THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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SC Court of Appeals

APPEAL FROM RICHLAND COUNTY
Court of Common Pleas

G. Thomas Cooper, Jr., Circuit Court Judge

Appellant 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 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 REPLY BRIEF OF APPELLANTS

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I. THE ACTION IS NOT SUBJECT TO THE REQUIREMENTS OF RULE 23(B)(1) BECAUSE THE ACTION IS NOT A LAWSUIT AGAINST AN UNINCORPORATED ASSOCIATION.

Respondents mistakenly assert that because the beneficiaries have a common purpose, are voluntary members, and have joint and several liability, that the trust is an unincorporated association. (Respondent's Initial Brief, p.16; R. _____).

Having a common purpose and voluntary membership is a hallmark of many trusts in South Carolina. This is usually associated with charitable trusts, but "[t]he great majority of the Code's provisions apply to both charitable and noncharitable trusts without distinction." Reporter's comments to S.C. Code Ann. § 62-7-103 (2014) (reporter's comments). Although the Home Builders Fund is a noncharitable trust, having a common purpose and voluntary membership is not disallowed by South Carolina law. To the contrary,

> [i]n the absence of a statute to the contrary, a settlor may create a trust for any lawful purpose, and the trust may be created for the settlor's own benefit as well as the benefit of another. The material purposes of a trust are subject to the settlor's discretion, which is limited only to the extent its purposes are lawful, not contrary to public policy, and possible to achieve.

76 Am. Jur. 2d Trusts § 19 (internal citations omitted). These characteristics do not transform trusts into unincorporated associations.

In addition, there is no policy against beneficiaries having joint and several liability for shortfalls in a trust estate. "Except as limited by public policy, the extent of a beneficiary's interest is determined solely by the settlor's intent." S.C. Code Ann. § 62-7-103. The settlors for the Home Builder's Trust, the beneficiaries themselves, limited their own interest to provide for joint and several liability for shortfalls. This is part of

the trust agreement, allowed under South Carolina law, and does not transform the trust into an unincorporated association.

The trust was created in writing and specified that it was a trust throughout the document. The court stated: "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. _____). Even though the term "beneficiary" was not used, the document itself is entitled "Agreement and Declaration of Trust." (Trust, p.1; R. _____)

The Respondents assert that there was no trust *res* provided by a grantor. (Respondents' Initial brief, p.15; R. _____). This statement contains two errors: First, the trust *res* was comprised of the contribution of members to the fund as well as any interest made from investments. The comments to S.C. Code Ann. § 62-7-401 explain that the *res* does not have to be large, nor does it have to be immediately available:

> The property interest necessary to fund and create a trust need not be substantial. A revocable designation of the trustee as beneficiary of a life insurance policy or employee benefit plan has long been understood to be a property interest sufficient to create a trust. Furthermore, the property interest need not be transferred contemporaneously with the signing of the trust instrument.

Id. (internal citations omitted). Second, the Respondents incorrectly assert that there must be a grantor of property to form a trust *res.* However, there is no requirement in South Carolina law that a trust must be created by a third party grantor. The creator of a trust, the settlor, can also be the beneficiary of a trust. Restatement (Second) of Trusts § 156 (1959).

The designated beneficiaries were specified in the trust document as members of the Home Builders Association of South Carolina. The beneficiaries are capable of ascertainment or are ascertainable in the future. *See* S.C. Code Ann. § 62-7-402.

("While some beneficiaries will be definitely ascertained as of the trust's creation, subsection (c) recognizes that others may be ascertained in the future as long as this occurs within the applicable perpetuities period"); Restatement (Second) of Trusts § 112 (1959) ("It is not necessary ... that the beneficiary should be known at the time of the creation of the trust"). "A beneficiary designation is sufficient for a private trust if the identity of the beneficiary can be ascertained objectively, solely from the standards stated in the instrument." 76 Am. Jur. 2d Trusts § 53.

A trust cannot be treated as an unincorporated association because the laws of South Carolina prescribe very different duties and responsibilities for their governance. A trustee's primary duty is to the beneficiaries, while a director's primary duty is to the corporation in addition to the shareholders. Compare § 62-7-802 with *Clearwater Trust v. Bunting*, 367 S.C. 340, 349, 626 S.E.2d 334, 338 (2006).

