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Continuing Corporate Liability For Federal Crime After State Dissolution Of Corporation

Melrose Distillers, Inc. v. United States[1]

Three corporate defendants — Melrose Distillers, Inc., CVA Corporation, and Dant Distillery and Distributing Corporation — all wholly owned subsidiaries of Schenley Industries, were indicted for alleged violations of Sections 1 and 2 of the Sherman Act.[2] Shortly after the indictment against them was returned, they were dissolved under their respective state statutes, (Maryland and Delaware) and were recreated as divisions of the parent firm. Their motion for a dismissal of the indictment under the claim that their dissolution abated the proceedings was denied by the United States District Court for Maryland, which, upon the subsequent plea of *nolo contendere,* levied fines against them. The Court of Appeals for the Fourth Circuit affirmed.[3] On writ of certiorari, the Supreme Court, in turn, affirmed, stating that the three corporations retained sufficient life under state law to allow these criminal proceedings to continue, without finding any need to resolve the exact interpretation of provisions of the state abatement statutes. The Court reasoned: (1) that the Sherman Act, §8, "defines 'person' to include corporations 'existing' under the laws of any State", and (2) regardless of how Maryland and/or Delaware construe their respective statutes allowing dissolved corporations to continue in existence for "proceedings" already begun (narrowly, so as to preclude subsequent state criminal prosecutions, or

[1] 359 U.S. 271 (1959).
[2] 26 STAT. 209, §§ 1, 2; 15 U.S.C.A. (1951), §§ 1, 2.
[3] 258 F. 2d 726 (1958), Rec. Dec. 19 Md. L. Rev. 82 (1959).

broadly, so as to include them), the corporation was "an 'existing' enterprise for the purposes of §8".[4] The Supreme Court as a policy matter concluded:

> "Petitioners were wholly owned subsidiaries of Schenley Industries, Inc. After dissolution they simply became divisions of a new corporation under the same ultimate ownership. In this situation there is no more reason for allowing them to escape criminal penalties then damages in civil suits. As the Court of Appeals noted, a corporation cannot be sent to jail. The discharge of its liabilities whether criminal or civil can be effected only by the payment of money."[5]

A basic question presented by the case was whether an analogy exists between the death of a natural person and the dissolution of a corporation; and, if so, whether the legal consequences and ramifications are identical. The Supreme Court itself, in three prior decisions ranging from 1927 to 1949 had taken the position that, at common law, dissolution and death are analogous as to the abatement of liability.[6] In each of these three cases, as well as three others decided in the lower Federal courts,[7] the principle that only a statute enacted in the state of incorporation can sustain sufficient life in a dissolved corporation to render it liable in its transformed state, had been followed without exception. Chief Justice Taft expressed this majority rule quite clearly in stating:

> "It is well settled that at common law and in the Federal jurisdiction a corporation which has been dissolved is as if it did not exist, and the result of its dissolution cannot be distinguished from the death of a natural person in its effect."[8]

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[4] 359 U.S. 271, 273-274 (1959).

[5] *Ibid.*, 274.

[6] Oklahoma Natural Gas Co. v. State of Oklahoma, 273 U.S. 257 (1927); Defense Supplies Corp. v. Lawrence Warehouse Co., 336 U.S. 631 (1949); Chicago Title and Trust Co. v. Forty-One Thirty-Six Wilcox Building Corp., 302 U.S. 120 (1937).

[7] U.S. v. Line Material Co., 202 F. 2d 929 (6th Cir. 1953); U.S. v. U.S. Vanadium Corp., Electro-Metallurgical Co. and Electro-Metallurgical Sales Corp., 230 F. 2d 646 (10th Cir. 1956); cert. den. 76 S. Ct. 836 (1956); U.S. v. Leche, 44 F. Supp. 765 (D.C. La. 1942).

[8] Oklahoma Natural Gas Co v. State of Oklahoma, *supra*, n. 6, 259. The existence of contrary holdings is admitted by the Court in a later case, in which, though siding with the majority, the Court stated that the analogy has "not been the subject of universal admiration . . . and is by no means exact". Defense Supplies Corp. v. Lawrence Warehouse Co., *supra*, n. 6, 634. The Appellate Division of the New York Court has adopted this minority view. Wilson v. Brown, 175 N.Y.S. 688, 692 (1919).

