corporation by estoppel should be applied to protect those who have acted in good faith, but should never be applied when it would be inequitable or would benefit a party who has acted negligently or in bad faith.

By starting with the presumption that the doctrine of corporation by estoppel is applicable and then determining whether its application is disabled by section 139, a court can consistently reach just results. Such an approach would yield better results than if the court were to blindly use corporation by estoppel in every situation where it could apply. Such an approach would also yield better results than if the court were to blindly eliminate the doctrine to the detriment of those who have relied in good faith on the existence of the corporation and who therefore cannot receive justice because the corporation does not exist.

76. See FLETCHER, supra note 21, §§ 3944-3952.
77. Ziegler, supra note 18, at 1146 (arguing that while the courts should apply corporation by estoppel in some situations, it should not be applied in this factual scenario).
78. See Childs v. Philpot, 487 S.W.2d 637, 641 (Ark. 1972); Ziegler, supra note 18, at 1124.
V. CONCLUSION

De facto corporations and corporation by estoppel developed under the common law as a way for the courts to prevent harsh results when parties innocently failed to comply with the requirements of corporate formation. Over time this area of the law became inconsistent and unpredictable. In an attempt to create a bright-line rule regarding the beginning of corporate existence, the drafters of the Model Business Corporation Act eliminated the doctrine of de facto corporations. Questions have remained, however, regarding the effect of the Model Act on the doctrine of corporation by estoppel.

_Morse_ is the first case in which the Utah courts have addressed the impact of the Model Act on de facto corporations and corporation by estoppel. The Utah Court of Appeals correctly found that the Utah Business Corporations Act eliminated the possibility of de facto corporations. With respect to the doctrine of corporation by estoppel, the court also reached the correct result on the facts of _Morse_; however, the broad language of the court precluding the doctrine of corporation by estoppel in all circumstances under the Act goes too far and is not required by the Act. If followed, this conclusion would significantly tie the courts' hands in preventing injustice.

Instead, courts should approach corporation by estoppel questions with the presumption that the doctrine applies unless precluded by the Act. Section 139 does preclude the application of corporation by estoppel in some circumstances. In other circumstances, it is good public policy to apply corporation by estoppel to prevent parties from benefitting from their negligence or bad faith in complying with the formalities of incorporation.

_Douglas C. Waddoups_