

## JURISDICTION OVER FOREIGN CORPORATIONS: THE NORTH CAROLINA STATUTE

WITH THE DECISION of *Shepard v. Rheem Mfg. Co.*<sup>1</sup> the North Carolina Supreme Court has for the first time constitutionally approved an application of North Carolina's innovating statutory provision, G.S. 55-145(a)(3),<sup>2</sup> governing the jurisdiction of its courts over foreign corporations. That novel section reads as follows:

A foreign corporation may be subject to suit in a state court by a resident of North Carolina on any cause of action arising:

(3) Out of the production, manufacture, or distribution of goods by such corporation with the reasonable expectation that those goods are to be used or consumed in this State and are so used or consumed, regardless of how or where the goods were produced, manufactured, or sold or whether or not through the medium of independent contractors or dealers.

In the *Rheem* case, the third decision to interpret the above statute, the plaintiff, a North Carolina resident, sued in North Carolina<sup>3</sup> to recover for personal injuries caused by the explosion of a gas water heater, alleged to have been negligently manufactured. The defendant, a California corporation,<sup>4</sup> sold its products to wholesale purchasers in North Carolina but had not been formally admitted to transact business within the state. As a part of its operations, the defendant corporation employed three agents to solicit orders in North Carolina. Two of these agents lived in the state and all obtained at least fifty per cent of their orders there. All orders were finally accepted by Rheem outside North Carolina. The ruling of the lower court denying a motion to

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<sup>1</sup> 249 N. C. 454, 106 S.E.2d 704 (1959).

<sup>2</sup> The purpose of this statute, as expressed by the draftsmen, is to extend corporate jurisdiction in accordance with the Supreme Court's decision in *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). This extension is based on the policy that it is better to extend jurisdiction than to compel state residents to sue in foreign jurisdictions. Latty, Powers, and Breckeuridge, *The Proposed North Carolina Business Corporation Act*, 33 N.C.L. REV. 26 (1954).

<sup>3</sup> Process was served on the Secretary of State under GEN. STAT. § 55-146 (Supp. 1957). This statute provides that the Secretary must mail a copy of the process to the address of the corporation. This type of non-resident service is authorized by GEN. STAT. § 55-145(c) (Supp. 1957), which makes the Secretary of State the agent of any corporation subject to suit under GEN. STAT. § 55-145.

<sup>4</sup> *Moody's Industrial Manual* 806 (1958).

dismiss for lack of jurisdiction was affirmed on appeal, both courts relying on G.S. 55-145(a)(3) to find jurisdiction over the defendant. In arriving at this conclusion, the North Carolina Supreme Court stated that the two previous cases which held this section of the statute unconstitutional in application as violative of due process,<sup>5</sup> were distinguishable on their facts; but no attempt was made by the court to delineate these factual distinctions.

The curt dismissal of *Erlanger Mills, Inc. v. Cohoes Fibre Mills*,<sup>6</sup> and *Putnam v. Triangle Publications Inc.*,<sup>7</sup> as being factually inapplicable, justifies another look at these two cases. The *Erlanger* case involved a suit by a North Carolina corporation against a New York corporation to recover damages for a shipment of defective goods. The order for these goods was placed and accepted in New York, and the goods were shipped f.o.b. New York. The suit, originally filed in a North Carolina state court, was later removed to a federal district court sitting in North Carolina. A motion to dismiss for lack of jurisdiction was granted on the ground that an application of G.S. 55-145(a)(3) to the particular facts would violate due process, since the "minimum contacts" test<sup>8</sup> laid down by *International Shoe Co. v. Washington*<sup>9</sup> would not be satisfied thereby.

