

THE STATE OF SOUTH CAROLINA
In The SUPREME COURT

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S.C. Supreme Court

APPEAL FROM HORRY COUNTY
Court of Common Pleas

The Honorable Steven H. John, Circuit Court Judge

Case No: 2010-CP-26-8505
Appellate Case Number: 2013-000107

Carolina First Bank n/k/a TD Bank, NA, Petitioner;

v.

BADD, LLC and William M. McKown, Respondents

BRIEF OF RESPONDENTS

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STATEMENT OF ISSUES ON APPEAL

Whether a defendant can be denied his constitutional right to a jury trial on a legal claim against him because the plaintiff elects to bring the legal claim against him in combination with an equitable cause of action against a different defendant?

Whether the Court of Appeals erred in finding that the determination of whether the counterclaims asserted by the Respondents were compulsory or permissive was not determinative as to the Respondents' rights to have those claims heard by a Jury?

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STATEMENT OF THE CASE

Carolina First Bank (the "Bank") sued BADD, LLC (the "Debtor") and sought to foreclose upon a mortgage given by the Debtor to the Bank. See Record at p. 24. With its complaint, the Bank made a motion to refer the matter to the Master-in-Equity pursuant to Rule 53(b) of the South Carolina Rules of Civil Procedure (the "Rules"). See Record at p. 75. Also in the complaint, the Bank elected to include a request for relief against William M. McKown (the "Guarantor", jointly with Debtor the "Respondents") based upon his independent and completely separate guarantee agreement. See Record at p. 24, ¶38. Both the Debtor and the Guarantor timely answered, demanded a jury trial and brought a counterclaim that seeks to preserve their breach of contract cause of action against the Plaintiff. See Record p. 79- 84.

The Court scheduled a hearing on the motion to refer, but prior to the hearing, the Debtor and the Guarantor moved to amend their Answer and Counterclaim to provide greater specificity to the second counterclaim, to include a counterclaim for civil conspiracy and to bring a third party complaint. See Record at p. 90- 116 (the "Amended Answer"). At the hearing on the Motion to Refer, the Court granted the motion to amend and indicated that it would consider the motion and

the response based upon the averments of the Amended Answer. See Record at 130, lines 4-7. The Court found that the Counterclaims and Third Party Complaint were permissive, that the Defendants had waived their right to a jury trial because they were permissive and referred the entire matter to the Master-in-Equity. See Record at p. 1-8. On Appeal, the Court of Appeals reversed and remanded the Court's order holding the action against the Guarantor was legal in nature and, therefore, the Trial Court erred in referring the entire matter to the Master-in-Equity. See Order of Court of Appeals.

STANDARD OF REVIEW

In interpreting the meaning of the South Carolina Rules of Civil Procedure, the Court applies the same rules of construction used to interpret statutes. *Green v. Lewis Truck Lines, Inc.*, 314 S.C. 303, 443 S.E.2d 906 (1994). Similarly, "whether a party is entitled to a jury trial is a question of law," and the court may decide questions of law with "no particular deference to the [circuit] court." *Verenes v. Alvanos*, 387 S.C. 11, 15, 690 S.E.2d 771, 772-73.

FACTS

In March and April 2008, the Debtor borrowed money from the Bank and purchased three warehouse units in a building that contained seven total units (the "Warehouse Units") and pledged the Warehouse Units as collateral for the loan from the Bank. See Record at p. 18-19, ¶ 12, 13, 14, and 16; Record at p. 107-116 (the "Amended Answer"), ¶ 22 and 23. In 2009, Charles A. Christenson ("Christenson") who was a member of the Debtor was having financial problems and brought a third party in to take over his obligations. Record at p. 111, ¶ 27. Pursuant to the Amended Answer, this third party was allowed to take over the operations of the Debtor and pursuant to an alleged conspiracy with the Bank, proceeded to create a default in the loan obligations in an effort to allow

the Bank to foreclose on the Warehouse Units so that he could purchase the property at a significantly reduced price at a foreclosure sale. Record p. 112-113, ¶31 through 38. Because of the default, the Plaintiff foreclosed against the debtor and included in the foreclosure, a claim against the Guarantor. Record at p. 8, ¶38.

