South Carolina Law Review

Volume 19
Issue 1 *1966-1967 Survey Issue*

Article 7

1967

Corporations

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CORPORATIONS

I. Judicial Decisions

A. Fraudulent Conveyances

By far the most interesting of the corporation cases arising in the past surveyed period is *Jeffords v. Berry*,[1] in which the receiver of an insolvent corporation brought an action to set aside a deed by the corporation to the defendants on the grounds that it was a fraudulent conveyance. On January 23, 1965, the corporation, of which the plaintiff-respondent was appointed receiver in March of 1965, conveyed to the defendant-appellants certain real estate in Orangeburg. The deed recited a consideration of 1,000 dollars which was paid. In addition, the deed was made subject to certain mortgage indebtedness totalling approximately 30,900 dollars, plus outstanding taxes and other liens of record. Though the deed was taken subject to the above described indebtedness, it was stipulated in the deed that none of the indebtedness would be assumed by the grantees. The referee found that the fair market value of the property was approximately 36,000 dollars and that the value of the property over lien indebtedness was approximately 6,000 dollars.

The plaintiff alleged that the corporation grantor was insolvent at the time the deed was executed, that one of the defendants was the attorney for the grantor, that the consideration was grossly inadequate and that the transfer was prejudicial to the rights of the creditors. The defendants alleged that the conveyance was for valuable consideration, that they had no information to form a belief as to the insolvency of the corporation and further, the defendant lawyer alleged that although he had represented the grantor from time to time, he was not under a retainer.

The lower court affirmed the findings of the special referee and ordered that the deed in question be set aside and cancelled. At the heart of this controversy was the application of the Statute of Elizabeth,[2] which reads in part:

> Every . . . conveyance . . . which may be had or made for any intent or purpose to delay, hinder or defraud creditors and others of their just and lawful actions, suits, debts,

1. 247 S.C. 347, 147 S.E.2d 415 (1966).
2. S.C. Code Ann. § 57-301 (1962).

> accounts . . . shall be deemed and taken . . . to be clearly and utterly void, frustrate, and of no effect. . . .

The leading case in this area is *Gardner v. Kirven*,[3] which states:

> Our courts, in interpreting this statute, have held that conveyances shall be set aside under two conditions: First, where the transfer is made by the grantor with actual intent of defrauding his creditors where that intent is imputable to the grantee, even though there is valuable consideration; and Second, where a transfer is made without actual intent to defraud the grantor's creditors, but without consideration.

The lower court concluded that the deed should be set aside because at the time of the conveyance the grantor was insolvent and the consideration was inadequate.

In spite of this finding, the supreme court reversed on the grounds that the consideration, while inadequate, was not grossly inadequate. The supreme court in *Jeffords* relied heavily on the *Gardner* test. The court reasoned that since the deed was not without consideration, there must be actual intent to delay, hinder, or defraud creditors on the part of the grantor which could be imputable to the grantee. The court seemed to ignore *Rice v. City of Columbia*,[4] relied on in the *Gardner* decision, in which the court defined actual intent. The court stated:

> No rule of equity appeals more to the judicial conscience than that which requires the assets of an insolvent corporation to be distributed ratably among creditors. . . . He who claims a departure from this rule must establish his right clearly.[5]

The court in *Rice* concluded:

> They [the defendants] solemnly assert their innocence of any intention to hinder, delay, or defraud the other creditors, as if their innocence can shield them from the presumption that they intended the natural consequences of their acts. The equity of the creditors generally to an equal

3. 184 S.C. 37, 40, 191 S.E. 814, 816 (1937).
4. 143 S.C. 516, 141 S.E. 705 (1926).
5. *Id.* at 538-39, 141 S.E. at 712.

> distribution of the assets of the insolvent cannot be annihilated by such a quibble. It makes not a particle of difference that they intended simply to secure their deposits; the effect of their *acts* is all that needs to be considered. If they proved to be the means of thwarting that equity which so appeals to the judicial conscience, they will be utterly destroyed.[6]

These are strong words, and yet their effect is not evident in the *Jeffords* decision. The clear implication of *Rice* and *Gardner*, not to mention the Statute of Elizabeth itself, is that one is presumed to know the consequences of conveying out the main asset of an insolvent corporation for a clearly inadequate consideration, and that consequence is that creditors will be hindered, delayed or defrauded. In *Jeffords*, the court seems to engage in a semantic debate over the terms "inadequate" and "grossly inadequate" rather than dealing with the substantive questions in the case. In the process, they have approved precisely the sort of transaction which the Statute of Elizabeth prohibits. The *Jeffords* decision must be viewed as a weakening of the protection which the Statute of Elizabeth has afforded creditors to pro rata shares in the assets of an insolvent corporation.

B. Stock Redemption Agreements with an Insolvent Corporation

Cunningham v. Jaffe[7] raises several questions in connection with the general problem of the creditor's protected interest in the assets of an insolvent corporation. The plaintiff, trustee in bankruptcy of the corporation, sought to have a stock redemption agreement between the insolvent corporation and the defendants, officers and directors of the corporation, declared void because it impaired the capital of the corporation and because the chairman of the board and the president had no knowledge of the agreement. The bankrupt, a Delaware corporation, was organized in July 1962 with a paid in capital of 50,000 dollars. It then purchased the assets of a South Carolina corporation with substantially the same name for 500,000 dollars—50,000 dollars in cash and 450,000 dollars represented

6. *Id.* at 543, 141 S.E. at 713.
7. 251 F. Supp. 143 (D.S.C. 1966).

by loans. The business steadily lost money. As of March 2, 1963, operating expenses had exhausted the capital of the corporation. On March 9, 1963, the corporation entered into the stock redemption agreement with the defendants whereby the defendants would sell their stock back to the corporation for 100,000 dollars —more than twice the original purchase price.

