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## Corporations

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## CORPORATIONS

### I. FRAUD AND MISREPRESENTATION

The case of *Jacobson v. Yashik*<sup>1</sup> provided probably the most interesting court conclusion in the field of corporate law this past year. The plaintiff and the defendant owned all the capital stock in a close corporation. The defendant was the president, general manager, majority stockholder (75%) and the dominant figure in the corporation. In 1964 the defendant purchased the plaintiff's shares (25%) and proceeded to sell them at a profit to a third party under a previously arranged contract of sale. The plaintiff sued under two theories: (1) Failure of the defendant to inform her that he had contracted to sell her stock at a price in excess of that which he was paying to her was a fraudulent concealment, in violation of a fiduciary duty entitling her to a proper pro rata share of the full value received by the defendant; (2) By reason of the existent fiduciary duty, failure to reveal the contract amounted to a constructive representation that no such contract existed, thus entitling plaintiff to the sum of \$100,000.00 actual and punitive damages. The defendant demurred upon the grounds that: (1) Mere silence as to his selling arrangements was no active perpetration of fraud and therefore insufficient to state a cause of action; (2) No allegation had been made that the defendant gained special knowledge by the fact of his position in the corporation. The defendant argued the so-called majority rule: that an officer or director of a corporation does not stand in a fiduciary relation with a stockholder with respect to his stock, and in the absence of circumstances from which fraud or unfair dealings may be inferred, an officer or director of a close corporation is under no duty to volunteer information to a stockholder from whom he purchases stock.<sup>2</sup>

The plaintiff claimed that, because of the defendant's dominant position in the corporation, the court should rule under the special facts doctrine exception to the majority rule, *i.e.*, that when a director or officer has knowledge of special facts by virtue of which the value of the stock has been enhanced, but which special facts are not known to the minority stockholder, the officer or director is required to make a full disclosure of

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1. 155 S.E.2d 601 (S.C. 1967).

2. Brief for Appellant-Respondent.

such facts.<sup>3</sup> For authority the plaintiff cited *Black v. Simpson*.<sup>4</sup> In that case the defendant, a director and general manager of an open corporation actively induced plaintiffs to sell their stock. In sustaining the overruling of defendant's demurrer, the *Black* court, in apparent dicta stated:

The defendant, as director and manager, was trustee not only of the corporation, but for all the stockholders. 10 Cyc. 787, 2 Pomeroy's Eq., sec. 1090. His duty was to manage the corporate property for the benefit of the stockholders; and in the performance of that duty he was chargeable with the utmost good faith. It was a breach of his trust to all of the stockholders to use any means to acquire for himself the corporate property except in the open after giving to the stockholders, fully and candidly all material information he possessed as to its condition and value . . . .<sup>5</sup>

In writing its decision the *Jacobson* court acknowledged both the majority rule and the exception to the rule. Utilizing the above quoted statement from *Black* which the plaintiff had interpreted as dicta, the court came to the innovative conclusion that:

[W]e think that the *holding* in the *Black* case commits this court to the minority rule above stated, that officers and directors of a corporation stand in a fiduciary relationship to the individual stockholders and in every instance must make a full disclosure of all relevant facts when purchasing shares of stock from a stockholder.<sup>6</sup>

Several questions are posed by the court's conclusion.

1. What significance should be attached to the fact that the court has applied the minority rule to the close corporation?
2. What effect will this case have in blurring certain distinctions between the open and close corporation?
3. Accepting the broad language used by the court in applying the minority rule, might the court not narrow its scope if confronted with differing factual situations?

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3. Brief for Plaintiff, Respondent-Appellant.

4. 94 S.C. 312, 77 S.E. 1023 (1913).

5. *Id.* at 315, 77 S.E. at 1025.

6. *Jacobson v. Yaschik*, 155 S.E.2d 601 (S.C. 1967) (emphasis added).

This minority rule has generally been one applied to the duty owed by officers, etc. in open corporations. In considering the close corporation most courts have looked to situations involving superior knowledge, confidential relations, and special circumstances affecting duties. As a matter of policy, however, this new ruling may be beneficial to the operations within the close corporation. There the minority stockholder stands to lose more than an ordinary stockholder considering that the former usually owns a greater share of the outstanding stock than the latter.