LEGAL ARGUMENT

The question before the Court of Appeals and this Court is whether a defendant alleging issues of fact regarding defenses and counterclaims of breach of contract, conspiracy, and unconscionability in response to an action for breach of a guarantee is no longer provided the right to a trial by jury simply because the plaintiff chooses to join its action with that of a foreclosure action. The Court of Appeals properly found that South Carolina law does not allow the Petitioner to waive the Respondents right to have the issues heard by a jury through artful pleading. When a claimant brings an action of law against a party, that party has a right to have a trial by jury on all legal claims it has against the claimant. *Johnson v. South Carolina National Bank*, 292 S.C. 51, 354 S.E.2d 895 (1987). Because (a) the South Carolina Constitution protects the right to trial by juries, (b) the Rules of Procedure in South Carolina, specifically Rule 13 and 42, provide for such trials, and (c) the logical relationship between the claims of Petitioner and Respondent in this action establish that the counterclaims are compulsory, the Court of Appeals decision should be affirmed.

- I. *The South Carolina Constitution requires that the right to a jury remain inviolate and the Plaintiff cannot be allowed to waive a Defendant's right to a jury simply by including an equitable cause of action against a different Defendant.*

The holding by the Court of Appeals was in accordance with South Carolina law and should be affirmed. Petitioner first contends the Appellant court erred in remanding the Circuit Court's order referring all actions in this matter to the Master-in-Equity.

Contrary to South Carolina law, the Petitioner asserts all counterclaims asserted by a guarantor, regardless of their factual basis or logical relationship to the complaint, are permissive counterclaims if the Plaintiff's action on a guarantee is joined with a foreclosure action. Thus by bringing the foreclosure action, the Plaintiff is able to waive the Defendant's constitutional right to a jury trial. Under the Bank's theory, to preserve his right to a jury, a guarantor would be required to bring a separate action against the Bank. Then after bringing the separate action, the guarantor would be required for convenience and economy's sake, move to have the two actions consolidated under Rule 42, SCRCF. Such an argument is in direct conflict with South Carolina law. See, e.g., *C & S Real Estate Services, Inc. v. Massengale*, 290 S.C. 299, 350 S.E.2d 191 (1986), modified on other grounds; *Johnson*, 292 S.C. 51, 354 S.E.2d 895; and *John D. Hollingsworth on Wheels v. Arkon Corp.*, 273 S.C. 461, 257 S.E.2d 165 (1979).

Further, the Petitioner's argument is in direct contradiction with South Carolina Rules of Civil Procedure and the Constitution. Article 1, Section 14 of the South Carolina Constitution states that "[t]he right of trial by jury shall be preserved inviolate." The right to trial by jury is a fundamental right. See *Wright v. Colleton County School Dist.*, 301 S.C. 282, 391 S.E.2d 564 (1990). As such, any abridgement of that right is subject to strict scrutiny. *Lane v. Gilbert Const. Co., Ltd.*, 383 S.C. 590, 600, 681 S.E.2d 879, 884 (2009). Similarly, Courts that examine the waiver of this inviolate right generally follow the rulings of the United States Supreme Court and hold:

The Seventh Amendment right to trial by jury is a fundamental right. Courts will narrowly construe any waiver of this right and will indulge in every reasonable presumption against waiver.

See *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 79 S.Ct. 948, 3 L.Ed.2d 988 (1959); *Aetna Insurance Co. v. Kennedy*, 301 U.S. 380, 57 S.Ct. 809, 81 L.Ed. 1177 (1937). While the Petitioner

rightly states, this provision preserves the right of trial by jury only in those cases in which the parties were entitled to it under the law or practice existing at the time of the adoption of the Constitution. *E.g., Pelfrey v. Bank of Greer*, 270 S.C. 691, 244 S.E.2d 315 (1978). Generally, “the relevant question in determining the right to trial by jury is whether an action is legal or equitable; there is no right to trial by jury for equitable actions.” *Lester v. Dawson*, 327 S.C. 263, 267, 491 S.E.2d 240, 242 (1997). Contrary to Petitioner’s argument, however, the Supreme Court has held that actions on guarantees are legal in nature. *S. Bank & Trust Co. v. Harley*, 295 S.C. 423, 424, 368 S.E.2d 908, 909 (1988)(holding that an action on a guarantee seeking a deficiency was an action of law), see also *TranSouth Fin. Corp. v. Cochran*, 324 S.C. 290, 295, 478 S.E.2d 63, 65 (Ct. App. 1996)(“it is well settled that a guarantor's liability is an independent contractual obligation.”). Further, an action for damages for a breach of contract is an action at law and either party has the right of trial by jury. See *Airfare, Inc. v. Greenville Airport Comm'n*, 249 S.C. 265, 269, 153 S.E.2d 846, 848 (1967). Thus, under South Carolina law at the time of the adoption of the Constitution, the Respondents were entitled to a trial by jury and continue to be entitled to the right to a jury trial in the legal actions involved in this matter.

