THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM RICHLAND COUNTY
Court of Common Pleas

G. Thomas Cooper, Jr., Circuit Court Judge

Appellant Case No. 2014-000963

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SC Court of Appeals

Allen Patterson, Steve Tilton, Richard Sendler, Lincoln Privette, Marc Ellis, Joey Carter, Barry Davis, Michel Nieri, Allen Patterson Residential LLC, Tilton Group, Sendler Construction Co., Inc., Privette Enterprises, Ellis Construction Co., Inc., The Barry Davis Company, Inc., Great Southern Homes, and J. Carter, LLC, on behalf of themselves and others similarly situated..Appellants,

v.

Herb Witter, Colin Campbell, Eddie Weaver, Tom Markovich, Keith Smith, Jim Gregorie, individually and as Trustees of the South Carolina Home Builders Self Insurers Fund, and the South Carolina Home Builders Self Insurers Fund..Respondents.

INITIAL BRIEF OF APPELLANTS

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STATEMENT OF ISSUES ON APPEAL

I. JUDGE COOPER IMPROPERLY RELIED ON THE PLEADING REQUIREMENTS OF RULE 23(b) REGARDING DERIVATIVE ACTIONS BROUGHT BY SHAREHOLDERS TO DISMISS THIS CASE BECAUSE THE TRUST FUND IS A TRUST WHICH IS NOT SUBJECT TO THE PLEADING REQUIREMENTS OF RULE 23(b).

II. JUDGE COOPER IMPROPERLY RELIED ON THE PLEADING REQUIREMENTS OF RULE 23(b) TO DISMISS THE CASE BECAUSE THE TRUST FUND IS NOT AN UNINCORPORATED ASSOCIATION, THE BENEFICIARIES OF THE TRUST ARE NOT SHAREHOLDERS, AND THE ACTION IS NOT DERIVATIVE.

III. EVEN IF THE COURT REQUIRES THE TRUST BENEFICIARIES TO COMPLY WITH RULE 23(b), THE BENEFICIARIES HAVE MET THE PLEADING REQUIREMENTS OF RULE 23(b), AND JUDGE COOPER DISMISSED THE COMPLAINT IN ERROR.

STATEMENT OF THE CASE

The Plaintiffs are beneficiaries of a trust. (Trust, R. _____). In February 2012, they sued the Defendants for breach of their duties as trustees. The matter was originally brought in February 2012 as case number 2012-CP-32-00757. (Original Complaint, R. _____). By consent of the parties, the matter was moved to Richland County and assigned case number 2012CP-40-04311. In that case, the Trustees moved to dismiss alleging that the action against them must be brought in Probate Court because they were the trustees of a trust. Judge Manning granted that motion. (Manning Order, R. _____). The Plaintiffs then sued in Probate Court on April 9, 2013, and removed the case to Circuit Court. (Complaint, R. ______; Removal, R. _____). The Defendants moved to dismiss, arguing that the entity was not a trust, but an unincorporated association subject to the additional pleading requirements of Rule 23. Judge Cooper denied their motion on November 8, 2013. (1st Cooper Order, R. _____). The Defendants moved to reconsider. Judge Cooper reversed his earlier position and dismissed the complaint on February 11,

2014. (2nd Cooper Order, R. _____). Judge Cooper held that the Trust Fund is not a "trust in its commonly recognized form." As a result, he treated the trust as an unincorporated association and held the pleadings to the standards required for derivative actions under South Carolina Rule of Civil Procedure 23(b). Judge Cooper then determined that the trust beneficiaries did not comply with Rule 23(b) because they did not allege with particularity the efforts they made to satisfy the pre-suit demand request in Rule 23(b). As a result, he dismissed the Complaint. The Plaintiffs moved to reconsider, and Judge Cooper denied their motion. (3rd Cooper Order, R. _____). The Plaintiffs filed their Notice of Appeal May 1, 2014.

FACTS

In September 1995, the South Carolina Home Builders Association created a trust to administer worker's compensation benefits for its members. That trust is titled the South Carolina Home Builders Self Insurers Fund (Trust Fund). (Trust, R. _____). The Trust Fund had several members of the South Carolina Home Builders Association on its board and worked in conjunction with the South Carolina Home Builders Association to sell worker's compensation insurance policies and administer the policies. (Affidavit of David Gully, R. _____).

The Trustees have made significant actions towards dissolving the trust and creating a new insurance company with the proceeds. The new insurance company would be a mutual insurance company of which the Trustees would all be board members. The insurance company would not have any particular benefit to the beneficiaries of the trust. The assets of the trust would be used to set up a company competing with the trust. The Trustees transferred approximately five million dollars out

of the trust to do this. At some point, they transferred the money back into the trust. There is approximately $20,000,000 remaining in the trust to fund its liabilities. However, the Trustees intend to use these funds to set up a separate insurance company which will convey no benefit to the beneficiaries of the trust. (Complaint; Affidavit of David Gully, R. _____).