Proceeding from this principle, there is virtual unanimity in looking to the state statutes for changes in the common law rule. The states, however, are far from uniform in their statutory treatment of the problem; for, not only do the provisions themselves vary, but, in some cases, the same thought is expressed in different ways, leading to divergent interpretations. Under the Delaware statute, for example, a dissolved corporation continues in existence for a period of three years from its official expiration for the purpose of prosecuting or defending "suits, actions and proceedings" to which it is a litigant. The statute prolongs the life of such a corporation until judgment or decree is granted in cases where certain types of litigation were commenced by or against the firm either prior to or within the three year period.[9]

In Maryland, the effect of dissolution was expressed quite clearly in Section 78 (a) of the 1951 Code, which stated that dissolution shall not abate "any pending suit or proceeding by or against the corporation, and all such suits may be continued with such substitution of parties, if any, as the Court directs."[10] In addition to the aforementioned section, the Court in the instant case cited Section 72 (b) of the 1951 Code, which provides that, although the dissolution of a corporation is effective when the articles of dissolution are accepted for record by the State Tax Commission, the firm nevertheless remains in existence for the purposes of "paying, satisfying, and discharging any existing debts and obligations . . . and doing all other acts required to liquidate and wind up its business and affairs."[11]

As to Section 78 (a), since the clarity and directness of the statute's wording left little doubt as to its intent, the Court concerned itself only with the interpretation as to what forms of litigation were to be included under it, the problem being centered on the construction of the words "suit" and "proceeding." The question on point was whether these words have sufficient latitude to encompass criminal prosecution.

There has been little doubt but that civil litigation does not abate under the statutes, both in the Federal and State Courts. Only six days prior to the *Melrose* decision, the Maryland Court of Appeals, in *Baltimore County v. Glendale Corporation,* wherein a suit for specific performance of certain contracts was brought, stated unequivocably that

[9] 8 DEL. CODE (1935) § 42.

[10] MD. CODE (1951), Art. 23, § 78(a); *cf.* MD. CODE (1957), Art. 23, § 82(a).

[11] MD. CODE (1951), Art. 23, § 72(b); (1957), Art. 23, § 76(b).

the mere fact of dissolution would not affect the civil liability of the defendant corporation.[12]

As to whether the words include criminal prosecution, a marked conflict exists among the courts. Taking the words "suit," "proceeding," and "action" together in a series, as they appear in the Delaware Code, the Circuit Court for the Tenth Circuit decided, in an oft-cited opinion, that they include only civil litigation, reasoning that criminal prosecution, being different in nature and not being specifically mentioned, was not intended to be included in the exceptions to the common law.[13] Although abating the cause before it, the Court was faced with a case similar to *Baltimore County v. Glendale*,[14] in that the action was not actually pending at the time of the defendant's dissolution; and its decision may be distinguished from those contrary to it in that respect.

The Circuit Court of Appeals for the Sixth Circuit reached the same conclusion, however, finding that, although "action" and "proceeding" may explain "suit" they do not expand its meaning sufficiently to warrant continuation of criminal prosecutions.[15]

The Court of Appeals for the Seventh Circuit took issue with this reasoning, stating:

> "We agree that the word 'suit' or the word 'action' standing alone might reasonably be held as not including a criminal prosecution, but when the word 'proceeding' is added we think a combination is presented which is well near inclusive of all forms of litigation."[16]

In documenting its interpretation, the Court referred to the Federal Rules of Criminal Procedure, in which the term "criminal proceeding" is used.[17] Also cited by the Court is an opinion of the Court of Appeals for the Fourth Circuit which, in construing the more controversial Delaware law, agreed that the word "proceeding" is broader than "action" or "suit," and, to fulfill the *raison d'etre* of the statute, must be given full latitude.[18]

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[12] 219 Md. 465, 150 A. 2d 433 (1959).