The argument laid out by Petitioner disregards that the action on the guarantee brought by it was legal and flatly rejects South Carolina law supporting that such an action provides a right to trial by jury. Contrary to Petitioner’s assertions, this case involves a suit of a guarantor or simply, a breach of contract cause of action not merely a deficiency. The cases cited by Petitioner dealing with actions for a deficiency where no suit on a guarantee is considered have no bearing on the present issue addressed by the Court of Appeals. Further, while Petitioner wishes to distinguish one action on a guarantee from its own, any action on a guarantee is legal in nature and this is well

settled law in South Carolina. See *Johnson*, 292 S.C. 51, 354 S.E.2d 895. In *Johnson*, the Supreme Court again examined the issue of whether a suit on a guarantee was legal or equitable. *Id.* Specifically, South Carolina National Bank had answered Johnson's complaint and asserted a cause of action for damages against Johnson based upon his guarantee. *Id.* The Supreme Court held, that the Counterclaim was a legal Counterclaim and that it entitled the Johnsons to a jury trial. *Id.*

The Supreme Court's decision in *McLaurin v. Hodges*, 43 S.C. 187, 20 S.E. 991, 993 (1895), is illustrative of the principal of law Petitioner misconstrues. In an action for foreclosure in which the defendant brought a defense and counterclaim of usury, the Supreme Court went to great lengths to explain when the right to a jury trial arises in such matters. *Id.* The Court held that "[t]he principle which must enter into a defense to an equitable cause of action to give the defendant the right to demand a trial before a jury is that it exists as a separate and distinct matter from plaintiff's equitable cause of action." The court went on to hold that the defense and counterclaim of usury was "so interwoven in the plaintiff's mortgage, which is but a security to the debt, and cannot exist without such debt, that, if they subsist, they make up a part of the very entity of the action." *Id.* 43 S.C. 187, 20 S.E. 991, 993. By defining the rule in South Carolina that "a guaranty of payment is an obligation *separate and distinct* from the original note," this Court in *Citizens & S. Nat. Bank of S. Carolina v. Lanford*, 313 S.C. 540, 544, 443 S.E.2d 549, 551 (1994)(emphasis added), confirmed that a right to a trial by jury exists in such actions. Thus, there is no doubt, no question and no legal issue that the Guarantor is entitled to a jury trial and the Appellate Court correctly ruled the trial court was in error in referring the legal actions in this case to the Master in Equity.

II. *South Carolina Jurisprudence provides that, whether permissive or compulsory, the bringing of a counterclaim in a legal cause of action does not result in an outright*

waiver of a right to jury trial.

Petitioner wrongfully argues that through its artful pleading, a guarantor is forced to decide whether to bring its counterclaims in a separate action or waive its right to a jury. The Petitioner inappropriately cites *Johnson*, 292 S.C. 51, 354 S.E.2d 895, for this supposition. The Petitioner argues that a guarantor, under the holding in *Johnson*, is forced to risk waiving its rights to jury trial in the event such a counterclaim is later deemed permissive. South Carolina law and Rule 13, SCRCP, however, avoids placing the guarantor in such a dilemma. If it is uncertain whether a counterclaim is compulsory or permissive, the pleader may simply plead the claim and make demand for a jury trial on it. *Keels v. Pierce*, 315 S.C. 339, 433 S.E.2d 902 (1993). If it is compulsory, he retains his right to a jury trial. *See Johnson*, 292 S.C. 51, 354 S.E.2d 895. If it is permissive, the court, on its own motion or the motion of the pleader, may order a separate trial of the counterclaim pursuant to Rule 42(b) to avoid prejudice to the pleader's right to a jury trial. *See* Rule 13(i), SCRCP.

