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I. EFFECT OF FRAUDULENT INSURANCE CLAIM LIMITED

In *Johnson v. South State Insurance Co.*[1] the South Carolina Supreme Court held that the insured's fraudulent claim for loss of unscheduled personal property (household contents) defeated recovery for only the unscheduled personal property. The court ruled that the provisions of the policy were severable and, therefore, the fraud did not preclude recovery for loss of dwelling and additional living expenses.[2] The *Johnson* holding places South Carolina among a minority of jurisdictions that allow an insured who has submitted a knowingly false claim to recover for any part of the loss insured under a single policy.[3]

1. 288 S.C. 239, 341 S.E.2d 793 (1986).

2. *Id.*

3. "The general rule seems to be that fraud, attempted fraud, or false swearing as to any part of the property included in a proof of loss prevents recovery for any portion thereof." 5A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 3595 (1970). *See generally* 44 AM. JUR. 2D *Insurance* § 1341 (1975); R. KEETON, INSURANCE LAW §§ 6.5(c) & 7.2(b) (1971); 45 C.J.S. *Insurance* § 1021 (1946). For jurisdictions following the majority position, see Smith v. Insurance Co. of N. Am., 213 F. Supp. 675 (D. Tenn. 1963), *aff'd in part, rev'd in part on other grounds sub nom.* Trice v. Commercial Union Assur. Co., 334 F.2d 673 (6th Cir. 1964), *cert. denied*, 380 U.S. 915 (1965); Oshkosh Packing & Provision Co. v. Mercantile Ins. Co., 31 F. 200 (E.D. Wis. 1887); Home Ins. Co. v. Hardin, 528 S.W.2d 723 (Ky. 1975); Hall v. Western Underwriters' Ass'n, 106 Mo. App. 476, 81 S.W. 227 (1904); Moreau v. Palatine Ins. Co., 84 N.H. 422, 151 A. 817 (1930); Sunbright Fashions, Inc. v. Greater N.Y. Mut. Ins. Co., 34 A.D.2d 235, 310 N.Y.S.2d 760 (1970); Saks & Co. v. Continental Ins. Co., 23 N.Y.2d 161, 242 N.E.2d 833, 295 N.Y.S.2d 668 (1968); Happy Hank Auction Co. v. American Eagle Fire Ins. Co., 286 A.D. 505, 145 N.Y.S.2d 206 (1955), *modified*, 1 N.Y.2d 534, 136 N.E.2d 842, 154 N.Y.S.2d 870 (1956); Henricksen

Johnson sued South State to recover benefits under a homeowner's policy which provided fire coverage of $15,000 on the dwelling, $7,500 on unscheduled personal property, and $3,000 for additional living expenses. South State denied liability on the ground that Johnson filed a fraudulent claim for the unscheduled personal property. The jury, however, awarded Johnson $15,500 for the loss of dwelling and additional living expenses pursuant to instructions from the trial judge that the policy was severable and that the fraud need not defeat the entire recovery.[4]

The court of appeals reversed the trial court's judgment and ruled that under the terms of the insurance contract, Johnson's act of submitting a fraudulent claim for the household contents invalidated the entire policy and precluded all recovery under the policy.[5] The South Carolina Supreme Court disagreed with the court of appeals and followed the earlier federal district court interpretation of South Carolina insurance law in *Kerr v. State Farm Fire & Casualty Co.*[6] Both *Kerr* and *Johnson* establish the rule that when an insurance policy covers separately valued items, the policy is divisible, and a fraudulent claim operates to void only the provision directly tainted by the fraud.[7]

The opposing conclusions reached by the court of appeals and by the supreme court follow divergent lines of reasoning which include contrary readings of South Carolina precedent and different views regarding the most salient public policy implications. The court of appeals' decision was grounded on an examination of the insurance contract between Johnson and South State. The South State policy contained a fraud clause common to most fire insurance policies. The fraud clause expressly provided that the "entire policy" would be void if, after a loss, the insured was guilty of fraud or false swearing concern-

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v. Home Ins. Co., 237 Or. 539, 392 P.2d 324 (1964); Home Ins. Co. v. Connelly, 104 Tenn. 93, 56 S.W. 828 (1900); Moore v. Virginia Fire & Marine Ins. Co., 69 Va. (28 Gratt.) 508 (1877); Mosie v. Automobile Ins. Co., 105 W. Va. 226, 141 S.E. 871 (1928); Worachek v. New Denmark Mut. Home Fire Ins. Co., 102 Wis. 88, 78 N.W. 411 (1899).

4. Johnson v. South State Ins. Co., 286 S.C. 235, 236, 332 S.E.2d 778, 778 (Ct. App. 1985).

5. *Id.* at 237, 332 S.E.2d at 779.

6. 552 F. Supp. 992 (D.S.C. 1982), *aff'd in part, rev'd in part on other grounds*, 731 F.2d 227 (4th Cir. 1984).

7. *Id.* at 993; 288 S.C. at 241, 341 S.E.2d at 794.

ing the subject of the insurance.[8] Since under South Carolina law any contract—including an insurance contract—is to be "understood in its plain, ordinary and popular sense,"[9] the court reasoned that the contract should be construed and enforced according to its terms.[10] The court of appeals further justified its decision to preclude all recovery due to a fraudulent claim of loss by the insured as consonant with the established policy of promoting honesty, good faith, and fair dealing between the parties to an insurance contract.[11]

The supreme court's decision was based on the court's analysis of a line of South Carolina cases involving breach of conditions to insurance policy coverage. The court cited *Trakas v. Globe & Rutgers Fire Insurance Co.*[12] for the well-established rule that "forfeitures of insurance contracts are not favored."[13] *Trakas* also supports the proposition that when a policy could

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8. The policy issued to Johnson contained the following language:

> This entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.