This decision also appears to give the close corporation stockholders protection equivalent to that which the fraud and misrepresentation provisions of the Securities Exchange Act<sup>7</sup> give the stockholders in the open corporation. Historically, these provisions have offered more protection to minority stockholders of the open corporation. It is much easier to prove that a majority stockholder, such as an officer in an open corporation, is by virtue of his inside position in possession of information not available to minority stockholders. Under the provisions of this act against the use of manipulative and deceptive devices in the purchase of securities, a closely held corporation, negotiating for the purchase of a minority shareholder's stock, can fairly deal with those who have had many years of intimate acquaintances with the affairs of the corporation. Now, fair dealing must be accompanied by a full disclosure to the stockholders of all facts affecting actions taken by the officers or directors.

It is obvious that the defendant in *Jacobson* was the dominant figure in the close corporation. Even so, the court "stretched" the law in applying *Black* (active misrepresentation, open corporation) to *Jacobson* (mere silence, close corporation). How much further the court will be willing to apply the minority rule is difficult to determine. For instance, would this broad application of the minority rule be applied to a situation in which the person purchasing the stock in a close corporation was not a dominant figure (holding no office and having ownership of less than a majority of the stock)? The general trend of authority indicates that being an officer or corporate official is the important factor in determining whether the minority rule is applied. Also, how would the court treat the majority stockholder in the close corporation who held no elected or appointed

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7. 15 U.S.C.A. § 78a (1963). For a discussion of the application of the Securities Exchange Act to close corporations see Annot., 7 A.L.R.3d 486 (1966).

position? In summary, the court has, with the questionable judicial authority of the *Black* case, blurred certain distinctions between close and open corporations. It is doubtful, however, that it will apply the broad minority rule in an all encompassing fashion in situations such as the hypotheticals suggested above.

## II. SERVICE OF PROCESS UPON FOREIGN CORPORATIONS

During the year there was an increase in the cases litigated under our service of process statute.<sup>8</sup> These cases indicate not only a continuing broadened application of our statute,<sup>9</sup> but also an inclusion of a greater diversity of types of foreign business activities.

The South Carolina Supreme Court has admitted that no universal formula has been, or is likely to be, devised for determining what constitutes "doing business" by a foreign corporation within a state in such sense as to subject it to the jurisdiction of the courts of that state. The question must be resolved upon the facts of the particular case.<sup>10</sup>

In *Carolina Boat and Plastics Company v. Glascoat Distributors, Inc.*<sup>11</sup> Glascoat's salesman called regularly upon firms in South Carolina for the purpose of soliciting orders for Glascoat's products. Orders were filled by shipment in interstate commerce or directly from the manufacturer amounting to more than \$10,000 annually. Glascoat, in contesting sufficiency of service, relied heavily upon *Phillips v. Knapp-Monarch Co.*,<sup>12</sup> in which the defendant made no sales in South Carolina and had no agents here. There it was held: a foreign corporation whose manufactured products passed through channels of trade into South Carolina where they were resold by independent merchants did not "transact business in the State."<sup>13</sup> *Carolina Boat* differed factually, the agent having soliciting orders directly from firms within the state. The court, however, made no reference to the *Phillips* decision or this factual distinction. Without applying any specific factual test it listed certain factors for con-

8. S.C. CODE ANN. §§ 10-424, 12-23.24 (1962).

9. *Id.*

10. *E.g.*, *State v. Ford Motor Co.*, 208 S.C. 379, 38 S.E.2d 242 (1946); *Jones v. General Motors Corp.*, 197 S.C. 129, 14 S.E.2d 628 (1941).

11. 249 S.C. 49, 152 S.E.2d 352 (1967).