The Trustees have purchased a building with trust assets as well as an expensive software program for the purpose of creating another insurance company which will convey no benefit to the beneficiaries of the trust. The Trustees have used these assets to begin setting up a separate insurance company which will convey no benefit to the beneficiaries of the trust and have not reimbursed the trust for these costs including the use of facilities, the software programs, and the employees of the trust. If the trust continues along its present course, there will be insufficient assets to cover its risks which will expose the beneficiaries to additional risk. All beneficiaries of the trust are subject to personal liability for any shortfall in trust assets. (Affidavit of David Gully, R. _____).

ARGUMENT

I. JUDGE COOPER IMPROPERLY RELIED ON THE PLEADING REQUIREMENTS OF RULE 23 TO DISMISS THIS CASE BECAUSE THE SELF INSURERS TRUST IS A TRUST WHICH IS NOT SUBJECT TO THE PLEADING REQUIREMENTS OF RULE 23(b).

A. THE TRUST FUND MEETS THE SOUTH CAROLINA REQUIREMENTS FOR A TRUST.

A trust is created by "written declaration signed by the owner of property that the owner holds identifiable property as trustee." S.C. Code Ann. § 62-7-401(a)(2) (2013). For a trust to be created, there must be "a declaration of the trust, property to which the trust pertained, a Trustee, and named beneficiaries." *Johnson v. Thornton,* 264 S.C. 252,

257, 214 S.E.2d 124, 127 (1975); *see also,* Restatement (Second) of Trusts § 2 (1959). A beneficiary is defined as a "person that has a present or future beneficial interest in a trust, vested or contingent." S.C. Code Ann. § 62-7-103 (2)(A).

The Trust Fund is a trust. It meets all requirements of a trust in South Carolina. It was created by a written declaration. There is identifiable property, named trustees, and the beneficiaries are named or identified. (Trust, pp. 1-9, R. _____).

The trial court erred when it held that the Trust Fund was not a trust. The court stated: "[t]he Agreement and Declaration of Trust in this case is replete with references to trustees and trustee duties and obligations. There is no reference to, or provisions for, 'beneficiary(ies)' in the document." (2nd Cooper Order, p.3, R. _____). The court reasoned that because the word "beneficiary" was not used, beneficiaries were not created. However, the Trust used the word "member" to identify the beneficiaries, since all beneficiaries were also members of the South Carolina Home Builder's Association. The court was in error, since the use of the term "member" rather than "beneficiary" does not disqualify the Trust Fund as a trust.

"[N]o particular form of words is essential to the creation of an express trust, but unquestionably an intention so to do, on the part of the person to whom such creation is imputed, is essential." *Richardson v. Inglesby,* 34 S.C. Eq. 59, 101 (S.C. Ct. App. 1866). Even the word "trust" does not have to be used in the document creating a trust as long as all requirements are met. *Hunter v. Hunter*, 58 S.C. 382, 36 S.E. 734, 736 (1900).

> There is no particular formality required or necessary in the creation of a trust. Any agreement or contract in writing, made by a person having the power of disposal over property, whereby such person agrees or directs that a particular parcel of property, or a certain fund, shall be held or dealt with in a particular manner for

> the benefit of another, in a court of equity, raises a trust in favor of such other person.

Black v. Harman, 127 S.C. 359, 359, 120 S.E. 705, 710 (1923) (J. Hothran, dissenting) *citing* 1 Perry, Trusts (3d Ed.) § 82. There are no required words for the establishment of a trust. As long as the agreement declares that property is held by one for the benefit of another, a trust is created. *Id.*

The content of the trust document indicates that the member beneficiaries were to benefit from the trust's operations. (Trust, pp. 1, 3, R. _____). The Trust Agreement states that "the Settlor and the Trustees intend to . . . establish[] a group self insurers fund . . . *for the benefit of the members;*" and that this is "*in the best interest of the members.*" Though the word member is used instead of beneficiary, the agreement is a contract in writing, made by a person having the power of disposal over a certain fund, which shall be held or dealt with in a particular manner for the benefit of another. *Black,* 127 at 359, 120 S.E. at 710.

The trust document also states explicitly that it is a trust. "The Agreement and Declaration of Trust in this case is replete with references to trustees and trustee duties and obligations . . . ." (2nd Cooper Order, p.3, R. _____). The first page of the document declares that it is an "AGREEMENT AND DECLARATION OF TRUST CREATING THE SOUTH CAROLINA HOME BUILDERS SELF INSURERS FUND." (Trust, p.1, R. _____). Article II is titled "CREATION OF THE TRUST" and calls the fund a trust fund as follows:

> There is hereby established and created a Trust Fund which shall be known as the SOUTH CAROLINA HOME BUILDERS SELF INSURERS FUND and the Trustees thereof may hold property, enter into contracts and in all matters as hereinafter set forth act in

> behalf of the Trust Fund in that name. This Trust Fund shall be used for the purposes as hereinafter set forth.

