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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM GREENVILLE COUNTY
Court of Common Pleas, Business Court Program

R. Lawton McIntosh, Circuit Court Judge

Appellate Case No. 2020-001645
Case No. 2019-CP-23-00998

McMillan Pazdan Smith, LLC, ... Plaintiff/Counterclaim Defendant-Respondent,

v.

Donza H. Mattison,. . . . . Defendant/Counterclaimant-Appellant,

---

Donza H. Mattison, in a Derivative Capacity on Behalf of McMillan Pazdan Smith, LLC,. . . . . Third-Party Plaintiff-Appellant,

v.

Rondald G. Smith, Estate of Joseph M. Pazdan, Brad B. Smith, and Chad C. Cousins. . . . . Third-Party Defendants-Respondents.

APPELLANT'S PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

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Pursuant to Rule 221(a), SCACR, Appellant, Donza H. Mattison (hereinafter "Ms. Mattison"), by and through her undersigned counsel, hereby files this Petition for Rehearing of the Court's opinion of August 7, 2024, in the above-captioned case. With respect, the Court's opinion overlooked or misapprehended the following points of law or fact:

(1) The Court misapplied the final factor of the test from Davis v. Comed, Inc., 619 F. 2d 588 (6th Cir. 1980), i.e., "the degree of support plaintiff was receiving from the shareholders [s]he purported to represent." Id. at 593-94 (emphasis added). Because the Court properly identified this case as a "class of one" derivative action, the views of non-similarly situated minority members who were inherently biased as current employees of MPS, are not relevant to whether Ms. Mattison could serve as a fair and adequate representative of the company and the interests of similarly situated owners (i.e., only herself). See Boathouse at Breach Inlet, LLC, by and through Stoney v. Stoney, 442 S.C. 633, 647, 900 S.E.2d 483, 491 (Ct. App. 2024) ("[A] single member of a limited liability company may 'fairly and adequately represent the interests of' a class of one and have standing to maintain a derivative action.") (emphasis added).

(2) In any event, the Court's decision is contrary to the holding of the South Carolina Court of Appeals in Stoney requiring the court to examine potential sources of bias among other shareholders or members who express disagreement with, or opposition to, the derivative action and, therefore, may not have the best interests of the corporation or company at heart. See Stoney, 442 S.C. at 647–48, 900 S.E.2d at 491 ("Ignoring the opposing shareholders' motivations [for not joining or supporting the derivative action] could 'permit corporate looting and malfeasance in circumstances where all but one shareholder . . . are at risk of personal detriment were the malfeasance brought to light.'") (quoting Angel Invs. LLC v. Garrity, 216 P.3d 944, 951 (Utah

2009)). Not only was Ms. Mattison in the best position to discover the alleged wrongdoing in light of her broader access to the financial records of the company as part of the valuation process for her shares, but she was also the only member of the firm who is not a current employee and, thus, did not have to fear retaliation in her employment by the alleged wrongdoers. The inference that other minority members might place their job security ahead of their relatively minor ownership interests in the company is amply supported by the record, especially on a motion for summary judgment. As Ms. Mattison stated in her affidavit, "Because I am no longer a current employee of MPS and do not depend on my employment with the firm to earn a livelihood, I believe that I am the only minority member of the firm who is in a position to challenge the self-dealing transactions I have raised in [the derivative action in] my Third-Party Complaint." (R. 1098, ¶ 31).

(3) Although the Court properly ruled that the unsworn statements by all of the other members of MPS should not have been considered by the circuit court on a motion for summary judgment, the Court improperly relied on the deposition testimony of six of the minority members as essentially ratifying their unsworn statements disavowing the derivative action. Importantly, none of the minority members who were deposed had actually read Ms. Mattison's Third-Party Complaint containing the derivative action allegations, and their opposition to Ms. Mattison's contentions was based on their subjective belief that those claims did not have any merit and that Third-Party Defendants were honorable people. The depositions merely confirmed that Third-Party Defendants had done a good job of keeping the other minority members in the dark.