286 S.C. at 236, 322 S.E.2d at 778-79. An innocent overestimation or mistake will not establish fraud. To balance the harshness of the rule, courts have placed a heavy burden on the insurer to establish that the false statements are of material facts and were willfully and knowingly made with the intention of defrauding the insurer. Nabors v. South Carolina Farm Bureau Mut. Ins. Co., 273 S.C. 126, 129, 255 S.E.2d 337, 338 (1979); Mulkey v. United States Fidelity & Guar. Co., 243 S.C. 121, 126, 132 S.E.2d 278, 281 (1963). *See generally* Annotation, *Overvaluation in Proof of Loss of Property Insured as Fraud Avoiding Fire Insurance Policy*, 16 A.L.R.3D 774 (1967).

9. 286 S.C. at 237, 332 S.E.2d at 779 (citing Carroway v. Johnson, 245 S.C. 200, 139 S.E.2d 908 (1965)); *see also* Gambrell v. Travelers Ins. Co., 280 S.C. 69, 310 S.E.2d 814 (1983); General Ins. Co. of Am. v. Palmetto Bank, 268 S.C. 355, 233 S.E.2d 699 (1977); Helton v. St. Paul Fire & Marine Ins. Co., 286 S.C. 220, 332 S.E.2d 776 (Ct. App. 1985); Jenkins v. Southern Home Ins. Co., 284 S.C. 320, 326 S.E.2d 176 (Ct. App. 1985).

10. 286 S.C. at 237, 332 S.E.2d at 779.

11. *Id.* at 238, 332 S.E.2d at 779; *see* Chaachou v. American Cent. Ins. Co., 241 F.2d 889 (5th Cir. 1957). *Cf.* Nichols v. State Farm Mut. Auto. Ins. Co., 279 S.C. 336, 306 S.E.2d 616 (1983); Brown v. South Carolina Ins. Co., 284 S.C. 47, 324 S.E.2d 641 (1984)(insurers held to covenant of good faith and fair dealing). A further deterrent is provided by the statute which makes presentation of a knowingly false claim to an insurance company a misdemeanor punishable by a fine, imprisonment, or both. S.C. CODE ANN. § 38-9-310 (Law. Co-op. Supp. 1986).

12. 141 S.C. 64, 139 S.E. 176 (1927)(insurer's violation of provision limiting additional insurance on fixtures precluded recovery on fixtures, but did not preclude recovery on merchandise covered by the policy).

13. 288 S.C. at 241, 341 S.E.2d at 794.

have been issued in two divisible parts, the policy is severable, and breach of a condition going to one part results in forfeiture of that part only.[14]

On facts similar to those in *Johnson*, the federal district court in *Kerr* interpreted South Carolina insurance law as requiring that a fraudulent claim for the contents of a home operated to cancel only that part of the policy to which the fraud directly applied.[15] The *Kerr* holding follows the *Reynolds-McGee* rule which stipulates that to void a provision of an insurance policy, the breach of condition must be causative.[16] For example, the supreme court recently applied the *Reynolds-McGee* rule in *South Carolina Insurance Co. v. Collins*.[17] The court held that since there was no causal connection between an airplane crash and the failure of the insured pilot to have a valid medical certificate as required by the policy, the estate of the insured would not be denied recovery.[18]

The issue not addressed by the *Kerr-Johnson* rationale is whether the causative condition analogy applies when the insured has knowingly and willfully submitted a false claim with the intent to defraud the insurer. The court of appeals' position, that the causal connection analysis is not applicable, is supported by prior cases that restate the *Trakas* rule to exclude specifically the divisibility of policy provisions in situations of fraud or false swearing by the insured.[19] In *Evans v. Century*

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14. *Id.* "[W]here the property insured consists of different items which are separately valued or insured for separate amounts, the contract is divisible, and a breach of warranty or condition as to one item will not affect the insurance on the remainder of the property, even though the premium be entire." 141 S.C. at 69, 139 S.E. at 177.

15. 552 F. Supp. 992 (D.S.C. 1982), *aff'd in part, rev'd in part on other grounds*, 731 F.2d 227 (4th Cir. 1984).

16. *See* McGee v. Globe Indem. Co., 173 S.C. 380, 175 S.E. 849 (1934)(where there was no causal connection between the policy exclusion of coverage based on the age of the driver and the collision, the provision of the policy excluding coverage of an unlawful driver did not void the insurer's liability); Reynolds v. Life & Casualty Ins. Co., 161 S.C. 214, 164 S.E. 602 (1932) (since the insured's injuries were not proximately caused by riding on the running board in violation of a city ordinance, the breach of the policy provision excluding liability for loss sustained while committing an act in violation of the law was held not to deny recovery).

17. 269 S.C. 282, 237 S.E.2d 358 (1977).

18. *Id.*

19. *See, e.g.*, Johnson v. South State Ins. Co., 286 S.C. 235, 238, 332 S.E.2d 778, 780 (Ct. App. 1985).