(Trust, p.3, R. _____). It continues by stating that:

> WHEREAS, it is considered to be in the best interest of the members of the Home Builders Association of South Carolina, Inc. that an Agreement and Declaration of Trust fully setting forth the duties and responsibilities of the Trustees be entered into.

(Trust, p.1, R. _____). In addition, the agreement states: "[t]he Board of Trustees shall have all authorities and powers granted to Trustees generally under the laws of South Carolina including the powers and authorities conferred under the Uniform Trustee's Powers Act." (Trust, p.11, R. _____). And, it cites Section 62-7-703(b) of the Probate Code to set forth the powers of the trustees. (Trust, p.11, R. _____).

The trial court reasoned that because "[e]ach member pays a predetermined rate" to the fund that the fund cannot be trust. (2d Cooper Order, p.3, R. _____). This reasoning is in error. The settlor of a trust is defined as "a person, including a testator, who creates, or contributes property to, a trust." S.C. Code Ann. § 62-7-103. Therefore, the member beneficiaries of the trust contribute to the trust fund. There is no South Carolina law prohibiting a settlor from being a beneficiary of a trust or prohibiting beneficiaries of a trust from contributing to it.

The Trust Fund meets all requirements of a trust, states that it is a trust, and refers to South Carolina Probate Code in defining trustee powers. It has a settlor, trustee, and beneficiaries. It is not incorporated. If it is not a trust as the trustees argue, what can it be?

If it is an unincorporated association, it could be a partnership. But there is no document indicating that any of the parties intended it to be a partnership. It is not a

union, fraternal organization, sports team, or unincorporated church. The trust document makes no reference to it being an unincorporated association. It is not registered as a business trust. If the Trust Fund is not a trust, it does not identify as any entity currently recognized at law. It would have to be an entirely new species of business organization.

B. THE DEFENDANTS HAVE ALREADY ASSERTED THAT THE TRUST FUND IS A TRUST AND CANNOT NOW CONTEND THAT IT IS NOT.

The Plaintiffs are beneficiaries of the Trust Fund and sued the Defendants for breach of their duties as trustees. The matter was originally brought in February 2012 as case number 2012-CP-32-00757. In that case, the Trustees moved to dismiss on the basis that the Trustees must be sued in Probate Court because they served a trust. The Trustees stated: "this action should be dismissed for lack of subject matter jurisdiction as it involves the internal affairs of a trust." (1st Notice of Motion and Motion to Dismiss by Defendants, p.2, R. _____). In support of this motion, the Trustees submitted the affidavit of Jeffrey Ranew. He continually refers to the South Carolina Home Builders Self Insurers Fund as a trust and the funds as a trust corpus. (Affidavit of Jeffrey Ranew, R. _____).

Judge Manning granted the motion to dismiss, stating:

> In particular, the Defendants have moved to dismiss on the basis of lack of subject matter jurisdiction. The Defendants argued that this lawsuit involved the internal affairs of the Trust such that it must be filed in the Probate Court under South Carolina Code Section 62-7-201.... It is clear from the documents submitted to the Court that this dispute concerns a trust.... With this in mind, the Court dismisses this lawsuit without prejudice such that it may be refiled in Probate Court to cure any alleged defects in subject matter jurisdiction.

(Manning Order, R. _____).

In their Second Motion to Dismiss, the Defendants took the position that the trust is not a trust, but an unincorporated association. (2d Notice of Motion and Motion to Dismiss, R. _____). The Trustees cannot now claim that the Trust Fund is not a trust when they previously maintained that it was a trust and received relief under that theory.

Judicial estoppel precludes a party from adopting a position in conflict with one earlier taken in the same or related litigation. *Hayne Federal Credit Union v. Bailey*, 327 S.C. 242, 252, 489 S.E.2d 472, 477 (1997) (citing *Colleton Regional Hosp. v. MRS Med. Rev. Systs.*, 866 F. Supp. 896 (D.S.C. 1994)). Judicial estoppel applies to inconsistent statements of fact. *Id.* "When a party has formally asserted a certain version of the facts in litigation, he cannot later change those facts when the initial version no longer suits him." *Id.*

In *Hayne Federal Credit Union v. Bailey*, Mr. Bailey claimed ownership of a house through a resulting trust. Earlier, in his divorce, he disavowed any interest in the property and maintained that the property belonged to his son. The Supreme Court held Mr. Bailey was estopped from later claiming an interest in the property because in his divorce he attributed ownership to his son.

Likewise, the Trustees cannot now claim that the Trust Fund is not a trust. The Trustees obtained an order from the court dismissing the previous lawsuit based on their factual assertion that the South Carolina Home Builders Self Insurers Fund was a trust. Now, the Trustees take the position that it is not a trust, but an unincorporated association, which changes the pleading requirements of the lawsuit. The Trustees cannot assert these two different versions of the facts. They are bound by the assertion made in the previous lawsuit and the order which resulted. Thus, the Trust Fund is a

trust, not an unincorporated association, and does not have to comply with Rule 23(b) regarding derivative actions.