(4) The Court's decision is also contrary to the concerns repeatedly expressed by the Stoney Court of potentially leaving one or more shareholders without an available remedy for wrongdoing by those in control of the company, where the individual shareholder cannot pursue an

individual claim because the alleged losses at issue are not "separate and distinct" from those of the corporation. Id. at 647, 900 S.E.2d at 490 (stating that rejecting a "class of one" derivative action "would be to deprive a sole dissenting shareholder from seeking relief from another shareholder's wrongdoing."); see also, id. at 651, 900 S.E.2d at 493 ("To deny [the derivative plaintiff] standing in the derivative action would deny him and the Company a remedy, which we find is not the intent of Rule 23(b)(1)."). At two separate places in the Stoney opinion, the court quoted with approval from the Texas Supreme Court case of Eye Site, Inc. v. Blackburn, 796 S.W.2d 160, 163 (Tex. 1990): "'[W]e question the wisdom of construing [the rule [or] the derivative standing rule] in any manner which prevents a shareholder in a close corporation from enforcing his rights.'" Stoney, 442 S.E.2d at 647, 651, 900 S.E.2d at 491, 493. If Ms. Mattison's derivative action is not allowed to proceed, no one could ever bring a claim to remedy the same alleged wrongdoing because such claims would now be long-barred by the applicable statutes of limitations and could not be saved by the discovery rule or tolling for fraudulent concealment.

(5) The Court's determination that Ms. Mattison could not "fairly and adequately" represent the interests of the LLC disregards the underlying purpose of Rule 23(b)(1), SCRCP, and S.C. Code Ann. § 33-44-1101, of ensuring that a derivative action will be vigorously pursued, because of considerations of issue preclusion, as recognized by the Stoney court. In Stoney, the court stated, "We must keep in mind that '[c]harged emotions and economic antagonism are virtually endemic to disputes in closely held corporations.' We therefore 'must look beyond the mere presence of economic and emotional conflict, placing more emphasis on whether the totality of the circumstances suggest that the plaintiff will vigorously pursue the suit and that the remedy sought is in the interest of the corporation.'" Stoney. 442 S.C. at 648, 900 S.E.2d at 491 (quoting Cattano

v. Bragg, 727 S.E.2d 625, 629 (Va. 2012)). Here, there is nothing in the record to suggest that Ms. Mattison has been anything other than vigorous in pursuing the derivative action on behalf of the company. The Court focused on only one of the eight Davis factors (viz. lack of support from other members), rather than applying the "totality of the circumstances" approach adopted in Stoney, even though the Court expressly found that Ms. Mattison satisfied many of the other factors: she is the driving force in the litigation, she is familiar with the proceedings, that she did not initiate other litigation with MPS, and she is not vindictive towards MPS or the other minority members. (Slip Op., at 15-16).

(6) The Court misapprehended counsel's argument from the summary judgment hearing that Ms. Mattison's goal in the derivative action was to increase the value of her shares as some type of admission that she was improperly using the derivative action to gain leverage in the valuation portion of the case. The derivative action, if successful, would obviously increase the value of Ms. Mattison's shares because the remedy sought in the derivative action is for Third-Party Defendants to return to the company the value of their excessive compensation, distributions, and benefits and to disgorge the improper gains they obtained through insider transactions. If that money was returned to the company, the company's assets and profitability would increase, thereby increasing the value of Ms. Mattison's ownership interests in the company proportionately. The Court completely ignored the only factual evidence in the record on this issue, which is Ms. Mattison's affidavit where she stated, "The monetary demand that my attorney made in his letter of January 14, 2019, was based on my expert's evaluation of the latest HDH Advisors' summary report, with adjustments made based on the limited information that we had at that time. I was not seeking any additional value or 'premium' on the value of my shares to 'purchase my silence' with respect to the

possible derivative shareholder claim." (R. 1094, ¶ 15) (emphasis added). The Court thus impermissibly drew a factual inference in favor of Respondents on this issue, which is not supported by the Record on Appeal, especially on review of the lower court's order granting Respondents' Motion for Summary Judgment.

(7) The Court improperly focused on the pre-mediation demand letter of January 14, 2019 as evidence that Ms. Mattison is somehow using the derivative action as leverage to extort an artificially high value for the redemption of her ownership interests in MPS. The pre-mediation settlement demand by Ms. Mattison has nothing to do with her ability to fairly and adequately represent the interests of MPS in the derivative action or to vigorously pursue the wrongdoers on behalf of the company in litigation. If Ms. Mattison had settled her valuation case at mediation and released or waived her rights to bring a derivative action, there would have been no preclusive effect on the ability of other minority members of the firm to bring the derivative action based on the same allegations that Ms. Mattison raised in this case. After the derivative action was filed, neither Ms. Mattison nor her undersigned counsel ever offered to settle the derivative action in exchange for her receiving of a higher value for her ownership interests in MPS. In fact, in her affidavit, Ms. Mattison specifically states that on two occasions she rejected Respondents' proposals for her to drop her derivative action with prejudice in exchange for Respondents' agreement not to seek attorneys' fees and costs against her. (R. 1098, ¶ 30). Accordingly, the pre-litigation and pre-mediation demand letter of January 14, 2019, does not have any bearing on Ms. Mattison's ability to serve as a fair and adequate representative of her interests as a member of the LLC and those of the company.