12. Brief for Appellant, *Phillips v. Knapp-Monarch Co.*, 245 S.C. 383, 140 S.E.2d 786 (1965).

13. *Phillips v. Knapp-Monarch Co.*, 245 S.C. 383, 140 S.E.2d 786 (1965).

sideration in determining whether a corporation is doing business in the state: (1) duration and nature of the corporate activity within the state, (2) the character of the acts giving rise to the litigation, (3) the circumstances of their commission, and (4) the relative inconvenience to the respective parties of a trial in the state of the forum. It held that there was sufficient contact for service using the vague jurisdictional test from *Boney v. Trans-State Dredging Co.*<sup>14</sup> requiring only that the corporation have such contact with the state that the maintenance of an action against it in personam shall not "offend notions of fair play and substantial justice." With business procedures becoming increasingly sophisticated, situations similar to the *Phillips* case may become increasingly vulnerable to our service of process statute utilizing this broadening principle of the law.

In *Ard v. State Stove Manufacturers*<sup>15</sup> the federal district court held that a foreign corporation engaged in the manufacture of household appliances which it sold directly to approximately 25 concerns in the state which in turn sold to the general public and which had a manufacturer's representative that called on prospective customers in the state had the necessary minimum contacts consonant with fundamental fairness for the court to exercise jurisdiction based on substituted service on the corporation in accordance with South Carolina statutes. The court, moreover, recognized factual similarities with the previous decisions of *Shealy v. Challenger Manufacturing Co.*<sup>16</sup> (defendants both delivered products into the state in trucks driven by its employees) and *Carolina Boat*<sup>17</sup> (solicitation by agents).

In *Middlebrooks v. Curtis Publishing Company*<sup>18</sup> the defendant magazine publisher solicited subscriptions and distributed its magazines in the state to wholesale dealers through its wholly owned subsidiary. Upon the facts the federal district court applied a Tenth Circuit decision, *Curtis Publishing Company v. Cassel*,<sup>19</sup> concerning the questions of "minimum contacts" and due process of law. The court again recognized that our state

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14. 237 S.C. 54, 115 S.E.2d 508 (1960). The test seemingly broadens the statutory limits to the constitutional bounds set by *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

15. 263 F. Supp. 699 (D.S.C. 1967).

16. 304 F.2d 102 (4th Cir. 1962).

17. 249 S.C. 49, 152 S.E.2d 352 (1967).

18. 264 F. Supp. 373 (D.S.C. 1967).

19. 302 F.2d 132 (10th Cir. 1962).

supreme court has made it clear that the term "doing business" has been equated with such minimal contacts that the maintenance of a suit does not "offend traditional notions of fair play and substantial justice," and that whatever limitations it imposes is equivalent to that of the due process clause of the fourteenth amendment.

In *Siegling v. International Association of Approved Basketball Officials, Inc.*,<sup>20</sup> the federal district court held that contacts between a Maryland incorporated national association of basketball officials and local boards and members in South Carolina from which the association profited financially through royalties on sales of approved equipment were such that the assumption of jurisdiction of a diversity suit against the association did not offend traditional notions of fair play and substantial justice, and would be consonant with the due process provisions of the fourteenth amendment. From *Shealy*,<sup>21</sup> *Carolina Boat*,<sup>22</sup> and *Boney*<sup>23</sup> the court formulated a general principle that although there is no set formula by which "minimum contacts" may be weighed, the material factor is the quality and nature of the corporation's activity rather than quantity (repeated in *Middlebrooks*,<sup>24</sup> *supra*). It applied this formula to this situation in which there were no subsidiary dealings, soliciting agents, or business franchising. *Siegling* was not a case of actually "doing business," but rather of controlling activities within the state.

In *Amicale Industries, Inc. v. S.S. Rantum*<sup>25</sup> the federal district court was asked to decide three separate issues: (1) whether service of process on a local port agent was valid service on a foreign ship owner in an in personam action, (2) whether a foreign ship owner was amenable to substituted service pursuant to a state "long-arm" statute; and (3) whether the court should have declined jurisdiction in any event on the ground that the bills of lading stated that exclusive jurisdiction of the controversy be vested in the German courts. The court found that there was no contractual agreement between the local agent and the foreign shipping company, and that therefore service upon the local agent was insufficient. In determining the second issue, the

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20. 262 F. Supp. 441 (D.S.C. 1966).

21. 304 F.2d 102 (4th Cir. 1962).

22. 249 S.C. 49, 152 S.E.2d 352 (1967).