II. RULE 23(b) DOES NOT APPLY TO THE TRUST FUND BECAUSE THE TRUST FUND IS NOT AN UNINCORPORATED ASSOCIATION, THE BENEFICIARIES OF THE TRUST ARE NOT SHAREHOLDERS, AND THE ACTION IS NOT DERIVATIVE.

A. THE TRUST FUND IS NOT AN UNICORPORATED ASSOCIATION.

The trial court erred when it re-classified this lawsuit as a derivative suit by changing the Trust Fund into an unincorporated association. The Plaintiffs are the beneficiaries of the Trust Fund.[1] The trustee Defendants must operate the trust for the benefit of the Plaintiff beneficiaries, not for the benefit of a separate corporation or association.

Under South Carolina law, trusts are not unincorporated associations. For example, the South Carolina Real Property Valuation Reform Act defines a legal entity in the disjunctive as a "corporation, partnership, limited liability company, unincorporated association, or trust." S.C. Code § 12-37-3160(c). Likewise, the Uniform Land Sales Practice Act lists trusts and unincorporated associations as separate types of business entities as follows:

> (3) "*Person*" means an individual, corporation, government, or governmental subdivision or agency, business trust, estate, trust, partnership, unincorporated association, two or more of any of the foregoing having a joint or common interest, or any other legal or commercial entity.

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[1] In addition, each beneficiary of the Trust Fund is jointly and severally liable for underfunded losses of the Self Insurers Fund. (Affidavit of David Gully, ¶13). Under South Carolina law, a shareholder is not liable for corporate losses. S.C. Code Ann. § 33-6-220(b).

S.C. Code Ann. § 27-29-10(3). The South Carolina Consumer Protection Code uses a similar definition. *See*, S.C. Code Ann § 37-25-10(2).

In addition, the South Carolina Code makes separate provisions for naming an unincorporated association in a lawsuit and for serving an unincorporated association. *See*, S.C. Code Ann. §§ 15-5-160 and 15-9-330. The Code also includes separate provisions for collection of judgments against unincorporated associations. *See*, S.C. Code Ann. § 15-35-170. The South Carolina Corporate Code defines both an unincorporated association and a trust as legal entities naming each one separately. *See*, S.C. Code Ann. § 33-1-400(11). So do the South Carolina Nonprofit Corporation Act and the South Carolina Unfair Trade Practices Act. *See*, S.C. Code Ann. §§ 33-31-140(15) and 39-5-10(a),

The Code also separately sets forth how to create a trust. *See*, S.C. Code Ann. § 62-7-401. It sets forth what venue is appropriate for suit against a trust. S.C. Code Ann. § 62-7-204. In fact, Article 7 of the South Carolina Probate Code contains the South Carolina Trust Code which contains detailed law regarding the creation and governance of trusts. *See*, S.C. Code Ann. §§ 62-7-101 to 62-7-1106.

As a result, the South Carolina Code treats unincorporated associations and trusts as distinct legal entities. And, Judge Cooper erred in redefining the Trust Fund as an unincorporated association and subjecting it to the requirements of Rule 23(b).

The trust document makes the beneficiary members of the Trust Fund jointly and severally liable for its debts, but this does not transform the Trust Fund into an unincorporated association. The Trust Fund calls itself a trust, calls its board members trustees, and meets the definition of a trust. Trusts are not treated as unincorporated

associations in South Carolina. There is no South Carolina authority of any sort treating a trust as an unincorporated association. Therefore, the Trust Fund should be treated as a trust – not an unincorporated association. As a result, the Trust Fund is not entitled to the derivative action protections of Rule 23(b) which apply only to corporations and unincorporated associations.

B. THE BENEFICIARY MEMBERS ARE NOT SHAREHOLDERS AND DO NOT HAVE THE RIGHTS OF SHAREHOLDERS.

Under Rule 23(b) a derivative action is "brought by one or more *shareholders or members to enforce a right of a corporation or of an unincorporated association*...." Nevertheless, Judge Cooper applied it to this action against a trust. Thus, to apply Rule 23(b), the beneficiaries of the trust would have to be shareholders of a corporation or members of an unincorporated association. A shareholder is a "person in whose name shares are registered in the records of a corporation or the beneficial owner of shares...." S.C. Code Ann. § 33-1-400. There are no registered shares in the Trust Fund.

In addition, shareholders have certain rights which the beneficiaries of the Trust Fund do not have. These rights give shareholders protection against abuses of directors. These rights include: the right to elect directors, S.C. Code Ann. § 33-8-103, notification of and opportunity to attend shareholder meetings, S.C. Code Ann. § 33-7-105, access to a list of shareholders entitled to vote, S.C. Code Ann. § 33-7-200, the right to distributions, S.C. Code Ann. § 33-6-400, the preemptive right to acquire unissued shares, S.C. Code Ann. § 33-6-300, the right to submit demands for meetings, S.C. Code Ann. § 33-7-102, the right to remove directors, S.C. Code Ann. § 33-8-108, and the right to dissent and obtain payment of shares, S.C. Code Ann. § 33-13-102.