(8) The Court improperly gave consideration to the amount of the pre-mediation demand in the undersigned counsel's letter of January 14, 2019, which demand was specifically requested

by Respondents' counsel prior to mediation. Unfortunately, the Court has misread language in Defendant's Memorandum of Law in Opposition to Motion to Dismiss Amended Third-Party Complaint–that "the letter was not written in the context of settlement negotiations" (R. 680)–as referring to the letter of January 14, 2019. That paragraph of the brief was actually discussing the second notice letter of June 18, 2019, which was written to remedy what Respondents had previously alleged were defects in the letter of January 14, 2019, after the court dismissed the derivative action without prejudice and allowed Defendant's counsel to re-serve the notice letter and amend the third-party complaint. A careful reading of the entirety of that paragraph clearly demonstrates that each of the five points discussed by counsel was referring to the June 18, 2019 letter, not the January 14, 2019 letter. Exhibits B-D referenced at the end of that paragraph were copies of the June 18, 2019 letter written to all four of the individual Third-Party Defendants. (R. 681, 160-167). Furthermore, the fact that Ms. Mattison generally referred to the letter of January 14, 2019 in her original pleading was not a waiver of the strict confidentiality of the mediation process or the confidentiality provisions of Rule 408, SCRE, for settlement discussions; instead, Ms. Mattison was merely asserting that she had satisfied the procedural step of the pre-suit demand, which is a prerequisite to filing a derivative action (in the alternative to showing the futility of such demand). See Rule 23(b)(1), SCRCP. Ms. Mattison and her counsel have been very careful not to violate the confidentiality rules of mediation. (R. 194, ¶ 16). Although the Court down-played the significance of the amount of the initial demand because it was not discussed in the summary judgment order, during the hearing on that motion the circuit court specifically stated that the large amount of the demand when compared to MPS's original offer was "the biggest thing I've seen [with regard to] whether or not Ms. Mattison could perform as a fiduciary [in the derivative action]." (R. 315).

(9) The Court conflated Ms. Mattison's interests in pursuing this litigation and her concomitant effort to advance the interests of MPS in the derivative action with the interests of Third-Party Defendants in the derivative action. The fundamental interest of MPS as an entity, separate and distinct from its members, is to grow the value of the company, which is exactly what a successful derivative action would do by bringing additional equity capital back into the company that was allegedly wrongfully misappropriated by the managing members. Only Third-Party Defendants, who have allegedly enriched themselves at the expense of the company and in violation of their fiduciary duties to the company, have interests that are adverse to Ms. Mattison's derivative action. MPS also has an independent interest in ensuring that its operations are conducted in accordance with its by-laws and operating agreement, as well as with the statutory requirements of LLCs and applicable common-law duties, even if its managing members have operated the company otherwise. Ms. Mattison clarified in her affidavit that she is not trying to disenfranchise any minority member who has received ownership units after her employment with the firm ended: "My intention in filing the Counterclaims against MPS is not to strip any current shareholders or members of MPS of their partnership status. Although my research shows that Section 33-44-404(c)(7) [of the South Carolina Code] requires unanimous consent of all members of an LLC to admit new members, **I have offered to sign whatever documents would be necessary to ratify the admission of any current members of MPS**." (R. 1096-97) (emphasis in original). Even though Ms. Mattison testified that she has no personal animosity towards the two newest partners in the firm at the time, because the derivative action sought "class of one" status, any collateral consequences to members who have been admitted into the firm without complying with the LLC statutes's requirement of unanimous consent of all members should not have been considered by the Court at all, much less

as disqualifying Ms. Mattison from pursuing a derivative action on behalf of MPS.

(10) The Court improperly speculated that "it is unclear what effect a finding that all of the Majority Members overcompensated themselves at the firm's expense and requiring them to return funds to MPS would have on the firm's future." (Slip Op., at 15). Although there is nothing in the record to create such a factual concern, one of the four named Third-Party Defendants (Joseph M. Pazdan) passed away during the pendency of this appeal, and another (Rondald G. Smith) has since cashed in most or all of his membership units in MPS. More importantly, in November 2019, the members of MPS changed the management structure of the company to be run by a new board of directors instead of by the four individuals who are the named Third-Party Defendants in the derivative action. In any event, the Stoney Court recognized that "'[c]harged emotions and economic antagonism are virtually endemic to disputes in closely held corporations,'" Stoney, 442 S.C. at 648, 900 S.E.2d at 491 (quoting Cattano, 727 S.E.2d at 629), and that such collateral concerns about the continued harmony within the company should not preclude a derivative action by one of the minority members from going forward.

