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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM CHARLESTON COUNTY
Court of Common Pleas
The Honorable Mikell R. Scarborough, Master-in-Equity

Court of Appeals Case No. 2020-001583

Bonnie Wall, individually and derivatively,
and Walter B. Wall, Jr.……..……Appellants,

v.

Jonathan Dye, Shaun Dye, Shellmore Homeowners' Association, Inc., and
John H. Chakides, Jr., individually and
in his capacity as Director of Shellmore Homeowners' Association, Inc.,
……..……..……Respondents.

REPLY IN SUPPORT OF PETITION FOR REHEARING

Appellants and Respondents do agree on one thing, and that is that the question of "whether a fiduciary duty should be imposed . . . is a question of law for the court." Return to Petition for Rehearing at p. 1, *citing Hendricks v. Clemson University*, 353 S.C. 449, 578 S.E.2d 711 (2003). The purpose of this Petition for Rehearing—and this appeal—is to respectfully ask this Court to correct mistakes of law and hold that the Respondent homeowners' association, and the Respondent director, do owe fiduciary duties to Appellants. As to the question of whether those duties were ***breached***, which is a factual question, the Court should remand for discovery and trial.

I. Fiduciary duties exist in this context.

Ignoring South Carolina's Nonprofit Corporation Act entirely, Respondents argue two reasons against fiduciary responsibility. First, they rely on the inapposite *O'Shea v. Lesser* case, which was later cited in a short footnote by *Fisher v. Shipyard Vill. Council of Co-Owners, Inc.*—but neither of these cases had anything to do with corporate form. Next, Respondents argue that tort liability and contract liability cannot co-exist. For the reasons below, this Court should set aside Respondents' arguments and rehear its Opinion.

A. That Respondent HOA is a nonprofit corporation *does* matter.

Respondents rely only on the common law to argue that a fiduciary duty does not exist, failing altogether to address the significance of the Nonprofit Corporation Act (and the entire body of corporation law, which has recognized that corporate directors have fiduciary duties for more than 100 years). But a legal duty can be "created by statute, contract, relationship, status, property interest, or some other special circumstance." *Spence v. Wingate,* 395 S.C. 148, 716 S.E.2d 920 (2011) (emphasis added). In addition to other sources,[1] the fiduciary duties owed by the directors in this case are statutory; they are expressly created by South Carolina's Nonprofit Corporation Act.

Statutory law specifically and unequivocally imposes fiduciary duties on directors of nonprofit corporations. *See, e.g.,* S.C. Code § 33-31-202(b) (directors are personally liable for "any breach of the director's duty of loyalty to the corporation or its members," and "for acts and omissions not in good faith," and "for any transaction from which a

[1] Appellants incorporate by reference all previous briefing on this issue, including their arguments that the directors of an HOA owe fiduciary duties by virtue of their position in a relationship of trust, and their control over the property interests and property values of the HOA's members, as well as those owed by virtue of their control over the corporation.

director derived an improper personal benefit."). **This should be a "mike-drop" moment** for the Walls: the statute which governs their nonprofit HOA clearly says that the directors of nonprofit corporations owe fiduciary duties to both the corporation and to its members, for which those directors may be held personally liable. "[C]ourts are bound to give effect to the expressed intent of the Legislature." *Denson v. Nat'l Cas. Co.*, 439 S.C. 142, 886 S.E.2d 228 (2023). This Court **exists** to correct errors of law, including the lower court's error on this key question of law. No more should need to be said.

And yet, this Court's Opinion mistakenly finds that the corporate form of the HOA here is a "distinction" that does not "matter[]." (Op. at p. 3). Respondents seize on this misapprehension by the Court, and they try to justify it. They cite isolated snippets of incongruous case law,[2] where the application of the Nonprofit Corporation Act—and the duties it imposes—was not put before the Court to decide, and therefore the question was not considered. *See Kennedy v. Retirement System,* 349 S.C. 531, 564 S.E.2d 322 (2001) ("[A]ppellate courts, like well-behaved children, do not speak unless spoken to and do not answer questions they are not asked."). This Court should set aside both *O'Shea* and *Fisher*; they are not binding because they did not examine and have nothing whatsoever to do with corporate organization or statutory duties.