The beneficiaries of the Homebuilder's Trust do not have the right to dissent. They do not have the right to shares. They do not have a right to meetings. They do not have the right to distributions, the right to acquire unissued shares, the right to submit demands. In derivative actions, the law presumes there are other rights which belong to the shareholder bringing the action. The members of the trust are not shareholders, they do not have shareholder rights, and Rule 23(b) protections do not apply to the Trust Fund.

C. THIS ACTION IS NOT A DERIVATIVE ACTION.

1. Derivative Actions Do Not Apply To Trusts.

The plain meaning of Rule 23(b) does not apply it to trusts. "Where a statute uses a word having a well-recognized meaning in law, the presumption is that the Legislature intended to use the word in that sense." *Coakley v. Tidewater Construction Corp.*, 194 S.C. 284, 9 S.E.2d 724 (1940).

The trial court erred in holding that Rule 23(b) applies to the Trust Fund. The Rule reads:

> In a derivative action brought by one or more *shareholders or members to enforce a right of a corporation or of an unincorporated association*, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege that the plaintiff was a shareholder or member at the time of the transaction....

Rule 23 (b)(1) (emphasis added).

The Rule specifically includes corporations and unincorporated associations. It does not mention trusts. If the legislature had intended for the rule to apply to trusts, it could have included trusts in the language of the rule. All case law involving derivative actions in South Carolina involves corporations and unincorporated associations, including partnerships. No South Carolina court has ever applied this rule to trusts.

The harm from mismanagement of the trust flows directly to the beneficiaries who are liable for any shortfalls in trust assets. The harm does not flow to a corporation. "[A] shareholder's suit is derivative if the gravamen of his complaint is an injury to the corporation and not to the individual interest of the shareholder." *Brown v. Stewart*, 348 S.C. 33, 49, 557 S.E.2d 676, 684 (S.C. Ct. App. 2001). Here, the injury is to each beneficiary who must, individually, make up for any shortfall in trust assets. The shortfall will not be made up by the trustees. Therefore, according to the plain language of the rule and the case law on derivative suits, Rule 23(b) does not apply to this action brought by the beneficiaries of the Trust Fund.

Every South Carolina case on trusts has been brought by beneficiaries without following the requirements set out in Rule 23(b). There are no South Carolina cases requiring the beneficiaries of a trust to follow Rule 23(b). South Carolina cases by beneficiaries against trustees do not require a derivative action or compliance with Rule 23(b): *E.g. Cartee v. Lesley,* 290 S.C. 333, 335, 350 S.E.2d 388, 389 (1986) ("Petitioners are the beneficiaries of a trust administered by [the trustees]. The beneficiaries brought suit against the trustees for negligence and breach of fiduciary duty alleging the estate had been mismanaged."); *Epworth Orphanage v. Long,* 199 S.C. 385, 19 S.E.2d 481 (1942) ("The complaint alleges a cause of action in equity against the executors and trustees of a testamentary trust, all the beneficiaries of said trust being made parties."); *Mayer v. M.S. Bailey & Son,* 347 S.C. 353, 359-60, 555 S.E.2d 406, 409 (Ct. App. 2001) ("we hold that as a minimum the [beneficiaries] had both standing and justiciable rights that a court of equity could protect."); *Rembert v. Gressette,* 318 S.C. 519, 520, 458 S.E.2d 552, 553 (Ct. App. 1995) ("Three beneficiaries . . . opposed the planned

distribution of the trust assets and counterclaimed against the trustees...."); *Ramage v. Ramage,* 283 S.C. 239, 243, 322 S.E.2d 22, 25 (Ct. App. 1984) ("[The beneficiaries] brought this action to have the quitclaim deed set aside and to enforce the terms of the trust.). South Carolina courts allow trust beneficiaries to bring actions against trustees. There is no South Carolina rule, statute or case which treats an action by trust beneficiaries as a derivative stockholder action or which require beneficiaries of a trust to comply with Rule 23(b).

2. <u>This Lawsuit Alleges Direct Injury To The Beneficiaries</u>.

The action brought by the Beneficiaries is not derivative, but a direct action. "[A] direct action is one where misconduct by the management of a corporation causes a particular loss to an individual shareholder." *In re Greenwood Supply Co.,* 295 B.R. 787, 795 (Bankr. D.S.C. 2002). Courts have ruled that actions based upon allegations of breach of fiduciary duty and negligent mismanagement that resulted in a reduction of a shareholder's ownership in a corporation constitute direct actions. If there are allegations of a distinct injury to the shareholder, the action is not derivative. *Id.*

The Beneficiaries are not shareholders, and they have each suffered a particular loss. The trust was to be operated for the benefit of its members. Each member is a beneficiary of the trust. Therefore, mismanagement of the trust results in a direct loss to each beneficiary. Because they are beneficiaries and not shareholders, their only recourse is to bring a direct action. Since the Plaintiffs are beneficiaries of the trust, they have standing to bring this action.