Further, the law as relied upon by Petitioner and expressed in *Johnson* applies only when it is clear the counterclaim is permissive. *See Keels*, supra. Thus, only when it is clear the action is equitable and the counterclaim is permissive is such analysis proper. *See Keels*, supra. In such a situation, the pleader is on notice that “asserting an obviously permissive counterclaim, which under the Rule 13 could be asserted in a separate jury trial, waives the right to trial by jury by operation of law.” *Id.*, 315 S.C. at 341-342, 433 S.E.2d at 903. However, if uncertainty exists, the pleader does not waive his right to a jury trial if the court later decides the claim is permissive. *Id.* Such an analysis conforms with the opinion of the Court of Appeals. The Appellate Court correctly held that such analysis is not needed in this action as the action by the Petitioner is legal. Here whether permissive or compulsory, the Guarantor retains the right to a trial by jury.

III. *The counterclaims brought by Respondents had a logical relationship to the causes of action brought by Petitioner and were therefore Compulsory.*

While the Court of Appeals' analysis was correct, the Circuit Court erred in finding and Petitioner is mistaken in arguing the Respondents' counterclaims were permissive. A counterclaim is compulsory "if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." Rule 13(a), SCRPC; *see also Mortgage Elec. Sys., Inc. v. White*, 384 S.C. 606, 614, 682 S.E.2d 498, 502 (S.C. Ct. App. 2009). This Court has gone on to hold that a counterclaim is compulsory only if a "logical relationship" exists between the claim and the counterclaim. *See North Carolina Fed. Sav. & Loan Ass'n v. DAV Corp.*, 298 S.C. 514, 381 S.E.2d 903 (1989). The Guarantor's claims that the Petitioner breached the agreement it now seeks to enforce and that the foreclosure action itself is in accordance with a conspiracy to deprive the Respondents of property are logically related to the actions brought by the Petitioner for foreclosure and suit on a guarantee. Thus, they are compulsory.

While the date of the execution of the agreements sued upon is different than that of the date of the alleged misconduct of the Bank, the actions are logically related and are, therefore, compulsory. The Petitioner's erroneous argument relies exclusively on the date of the loan origination and the date of the allegations of the counterclaims. The Petitioner argues that because the loans were originated in 2008 and the conspiracy and breach of contract by the Bank began in 2009, the allegations of Plaintiff's complaint could have no logical relationship to the allegations of the Defendants' counterclaims. This argument is deeply flawed. In fact, the Petitioner is not suing on the execution of the note, mortgage or guarantee, but rather alleging a later breach of promises contained in the note, mortgage and guarantee. This breach has a direct and logical relationship with

the allegations of the Counterclaims. Specifically, the counterclaims allege the Bank caused the breach as part of its conspiracy with the Third Party and in conspiring with the Third Party breached the promises contained in the note, mortgage and guarantee.

Under South Carolina law, the courts do not simply look at the date to determine a logical relation. Whether a counterclaim is logically related to the initial claim “depends upon the facts of each case.” *Beach Co. v. Twillman, Ltd.*, 351 S.C. 56, 61, 566 S.E.2d 863, 865 (Ct. App. 2002)(making no mention of the dates of execution and corresponding breach, the Court of Appeals held that a counterclaim for breach of the same contract for which the complaint seeks an action on is logically related). The United States Supreme Court, when describing the benefit of the logical relationship test, held

“‘Transaction’ is a word of flexible meaning. It may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship. [...] That they are not precisely identical, or that the counterclaim embraces additional allegations [...] does not matter. To hold otherwise would be to rob this branch of the rule of all serviceable meaning, since the facts relied upon by the plaintiff rarely, if ever, are, in all particulars, the same as those constituting the defendant's counterclaim.”

Moore v. New York Cotton Exchange, 270 U.S. 593, 610, 46 S.Ct. 367, 371, 70 L.Ed. 750, 757 (1926). The present actions both involve the construction of the underlying note, mortgage, guarantee, and other contractual understandings between the parties. Whenever two courts look at the same contract, differing interpretations are possible, even if not likely. Even if both courts read the contract in the same way, one of them will have spent its time doing so unnecessarily. This is the sort of exercise that the compulsory counterclaim rule seeks to avoid, just as it also seeks to prevent inconsistent outcomes. *See also Keith A. Keisser Ins. Agency, Inc. v. Nationwide Mut. Ins. Co.*, 246

F. Supp. 2d 833, 836 (N.D. Ohio 2003)(holding claims alleging that the other party breached one or more of their contractual obligations to the other brought in response to action for breach are inherently logically related).