<sup>5</sup> Any judgment rendered against a corporation over which a court has no jurisdiction is void as a violation of due process. *Pennoyer v. Neff*, 95 U.S. 714 (1877). Originally, it was held that jurisdiction could be obtained over a corporation only in the state of incorporation. *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 517, 588 (1839). Because of the increasing expansion and complexity of corporate activity, this position became untenable and theories of "implied consent" and "presence" were developed. Under these theories, a state could exert jurisdiction over foreign corporations whenever the corporation was "doing business" in the state. *St. Clair v. Cox*, 106 U.S. 350 (1882); *International Harvester Co. v. Kentucky*, 234 U.S. 579 (1914); *Green v. Chicago, B. & Q.R.R.*, 205 U.S. 530 (1906). However, in *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), the Supreme Court characterized the "presence" theory as begging the question and the "implied consent" theory as a legal fiction. As a substitute for these tests of jurisdiction, the Court laid down what has come to be known as the "fairness" or "minimum contacts" test.

<sup>6</sup> 239 F.2d 502 (4th Cir. 1956).

<sup>7</sup> 245 N.C. 432, 96 S.E.2d 445 (1957).

<sup>8</sup> "[D]ue process requires only that in order to subject a defendant to a judgment in personam, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend traditional notion of fair play and substantial justice." *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). Those demands may be met by such contacts of the corporation with the state of the forum as make it reasonable, in the context of our federal system of government, to require the corporation to defend the particular suit which is brought there. An "estimate of the inconveniences" which would result to the corporation from a trial away from its "home" or principal place of business is relevant in this connection. *Id.* at 317.

<sup>9</sup> 326 U.S. 310 (1945).

The determination that the facts of the *Rheem* and *Erlanger* cases are distinguishable is easily supportable. In the *Erlanger* case, the contract sued upon was made outside of North Carolina, and the defendant had never previously done business in North Carolina.<sup>10</sup> The rather extensive activities of Rheem, on the other hand, had been continuously and systematically conducted in North Carolina for several years. Illustrative of the substantial nature of Rheem's operations in the state is the \$1,685,113.92 volume of business transacted by Rheem there during the last fiscal year. Courts have traditionally been more willing in tort than in contract cases to extend the scope of the jurisdiction concept.<sup>11</sup> Accordingly, the fact that the *Erlanger* case dealt with an alleged

<sup>10</sup> 239 F.2d 502, 505 (4th Cir. 1956).

<sup>11</sup> The Supreme Court first recognized the hardship inherent in compelling a plaintiff to sue in a foreign court to recover for injuries arising out of an automobile accident in the case of *Hess v. Pawloski*, 274 U.S. 352 (1927). The Court in allowing jurisdiction of a non-resident stressed the dangerous nature of the driving of an automobile within the state. This seems to be the first real extension of in personam jurisdiction, and it is clear that but for the tortious nature of the case jurisdiction would not have been granted.

Since the decision of the Supreme Court in *International Shoe v. Washington*, 326 U.S. 310 (1945), state statutes purporting to take advantage of the new tests of jurisdiction laid down in that case have been passed. Only a few cases have been decided under these new statutes, but it is believed that these cases show that jurisdiction is more easily obtained when it is sought for a tort case. Perhaps the clearest illustration of this fact is seen in the words of a Vermont court: "Common ideas of justice require that a foreign corporation be subject to suit in the courts of a state where it does a tortious act, when the state so elects, and when the suit is based on such act." *Smyth v. Twin State Improvement Corp.*, 116 Vt. 569, 575, 80 A.2d 664, 668 (1951). Jurisdiction was granted by a Maryland court in the case of *Johns v. Bay State Abrasive Prods. Co.*, 89 F. Supp. 654 (D. Md. 1950), and again a tort claim was involved. Among the tort cases arising under the new liberal statutes, only *Putnam v. Triangle Publications Inc.*, 145 N.C. 432, 96 S.E.2d 445 (1957), has denied jurisdiction.