The trial court erred when it held: "[t]he gravamen of the Plaintiffs' Complaint alleges that the fund has been injured, not that the members have been injured." (2nd Cooper Order, p.4, R. _____). The Complaint says:

> 21. The Defendants have removed approximately five million dollars from the trust corpus for the purpose of establishing a separate member owned insurance company which will not provide any benefit to the Beneficiaries of the Trust.
> 22. The Trustees did not advise the beneficiaries that the funds could have been returned to them....
>
> 40. As a direct and proximate result of the Defendants' breach of their fiduciary duties and breach of the trust agreement, the Plaintiffs have been injured including, but not limited to, loss of funds, attorney fees, harassment and aggravation, loss of trust assets, higher payments into the Trust, and other damages all to their actual damage....
>
> 60. The beneficiaries' best interests would be served by a termination of the Trust and distribution of its assets to the beneficiaries.

(Complaint, R. _____). The Beneficiaries allege that the Trustees took monies from the Trust Fund, monies which were to be used for their benefit only, and used it for another purpose which injured them individually. The Complaint states the harm from the mismanagement of the trust flows directly to the beneficiaries, who are liable for any shortfalls in trust assets. The injury is to each beneficiary who must, individually, make up for any shortfall in trust assets.

3. <u>Even If The Trust Fund Is Treated As An Unincorporated Association, The Beneficiaries' Claims Are Not Derivative But Individual Such That They Are Not Governed By Rule 23(b)</u>.

There are two exceptions to the general rule that a shareholder cannot sue for injuries to his corporation: (1) where there is a special duty between the wrongdoer and the shareholder, and (2) where the shareholder suffered an injury separate and distinct

from that suffered by other shareholders. *Rice-Marko v. Wachovia Corp.*, 398 S.C. 301, 308, 728 S.E.2d 61, 65 (Ct. App. 2012). The Trustees have a special duty to the member beneficiaries.

The Trust document states that: "The Board of Trustees shall have all authorities and powers granted to Trustees generally under the laws of South Carolina including the powers and authorities conferred under the Uniform Trustee's Powers Act" (Trust, p.11, R. _____). The South Carolina Trust Code reads: "the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with this article," and that a "trustee shall administer the trust solely in the interests of the beneficiaries." S.C. Code Ann. §§ 62-7-801 and 62-7-802 (a).

Even when trustees act in good faith, any action they take must be in the interests of the beneficiaries. Because of this special duty, the beneficiaries meet the exception and can sue for injuries without bringing a derivative action.

III. EVEN IF THE COURT REQUIRES THE TRUST BENEFICIARIES TO COMPLY WITH RULE 23(b), THE BENEFICIARIES HAVE MET THE PLEADING REQUIREMENTS OF RULE 23(b) AND JUDGE COOPER DISMISSED THE COMPLAINT IN ERROR.

A. EVEN THOUGH THE TRUST BENEFICIARIES ARE NOT SUBJECT TO RULE 23(b), THEY HAVE COMPLIED WITH IT.

The beneficiaries have complied with the requirements of Rule 23(b). This rule requires a verification of the complaint. Each plaintiff has verified the complaint under oath. These verifications were served on the Defendants.

Rule 23(b) also requires that the Plaintiff set forth "the efforts, if any, made" to obtain the action desired. The complaint sets this out as follows:

> 8. To the extent required by South Carolina Rule of Civil Procedure 23, the Plaintiffs allege:
>
> a. The Plaintiffs were beneficiaries of the trust at all times relevant including when the transactions complained of were made.
>
> b. The Plaintiffs, their agents or others on their behalf have made efforts to obtain the action they desire in this matter including correspondence to counsel for the Defendants, meetings with counsel for the Defendants, correspondence to the Trust and a previous lawsuit to no avail.

Plaintiffs' counsel also sent a letter to defense counsel setting forth the relief requested before bringing the suit. This letter was referenced in the Complaint (Transcript, pp. 27-31, R. _____) and states:

> In particular, our clients believe the following actions are necessary and should be taken on behalf of the fund:
>
> 1. The $5,000,000 which was taken out of the fund as excess funds to establish a competing mutual fund should be distributed immediately to the beneficiaries of the Trust as it is not needed for the operation of the South Carolina Home Builders Self Insurers Fund.
>
> 2. An accounting should be made of all remaining funds in custody of the South Carolina Home Builders Self Insurers Fund. All funds not necessary to insure liability should be distributed to members of the Trust.
>
> 3. Elections have not been held as required by the Trust documents. Elections should be held for all positions of Trustees.
>
> 4. The Trust should be dissolved as it appears in the Trustees' decision that a competing entity should be set up and that the Trust no longer serves its functions. As a result, the Trust should be dissolved with requisite amounts kept on hand to insure against future liabilities with the remaining assets distributed to members of the Trust.
>
> 5. All assets contemplated for use by the Mutual Fund and purchased with that intent should be sold with the proceeds to be distributed to beneficiaries of the Trust.