The Petitioner is misguided in its reliance on the decision in *DAV Corp.* for the premise that timing is critical to the analysis. In *DAV Corp.*, five of the six counterclaims were held to be compulsory legal counterclaims that had a logical relationship with the foreclosure action. All five of these compulsory counterclaim had one thing in common, they all went to the issue of the alleged breach by the plaintiff. The court held that they were compulsory because they challenged the issue of breach and whether the plaintiff was entitled to enforce the documents it was relying upon for the foreclosure action. While identifying that the execution of the notes and the alleged breaches by the defendant were different, this Court held that such counterclaims “clearly” have a logical relationship to the original action. *Id.* 298 S.C. 514, 518, 381 S.E.2d 903, 905. Clearly, in this case, the counterclaims are compulsory and the trial court erred in finding them permissive and referring this matter to the master in equity.

Here, the Petitioner seeks to foreclose upon a debt and seeks damages under a guarantee. The Guarantor challenged that debt and alleged (1) the potential involvement of the Bank in a conspiracy relating to the administration of that debt; (2) breach of the underlying mortgage and note; and the (3) breach of the covenant of good faith and fair dealing through actions taken by the Bank. Each of these counterclaims are compulsory counterclaims. Each of these counterclaims relates to the administration of the debt, and whether the Plaintiff has the right to foreclose on this property. The simplistic chronological approach to determining the logical relationship between the complaint and the counterclaims is not only flawed but further supports the claim that such actions are logically

related. In this case, the counterclaims allege breaches beginning in 2009 and the complaint alleges a breach in September 2010. So, as alleged in the counterclaims, the breach of the Debtor was chronologically after the breach by the Bank and therefore “logically related.”

The Petitioner’s argument that the claims asserted by Respondents are permissive is deeply flawed and would create an absurd result. Were this Court to hold that Respondents’ claims were permissive, it would imply that future actions on guarantees could result in separate actions. Thus, a bank suing to enforce a guarantee could be awarded damages and another action by the guarantor could result in an award for damages. Separate conflicting decisions on the same agreement, just as Rule 13(a), SCRPC seeks to avoid. The Petitioner would argue and a court agree that the claims asserted by Respondents in the second action were required to be asserted in the prior action because, if successfully litigated, the claims would nullify a successful judgment entered in favor of the Bank or impair its rights established in the action. *See Revised Restatement (Second) of Judgments* § 22(2)(b) (1982)(stating a defendant who may interpose a claim as a counterclaim in an action but fails to do so is precluded, after the rendition of judgment in that action, from maintaining an action on the claim if the “relationship between the counterclaim and the plaintiff’s claim is such that successful prosecution of the second action would nullify the initial judgment or would impair rights established in the initial action”). A holding by this Court that Respondent’s claims are permissive would drastically change South Carolina jurisprudence on the doctrine of res judicata. *See Davis v. Murphy*, 1846 WL 2374 (May 1846). Thus, any argument that the counterclaims of Respondents are permissive must fail.

CONCLUSION

The Court of Appeals order was legally proper under South Carolina law.¹ The trial court made clear legal error in finding that the separate claim against the Guarantor did not entitle the Guarantor to a jury trial on the Plaintiff's complaint against him. The trial court made clear error when it found the Defendants had waived their right to a jury. The trial court made clear legal error when it found the Defendants' counterclaims were not compulsory based upon a simplistic, and mistaken, chronological analysis. And, the trial court made clear error when it referred this matter to the Master-in-Equity. The Appellate Court's decision must be affirmed.

Respectfully submitted,

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¹ The Respondents would note that they, just as Petitioner, were unable to find authority to support the Petitioner's argument that a court on appeal may not cite to any authority not previously cited by any of the parties to that appeal. *See Petitioner's Brief Issue II*. Respondents would also note that under Rule 208(D) of South Carolina Appellate Court Rules, such an argument is improper.

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PROOF OF SERVICE

I, the undersigned, of the law offices of Gleissner Law Firm, LLC, attorneys for Respondents, BADD, LLC and William McKown, do hereby certify that I have served all counsel in this action with a copy of the pleading(s) referenced below to the following address(es):

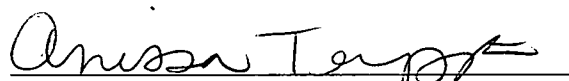
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