Insurance Co.[20] the *Trakas* rule was restated to read as follows: "[T]he rule established by the great weight of decisions is that in the *absence of fraud* or any act condemned by public policy, the contract is divisible . . . ."[21] Stated conversely, when fraud by the insured is present, the policy is not divisible. This position seems to be favored in both *Nabors v. South Carolina Farm Bureau*[22] and *Mulkey v. United States Fidelity & Guaranty Co.*[23] Since *Evans* did not involve fraud, and fraud was not established in *Nabors* and *Mulkey*, the *Kerr* opinion dismissed as dicta the language recognizing the fraud exception to policy divisibility.[24] In *Johnson* the supreme court expressly overruled *Evans*, *Nabors*, and *Mulkey*.[25]

Comparison of the court of appeals' opinion with the supreme court's opinion raises the additional issue of whether the contract clause which stipulated that a fraudulent claim would void the "entire policy" should be enforced. The court of appeals, in accord with the majority of jurisdictions, decided that the fraud clause should be enforced to preclude all recovery under the contract.[26] Since the supreme court failed to address the contract issue, it is not clear how the court justified not enforcing the contract according to its terms. *Johnson* does make clear, however, that if a policy covers separately valued items, the policy will be construed as divisible, and standard contract language prohibiting fraud by the insured will not be enforced to deny total recovery.

South Carolina insurance law mandates that when a policy is ambiguous or capable of two reasonable interpretations, the policy must be construed to permit recovery by the insured.[27] Perhaps the supreme court used the separate valuation of the

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20. 201 S.C. 273, 22 S.E.2d 877 (1942).

21. *Id.* at 280, 22 S.E.2d at 880 (emphasis added).

22. 273 S.C. 126, 255 S.E.2d 337 (1979).

23. 243 S.C. 121, 132 S.E.2d 278 (1963).

24. 552 F. Supp. at 994 (D.S.C. 1982), *aff'd in part, rev'd in part on other grounds*, 731 F.2d 227 (4th Cir. 1984).

25. 288 S.C. at 241, 341 S.E.2d at 794.

26. *See* sources and cases cited *supra* note 3.

27. *See* Gaskins v. Blue Cross-Blue Shield, 271 S.C. 101, 245 S.E.2d 598 (1978); Emmanuel Baptist Church v. Southern Mut. Church Ins. Co., 259 S.C. 223, 191 S.E.2d 255 (1972); Hann v. Carolina Casualty Ins. Co., 252 S.C. 518, 167 S.E.2d 420 (1969). *But see* Deese v. American Bankers Life Assur. Co., 264 S.C. 160, 208 S.E.2d 736 (1974); Long v. Adams, 280 S.C. 401, 312 S.E.2d 262 (Ct. App. 1984).

personal property, the dwelling, and the additional living expenses as reasons to construe the policy as severable. By construing the policy as severable, the court prevented voiding the "entire policy," which seems to be required by the language of the fraud clause in the contract. Practitioners should note, however, that the *Johnson* decision did not address a potential recovery for items within the personal property valuation which were actually destroyed. The decision probably should be read as permitting recovery only for items both separately valued and not within the valuation category directly connected to the fraudulent claim.

Perhaps the most compelling justification for the *Johnson* ruling is the well-established public policy theme in South Carolina insurance law that forfeitures are to be avoided.[28] Though this policy was not articulated by the court, forfeiture of the entire recovery for the loss of both personal property and of dwelling would place an extreme hardship on an insured. The result of *Johnson* is that the insured, though guilty of submitting a fraudulent claim, will forfeit only that separately valued portion of the recovery directly tainted by the fraud. The insured will be protected from the harsher result of forfeiture of the entire coverage under the policy.

Janis Y. Dickman

II. Impact on Public Necessary to Invoke Unfair Trade Practices Act

In *Noack Enterprises, Inc. v. Country Corner Interiors of Hilton Head Island, Inc.*[29] the court of appeals held that fraudulent or unfair conduct must have an impact on the public interest to be actionable under the South Carolina Unfair Trade Practices Act (UTPA).[30] The court sustained a demurrer to Noack's UTPA cause of action alleging unfair practices in connection with the sale of a retail business to Noack.[31] Noack did not allege that the practices would have an impact on the pub-

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28. *See* cases cited *supra* notes 12, 13 and 27.

29. 290 S.C. 475, 351 S.E.2d 347 (Ct. App. 1986), *cert. granted*, No. 0828, Davis Adv. Sh. No. 18 (S.C. May 30, 1987).

30. S.C. Code Ann. §§ 39-5-10 to -430 (Law. Co-op. 1985).

31. 290 S.C. at 476, 478, 351 S.E.2d at 348, 350.

lic.[32] The court held that the UTPA was not enacted to redress purely private wrongs in business transactions not involving the public interest.[33]

The suit involved an agreement in which Country Corner agreed to sell all of its assets to Noack Enterprises. Noack later sued for breach of contract accompanied by fraudulent acts and with fraudulent intent, and for violation of the UTPA.[34] Country Corner demurred to the second count, claiming that it failed to state facts sufficient to constitute a cause of action under the UTPA.[35] The trial court sustained the demurrer and the court of appeals affirmed the trial court.[36]

The *Noack* court examined the wording of the statute to give effect to its underlying legislative intent. The statute deems as unlawful "unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce."[37] The statute defines "trade or commerce" to "include the advertising, offering for sale, sale or distribution of any services and any property, tangible or intangible, real, personal, or mixed, or any other article, commodity or thing of value wherever situate, *and shall include any trade or commerce directly or indirectly affecting the people of this State.*"[38] The court held that the "shall include" language limited the use of the UTPA cause of action to certain kinds of trade or commerce.[39] An act or practice which affects only the parties to a particular commercial transaction, therefore, does not of itself violate the UTPA.[40]