(Demand Letter, R. _____). The Trustees acknowledged to the court that this letter was received and was authentic. (Transcript pp. 27-28, R. _____).

Courts consider elements referenced in complaints if they are incorporated by reference. *Carolina First Corp. v. Whittle,* 343 S.C. 176, 190, 539 S.E.2d 402, 410 (Ct. App. 2000). Demand letters, even though not attached to a complaint but referenced in the complaint satisfy the requirements of Rule 23. *Stoner v. Walsh,* 772 F. Supp. 790, 797 (S.D.N.Y. 1991). Along with exhibits attached to the complaint, *see Hal Roach Studios, Inc. v. Richard Feiner & Co., Inc.,* 896 F.2d 1542, 1555 n.19 (9th Cir. 1989), courts also consider documents "referenced by the complaint and accepted by all parties as authentic." *Van Buskirk v. Cable News Network, Inc.,* 284 F.3d 977, 980 (9th Cir. 2002).

In its order, the trial court stated "[a]t a minimum, the demand must identify the alleged wrongdoers...." The Complaint reads:

> 19. The Defendants are trustees under the Agreement and Declaration of Trust Creating The South Carolina Home Builders Self Insurers Fund.

It should "describe the factual basis of the alleged wrongful acts..."

> 20. The Defendants have voted to remove assets from the Trust in order to incorporate a new member owned insurance company which confers no benefits upon the beneficiaries of the Trust.
> 21. The Defendants have removed approximately five million dollars from the trust corpus for the purpose of establishing a separate member owned insurance company which will not provide any benefit to the Beneficiaries of the Trust.

"and the harm caused..."

> 40. As a direct and proximate result of the Defendants' breach of their fiduciary duties and breach of the trust agreement, the Plaintiffs have been injured including, but not limited to, loss of

> funds, attorney fees, harassment and aggravation, loss of trust assets, higher payments into the Trust, and other damages all to their actual damage.

and "request [] remedial relief...."

> 41. The Plaintiffs are entitled to an Order of this Court ordering that the Trustees be removed for breach of their fiduciary duties and breach of trust, that new trustees be elected, that all trust assets be returned to the Trust, that all damages incurred and funds taken out of the trust in breach of fiduciary duties and trust agreement be awarded, enjoining further violations of the fiduciary duties and trust agreement, and awarding the Plaintiffs and the class actual and punitive damages.
> 53. The Plaintiffs request an order of this Court ordering that the Defendants must comply with the Agreement and Declaration of Trust Creating The South Carolina Home Builders Self Insurers Fund and their fiduciary duties.
> 54. In particular, the Plaintiffs are entitled to an order of this Court ordering that the Defendants may not take funds or assets from the trust for the purpose of setting up a member owned insurance company.
> 57. The Plaintiffs hereby demand an accounting pursuant to South Carolina trust law and common law for all expenditures made by the trust.
> 62. The Plaintiffs ask that a receiver be appointed and that the Trust be terminated with the assets distributed to the beneficiaries after costs and fees.

(2nd Cooper Order, R. _____; Complaint, R. _____). The wrongdoers are identified. The factual basis for the wrongful acts is established. The harm is identified, and the beneficiaries requested remedial relief. In addition, the Complaint is verified by beneficiaries. It alleges the action taken to obtain relief as well as the relief requested.

As a result, the Plaintiffs have complied with Rule 23(b) by stating in detail their request for relief, verifying their complaint, and stating that they undertook efforts to obtain that relief.

B. THE TRIAL COURT RELIED UPON *CAROLINA FIRST CORP. V. WHITTLE* TO GRANT THE TRUSTEES' MOTION. THIS DISMISSAL IMPROPERLY APPLIED RULE 23(b) AND SHOULD BE OVERTURNED.

The trial court relied on *Carolina First Corp. v. Whittle,* 343 S.C. 176, 539 S.E.2d 402 (Ct. App. 2000), to determine the beneficiaries did not comply with Rule 23(b). This decision is erroneous and should be overturned.

The trial court quoted extensively from *Whittle* to explain the requirements of Rule 23. *Whittle* states "that the sufficiency of the pleading in meeting the requirements of Rule 23 must be based solely upon the allegations contained within it." *Id.* at 188-89, 539 S.E.2d at 409, *citing McCormick v. England,* 328 S.C. 627, 633, 494 S.E.2d 431, 433 (Ct. App. 1997). This conclusion is in error. *McCormick* did not involve application of Rule 23: it concerned whether or not a physician's breach of confidentiality constituted a cause of action. *Id.* at 630, 494 S.C. at 432. The court's citation of *McCormick* does not mention Rule 23. *Id.* at 632-33, 494 S.E.2d at 433 (Ct. App. 1997).

