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Corporate and Business Law

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CORPORATE AND BUSINESS LAW

Segall v. Shore[1] was an *intra familia* battle over the businesses left by the late Max Shore. The action was brought by the decedent's daughter, Jean Segall, and her two children as beneficiaries under the will of Max Shore. The complaint charged two of the decedent's sons, Reuben and Sidney Shore, and an accountant of the Shore businesses, Morris Root, with mismanaging the operation of the three businesses following Max Shore's death in 1971.[2] Also, Jean Segall, as an executor and trustee under the will of Max Segall, sued the same three individuals for breach of their duties as executors and trustees under the will of Max Shore.

At the time of his death, Max Shore held an interest in three business concerns:

1) all of the common stock in MacShore Classics, Inc. (Classics);
2) 25% of the common stock of the Shore Company, Inc. (Shore Company); and
3) a one-third interest in the partnership Carolina Blouse Company (Carolina Blouse).[3]

All three businesses were involved in one single activity, the production of goods for the Lady Arrow Division of Cluett Peabody and Co., Inc. (Lady Arrow). The Shore Company held title to two production plants; Classics purchased raw materials, subcontracted the work and sold the finished goods to Lady Arrow; and Carolina Blouse subcontracted the work from Classics.

The relationship with Lady Arrow began in 1969 when the defendant Reuben Shore solicited business from Lady Arrow for Carolina Blouse. From November 1970, until the death of Max Shore, the sales to Lady Arrow were channeled through Classics, apparently to take the tax advantage of earlier carry-forward losses by Classics. Carolina Blouse was not adequately compensated for its production costs by Classics; instead Classics made loans to Carolina Blouse to cover the latter's uncompensated

1. 264 S.C. 442, 215 S.E.2d 895 (1975).

2. Two of the family businesses were closely-held corporations, MacShore Classics, Inc. and the Shore Co., Inc. These corporations were named as defendants along with the third family business, Carolina Blouse Co., a partnership.

3. 264 S.C. at 446, 215 S.E.2d at 898. Ownership of preferred stock in Classics will be discussed *infra*. Max Shore was an equal partner with his two adult sons in Carolina Blouse.

costs. Prior to his death, Max Shore "totally dominated" the financial affairs of the three businesses.

The action against the individual defendants charged that, following the death of Max Shore, they had (1) failed to dissolve the partnership Carolina Blouse and failed to render an accounting to the estate of the deceased partner; (2) used their position[4] to appropriate corporate assets from Classics for their own beneficial use in the undissolved Carolina Blouse; and (3) used their position to occupy property of Shore Company without paying a fair rental value. For these activities, the plaintiffs sought an accounting of all business activities by the defendants after January 1, 1972, and a court-ordered dissolution of the two close corporations or, in the alternative, that the individual or corporate defendants be ordered to purchase at fair market value all of the plaintiffs' interest in the three businesses. In addition, the plaintiffs urged that the redeemable preferred shares of Classic held by them be redeemed by that corporation.[4.1]

The case was tried in the Court of Common Pleas of Greenville County, which entered judgment favorable to the plaintiffs following a reference to the Master in Equity. In a *per curiam* decision, the South Carolina Supreme Court adopted the decree of the trial court and ordered it reported.[5] Because the lower court decree issued by Judge Singletary cited no authorities, the discussion herein will refer to South Carolina cases and statutes as well as other relevant authorities with the aim of aiding the practitioner in applying this precedent. In ordering the individual defendants to render an accounting to the plaintiffs and the nominal defendant corporations, the court held the defendants to standards imposed under the Uniform Partnership Act,[6] the South

4. Reuben and Sidney Shore were equal partners in Carolina Blouse with Max Shore. In addition, they were officers and directors in both of the closely-held corporations. Morris Root was accountant for all three of the business concerns.

4.1 In addition, the plaintiff Jean Segall sought a declaration that she was the owner of mutual fund certificates formerly owned by Max Shore. The court found that a parol trust had been created by Max Shore and that beneficial ownership of the certificates had passed to Jean Segall prior to Max Shore's death. Also, the court enforced an April 19, 1972 agreement setting forth the manner in which the proceeds of these certificates were to be distributed. 264 S.C. at 452-53, 215 S.E.2d at 901.

5. At the beginning of the opinion's discussion of the law, Judge Singletary singled out the individual defendants and chastised them for failing to adhere to the "high standard of candor and trust" imposed upon executors of a decedent's will. 264 S.C. at 448, 215 S.E.2d at 899.

6. S.C. CODE ANN. §§ 52-1 to -79 (1962).

Carolina Business Corporation Act,[7] and South Carolina case law.

