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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In the Supreme Court

CERTIFIED QUESTIONS FROM
UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH CAROLINA
Sherri A. Lydon, United States District Judge

Jean Watkins, as Personal Representative of the Estate of Mildred Watkins, ……………Plaintiff,

v.

Countrywood Nursing Center, LLC, Sterling Healthcare, Inc., Guardian Resources, LLC, Robert W. Hagan, LaDonna Hagan, Chadwick S. Hagan, and Brooke Hagan McGee, ……...Defendants.

Appellate Case No. 2025-001718

BRIEF OF PLAINTIFF

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STATEMENT OF CERTIFIED QUESTIONS

1. **In an action to pierce the corporate veil, can defendants who were not parties to the underlying suit defend against liability on the grounds that they were not liable for the underlying claims? In other words, does South Carolina follow the rule outlined in *Minton et al. v. Cavaney*?**

2. **Does the answer change where the underlying judgment resulted from default or from sanctions striking the corporate defendant's answer?**

STATEMENT OF THE CASE

This matter stems from the unfortunate death of Mildred Watkins at a nursing home in Richland County nearly 14 years ago. (Order for Cert. at 2) Plaintiff Jean Watkins, the daughter and personal representative of the Estate of Mildred Watkins, filed a malpractice lawsuit ("Underlying Suit") against Countrywood Nursing Center, LLC, Sterling Healthcare, Inc., and Guardian Resources, LLC ("Entity Defendants"). (Order for Cert. at 2) After years of litigation, the Circuit Court struck the answer of the Entity Defendants for "act[ing] in bad faith during the discovery process, with willful disobedience to the Court, and with gross indifference to the Plaintiff's rights and to the rule of law." (Order for Cert. at 2-3) Entity Defendants appealed the order striking their answer and the Court of Appeals affirmed. (Order for Cert at 2, n. 2)

Upon remand, the trial court conducted a damages hearing and awarded $29,515,245.68 in damages. (Order for Cert. at 3) Entity Defendants have appealed this damages order to the Court of Appeals where it remains pending. (Order for Cert. at 3)

On September 18, 2024, Plaintiff filed this case as piercing the veil/alter ego claim against Entity Defendants and individuals she claims either owned or controlled businesses: Robert W. Hagan, LaDonna Hagan, Chadwick S. Hagan, and Brooke Hagan McGee ("Individual Defendants"). The case developed a discovery dispute as to the relevance of questions of liability and damages in the Underlying Suit. (Order for Cert. at 3) These certified questions followed.

STANDARD OF REVIEW

> In answering a certified question raising a novel question of law, this Court is free to decide the question based on its assessment of which answer and reasoning would best comport with the law and public policies of the state as well as the Court's sense of law, justice, and right.

Drury Dev. Corp. v. Found. Ins. Co., 380 S.C. 97, 101, 668 S.E.2d 798, 800 (2008), citing Peagler v. USAA Ins. Co., 368 S.C. 153, 157, 628 S.E.2d 475, 477 (2006).

ARGUMENT

Before the Court is a discovery dispute as to the scope of relevant evidence in a piercing the veil action filed subsequent to the underlying suit establishing liability of corporate entities. Fed. R. Civ. P. 26 sets forth that "[p]arties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense…". Fed. R. Civ. P. 26(b)(1). Certified Question #1 asks whether Individual Defendants may seek discovery to relitigate questions of liability resolved in the underlying suit. Certified Question #2 asks what preclusive effect, if any, the order striking Entity Defendants' answer in the underlying suit should have in the present case.

Each question will be addressed in turn.

1. **In an action to pierce the corporate veil, can defendants who were not parties to the underlying suit defend against liability on the grounds that they were not liable for the underlying claims? In other words, does South Carolina follow the rule outlined in *Minton et al. v. Cavaney*?**

The answer to the first certified question is "no." First, liability for the claims of the underlying suit (here, medical negligence) is not a relevant consideration in an equitable action seeking to pierce the corporate veil. Second, concerns of Due Process giving rise to the Minton rule are adequately protected by South Carolina's existing veil-piercing jurisprudence. Thus, Individual Defendants may not challenge liability in a subsequent piercing claim and South Carolina need not follow the Minton rule.