The *Whittle* court also relied upon *Hawes v. City of Oakland,* 104 U.S. 450 (1881), to support its decision. This case examined whether a shareholder was required to bring a demand at all:

> [I]t is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances, or action in conformity to his wishes.

Hawes, 104 U.S. at 460-61. The Court held that a demand must be made, and that the "efforts to induce such action as complainant desires on the part of the directors, and of the shareholders when that is necessary, and the cause of failure in these efforts should be stated with particularity...." *Id.* at 461.

Rule 23(b)(1) was adopted from the federal rules of procedure. The Official Reporter Comments to S.C. Code Ann. § 33-7-400 state that courts should use federal precedent to construe procedural rules as follows: "Bringing an additional set of litigation rules into the South Carolina Business Corporation Act on top of Rule 23(b)(1) was deemed inadvisable, particularly since courts called on to interpret the new South Carolina rule have a large body of federal precedent from which to draw." Official Reporter Comments, S.C. Code Ann. § 33-7-400. Thus, the Corporation Act contemplates that South Carolina courts will rely upon federal precedent when construing Rule 23(b).

Federal courts do not encourage dismissal of suits based on Rule 23(b). "Rule 23(b) was not written in order to bar derivative suits." *Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363, 371 (1966). Rather, the rule was written to prevent "strike suits," which are essentially worthless claims brought by persons trying to get a quick settlement. *Id.* The *Surowitz* court was very clear that Rule 23 should not prevent adjudication on the merits of a reasonable complaint:

> We cannot construe Rule 23 or any other one of the Federal Rules as compelling courts to summarily dismiss, without any answer or argument at all, cases like this where grave charges of fraud are shown by the record to be based on reasonable beliefs growing out of careful investigation. The basic purpose of the Federal Rules is to administer justice through fair trials, not through summary dismissals as necessary as they may be on occasion. These rules were designed in large part to get away from some of the old procedural booby traps which common-law pleaders could set to prevent unsophisticated litigants from ever having their day in court. If rules of procedure work as they should in an honest and fair judicial system, they not only permit, but should as nearly as possible guarantee that bona fide complaints be carried to an adjudication on the merits. Rule 23(b), like the other civil rules, was written to further, not defeat the ends of justice . . . . The dismissal of this case was error. It has now been practically three

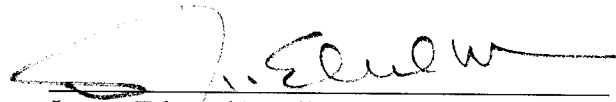
> years since the complaint was filed and as yet none of the defendants have even been compelled to admit or deny the wrongdoings charged. They should be.

Surowitz, 383 U.S. at 373-74. Just as in *Surowitz,* it has been over two years since the beneficiaries filed their complaint. They followed the order of the court declaring the Trust Fund as a trust by filing this matter in probate court. Now, the Trustees have placed another procedural hurdle. The rules of procedure are intended to result in an honest and fair judicial system in which parties have disputes resolved on their merits rather than procedural technicalities.

CONCLUSION

This Court should reverse Judge Cooper's order dismissing the beneficiaries' lawsuit against the Trust Fund because the pleading requirements of Rule 23(b) do not apply to actions against trusts, a trust is not an unincorporated association, and the beneficiaries complied with Rule 23(b).

Respectfully submitted,



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August 4, 2014

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

Appeal from Richland County
Court of Common Pleas

G. Thomas Cooper, Circuit Court Judge

Appellate Case No. 2014-000963

Allen Patterson, Steve Tilton, Richard Sendler,
Lincoln Privette, Marc Ellis, Joey Carter, Barry Davis,
Michel Nieri, Allen Patterson Residential LLC, Tilton
Group, Sendler Construction Co., Inc., Privette Enterprises,
Ellis Construction Company, Inc., The Barry Davis Company, Inc.,
Great Southern Homes, and J. Carter, LLC, on behalf of
themselves and others similarly situated..Appellants,

v.

Herb Witter, Colin Campbell, Eddie Weaver,
Tom Markovich, Keith Smith, Jim Gregorie,
individually and as Trustees of the South
Carolina Home Builders Self Insurers Fund, and
the South Carolina Home Builders Self Insurers Fund.........................Respondents.

PROOF OF SERVICE

I certify that I have served the Initial Brief of Appellants' on the Respondents by depositing a copy of it in the United States Mail, postage prepaid, on August 4, 2014, addressed to their attorneys of record as follows:

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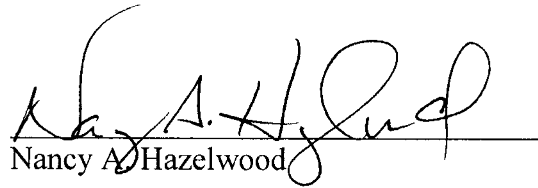

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August 4, 2014