23. 237 S.C. 54, 115 S.E.2d 508 (1960).

24. 264 F. Supp. 373, 375 (D.S.C. 1967).

25. 259 F. Supp. 534 (D.S.C. 1966).

court cited *Gkiafis v. S.S. Yiosonas*<sup>26</sup> and concluded that substituted service pursuant to Section 10-424 of the South Carolina Code<sup>27</sup> was sufficient. In *Gkiafis* the Fourth Circuit applied a similar Maryland statute<sup>28</sup> to serve a vessel which had been in port at Baltimore on only four occasions prior to the commencement of the action. On these facts the Fourth Circuit indicated that only a few contacts with the state can subject a corporation to jurisdiction, if the contacts themselves are sufficient. Our supreme court has not been confronted with the minimum contact argument based on a few contacts or a single transaction within the state. The *Amicale* court, however, by citing the *Gkiafis* case, reaffirms the broadening interpretation of our service of process statutes. The court ultimately declined jurisdiction on grounds that the bill of lading provision was reasonable and would be enforced.

*Surinam Lumber Corporation v. Surinam Timber Corporation*<sup>29</sup> was an action for a declaratory judgment in the federal district court, the basis of which was a contract between the plaintiff, a South Carolina corporation, and the defendant, a corporation of the country of Surinam, which contract was presently the subject of a lawsuit by the defendant in the courts of Surinam. Under the plaintiff's contract with the defendant, the plaintiff was to serve as exclusive selling agent for the defendant's products in South Carolina; but there was no showing that any order was ever filled by the defendant. The court noted further that under the terms of the contract the entire performance of the contract was to take place substantially in the country of Surinam. The court concluded that upon these facts the requisite minimum contacts to warrant jurisdiction were lacking.

It is important to emphasize that the contract which was the basis of the cause of action was essentially unconnected with the activities of the defendant in the state. Recognizing this, the court quoted *International Shoe* that:

[i]t has been generally recognized that the casual presence of the corporation agent or even his conduct of single or

26. 342 F.2d 546 (4th Cir. 1965).

27. "[S]ervice may be made by leaving a copy of the paper in the hands of the Secretary of State. . . ."

28. MD. CODE ANN. art. 23, § 96(d) (1957). "[S]uch 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. . . ."

29. 259 F. Supp. 206 (D.S.C. 1966).

isolated items of activities in a state in the corporation's behalf are not enough to subject it to suit on causes of action unconnected with the activities there.<sup>30</sup>

The Supreme Court in *Perkins v. Bequet Consolidated Mining Co.*<sup>31</sup> has subsequently held that under appropriate circumstances due process of law under the fourteenth amendment would not be violated by courts either taking or refusing jurisdiction of a foreign corporation in a cause of action *not arising* out of the corporation's activities within the state. With this broadening concept of "minimum contact," a slight increase of the defendant's activities within the state could have subjected it to our service of process statutes.

An interesting question can be raised regarding defendants activities within the state. Query: If a third party had exercised substituted service or service upon the exclusive selling agent, in an attempt to bring an action against the foreign corporation *relating to* the activities within the state, would the court find the requisite "minimum contacts?" Based upon the broadening concept of "minimum contacts" as previously mentioned, our courts might well accept this service as valid.

In *State v. Guy Mobile Home Corp.*<sup>32</sup> the state sought to recover a statutory penalty<sup>33</sup> from a foreign corporation for delay in filing the declaration designating the place it could be served with legal process.<sup>34</sup> The circuit court assessed the penalty at the rate of ten dollars per day, for the full period of 121 days during which the defendant did business in the state. On appeal by the corporation, the South Carolina Supreme Court *held* that where the corporation filed the declaration 121 days after it began to do business in the state, and the statute required that the declaration be filed within 60 days, the corporation should not have been assessed the statutory penalty of ten dollars a day for 121 days, but ten dollars per day for only sixty-one days.

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30. *Id.* at 209 quoting from *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

31. 342 U.S. 437 (1952).

32. 248 S.C. 386, 149 S.E.2d 913 (1966).