Contract cases arising under the new jurisdictional statutes present a rather different picture. Jurisdiction was allowed in *Compania De Astral S.A. v. Boston Metals Co.*, 205 Md. 237, 107 A.2d 357 (1954), but this case involved a suit against a foreign corporation which would have required a suit in a foreign country had jurisdiction not been granted, and the contacts which this company had within the state were more substantial than in the tort cases. Aside from this case, jurisdiction has been denied in contract cases. Florida denied jurisdiction in *Berkman v. Ann Lewis Shops*, 246 F.2d 44 (2d Cir. 1957), on the ground that "business venture" was not meant to change the traditional test of "doing business." Perhaps the reason for this difference between contract and tort cases is seen in the words of the court in the *Erlanger* case, when it was said that in that case the "quality and nature of the acts" did not appear to justify jurisdiction. In considering this distinction, however, it would be well to keep in mind the fact that the court in the *Erlanger* case expressly denied any difference between tort and contract. It is interesting to note that this denial was made while refusing jurisdiction in a contract case.

breach of contract suggests another possible ground for distinguishing the latter case from *Rheem*.

It is difficult, however, to find significant factual differences between the *Rheem* and *Triangle* cases. The plaintiff in *Triangle* sued a Delaware corporation in a North Carolina state court, alleging libel and invasion of privacy arising from a statement published in the defendant's magazine. For some time, the defendant had been distributing magazines to independent wholesalers in North Carolina, who took title to and made payment for these magazines outside of that state. Moreover, the defendant had three men who entered the state from three to five times a year in order to check sales figures and promote sales. Jurisdiction was denied by the North Carolina Supreme Court on the ground that the defendant did not have sufficient contacts with the state to satisfy due process requirements.

One conceivable basis for distinction between these cases lies in the difference in the dollar volume of business done by *Rheem* in North Carolina in a single year—\$1,685,113.92—and that done in the same length of time by *Triangle Publications*—\$85,000.<sup>12</sup> Both amounts involved are substantial, however, and it would seem less than realistic to distinguish the cases for this reason. Moreover, a comparison between money received from the sale of magazines and that from the sale of stoves probably does not adequately reflect the actual extent of the contact which these companies have with North Carolina residents. Indeed, regardless of respective dollar volumes, it is likely that more North Carolina residents were familiar with *Triangle* than with *Rheem* products.

The two cases could also be distinguished on the basis of the difference in the nature of the tort sued on in each case. While the *Rheem* case dealt with a suit for a personal injury which occurred in a single state, the *Triangle* case involved an alleged libel resulting from publication of a magazine which was distributed in many states. Since cases in which a multi-state tort is alleged are difficult for the courts to deal with, it is understandable that a court might be more reluctant to extend its jurisdiction to cover cases of this type. The choice of law problem which arises in multi-state tort situations, for example, is a problem which defies satisfactory solution.<sup>13</sup> It is impossible to tell whether this

<sup>12</sup> Brief for Appellant, p. 7, *Putnam v. Triangle Publications Inc.*, 145 N.C. 432, 96 S.E.2d 445 (1957).

<sup>13</sup> An indication of the confused state of the law in this area is found in Warner, *Multistate Publication in Radio and Television*, 23 LAW & CONTEMP. PROB. 14, 19-23 (1958).

factor influenced the Court in the *Triangle* case, however, since it was not mentioned in the court's opinion.

Perhaps the most significant difference between the two cases reposes in the extent of the activities carried on in North Carolina by the agents of the two companies. *Triangle's* agents entered North Carolina five times a year at most, while three of *Rheem's* agents solicited fifty to sixty-five per cent of their orders there, and two of these latter employees made their home in the state.<sup>14</sup> Yet, this difference in the respective agents' activities also seems insufficient to warrant divergent conclusions on the constitutional issue of an assertion of jurisdiction in each case.<sup>15</sup> Thus, in view of the similarity of the two cases, it is possible to conclude that the *Rheem* case represents a liberal and enlightened change in the North Carolina Supreme Court's attitude toward G.S. 55-145(a)(3) and jurisdiction over foreign corporations.