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[2] Neither of the two cases on which Respondents rely discuss the Nonprofit Corporation Act at all. *See Fisher v. Shipyard Vill. Council of Co-Owners, Inc.,* 409 S.C. 164, 760 S.E.2d 121 (Ct. App. 2014), *aff'd as modified*, 415 S.C. 256, 781 S.E.2d 903 (2016) (discussing fiduciary duty only in a short footnote); *O'Shea v. Lesser*, 416 S.E.2d 629, 308 S.C. 10 (1992) (discussing duty of developer-controlled committee which had reserved for itself "uncontrolled discretion."). In fact, the word "nonprofit" does not appear in either opinion.

Given the Legislature's clear intent to charge nonprofit directors with fiduciary duties, it would be perilous and improper (even in an Opinion without precedential value) to begin to carve out common-law exceptions to a bright-line rule of statutory law. The Nonprofit Corporation Act does not make an exception for board members who are "only" volunteers.[3] The Nonprofit Corporation Act does not make an exception for board members, just-in-case the nonprofit corporation happens to be a homeowners' association. The Nonprofit Corporation Act does not make an exception if the membership of the corporation seems small and insignificant.[4] Because the Nonprofit Corporation Act does not make such distinctions, neither should this Court.

Appellants respectfully request that this Court withdraw its Opinion and correct its error on this question of law—which has been answered by statute.

B. Relationships matter.

A legal fiduciary duty can be "created by statute, contract, relationship, status, property interest, or some other special circumstance." *Spence,* 395 S.C. 148, 716 S.E.2d

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[3] Nonprofit organizations such as hospitals, charities, schools, and churches ***are almost always run by volunteers.*** It is a slippery slope to say that directors of a nonprofit HOA are exempted from fiduciary requirements because they are "just volunteers," and this Court should act to correct its misapprehension. Volunteers or not, nonprofit directors control property, money, and interests belonging to others—who trust them to manage those things with the utmost care.

[4] The HOA here involves "only" fourteen properties, and the temptation may be to discount the seriousness of the corporate form for the reason that it just ***seems*** minor. But the law in this State imposes fiduciary duties, even on directors of small, closely-held corporations and family partnerships. *See Kiriakides v. ATLAS FOOD SYSTEMS & SERV.*, 338 S.C. 572, 527 S.E.2d 371 (Ct. App. 2000) ("Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.") (*quoting* New York's Chief Judge Cardozo).

920 (emphasis added). Significantly, the Legislature's decision to impose fiduciary duties on the directors of nonprofit corporations did not occur in a vacuum. Instead, it is the embodiment of over a hundred years of corporate common law. Three-quarters of a century ago, our South Carolina Supreme Court acknowledged this lengthy precedent, and the ***relational*** foundation for directors as fiduciaries, in the context of a hospital which was an eleemosynary (*i.e.* a nonprofit) organization, the directors of which took a hotly-contested vote to approve of an inappropriate disposition of the organization's property. After a fascinating and lengthy discussion of the trial and facts of the case, including whether certain directors should have recused themselves from the vote, the Court held:

> The foundation of suits such as this is the relation in the nature of an express trust between a director and his corporation, which is also similar in this quality to that of principal and agent. 'The directors or other members of the managing board are sometimes called trustees. Their legal position is the same no matter by what name they are called, whether directors, trustees, or governors . . . **Undoubtedly the directors of a corporation in the management of the corporate affairs occupy a position of extreme trust and confidence and exercise great power for good or bad over the corporation and its shareholders. They are agents for the corporation. Toward it and the shareholders they undoubtedly stand in a fiduciary relation as far as corporate business is concerned.**' South Carolina cases in accord with this universal concept may be found in West's S.E. Dig., Corporations, k307.

Gilbert v. McLeod Infirmary, 219 S.C. 174, 64 S.E.2d 524, 528-529 (1951) (cleaned up) (emphasis added).