The UTPA has created a problem that was typified in *Noack*: the statute's broad provisions defining the cause of action and providing for treble damages for willful violations have tempted overanxious plaintiffs to raise dubious complaints of unfair trade practices.[41] The legislature intended the UTPA to

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32. *Id.* at 478, 479, 351 S.E.2d at 350, 351.
33. *Id.*
34. *Id.* at 476, 351 S.E.2d at 348.
35. *Id.*
36. *Id.*
37. S.C. CODE ANN. § 39-5-20(a) (Law. Co-op. 1985).
38. S.C. CODE ANN. § 39-5-10(b) (Law. Co-op. 1985) (emphasis added).
39. 290 S.C. at 477, 478, 351 S.E.2d at 349, 350.
40. *Id.*
41. The Honorable Alexander M. Sanders, Remarks to Students at the Court of Appeals' Term Held at the University of South Carolina School of Law (Spring 1987).

control and eliminate "the large scale use of unfair and deceptive trade practices within the state of South Carolina."[42] The statute is not a catch-all remedy for fraud, but is instead a consumer protection statute.[43] A provision of the statute makes clear that the legislature intended for the courts to be guided by existing interpretation of the Federal Trade Commission Act, which proscribes "[u]nfair methods of competition in commerce and unfair or deceptive acts or practices in commerce."[44] The scope of these "deceptive acts" is defined by the Procedures and Rules for the Federal Trade Commission: "The Commission acts only in the public interest and does not initiate investigation or take other action when the alleged violation of law is merely a matter of private controversy and does not tend adversely to affect the public."[45]

The *Noack* court suggested that one way for an injured plaintiff to show that the alleged wrong has or will have an adverse impact on the public interest is to show that the act or practice has the potential for repetition.[46] The purpose of the "potential for repetition" standard is to narrow the applicability of the UTPA cause of action to those commercial transactions that will involve, by their very nature, the public and, therefore, the public interest.[47]

The decision of the court of appeals in *Noack* is of considerable importance in narrowing the applicability of the South Carolina UTPA. Although the *Noack* court noted that other state unfair trade practice statutes are not identical to South Carolina's UTPA,[48] the decision comports with the decisions of other states with similar statutes.[49] Practitioners should follow devel-

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42. Note, *Consumer Protection and the Proposed "South Carolina Unfair Trade Practices Act,"* 22 S.C.L. REV. 767, 787 (1970); *see also* Day, *The South Carolina Unfair Trade Practices Act: Sleeping Giant or Illusive Panacea?*, 33 S.C.L. REV. 479 (1982).

43. *See* Note, *supra* note 42; Day, *supra* note 42.

44. 15 U.S.C. § 45 (1982).

45. 16 C.F.R. § 2.3 (1987); *accord* Genesco Entertainment v. Koch, 593 F. Supp. 743, 752 (S.D.N.Y. 1984); *see also* Federal Trade Comm'n v. Klesner, 280 U.S. 19, 25 (1929). *Cf.* Gross-Haentjens v. Leckenby, 38 Or. App. 313, 589 P.2d 1209 (1979) (consumer fraud statute providing private right of action for deceptive practices does not provide a new remedy for common-law torts).

46. 290 S.C. 479, 351 S.E.2d at 351 (citing Anhold v. Daniels, 94 Wash. 2d 40, 614 P.2d 184 (1980)).

47. *Id.*

48. 290 S.C. at 477, 351 S.E.2d at 349.

49. Evanston Motor Co. v. Southern Toyota Distribs., Inc., 436 F. Supp. 1370 (N.D.

opments in litigation to determine how the South Carolina courts will treat complaints which contain various allegations of potential repetition.

Charles R. Beans

III. UNIFORM SECURITIES ACT GOVERNS SALE OF TOTAL STOCK IN CLOSE CORPORATION

In *Carver v. Blanford*[50] the South Carolina Supreme Court held that the sale of 100% of the stock of a close corporation fell within the purview of the South Carolina Uniform Securities Act.[51] This holding, based largely upon two 1985 United States Supreme Court cases construing federal securities laws,[52] recognizes that South Carolina will give broad reading to the term "security." Confusing statements in *Carver*, however, leave unclear the extent to which the "sale of business" doctrine, abandoned by the United States Supreme Court,[53] is still viable in South Carolina.

The dispute in *Carver* arose out of the Blanfords' sale of all of the capital stock of a South Carolina corporation.[54] Carver, the purchaser, later brought suit alleging common-law fraud and violation of the South Carolina Uniform Securities Act. Carver based his claims upon alleged misrepresentations and omissions of material facts in connection with the transaction.[55] At trial

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Ill. 1977); Zeeman v. Black, 156 Ga. App. 82, 273 S.E.2d 910 (1980); Butterfield v. Butler, 50 Okla. 381, 150 P. 1078 (1915).

50. 288 S.C. 309, 342 S.E.2d 406 (1986).

51. *Id.* at 311, 342 S.E.2d at 407. The South Carolina Uniform Securities Act is codified in S.C. CODE ANN. §§ 35-1-10 to -1590 (Law. Co-op. 1987). By reviewing the transaction under the Act, the finder of fact may determine whether the seller is liable under § 35-1-1490 for selling a "security" by means of an omission or a misstatement of a material fact.

52. The two cases are Landreth Timber v. Landreth, 471 U.S. 681 (1985), and Gould v. Ruefenacht, 471 U.S. 701 (1985).

53. 471 U.S. 681; 471 U.S. 701.