Even so, the *Rheem* case apparently does not push the jurisdictional power of the state's courts to the outermost bounds of constitutionality. Indeed, when tested by the United States Supreme Court's recent decision in *McGee v. International Life Ins. Co.*,<sup>16</sup> an assertion of jurisdiction in the *Triangle* case would not have extended beyond the ultimate constitutional limits.<sup>17</sup> In the *McGee* case, a unanimous Court held that the single act of mailing a re-insurance certificate to a California policy holder was enough to give the courts of California jurisdiction over a Texas insurance company,<sup>18</sup> even though this was the only

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<sup>14</sup> Neither of the companies had given their agents power to bind the company by accepting orders. *Shepard v. Rheem Mfg. Co.*, 249 N.C. 454, 106 S.E.2d 704, (1959). *Putnam v. Triangle Publications, Inc.*, 245 N.C. 432, 436, 96 S.E.2d 445, 449 (1957).

<sup>15</sup> If the residence of the agents were considered a distinction between these two cases, this would lead to the conclusion that *Rheem* could have avoided jurisdiction merely by having its agents live outside of North Carolina. This certainly would not make corporate contacts the test of jurisdiction. It is also clear that a distinction as to time spent in North Carolina by agents would not actually distinguish the contacts which North Carolina residents had with these companies.

<sup>16</sup> 335 U.S. 220 (1957).

<sup>17</sup> The most significant thing about the *McGee* decision is its fact situation. However, the following language in the Court's opinion is also significant: "[A] trend is clearly discernible toward expanding the permissible scope of state jurisdiction over foreign corporations and other nonresidents.

"[Of] course there may be inconvenience to the insurer if it is held amenable to suit in California where it had this contract, but certainly nothing which amounts to a denial of due process." *Id.* at 222, 224.

<sup>18</sup> In 1944 a California resident purchased a life insurance policy from an Arizona corporation, and in 1948 the International Life Insurance Co. agreed to assume the insurance obligations of this Arizona corporation. Acting under this agreement, International Life mailed a reinsurance certificate to the insured. As far as appears on the

contact which the insurance company had had with California.<sup>19</sup> Thus, the *McGee* case appears to draw the line of constitutionality so as to encompass easily both the *Rheem* and the *Triangle* cases.

Perhaps the *Rheem* case will mark a turning away from the overly restrictive approach to the application of G.S. 55-145(a)(3) which characterized the *Triangle* decision. However, since the facts of the instant case do not require any straining of constitutional dogma for the application of jurisdiction over a foreign corporation,<sup>20</sup> and since the North Carolina Supreme Court did not fully articulate its reasons for distinguishing the *Triangle* case, it is rather difficult now to assess accurately the ultimate significance of the *Rheem* decision.

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record, International Life had never solicited or done any insurance business in California, apart from the policy involved in this case.

<sup>19</sup> The fact that the statute which allowed service on this defendant applied to foreign insurance companies did not seem to be material to the court's holding, and there is no language in the opinion which would imply that this reasoning would be applied solely to insurance companies.

<sup>20</sup> It appears that many state courts have stretched the "doing business" concept to cover activities similar to those of *Rheem*. A District of Columbia court denied jurisdiction where the agent of the defendant company solicited a substantial portion of his business there because he did not have the power to make a binding contract. The Court of Appeals reversed this decision in an excellent opinion which cites many cases for and against liberal jurisdiction, saying: "[T]he fundamental principle underlying the "doing business" concept seems to be the maintenance within the jurisdiction of a regular, continuous course of business activities, whether or not this includes the final stage of contracting." *Frene v. Louisville Cement Co.*, 134 F.2d 511, 515 (D.C. Cir. 1943). This broad "doing business" concept also appears in *William I. Horlick Co. v. Bogue Elec. Mfg. Co.*, 146 F. Supp. 347 (D. Mass. 1956) (solicitation and promotional activities of a single agent); *Orange-Crush Grapico Bottling Co. v. The Seven-Up Co.*, 128 F. Supp. 174 (N.D. Ala. 1955) (regular and systematic trips to Alabama by agents); and *Perkins v. Louisville & N.R.R.*, 94 F. Supp. 946 (S.D. Cal. 1951) (office in California for the purpose of soliciting freight).

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