Upon the death of a partner, a partnership is dissolved[8] and the legal representative of the deceased partner is entitled to an accounting of the decedent's share.[9] Dissolution of the partnership destroys the partnership powers except those exercised for the purpose of winding up.[10] In failing both to dissolve Carolina Blouse upon the death of Max Shore and to render an accounting to the estate of their father, Reuben and Sidney Shore violated these provisions of the South Carolina law. Since partners are fiduciaries to one another or to the legal representative of a deceased partner,[11] the legal theory of constructive thrust operates to make the defendant sons liable to their father's estate for his interest valued at the time of his death. In addition, any income earned by the sons' wrongful use of the assets is also recoverable by the estate.[12] As part of the accounting of the partnership assets, the supreme court remanded the case to the Master for a determination of whether the debts of Carolina Blouse to Classics were intended to be enforceable or were created only for tax purposes.[13]

In addition to holding the individual defendants liable for breach of fiduciary duties owned to the partnership,[14] the court held Reuben and Sidney Shore liable for breach of duties owed

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7. S.C. CODE ANN. §§12-11.1 to -24.9 (Cum. Supp. 1975).

8. S.C. CODE ANN. § 52-63(4) (1962).

9. S.C. CODE ANN. § 52-79 (1962).

10. S.C. CODE ANN. §§ 52-65, 52-72 (1962).

11. S.C. CODE ANN. § 52-44 (1962).

12. 264 S.C. at 450, 215 S.E.2d at 900. The court did not use the term "constructive trust." South Carolina law had earlier held a partner liable to a deceased partner's estate for profits arising out of a breach of trust. Manship v. Newton, 94 S.C. 260, 77 S.E. 941 (1913). In addition, § 4(3) of the UNIFORM PARTNERSHIP ACT (S.C. CODE ANN. §§ 52-4(3), 52-5 (1962)) states that the law of agency applies under that act. § 407(1) of the RESTATEMENT (SECOND) OF AGENCY (1957) states:

> If an agent has received a benefit as a result of violating his duty of loyalty, the principal is entitled to recover from him what he has so received, its value, or its proceeds, and also the amount of damages thereby caused; except that, if the violation consists of the wrongful disposal of the principal's property, the principal cannot recover its value and also what the agent received in exchange therefor.

See generally Rizzo v. Rizzo, 3 Ill.2d 291, 120 N.E.2d 546 (1954); Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545 (1928). The latter case contains Judge Cardozo's classic standard for fiduciary conduct.

13. 264 S.C. at 450-51, 215 S.E.2d at 900.

14. The court did not discuss the breach of duty by the accountant of the three businesses, Morris Root. Presumably, he acquiesced to or aided Reuben and Morris Shore in their breaches.

by them as officers and directors to the two corporations. Under South Carolina law, officers and directors owe a duty of reasonable care to their corporations and the shareholders thereof.[15]

The court found that the defendants had breached this duty owed to Classics by appropriating for their own use the Lady Arrow relationship, a business opportunity belonging to Classics. In holding Reuben and Sidney Shore accountable to Classics for appropriation of the Lady Arrow opportunity and the resulting profits,[16] the court followed the established remedy for a fiduciary's self-enrichment at the corporation's expense:

> As a corporate official breaches a fiduciary duty to the corporation if he appropriates for himself an opportunity rightfully belonging to it, the corporation becomes entitled to all benefits he receives from utilization of such an opportunity. A court's usual approach is to impose a constructive trust on property the disloyal official acquires in usurping the opportunity and to require him to transfer ownership of the property to the corporation. The court will also compel him to account to the corporation for any profits which the usurpation has produced.[17]

The court likewise applied the same principle in holding the defendants accountable to Classics for damages and profits arising from uncompensated use of the corporation's equipment.[18]

The court also found that the defendants, operating through

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15. S.C. CODE ANN. § 12-18.15 (Cum. Supp. 1975) provides:

> The directors and officers of a corporation shall exercise their powers and discharge their duties in good faith with a view to the interests of the corporation and of the shareholders and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions.

See also Folk, *The Model Act and the South Carolina Corporation Law*, 15 S.C.L. REV. 275, 303 (1963) and Folk, *The South Carolina Corporation Law: Reconsiderations and Prospects*, 15 S.C.L. REV. 467, 479 (1963).

16. 264 S.C. at 449-50, 215 S.E.2d at 899-900.

17. F. O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS § 3.17 (1975) (footnote omitted). *See also* Pearlman v. Feldman, 219 F.2d 173 (2d Cir. 1955); 3 W. FLETCHER, CYCLOPEDIA OF CORPORATIONS § 861.1 (1965 ed.). In Guth v. Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503 (1939) the court held:

> The rule, inveterate and uncompromising in its rigidity, does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of confidence imposed by the fiduciary relation.

Id. at 270, 5 A.2d at 510.