54. Record at 1.

55. *Id.* In his first cause of action, brought under S.C. CODE ANN. § 35-1-1490 (Law. Co-op. 1987), Carver sought rescission of the purchase agreement, refund of $20,000 already paid plus interest, and attorneys' fees. In the second cause of action, alleging common-law fraud, Carver prayed for $95,000 in actual damages and $95,000 in punitive damages. While the complaint appears to have alleged fraud under S.C. CODE ANN. § 35-1-1210 (Law. Co-op. 1987), the court noted that the appellant admitted that no private right of action is created by that section. 288 S.C. at 311 n.2, 342 S.E.2d at 407 n.2; *see*

the judge found that the transaction did not fall within the scope of the Act and sustained the Blanfords' demurrer to both of Carver's causes of action.[56]

The supreme court noted that the demurrer to the securities claim was granted at trial because the sale of the corporation in question, although termed a stock-purchase agreement, was not a transaction governed by the South Carolina Uniform Securities Act.[57] The trial court had accepted the Blanfords' contention that the test formulated by the United States Supreme Court in *Securities Exchange Commission v. W.J. Howey Co.*[58] and *United Housing Foundation v. Forman*[59] excluded the sale of 100% of a corporation from within the ambit of securities regulation.[60] After trial and prior to argument before the South Carolina Supreme Court, however, the United States Supreme Court decided *Landreth Timber Co. v. Landreth*[61] and *Gould v. Ruefenacht.*[62] In *Landreth* and *Gould* the Supreme Court rejected the "sale of business" doctrine and held that when "the instrument involved is traditional stock, plainly within the statutory definition . . . [t]here is no need . . . to look beyond the characteristics of the instrument to determine whether the [federal securities] Acts apply."[63] The *Carver* court adopted the rea-

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Brief of Appellant at 3, 11-12. Whether a private cause of action exists under § 35-1-1210, which is analogous to 17 C.F.R. § 240.10b-5 (1987) (popularly known as Rule 10b-5 of the Federal Securities Exchange Act), remains unanswered and may give rise to litigation. The court summarily dismissed the second cause of action because the plaintiff failed to allege all of the essential elements of fraud. 288 S.C. at 311, 342 S.E.2d at 407.

56. Record at 24.

57. 288 S.C. at 310, 342 S.E.2d at 407.

58. 328 U.S. 293 (1946).

59. 421 U.S. 837 (1975).

60. The *Howey/Forman* test posits that the existence of a "security" under the Act requires "the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." 348 U.S. at 852. The sellers in *Carver* contended that the transaction was not within the protections of the Act because the sale to the plaintiff involved the entire business. According to the "sale of business" doctrine, purchase of all of the stock shows that the buyer does *not* expect "profits . . . from . . . efforts of others." *Id.*

61. 471 U.S. 681.

62. 471 U.S. 701. *Landreth* and *Gould* are important because South Carolina courts look to federal securities cases for guidance in interpreting state securities law. Bradley v. Hullander, 272 S.C. 6, 21, 249 S.E.2d 486, 494 (1978); McGaha v. Mosely, 283 S.C. 268, 273, 322 S.E.2d 461, 464 (Ct. App. 1984).

63. 471 U.S. at 690.

soning of the *Landreth/Gould* rule,[64] but also stated that the "sale of business" doctrine does apply "where control is *clearly* passed from seller to buyer."[65] The court, therefore, remanded the Securities Act claim for a determination of whether control passed from Blanford to Carver.[66]

Carver both clarifies and confuses South Carolina securities law. By adopting the *Landreth/Gould* rule the court aligned South Carolina with the Supreme Court's rejection of the "sale of business" doctrine when a transaction involves instruments labelled as stock and having the usual characteristics of stock.[67] The *Carver* court, however, created new questions about South Carolina law in this area by adding that the "sale of business" doctrine still applies to transactions in which control clearly passes from the seller to the purchaser.[68] The viability of the "sale of business" doctrine thus remains in question in South Carolina.[69]

D. Kay Tennyson

IV. JOINT CHECK RULE RECOGNIZED

The South Carolina Court of Appeals held in *Glidden Coatings & Resins v. Suitt Construction Co.*[70] that a materialman who requests that an owner or general contractor issue joint checks to him and a subcontractor, with no agreement as to the allocation of the proceeds, will be deemed to have been paid the

64. 288 S.C. at 310, 342 S.E.2d at 407.

65. *Id.* at 311, 342 S.E.2d at 407 (emphasis in original).

66. By remanding *Carver* for further fact-finding, the court implicitly recognized that the "sale of business" doctrine may still apply in certain cases.

67. In *Landreth* the United States Supreme Court abandoned the "sale of business" doctrine because it could lead to confusion and "arbitrary distinctions." 471 U.S. at 705.

68. The *Carver* case involved the sale of 100% of the stock of a company. If the court would not find that control had passed when the sale involves 100% of the stock, it is difficult to ascertain when, if ever, the "sale of business" doctrine would apply. Further, *Carver* may spawn additional litigation regarding the definition of the clear passage of control language. The *Carver* opinion offers no guidelines for determining the level of proof necessary to satisfy the clear passage of control requirement.

69. The only state case addressing the "sale of business" doctrine since the *Landreth* and *Gould* decisions clearly rejected it. *See* Specialized Tours, Inc. v. Hagen, 392 N.W.2d 520, 535 (Minn. 1986) (en banc). Consequently, no other jurisdictions offer guidance for future cases dealing with the "sale of business" doctrine in South Carolina.