Delaware law controlled as to the legality of the agreement. The Delaware Code provides:

> Every corporation organized under this chapter may purchase, hold, sell and transfer shares of its own capital stock; but no such corporation shall use its funds or properties for the purchase of its own shares when such use would cause any impairment of the capital of the corporation.[8]

It is interesting to note that the South Carolina Business Corporation Act has substantially the same provision.[9] If South Carolina courts follow the reasoning of this decision, a company will be forbidden to purchase its own capital stock when the value of its assets is less than the total amount of shares of its capital stock.[10] Thus, a corporation, particularly a close corporation, and corporate creditors will be protected against the abuses of corporate power which sometimes occur as officers or directors with a substantial financial investment in the corporation seek to desert the sinking ship by any available exit.

C. Jurisdiction

Both *Bramlett v. Arthur Murray, Inc.*[11] and *Rodrique v. Yale & Towne, Inc.*[12] discuss the often litigated question of what constitutes sufficient corporate contact to bring a foreign corporation within the jurisdiction of our courts. Both cases restate the well known rule that there is no precise test as to what business activities will bring a foreign corporation within the

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8. DEL. CODE ANN. § 8-160 (1953).

9. S.C. CODE ANN. § 12-15.17 (e) (Supp. 1965), provides as follows:
A corporation shall in no event purchase its own shares if the corporation is insolvent, or if such purchase or payment would render it insolvent, or would reduce the remaining net assets of the corporation below the aggregate preferential amount payable in event of liquidation to the holders of shares having preferential rights to the assets of the corporation.

10. See *In re* International Radiator Co., 10 Del. Ch. 358, 92 Atl. 255 (1914), Delaware's leading case in interpreting its stock redemption statute.

11. 250 F. Supp. 1011 (D.S.C. 1966).

12. 251 F. Supp. 73 (D.S.C. 1966).

jurisdiction of the court. In *Bramlett*, the court described the progression to the modern and more liberal concept of jurisdiction:

> The early restrictive concepts of *Pennoyer v. Neff*, 95 U.S. 714, have gradually evolved into the more modern philosophy as enunciated in *International Shoe Co. v. State of Washington*, 326 U.S. 610 (1945), that the question of jurisdiction of foreign corporations in state or federal courts is decided by "traditional notions of fair play and substantial justice." Such traditional notions are adequately met if a defendant has "minimum contacts" with the State of South Carolina. . . .[13]

The court cited the stringent controls exercised by the defendant over the South Carolina franchise and concluded that, practically speaking, the studios were nothing more than a branch of the Delaware corporation. The defendant contended that such controls were necessary to the protection of its trade name and trademark and were not intended to give it direct supervisory control. Though it recognized that control was necessary to the protection of rights in a trademark and maintenance of its secondary meaning, the court held that it did not follow that if these controls constituted sufficient contact to bring the foreign corporation within the jurisdiction of the forum state, the jurisdiction would not be invoked simply because the corporation did not intend to bring itself within that jurisdiction.

In *Rodrique*, the court found that the defendants, through a distributing agreement with a South Carolina corporation, had established the sort of substantive contacts which would justify maintenance of a personal injury action against it in South Carolina courts. Under the distributing agreement, the defendant made direct shipments from its plant in Arkansas to South Carolina customers, had direct supervision of the installation and inspection of the equipment purchased from it and was paid directly by the individual South Carolina customer. *Szantay v. Beech Aircraft Corp.*,[14] discussed in last year's corporations survey,[15] involved this same problem. It seems clear that in jurisdiction cases the South Carolina federal district courts will con-

13. Bramlett v. Arthur Murray, Inc., 250 F. Supp. 1011, 1015 (D.S.C. 1966).
14. 237 F. Supp. 393 (E.D.S.C. 1965), *aff'd*, 349 F.2d 60 (4th Cir. 1965).
15. 18 S.C.L. REV. 30, 32 (1966).

tinue to follow the liberal rule of *International Shoe Co.*[16] holding that federal courts are bound by the state's interpretation of its service of process statutes and that such statutes will be given the broadest construction concommitant with traditional notions of fair play and substantial justice.

II. Legislation

The only statute affecting the corporation field enacted in this survey period is Act No. 779,[17] which amends section 12-758 so as to reinstate material which was inadvertantly repealed by the South Carolina Business Corporation Act. Old section 12-101 was repealed in 1962. Part of that section contained provisions relating to the powers of charitable, social and religious corporations. The present act simply adds the old section 12-101 material to present section 12-758, and ratifies any action taken by such corporations in reliance on the repealed sections.

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16. International Shoe Co. v. Washington, 326 U.S. 310 (1945).
17. S.C. Acts & J. Res. 1966, p. 2057, amending S.C. CODE ANN. § 12-758 (1962).