The Walls ask this Court to step back and ponder *why* HOAs are so frequently organized as nonprofit corporations. The answer is because planned communities are set up in a way that confers on HOAs (and thus their directors) enormous decision-making

power over property and money belonging to their individual members. **Any other place a person lives, he can do whatever he wants with his property—and so can his neighbor.** But the decision to buy into a community bound by covenants and controlled by an HOA is a decision to give the HOA power over individual property use. It is a decision to trust the HOA to uniformly, consistently, and fairly enforce the reciprocal rules by which all land is bound, in the interest of maintaining consistency of design and of making decisions that lend value to the neighborhood as a whole.

The Opinion is mistaken in its understanding that homeowners' associations somehow have less control over homeowners' property than a developer.[5] When developers leave communities, they turn over their control to the HOA, which stands in the same relational position to members and their property as the developer once did. Indeed, Shellmore's Declaration of Covenants is one document by which the developers, here, turned over their control over the property and interests belonging to each one of the litigants involved in this action. (R. p. 36). In doing so, the developers expressly stated the intent that the covenants be "for the purpose of protecting the value and desirability of" every home in the neighborhood. (R. p. 37; *see also* R. 373, Articles of Incorporation, giving architectural control over each member's property to the HOA).

As a matter of law, the directors who control an HOA stand in a fiduciary relationship with those over whose property they have power, and thus they have fiduciary duties. Here, there is a question of fact as to whether the directors breached

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[5] HOAs likely have <u>more</u> control over members' property than a developer. They have assessment power, architectural control, and the ability to put liens on an owners' property. These powers can be abused and should be exercised as fiduciaries.

their fiduciary obligations to the members by secretly, without notice, and without following proper procedure, approving of something that had consistently been forbidden, and which damaged the Appellants' enjoyment of their own property and its value. (R. pp. 13-61; pp.163-165).

The Walls respectfully ask this Court to reconsider its decision under the common law (in addition to because of the Nonprofit Corporation Act).

C. The contracts here exist against a backdrop of fiduciary obligation.

Next, Respondents argue that not only do the directors of a nonprofit HOA not have a fiduciary duty—but apparently they do not have any tort duties whatsoever. Respondents' argument is that where there exists a contract (such as the governing documents[6] here), there can be no liability in tort. This is wrong under voluminous precedent, which makes a distinction—and imparts a cause of action—when bad faith overlies the non-performance of contractual obligations. The difference is conduct—the manner in which the party to the contract conducts himself. Both in the context of negligence and fiduciary duty, our cases acknowledge that a tort duty could "be created by . . . contract." *Spence,* 395 S.C. 148, 716 S.E.2d 920. Indeed, in every contract there exists an implied covenant of good faith and fair dealing, which goes beyond the contract to control the way in which it is performed. *See Road LLC v. Beaufort Cnty.*, S.C. Supreme Court Opinion No. 28204, (May 15, 2024) *(*"Rather, the implied covenant serves . . . to

[6] This Court overlooked that the governing documents at issue here include both real property and corporate documents. The Shellmore community is controlled by covenants, but corporate action is also dictated by past corporate acts—including the 2016 vote to prohibit covered docks and past precedent of denying applications for covered docks—as well as an obligation to enforce its rules uniformly. (R. p. 162). **In other words, the directors here were bound to be loyal to prior corporate action.**

govern the *manner* in which parties to a contract enforce their existing contractual rights and carry out their existing contractual duties - express or implied."). Importantly, the disputed facts of this case warrant discovery and trial on the conduct of the directors, and on the question of whether the directors acted (at a minimum) in good faith when they secretly appointed committee members, failed to provide notice, and rubber-stamped construction plans without ever actually seeing them, and without evaluating the (unseen) plans under the rubric required by the covenants.[7]

Further, South Carolina courts have on multiple occasions found tort duties alongside contractual liability, particularly in the context of a fiduciary relationship—including in several of the same cases wrongly asserted by Respondents. For example, in *Tommy L. Griffin Plumbing & Heating Co. v. Jordan*, the Supreme Court found that a fiduciary relationship does give rise to a tort action, in addition to one in contract:

> In most instances, a negligence action will not lie when the parties are in privity of contract. **When, however, there is a special relationship between the alleged tortfeasor and the injured party not arising in contract, the breach of that duty of care will support a tort action.** [internal citations omitted] ("special relationship" creates duty of care outside terms of contract). These concepts are not new. [citations omitted]. Rather, we restate the traditional concepts in modern terms.