[13] U.S. v. Safeway Stores, 140 F. 2d 834 (10th Cir. 1944).

[14] *Supra*, n. 12.

[15] U.S. v. Line Material Co., 202 F. 2d 929 (6th Cir. 1953).

[16] U.S. v. P. F. Collier and Son Corp., 208 F. 2d 936, 939, 40 A.L.R. 2d 1389 (Cir. 1953).

[17] 18 U.S.C.A. (1948), Rule 2.

[18] Bahen and Wright, Inc. v. Commissioner of Internal Revenue, 176 F. 2d 538, 539 (4th Cir. 1949).

In the instant case below, the Court of Appeals for the Fourth Circuit felt that the words of the statutes of both Maryland and Delaware, for purposes of survival of criminal suits, should include criminal as well as Civil proceedings, and adopting the same policy approach as the Supreme Court in the language quoted above said that to exempt the survival of criminal actions "would offend our sense of justice, pervert the obvious policy of the state in enacting these survival statutes, and provide an easy avenue of escape by corporations from the consequences of their criminal acts by the easy process of dissolution."[19]

The controversy concerning this technical interpretation of the three words, in so far as a federal criminal proceedings involving Maryland or Delaware corporations are concerned, was, apparently ended when the Supreme Court decided in the *Melrose* case that, "under both the Maryland and Delaware law the lives of these corporations were not cut short, as is sometimes done on dissolution . . . but were sufficiently continued so that this proceeding did not abate."[20]

However, it should be observed that a question is necessarily raised as to whether the interpretation of the Maryland law by the Court of Appeals (the Supreme Court, as indicated above did not rest on the interpretation below) in this decision would still be applicable; for, though too late to affect this case, the State Legislature has repealed Section 78 (a), apparently intending it to be replaced by Rule 222 of the Maryland Rules of Procedure.[21]

While the Reporter's note to Rule 222 indicates that no change in meaning from Section 78 (a) was intended, a problem arises because the Rule omits the words "suit" and "proceeding", which had been used in the statute, and merely states that an "action" shall not abate by reason of dissolution. In Rule 5 (a), stating definitions applicable throughout the Maryland Rules "action" is defined as not including a criminal proceeding.[22] Thus, whereas Section 78 (a) prevented abatement of "any pending suit or proceeding", which was susceptible of construction to include criminal proceedings, as accepted by the United States Court of Appeals below in the instant case,[23] Rule 222 applies by definition only to civil litigation.

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[19] 258 F. 2d 726, 728 (4th Cir. 1958).

[20] Melrose Distillers, Inc. v. United States, 359 U.S. 271, 272-73 (1959).

[21] Maryland Rules of Procedure, Rule 222 (1958).

[22] *Ibid.*, Rule 5(a).

[23] *Supra, circa* n. 4.

Unless this situation is corrected, by re-enacting the repealed portion of Section 78 (a), preferably with an amendment to specifically include criminal proceedings, or perhaps by adoption of a rule specifically related to abatement of proceedings against corporations as part of the new criminal rules,[24] the effect of dissolution of a Maryland corporation on abatement of state criminal proceedings would seem to become once again an unresolved problem, and also to suggest the possibility of further dispute in federal prosecutions.

From the strong expressions of policy quoted above from the Supreme Court and the United States Court of Appeals below in the instant case,[25] it would seem probable that the federal courts, even without further change in the Maryland statutes or rules, would take the liberal policy approach which the Supreme Court took in construing the Sherman Act in the instant case.

However, there can be little doubt that some clarification of the state situation in the manner suggested above, whether by statutes or rule, would be desirable. Possibly, consideration should be given also to the desirability of a provision for survival of corporations for purposes of any criminal liability for the period of limitations specified for any particular crime, whether or not proceedings had been started before dissolution.

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[24] Currently in the form of a Tentative Draft (February, 1960) as prepared by a subcommittee of the Rules Committee of the Court of Appeals of Maryland and circulated to the Bench and Bar for comment.

[25] *Supra, circa* ns. 4 and 19.