The sole focus of a piercing the veil claim is whether "[t]he corporate form may be disregarded…". Sturkie v. Sifly, 280 S.C. 453, 458, 313 S.E.2d 316, 319 (Ct. App. 1984). "The corporate form may be disregarded only where equity requires the action to assist a third party." Id., quoting Crabtree Investments, Inc. v. Aztec Enterprises, Inc., 479 F.Supp. 448 (M.D.La.1979). To make this determination, our courts employ a two-part test:

> The first part of the test, an eight-factor analysis, looks to observance of the corporate formalities by the dominant shareholders. The second part requires that there be an element of injustice or fundamental unfairness if the acts of the corporation be not regarded as the acts of the individuals.

Sturkie at 457–58, 313 S.E.2d at 318. The eight factors in Part One of the Sturkie test are:

> (1) whether the corporation was grossly undercapitalized;
> (2) failure to observe corporate formalities;
> (3) non-payment of dividends;
> (4) insolvency of the debtor corporation at the time;
> (5) siphoning of funds of the corporation by the dominant stockholder;
> (6) non-functioning of other officers or other directors;
> (7) absence of corporate records; and
> (8) the fact that the corporation was merely a facade for the operations of the dominant stockholder.

Hunting v. Elders, 359 S.C. 217, 224, 597 S.E.2d 803, 807 (Ct. App. 2004). None of these factors invokes reconsideration of the underlying liability of the entity whose corporate veil the Plaintiff seeks to pierce.

Our courts refer to Part Two of the Sturkie test, the "fundamental unfairness" prong, as "[t]he heart of a piercing the corporate veil dispute…". Mid-S. Mgt. Co. Inc. v. Sherwood Dev. Corp., 374 S.C. 588, 599, 649 S.E.2d 135, 141 (Ct. App. 2007). Part Two calls for consideration of the following:

> The burden of proving fundamental unfairness requires that the plaintiff establish (1) that the defendant was aware of the plaintiff's claim against the corporation, and (2) thereafter, the defendant acted

> in a self-serving manner with regard to the property of the corporation and in disregard of the plaintiff's claim in the property.

Sturkie at 459, 313 S.E.2d at 319. "The actual knowledge requirement has been clarified to mean that a person is 'aware of a claim against the corporation if he has notice of facts which, if pursued with due diligence, would lead to knowledge of the claim.'" Mid-S. Mgt. Co. Inc. at 599, 649 S.E.2d at 141, quoting Hunting v. Elders, 359 S.C. 217, 229, 597 S.E.2d 803, 809 (Ct. App. 2004). Nothing within Part Two of the Sturkie test calls for reconsideration of liability of the underlying suit. However, the "fundamental unfairness" prong does require a showing of an individual defendant's knowledge of the underlying suit and actions promoting his own self-interest regarding the underlying suit.

In light of the foregoing elements of proof required for a successful piercing claim, should South Carolina follow the "Minton rule" permitting the relitigation of issues of liability and/or damages in the underlying suit? Minton provides for such relitigation for a defendant who 1) was not a party to the underlying suit, or 2) did not control the litigation leading to the judgment. Minton v. Cavaney, 56 Cal.2d 576, 364 P.2d 473, 476 (Cal. 1961). Minton's ruling derives from the Due Process clause that "guarantees that any person against whom a claim is asserted in a judicial proceeding shall have the opportunity to be heard and to present his defenses." Motores De Mexicali, S. A. v. Superior Ct. In & ForLos Angeles Cnty., 51 Cal. 2d 172, 176, 331 P.2d 1, 3 (Cal. 1958). Drury summarized Minton as "hold[ing] that a judgment against an unresponsive corporate defendant must be set aside in a subsequent action to pierce the corporate veil if the shareholder defendant was not a party to the determination of corporate liability…". Drury at 103, 668 S.E. 2d at 801.