(11) Finally, the Court incorrectly relied on Ms. Mattison's counterclaims, which were compulsory counterclaims raised in response to the original Complaint filed against her by MPS, to conclude that she has an impermissible conflict of interest in bringing a derivative action on behalf of MPS. Ms. Mattison is not pursuing "other litigation" against MPS that might compromise her "undivided loyalty" to the company in pursuit of the derivative action on the company's behalf. The Court's reliance on cases like Smith v. Ayres, 977 F.2d 946, 949 (5th Cir. 1992), and Blum v. Morgan Guar. Tr. Co. of N.Y., 539 F.2d 1388 (5th Cir. 1976) is a misapplication of the applicable law. In Smith, the court rejected a proposed "class of one" derivative action by a shareholder who

owned the "infinitesimal" amount of one share out of 10 million authorized shares of the company and where "A catalog of the various lawsuits between these two parties and their affiliates would consume well over a full page." Smith, 977 F.2d at 948, 949. Similarly, in Blum, the proposed derivative action plaintiff bought his "infinitesimally small" amount of stock in the bank on whose behalf he was trying to bring the derivative action, with full knowledge of the alleged wrongdoing by the bank, and after the bank had notified him that he was in default on a note of more than $2 million. Blum, 539 F.2d at 1390. Here, there is no "other litigation" between Ms. Mattison and MPS. Ms. Mattison filed her derivative action as a Third-Party Complaint in the same litigation that MPS initiated regarding the valuation of her shares.

For all of the foregoing reasons, the Court should rehear this matter, should allow Appellant to proceed in this derivative action as a class of one on behalf of MPS as a "fair and adequate representative" to remedy the company's losses caused by the alleged breaches of fiduciary duty and self-dealing transactions by the managing members of the company, and should reverse the ruling by the circuit court dismissing the derivative action.

Because this case involves a question of exceptional importance and because of the divergence of the panel's opinion this case from the Court's previous opinion in Stoney, Appellant suggests that the matter should be reheard en banc pursuant to Rule 219, SCACR.

* * *

Appellant hereby incorporates by reference the briefs and supplemental brief she previously filed in this case.

August 22, 2024

s/ David E. Rothstein

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PROOF OF SERVICE

I certify that I have served Appellant's Petition for Rehearing and Suggestion for Rehearing En Banc on Respondents, McMillan Pazdan Smith, LLC, Rondald G. Smith, Estate of Joseph M. Pazdan, Brad B. Smith, and Chad C. Cousins, by email on August 22, 2024, addressed to their following attorneys of record: Samuel W. Outten and Miles Coleman, Nelson Mullins Riley & Scarborough LLP, 2 W. Washington St., Suite 400, Greenville, SC 2960; Thomas H. Keim, Jr., Ford Harrison, 100 Dunbar St., Suite 300, Spartanburg, SC 29306; and A. Mattison Bogan, Nelson Mullins Riley & Scarborough, LLP, 1320 Main St., 17th Floor, Columbia, SC 29201.

[Signature of Counsel on Following Page]

August 22, 2024

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August 22, 2024

VIA E-FILING (ctappfilings@sccourts.org)
AND VIA U.S. MAIL
Hon. Jenny Abbott Kitchings
Clerk, South Carolina Court of Appeals
P.O. Box 11629
Columbia, SC 29211

Re: McMillan Pazden Smith, LLC v. Donza H. Mattison etc.,
Appellate Case No. 2020-001645

Dear Ms. Kitchings:

I represent Appellant, Donza H. Mattison, in the above-referenced appeal. Enclosed please find Appellant's Petition for Rehearing and Suggestion for Rehearing En Banc. Please file the original and return a clocked-in copy to me via the court's email portal. I am also enclosing a check for $50.00 for the filing fee with the original, mailed copy of this letter.

As indicated on the attached Proof of Service for this petition, I am hereby serving a copy of the document on Counsel for Respondents.

Thank you in advance for your attention to this matter. If you have any questions or need anything else, please do not hesitate to call me or email me.

Sincerely yours,

David E. Rothstein

Enclosures (2)

cc: Samuel W. Outten, Esq. (all via email only, w/ encl.)
Miles Coleman, Esq.
A. Mattison Bogan, Esq.
Thomas H. Keim, Jr., Esq.