33. S.C. CODE ANN. § 12-737 (1962).

34. S.C. CODE ANN. § 12-721 (1962).

## III. "PIERCING THE CORPORATE VEIL"

*McCullough v. Urquhart*<sup>35</sup> and *Long v. McGlon*<sup>36</sup> can be discussed together because both examine the corporate structure or entity. In *McCullough*, vendors had contracted to sell land subject to restrictive covenants. Before conveyance the vendors incorporated but neglected to convey to the new corporation this land which was under a contract of sale to the plaintiffs. The corporation later recognized this error and issued a deed which was accepted by the vendees. The vendees then brought an action to have the title confirmed in them and to have the land declared free from restrictive covenants. They took the position that since the defendant corporation did not have title of record to the lots in question when the corporation conveyed them, such deed was void and could not operate to restrict the three lots. The court recognized that the corporation did not hold the record title, but that the stockholders who were the original vendors prior to incorporation, did. The court looked behind the corporate structure and held that the corporation was actually the stockholders acting to convey the land. Because the stockholders owned the corporation the land could be legally conveyed by it; and it was immaterial that the stockholders believed that they had previously conveyed the land to the corporation. Perhaps another way to view the transaction was that the corporation acted as the agent of the stockholders and was given the authority to convey this land.

The court concluded, upon good authority, that the plaintiffs were estopped to question the title of the defendants.<sup>37</sup>

*Long v. McGlon*<sup>38</sup> presented a question of novel impression to the federal district court. This was an action by a trustee of a bankrupt corporation against all the shareholders thereof, who were also the directors and officers, to hold them personally liable for the debts of the corporation. The defendant moved to dismiss the action on the grounds that the complaint failed to state a claim against the defendants for which relief could be granted. The rationale was that the complaint did not suffi-

35. 248 S.C. 328, 149 S.E.2d 909 (1966).

36. 263 F. Supp. 96 (D.S.C. 1967).

37. See, e.g., *Cruger v. Daniel*, 1 McMul. Eq. 153, 193 (S.C. 1841). "All parties and privies are bound by an estoppel . . . so a party accepting a conveyance is estopped to deny his grantor's title."

38. 263 F. Supp. 96 (D.S.C. 1967). Following a denial of the motion to dismiss, defendant defaulted in the action and judgment was entered for the plaintiff.

ciently allege facts which would support an action by the trustee for conversion of corporate funds; and that, while a creditor might pierce the corporate veil, a trustee could not. This second proposition presented the novel question.

The defendant based the second theory on the reasoning that the existence of the trustee affirmed the existence of the corporation. Having the trustee pierce the corporate structure would be a contradiction in terms. Moreover, a hardship would be worked on the creditors who were claiming against the corporation if their claims were shifted against individual shareholders. Although the court found no precedent which allowed a trustee to pierce the corporate veil, the court upset the corporate immunity on pure common sense and the logical objectives of liability.

First, in sections of the Bankruptcy Act<sup>39</sup> it is generally accepted that a trustee in bankruptcy represents all persons interested in the estate. Since the entire corporate stock was actually held by two stockholders, no prejudice to corporate creditors was caused by seeking to hold these individual shareholders. Moreover, does piercing the veil mean that the corporation does not exist or that it will be disregarded in this instance? Without answering this question specifically, the court reasoned: if the trustee exists, as claimed by the defendants, only as long as the corporation exists, the same might be said of corporate creditors. Now that these creditors have the standing to pierce the corporate veil it follows logically that the trustee should have the same power.

Finally, the court looked to provisions in the Bankruptcy Act,<sup>40</sup> giving the trustee the equivalent general powers of the creditors. From these provisions the court extracted the general principle of allowing the trustee to pursue all funds possibly available to pay creditors. Here the court is saying that not only can the trustee "pierce the corporate veil," but that in appropriate circumstances a trustee can pursue funds in bankruptcy wherever they exist. One final query: with a creditor suit and trustee suit against the shareholders of a nominal corporation, which would take precedence? This case indicates the general supremacy of the trustee.

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39. See generally, Notes, 11 U.S.C.A. § 110 1251-1330 (Supp. 1966).

40. 11 U.S.C.A. § 110 (c) (Supp. 1966).