Adopting the "Minton rule" is unnecessary because its Due Process concerns are already satisfied by Part Two of the Sturkie test, the "fundamental unfairness" requirement. This prong of

the Sturkie test already imposes upon piercing actions proof of knowledge of the Plaintiff's claims in the underlying suits and affirmative actions by the Individual Defendant to promote his own interests to the detriment of the Plaintiff's claims. Such defendants—whether previously named parties or not—have demonstrated notice of the prior litigation and efforts to protect their interests therein. Permitting such Defendants to revisit questions of damages and liability, on the other hand, will greatly increase the time (and expense) of litigation, thereby violating the equitable maxim that "a court of equity does not invite litigation." Drury Dev. Corp. at 102, 668 S.E.2d at 801, quoting Earle v. Webb, 182 S.C. 175, 188 S.E. 798, 802 (1936). "It is a principle of equity jurisprudence that a court of equity will take cognizance in a litigated matter of the rights of all parties having an interest, and grant such parties the right to be heard, and will issue such orders as may be necessary to prevent a multiplicity of suits." Id.

An examination of the practical application of Part Two of the Sturkie test to facts of this case demonstrates why it is sufficient to satisfy concerns of Due Process. As the District Court notes, the parties dispute the varying degrees of ownership and/or control each Individual Defendant possessed over the Entity Defendants. (Order of Cert. at 2, n.1) There is no dispute that Robert W. Hagan owned and controlled the Entity Defendants, thus he would not be permitted to relitigate liability under the Minton rule. However, if discovery reveals that one or more of the remaining Individual Defendants never possessed ownership or control of the Entity Defendants (a contention that is "not clear at this juncture")(Order of Cert. at 2, n.1), those facts would become dispositive of the piercing claims against them thus ending their exposure to potential liability and extinguishing concerns of Due Process.

2. **Does the answer change where the underlying judgment resulted from default or from sanctions striking the corporate defendant's answer?**

No, the answer to Question #1 should not change if the underlying judgment resulted from either default judgment or from sanctions striking an answer because the question of underlying liability is not at issue in the piercing the veil lawsuit. However, should the question of underlying liability become an issue in the piercing the veil lawsuit, the doctrine of collateral estoppel may be implicated. In that situation, the answer is yes, an answer stricken via sanctions should be treated as having been an "actual litigation" of the issues in the underlying suit and be given preclusive effect.

"Collateral estoppel, also known as issue preclusion, prevents a party from relitigating an issue that was decided in a previous action, regardless of whether the claims in the first and subsequent lawsuits are the same." Carolina Renewal, Inc. v. S.C. Dep't of Transp., 385 S.C. 550, 554, 684 S.E.2d 779, 782 (Ct. App. 2009), citing Judy v. Judy, 383 S.C. 1, 7, 677 S.E.2d 213, 217 (Ct. App. 2009). "The party asserting collateral estoppel must demonstrate that the issue in the present lawsuit was: (1) actually litigated in the prior action; (2) directly determined in the prior action; and (3) necessary to support the prior judgment." Carolina Renewal at 554, 684 S.E.2d at 782, citing Beall v. Doe, 281 S.C. 363, 369 n. 1, 315 S.E.2d 186, 189–90 n. 1 (Ct. App. 1984). "In the context of a default judgment, collateral estoppel or issue preclusion does not apply because an essential element of that doctrine requires that the claim sought to be precluded actually have been litigated in the earlier litigation." State v. Bacote, 331 S.C. 328, 331, 503 S.E.2d 161, 163 (1998), citing 50 C.J.S. Judgments § 797 (1997).