320 S.C. 49, 55, 463 S.E.2d 85, 88-89 (emphasis added); *see also Spence*, 395 S.C. 148, 716 S.E.2d 920 (tort action lay on behalf of former client, notwithstanding termination of representation agreement).

Respondents argue that our Supreme Court acknowledged in *Walbeck v. I'On* that

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[7] For a list of some of the disputed facts on which the Walls are entitled to discovery and trial, please *see* Appellants' Reply Brief, pp. 2-3; n. 5; n. 7; and Appellants' Initial Brief, pp. 2-10.

"in subdivisions with common areas that are subject to covenants, the responsibilities outlined in the covenants control." *Walbeck v. I'On Co.*, 439 S.C. 568, 586, 889 S.E.2d 537 (2023). ***But Respondents leave off the rest of the ruling***, which goes on to hold that—notwithstanding the community covenants—a tort action was proper because of the manner in which the parties conducted themselves in breaching those covenants. "Conduct that violates this mandate includes self-dealing, fraud, unconscionable conduct, misrepresentations, etc. . . . [T]he contractual duty to convey was overlaid by a fiduciary relationship, which means that while the non-conveyance was certainly a breach of contract, the subsequent self-dealing by Developers through the secret sale of the property to a third party constituted a breach of the Developers' fiduciary duties to the HOA." *Id*. at 585-587. In other words, Respondents' argument that tort and contractual duties cannot co-exist is simply wrong under established precedent, and it is defeated by the very cases that Respondents themselves rely upon. This incorrect argument was not the basis for this Court's Opinion, and this Court was right to reject it.

The Walls respectfully ask this Court to withdraw its Opinion and hold that the directors of a nonprofit homeowners' association do have fiduciary duties, as a matter of law, including duties to enforce and abide by the governing documents (both corporate and property) in good faith, in the best interest of the corporation and community as a whole, without regard to their own personal benefit, uniformly, consistently, and with notice to all whose property and rights are affected.

II. Questions of fact are for discovery and trial.

The *question of law* of whether Respondents owe a fiduciary duty, or whether their

conduct here is to be evaluated by the business judgment rule, does not—and should not—resolve the facts. In either instance, the factual circumstances surrounding the board's actions warrant discovery and trial.

Respondents characterize the facts here as "undisputed," wrongly telling this Court that it "correctly recognized that the undisputed facts presented in the record indicate" that Respondents' own actions were beyond reproach. **Respectfully, fact and credibility determinations do not belong in an appellate Opinion on a question of law.** Moreover, the trial court itself made no factual findings for this Court to review when it decided a discrete question of law, one-month after the Complaint was filed, that "there is no fiduciary duty owed by the directors to the Plaintiff." (R. p. 10). This Court overlooked that only the question of duty—and not that of breach—is before this Court in this appeal.

A. Fiduciary duty and business judgment are two sides of the same coin.

The business judgment rule co-exists with fiduciary responsibility. The business judgment rule is an affirmative defense which may protect corporate directors who, in fact, have acted within their fiduciary standard of care. *Fisher v. Shipyard Vill. Council of Co-Owners, Inc.*, 415 S.C. 256, 270-272, 781 S.E.2d 903, 910-911 (2016) ("the trial court should permit [board of directors] to assert the business judgment rule as a defense at trial."). The business judgment rule has an important common factor with fiduciary responsibility, and that is that both require corporate directors to act in good faith and in the best interest of the corporation. *Id*. Thus, our law is clear that the business judgment rule does not apply **if there is "a [factual] showing of bad faith, dishonesty, or**

incompetence." *Id.* ("the Board will not be entitled to the protection of the business judgment rule if the jury finds that the Board acted beyond the scope of its authority, or acted with corrupt motives or in bad faith.").