70. 290 S.C. 241, 349 S.E.2d 89 (Ct. App. 1986).

money due him up to the amount of the checks that he endorses.[71] The decision relied on the principles set forth by the South Carolina Supreme Court in *City Lumber Co. v. National Surety Corp.*[72] and recognized that *City Lumber* established the "joint check rule."[73] The court of appeals' opinion serves as a stern reminder that a materials supplier who attains co-payee status with a subcontractor to ensure payment for materials furnished must be diligent in protecting his interests.

This controversy arose from a construction project for which Suitt was the general contractor, Arrow Painting and Sandblasting was the subcontractor, and Glidden was the paint supplier to Arrow. Because Arrow had failed to pay Glidden for certain materials furnished on previous projects, Glidden required Arrow to request that Suitt issue checks payable jointly to Glidden and Arrow until Arrow's account with Glidden was paid in full. Suitt refused to guarantee the issuance of joint checks or any payment to Glidden, but indicated that it would attempt to make the checks payable jointly. Suitt issued five joint checks, totalling $26,133.00 to Glidden and Arrow, and Glidden endorsed each of the checks, even though Glidden received none of the proceeds.[74] Arrow eventually abandoned the project, owing Glidden $19,300.26. At no time prior to Arrow's abandonment did Glidden notify Suitt that it had not received full payment for the materials furnished to Arrow. Because the account remained unsatisfied, Glidden brought suit to foreclose its mechanic's lien and to recover against Suitt's bond.[75]

The circuit court, on the authority of *City Lumber*, held that Suitt's obligation to pay Glidden was discharged by Glidden's endorsement of the joint checks.[76] In *City Lumber* the supplier of paint and the subcontractor requested that the general contractor make a payment on the general contractor's agreement with the subcontractor, which would allow the subcontractor to make payments to the supplier on past due labor and materials accounts. The contractor issued a $3,500 check

71. *Id.* at 244, 349 S.E.2d at 91.
72. 229 S.C. 115, 92 S.E.2d 128 (1956).
73. 290 S.C. at 244, 349 S.E.2d at 91.
74. *Id.* at 242, 349 S.E.2d at 90.
75. *Id.* at 243, 349 S.E.2d at 90.
76. *Id.*

payable jointly to the supplier and subcontractor without directing the division of the proceeds. With the supplier's permission, the subcontractor endorsed the check with the supplier's name; the subcontractor later issued its own check for only $500 to the supplier.[77]

The supreme court ruled in *City Lumber* that the general contractor and its surety were released from liability for the subcontractor's indebtedness to the supplier when the subcontractor abandoned the project.[78] The court reasoned that the supplier, by endorsing the check without collecting the amount due on its account, forfeited its claim on the performance bond.[79] This result followed from the two well-recognized rules of law that " 'when a creditor has in his hands the means of paying his debt out of the property of his principal debtor, and does not use it, but gives it up, the surety is discharged,' "[80] and that "where one of two innocent parties must suffer a loss, it must be borne by that one of them, who, by his conduct, has rendered the injury possible."[81] In the court's opinion, to allow recovery would have been unfair because the supplier had an opportunity to satisfy the debt and failed to protect itself by securing payment on its account before endorsing the check.[82]

The court of appeals viewed the *City Lumber* outcome as dispositive of Glidden's foreclosure claim.[83] Glidden requested joint checks specifically because Arrow had previously failed to make timely payments on its debts to Glidden. In the court's estimation, "[t]he case would be little different if Suitt, at Glidden's request, had paid Glidden directly by check for the paints and materials and Glidden had then endorsed the check to Arrow."[84] Under these circumstances the court deemed that Glidden had been paid up to the amount of the joint checks.[85]

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77. 229 S.C. at 117, 92 S.E.2d at 129.

78. *Id.* at 119, 92 S.E.2d at 130.

79. *Id.*

80. *Id.* at 120, 92 S.E.2d at 131 (quoting Commercial Nat'l Bank v. Henninger, 105 Pa. 496 (1884)).

81. *Id.* at 121, 92 S.E.2d at 131.

82. *Id.* at 119, 92 S.E.2d at 130.

83. 290 S.C. at 243, 349 S.E.2d at 90.

84. *Id.* at 245, 349 S.E.2d at 91.

85. Two of the five joint checks were issued before any money was due on Arrow's account with Glidden. The amount of these checks, $8,997.08, was therefore deducted from the total of $26,133.00. This left Suitt exposed to liability of $2,164.34 on the

The supreme court's decision in *City Lumber* required the result in *Glidden*. For application of the "joint check rule," the cases are virtually indistinguishable. While there was no agreement in either case about the disposition of proceeds, "the only reasonable inference warranted by the circumstances [was] that [the supplier] was made a co-payee to enable it to collect whatever amount might be owing to it."[86] The logical assumption of the contractor in either case should have been that the supplier was collecting on its account, and the contractor, therefore, should not have been responsible later to make payment of that account. If this had not been intended, there would have been no reason to issue the checks in both names.

Absent the request for co-payee status, however, the result in *Glidden* may not have been the same. If, for some reason, joint checks were issued without such a request, the general principles cited in the cases may still support an affirmative duty of the supplier to satisfy his debts out of the available funds.[87] The court in *Glidden*, however, chose not to discuss the broader implications of its decision that this scenario suggests. The court's focus on the specific request for joint checks and the carefully worded holding probably indicates that not only must the supplier fail to avail itself of the opportunity to satisfy its debts, but also it must have created that opportunity in the first place.