Traditionally, default judgment is obtained via Rule 55, SCRCP for a failure "to plead or otherwise defend." Rule 55(a), SCRCP. However, default judgment may also be obtained via Rule 37, SCRCP as a sanction "against the disobedient party." Rule 37(b)(2)(C), SCRCP. As this Court recently recognized, "[s]triking an answer is 'harsh medicine that should not be administered

lightly.'" Bauknight as Tr. of James Brown 2000 Irrevocable Tr. v. Pope, 445 S.C. 408, 421, 914 S.E.2d 848, 855 (2025), quoting Karppi v. Greenville Terrazzo Co., 327 S.C. 538, 543, 489 S.E.2d 679, 682 (Ct. App. 1997). As the District Court noted, the Circuit Court in the underlying suit found the sanction to be warranted,

> finding "[t]he harm to the Plaintiff in this case is irreparable and must be met with the harshest of sanctions against the Defendants. The Defendants have acted in bad faith during the discovery process, with willful disobedience to the Court, and with gross indifference to the Plaintiff's rights and to the rule of law."

(Order of Cert. at 2-3) The Entity Defendants appealed the ruling and the Court of Appeals affirmed via unpublished opinion. See Watkins v. Sterling Healthcare, Inc., Op. No. 2021-UP-324 (S.C. Ct. App. filed September 8, 2021).

In the context of collateral estoppel, South Carolina courts do not appear to have addressed the distinction between Rule 55 default and Rule 37 default. However, a number of federal courts have "distinguish[ed] between 'true' default judgments where the defendant failed to answer the complaint from 'penalty' default judgments after a [d]efendant had filed an answer." In re Dardinger, 566 B.R. 481, 496 (Bankr. S.D. Ohio 2017). As the Third Circuit observed,

> This is not a typical default judgment where a defendant neglects or elects not to participate in any manner because of the inconvenience of the forum selected by the plaintiffs, the expense associated with defending the lawsuit, or some other reason. … Apparently, [the Defendant] realized the meritlessness of his position and decided to frustrate orderly litigation by willfully obstructing discovery. We do not hesitate in holding that a party such as Docteroff, who deliberately prevents resolution of a lawsuit, should be deemed to have actually litigated an issue for purposes of collateral estoppel application.

In re Docteroff, 133 F.3d 210, 215 (3d Cir. 1997)(internal citations omitted).[1]

The result must be the same in cases, such as this, where entity defendants have been declared in default as the result of a Rule 37 sanction. If the question of liability in the underlying suit is permitted to be relitigated, the entity defendants and any individual defendant controlling them must be collaterally estopped from contesting the issue. In the words of the Third Circuit, "[t]o hold otherwise would encourage behavior similar to [the defendants] and give litigants who abuse the processes and dignity of the court an undeserved second bite at the apple." Id.

CONCLUSION

For the reasons stated herein, the certified questions should be answered as set forth above. In the alternative, the Court should decline to answer the questions until definitive discovery may be completed on the question of the Individual Defendants' ownership or control of the Entity Defendants and the Court of Appeals issues a ruling on the Defendants' appeal of the award in the underlying action.

Respectfully submitted,

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[1] See also Matter of Gober, 100 F.3d 1195, 1205–06 (5th Cir. 1996), quoting Restatement (Second) of Judgments § 27 cmt. e (1982)("[T]he court struck Gober's pleadings only after Gober had repeatedly impeded the course of the proceedings by refusing to comply with discovery and by defying court orders. The Restatement contemplates that 'even if [an issue] was not litigated, the party's reasons for not litigating in the prior action may be such that preclusion would be appropriate.'"); In re Daily, 47 F.3d 365, 368 (9th Cir. 1995)("A party who deliberately precludes resolution of factual issues through normal adjudicative procedures may be bound, in subsequent, related proceedings involving the same parties and issues, by a prior judicial determination reached without completion of the usual process of adjudication. In such a case the 'actual litigation' requirement may be satisfied by substantial participation in an adversary contest in which the party is afforded a reasonable opportunity to defend himself on the merits but chooses not to do so.")

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