In this case, the Walls made the necessary factual showing of bad faith, dishonesty, and/or incompetence by submitting a verified complaint, documentary evidence, and supporting affidavits. This Court overlooked that the Walls' factual showing should have propelled the case to discovery and trial on the questions of fact—including whether the Respondents acted with bad faith, dishonesty, or incompetence such that the defense of the business judgment rule would not apply. "Summary judgment before discovery forces the non-moving party into a fencing match without a sword or mask." *McCray v. Md. Dep't of Transp.*, 741 F.3d 480, 483 (4th Cir. 2014).

B. Duty: Question of Law.
Breach: Question of Fact.

As to fiduciary duty, because the existence of a fiduciary duty is a question of law, the facts do not bear on this issue on appeal, and this Court was wrong to weigh the evidence and make decisions of fact in deciding it. Instead, the facts go to the question of breach—and not to the question of duty. Disputed facts belong in the realm of discovery and trial, and the question of the breach of a duty is a question of fact for trial. *Spence*, 716 S.E.2d 920, 928 ("whether Wingate breached a [fiduciary] duty . . . is a question of fact for a jury to determine."); *Guerin v. Hunt*, 118 S.C. 21, 110 S.E. 71 (1921) (where there is conflicting evidence or testimony, the question is one of fact); *see also* Jean Hoefer Toal *et al.*, *Appellate Practice in South Carolina* (3rd ed. 2016), Appendix B. Respondents' admissibility arguments (never ruled on) are the dominion of the Rules of Evidence,

which are to be employed at trial and in cross-examination, and not as a sword to stab at affidavits and documentary evidence[8] properly submitted to withstand summary judgment, pursuant to Rule 56, SCRCP. The Walls' evidence of secrecy, bad faith, self-dealing, lack of notice, and defiance of past corporate acts raised issues of fact on the material questions of breach and bad faith. *Youmans v. Youmans*, 128 S.C. 31, 121 S.E.2d 674 (1924) (the question of bad faith is one of fact).

The Walls respectfully ask this Court to modify its Opinion to remand for discovery and trial on the factual questions of breach, as well as the issues of fact surrounding the business judgment defense.

III. Civil Conspiracy

As to their civil conspiracy claim, Appellants rely on their previous briefing and the plain and unambiguous meaning of the word "tried" within our Supreme Court's directive in *Paradis*, which this Court has misapprehended. This Court should withdraw its Opinion and remand the civil conspiracy claim for discovery, so that it may be tried on the facts, under the *Paradis* standard.

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[8] As to the documentary evidence, including the 2016 Vote to prohibit covered docks: the Respondents mischaracterize this vote as "ineffective." **But it was a perfectly effective *corporate* act, which should have bound the directors.** Whether it was effective to restrict land is a different question, which would depend on whether the party against whom the restriction was to be enforced was a good faith purchaser for value (not at issue here).

CONCLUSION

The Walls respectfully ask this Court to reconsider its Opinion, which misapprehends South Carolina's Nonprofit Corporation Act, misunderstands precedent, makes factual determinations not permitted by its standard of review, and mistakes the Supreme Court's unambiguous instruction that *Paradis* should be applied to all cases that have not yet been tried.

Respectfully, the Walls ask that this Court would correct the errors of law and fact within its Opinion, and remand this case for discovery and trial.

Respectfully submitted,
FORD WALLACE THOMSON LLC

s/Ainsley F. Tillman
Ainsley F. Tillman, S.C. Bar No. 70551
Ainsley.Tillman@FordWallace.com
Ian S. Ford, S.C. Bar No. 12463
Ian.Ford@FordWallace.com
715 King Street
Charleston, South Carolina 29403
(843) 277-2011
Attorneys for Appellants Bonnie and Walter Wall

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……..……..……Respondents.

PROOF OF SERVICE

I certify that on June 17, 2024, I have served Appellants' Reply in Support of Petition for Rehearing on Respondents by sending the same to their attorneys of record, Andrew M. Connor and L. Sidney Connor, at their email addresses of record with the AIS.

s/ Ainsley F. Tillman
Attorney for Appellants