The court of appeals in *Glidden* used the foundations of the "joint check rule" established in *City Lumber* to formulate a specific rule of conduct for suppliers of materials. An owner or general contractor will not be liable to a supplier for a subcon-

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$19,300.26 owing on Arrow's account with Glidden.

86. 229 S.C. at 119, 92 S.E.2d at 130. This inference would arguably not be necessary in *Glidden* because Glidden requested the joint check for the specific purpose of enabling it to satisfy its account in full. 290 S.C. at 242, 349 S.E.2d at 90.

87. The court in *City Lumber* seemed to limit its holding in stating the following:

> The surety was equitably entitled to have the check applied to the discharge of the debts for which it was bound, but this was not done because of the negligence of [the supplier] in empowering [the subcontractor] to use the funds for any purpose which he desired. This is not a case of non-action on the part of the creditor, but positive and affirmative action injuriously affecting the surety.

229 S.C. at 120, 92 S.E.2d at 130. One writer has suggested that this language was a necessary corrollary to the principles relied upon in *City Lumber* and perhaps implicit in its holding. Karesh, *Security Transactions, Survey of South Carolina Law*, 9 S.C.L.Q. 134 (1956).

tractor's debt to the supplier for the amount of joint checks issued at the instance of the supplier for the very purpose of satisfying that debt. Practitioners should be diligent in advising clients to use the protective measure of joint checks to secure payment, especially if the checks are issued at the client's request.

David A. Savage

V. Time Limitation in Life Insurance Policy Upheld

In *Smith v. Independent Life & Accident Insurance Co.*[88] the South Carolina Supreme Court addressed the validity of an insurance policy clause which excluded coverage for a death occurring more than ninety days after the original injury. The time limitation was challenged as violative of public policy.[89] The supreme court, emphasizing freedom of contract and the problems related to proof of causation when death occurs long after an original injury, upheld the clause as valid and enforceable.[90]

Walter Smith was involved in an automobile accident on February 14, 1982. During his convalescence, he developed pneumonia and he died on August 6, 1982.[91] Ruth Smith, mother of the insured and beneficiary of Smith's accidental death policy, brought a claim under the policy for the $6,000 in proceeds.[92] The insurance company denied the claim because a clause in the policy excluded coverage for death occurring more than ninety days after the original injury. Ruth Smith then sued the insurer. At trial the presiding judge upheld the ninety day limitation in the policy and granted the insurance company's motion for summary judgment.[93] The sole issue on appeal was whether the ninety day provision violated public policy.

In upholding the provision, the South Carolina Supreme Court joined the majority of jurisdictions which have considered the validity of time limitation provisions in accident insurance

88. 289 S.C. 262, 346 S.E.2d 22 (1986).
89. Brief of Appellant at 7.
90. 289 S.C. at 262, 346 S.E.2d at 23.
91. Record at 23.
92. Record at 2.
93. Record at 23-26.

policies.[94] The court placed great emphasis on preserving freedom of contract. Other courts also have held that an insurance policy is a voluntary contract into which the parties freely enter, and, therefore, the unambiguous contract terms should bind both parties.[95] The supreme court further emphasized the many problems related to proof of causation when death occurs long after the original injury.[96] Several cases indicate that time limitation provisions minimize uncertainty about the cause of the insured's death, thus "enabling insurers to solve difficult questions of proximate cause."[97]

Perhaps the most compelling reason for the court's refusal to invalidate the time limitation was the court's reluctance to intervene in matters which are best left to the legislature and the South Carolina Insurance Department. The Insurance Department must approve all contracts for insurance in South Carolina before the policies can be written and issued. Assuming that the contract at issue in *Smith* was approved, the approval procedure provides strong evidence that the legislature does not believe the use of such limitation periods violates public policy.[98]

Only two jurisdictions have found similar time limitations to be against public policy, and two other jurisdictions have applied the "process of nature rule" rather than finding the provision to be violative of public policy.[99] Courts that have applied the "process of nature rule" have refused to enforce such clauses

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94. *See* Annotation, *Validity and Construction of Provision in Accident Insurance Policy Limiting Coverage for Death or Loss of Member to Death or Loss Occurring Within Specific Period After Accident*, 39 A.L.R.3D 1311 (1971); *see also* Bently v. Independent Life & Accident Ins. Co., 47 Ala. App. 15, 249 So. 2d 631 (1971); Haines v. Southern Life & Health Ins. Soc'y, 363 So. 2d 175 (Fla. Dist. Ct. App. 1978); Rhodes v. Equitable Life Assurance Soc'y, 54 Ohio St. 2d 45, 374 N.E.2d 643 (1978).

95. *See* Douglas v. Southwestern Life Ins. Co., 374 S.W.2d 788 (Tex. Civ. App. 1964); Brown v. United States Casualty Co., 95 F. 935, 936 (C.C.N.D. Cal. 1899).

96. 289 S.C. at 263, 346 S.E.2d at 23.

97. Record at 24; *see also* Fontenot v. New York Life Ins. Co., 357 So. 2d 1185 (La. Ct. App. 1978); Rhodes v. Equitable Life Assurance Soc'y, 54 Ohio St. 2d 45, 374 N.E.2d 643 (1978).

98. *See* Kirk v. Financial Sec. Life Ins. Co., 75 Ill. 2d 367, 389 N.E.2d 144 (1978).