18. 264 S.C. at 449-50; 215 S.E.2d at 899-900. *See also* F. O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS § 3.16 (1975).

the undissolved Carolina Blouse, had paid inadequate rent for a plant owned by the Shore Company but occupied by the defendants. The defendants had been paying $60,000 annual rent, but the court found that the fair market rental value for the plant, occupied wholly by defendants, was approximately treble that amount.[19] Although the court does not discuss the point, the burden apparently rested on the defendants to show "the fairness of the transaction," since neither the Shore Company board nor its shareholders approved the rental agreement.[20]

As a form of prospective relief, the plaintiffs urged the court either to dissolve the two corporations, or to force the corporations or the other shareholders thereof to purchase the shares held by the plaintiffs. Such relief is obtainable under the South Carolina Business Corporation Act of 1962.[21] The court ordered the case remanded for hearings as to what the proper relief would be under these facts.[22] At least one writer has noted that fiduciary misconduct such as discussed above may properly form the basis for court-ordered dissolution of a corporation.[23]

Prior to his death, Max Shore made a gift of $54,000 of Classics preferred stock each to Jean Segall, her children, and the families of Reuben and Sidney Shore. Beginning in June 6, 1971, some of these shares in the hands of family members of Reuben and Sidney Shore were redeemed.[24] In April 19, 1972, it was agreed by the parties that the shares in the hands of Jean Segall and her children would be redeemed. This redemption, however, never occurred and was opposed by the defendants in this action. Nonetheless, the court held that equity would allow redemption of the preferred shares held by Jean Segall and her children.[25]

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19. 264 S.C. at 454-55, 215 S.E.2d at 902.

20. S.C. CODE ANN. § 12-18.16 (Cum. Supp. 1975). *Also*, Folk, *The Model Act and the South Carolina Corporation Law*, 15 S.C.L. REV. 275, 303-05 (1963); Folk, *The South Carolina Corporation Law: Reconsiderations and Prospects*, 15 S.C.L. REV. 467, 479-81 (1963); Freeman, *Directors and Officers*, 15 S.C.L. REV. 396, 408-09 (1963).

21. S.C. CODE ANN. § 12-22.15 (Cum. Supp. 1975) sets forth the grounds for court-ordered dissolution. The grounds set forth in § 12-22.15(a)(4) and 12-22.15(a)(5) apparently would be apposite here. *See*, Folk, *The South Carolina Corporation Law: Reconsiderations and Prospects*, 15 S.C.L. REV. 467, 487-89 (1963); Smythe, *Dissolution of Corporations*, 15 S.C.L. REV. 435, 439-43 (1963). S.C. CODE ANN. § 12-22.23 (Cum. Supp. 1975) provides for alternate relief to dissolution, including court-ordered purchase of dissenters' shares.

22. 264 S.C. at 455, 215 S.E.2d at 902.

23. F. O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS §§ 3.15, 3.16, 3.17 (1975).

24. Most of the shares were redeemed in 1971 prior to Max Shore's death; $36,000 worth of the shares were redeemed following the founder's death.

25. 264 S.C. at 451-52, 215 S.E.2d at 900-01.

This holding is consistent with section 5-18 of the South Carolina Business Corporation Act,[26] which authorizes the issuance of redeemable shares. Although the statute prohibits issuance or redemption of shares "which by their terms purport to grant to any holder thereof the right to require the corporation to redeem such shares,"[27] the relief sought by the plaintiffs is not prohibited. The plaintiffs were not demanding redemption under any grant given by the preferred shares, but rather sought only to be treated equally with other preferred shareholders once the decision to redeem had been made.[28]

This case[29] highlights the problems that can arise from inadequate estate and business planning. Many problems of the type that arose here can be avoided by proper estate planning, proper choice of business organization, and careful drafting of partnership agreements and corporate charters. By use of such planning, a business founder and his attorney can provide for the painless transfer of family business property to succeeding generations without wasting business assets on the kind of avoidable litigation found in this case.

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26. S.C. CODE ANN. § 12-15.18 (Cum. Supp. 1975).

27. S.C. CODE ANN. § 12-15.18(b) (Cum. Supp. 1975).

28. The first redemption of preferred shares followed a resolution of Classics' Board of Directors approving the redemption. 264 S.C. at 451, 215 S.E.2d at 901. Presumably the articles of incorporation of Classics authorized redemption so as to satisfy the Business Corporation Act. S.C. CODE ANN. § 12-15.18(a) (Cum. Supp. 1975).

29. In addition to the issues discussed *supra*, the court ruled that the facts supported a finding that mutual funds purchased by the decedent were intended for Jean Segall and that the proceeds were to be distributed to her and Max Shore's grandchildren under an agreement signed by the defendants.