99. For cases which find the limitation violative of public policy, see Karl v. New York Life Ins. Co., 139 N.J. Super. 318, 353 A.2d 564 (1976); Burne v. Franklin Life Ins. Co., 451 Pa. 218, 301 A.2d 799 (1973). Georgia and California extended the "process of nature" rule in Strickland v. Gulf Life Ins. Co., 240 Ga. 723, 242 S.E.2d 148 (1978), and National Life & Accident Ins. Co. v. Edwards, 119 Cal. App. 3d 326, 174 Cal. Rptr. 31 (1981).

when enforcement might cause a victim's family and physicians to make a choice between pursuing a slim chance of an accident victim's recovery and risking forfeiture of the proceeds of the policy because of a time limitation clause.[100] In *Karl v. New York Life Insurance Co.*[101] the Superior Court of New Jersey stated that the decision about when to terminate life support systems is the "most difficult of human decisions"[102] and "should not be influenced by the crass thought that death benefits will be reduced if the patient lives beyond a certain number of days."[103]

The Supreme Court of Pennsylvania also recognized this dilemma in *Burne v. Franklin Life Insurance Co.*[104] and stated that "[t]o predicate liability under a life insurance policy upon death occurring only on or prior to a specific date, while denying policy recovery if death occurs after that fixed date, offends the basic concepts and fundamental objectives of life insurance and [is] contrary to public policy."[105] The courts in both *Burne* and *Karl* refused to enforce the ninety day time limitation provision.

Although these decisions appear to conflict with the court's ruling in *Smith*, they may be reconcilable. The facts of *Burne* and *Karl* are distinguishable from the facts of *Smith* in two important ways. First, in both *Burne* and *Karl* there was no question of whether the accident caused the insured's death.[106] Al-

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100. The recent development of the problem was illustrated in *Burne* in which the court said:

> The [time limitation] provision has its origins at a much earlier stage of medicine. Accordingly, the leading case construing the provision predates three decades of progress in the field of curative medicine. Advancements made during that period have enabled the medical profession to become startlingly adept at delaying death for indeterminate periods. Physicians and surgeons now stand at the very citadel of death, possessing the awesome responsibility of sometimes deciding whether and what measure should be used to prolong, even though momentarily, an individual's life. The legal and ethical issues attending such deliberations are gravely complex.

451 Pa. 218, 221-22, 301 A.2d 799, 801 (1973).

101. 139 N.J. Super. 318, 353 A.2d 564 (1976).

102. *Id.* at 325, 353 A.2d at 568.

103. *Id.*

104. 451 Pa. 218, 301 A.2d 799 (1973).

105. *Id.* at 222, 301 A.2d at 802.

106. In *Burne* the court stated that "it is conceded by the . . . insurance company that the injuries sustained were the direct and sole cause of the insured's death." 451 Pa. at 220-21, 301 A.2d at 801. In *Karl* the court stated that "it has been clearly and convincingly established that Karl died . . . as the direct result, independently of all other

though the court in *Smith* did not address whether the accident was the proximate cause of the insured's death, the situation was not as clear as the those before the courts in *Burne* and *Karl.*

The second and most important distinction between *Smith* and the *Burne* and *Karl* cases is that in the latter cases, at some point between the accident and the death, life support systems aided the insured and the insured may have been incapable of surviving without them.[107] In *Burne* and *Karl*, therefore, the insured's family and physicians could have been confronted with the very choice which those courts sought to avoid. *Smith* did not indicate that the insured's family and his physician encountered this dilemma.

These factual distinctions are important in comparing the relative merits of the public policy arguments advanced in *Smith* with those advanced in *Burne* and *Karl.* In situations similar to the facts of *Smith*, there is danger that the death was not caused by the accident, but there was no such danger in *Burne* or *Karl.* Thus, the argument in favor of enforcing the clause was stronger in *Smith.*[108] On the other hand, when, as in *Smith*, no possibility exists that the insured's family or physicians would be forced to choose between artificial life for the insured and the proceeds of his accidental death insurance policy, the public policy argument against enforcement of the clause is less persuasive than in *Burne* and *Karl.*[109] Although the

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causes, from accidental bodily injury." 139 N.J. Super. at 324, 353 A.2d at 567.

107. In *Burne* the court stated that "the most sophisticated medical techniques [were] utilized, merely to keep [the insured] medically alive, albeit in a vegetative state." 451 Pa. at 220, 301 A.2d at 801. In *Karl* the court stated that five months after the accident, the insured "had no immediate need of the full range of sophisticated life-support equipment and services of a modern hospital." 139 N.J. Super. at 322, 353 A.2d at 566. The implication of this statement is that at some other point, Karl was in need of the life-support equipment.

108. The absence of uncertainty about the cause of death also may weaken the freedom of contract argument. The *Karl* court pointed out that the purpose of time limitation clauses is "to protect the company from having to pay where it is doubtful that the death was caused by an accident." 139 N.J. Super. at 327, 353 A.2d at 568.

109. Though the supreme court indicated that whether a particular clause in an insurance contract violates public policy is a question "for legislative consideration," 289 S.C. at 264, 346 S.E.2d at 23, the court appears to have the power to declare an insurance clause invalid on those grounds. In Rhame v. National Grange Mut. Ins. Co., 238 S.C. 539, 121 S.E.2d 94 (1961), the supreme court stated that insurance companies may limit their liabilities in any way they please, "provided they are not in contravention of some

overwhelming weight of authority upholds such time limitations in insurance policies, the above-mentioned distinctions and arguments should be carefully considered by the practitioner who litigates a time limitation clause.

James R. Courie

statutory provision or public policy." *Id.* at 544, 121 S.E.2d at 96; *see also* Marchant v. South Carolina Ins. Co., 281 S.C. 585, 316 S.E.2d 707 (Ct. App. 1984).