If a trustee violates his duty, there are prescribed remedies for the court to follow. § 62-7-1001. This is not the case with a breach of duty by a director. *See* § 33-8-300. A beneficiary may ask the court to remove a trustee, but a director must be removed by vote of the shareholders. *Compare* § 62-7-706 *with* § 33-8-108. Corporations are required to hold annual meetings of shareholders and provide a list of voting groups. *See* § 33-7-701. However, there is no such requirement for trustees to have annual meetings of beneficiaries.

The court erred by holding that the Home Builder's Trust was an unincorporated association and that the members are shareholders. Shareholders have certain rights that the beneficiaries of the Trust Fund do not have. Beneficiaries of the trust do not have the right to 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. It is unfair to impose the label of unincorporated association to the trust since the trust beneficiaries do not have the protections of shareholders in a corporation. In essence, by holding that the trust is an unincorporated association, the court has changed the entire contract between the parties, and allowed the trustees to hold more power than was anticipated or allowed by South Carolina law.

II. THE ACTION IS NOT SUBJECT TO THE REQUIREMENTS OF RULE 23(B)(1) BECAUSE THE ACTION IS NOT DERIVATIVE.

"A derivative action is an action by a stockholder to obtain relief for an alleged wrong committed against the *corporation*." 18 C.J.S. Corporations § 482 (emphasis added). However, a breach of trust gives rise to an action on the part of a beneficiary *for any loss to the trust estate*. 76 Am. Jur. 2d Trusts § 333 (internal citations omitted).

The beneficiaries of the Home Builder's Trust claimed damage to both the trust corpus and to themselves as individuals. The court incorrectly held that since the beneficiaries are claiming damage to the trust corpus, the action is derivative in nature. This is not the law in South Carolina. It is necessary for a trust to have a corpus or *res* upon creation. If the trustee damages that trust estate, a beneficiary may bring a breach of trust action even though no distributions from the trust have been made. The trust code does not require that the beneficiaries bring a derivative action. § 62-7-1001, 1002. In other words, even though there has not yet been any distribution from a trust, the law

indicates that damages to a trust corpus are eventually borne by the beneficiaries, who have the right to bring an action for breach of trust.

The Home Builder's Trust Fund consists of a trust corpus held by trustees for the benefit of the beneficiaries. While the administration of that trust may be businesslike in nature, the trustees are not directors. The trust specifies that the beneficiaries do not have control over the funds, even though they were also the settlors who contributed the funds: "The Trustees shall have said authority [in] retaining control over all funds collected or dispersed." (Trust pp. 9, 10; R. _____). The individual beneficiaries have been damaged by the acts of the trustees. The Beneficiaries are not shareholders, and they have each suffered a particular loss. Therefore, mismanagement of the trust results in a direct loss to each beneficiary. Since the Plaintiffs are beneficiaries of the trust, they have standing to bring this action.

III. RESPONDENTS ARE JUDICIALLY ESTOPPED FROM CLAIMING THAT THE FUND IS ANYTHING OTHER THAN A TRUST.

Respondents claim that they never intended for the trust code to apply to the Home Builder's Trust, but that they were simply offering an alternative legal theory for the court. (Respondents' Initial Brief, p.21; R. ____). The court, however, issued an order that states:

> [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. _____) (emphasis added). The court, therefore, has issued an order that declares the Home Builder's Trust to be a trust and not an unincorporated association. "When reviewing an action at law, on appeal of a case tried without a jury, the appellate court's jurisdiction is limited to correction of errors at law. The appellate court will not disturb the judge's findings of fact as long as they are reasonably supported by the evidence." *Epworth Children's Home v. Beasley,* 365 S.C. 157, 164, 616 S.E.2d 710, 714 (2005). Respondents did not appeal this ruling by the court. An unappealed ruling, right or wrong, is the law of the case. *Georgetown Cnty. League of Women Voters v. Smith Land Co.,* 393 S.C. 350, 357, 713 S.E.2d 287, 291 (2011); *see also Warren v. Yarborough,* 2012-UP-401, 2012 WL 10860503 (S.C. Ct. App. July 11, 2012) ("the probate court order dated November 20, 2007, wherein the court found Appellant had breached his duty as Trustee was not appealed by Appellant. Thus, the findings of the probate court ... are the law of the case.")

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.

IV. EVEN IF RULE 23(B) APPLIES TO THE TRUST, THE PLEADING REQUIREMENTS HAVE BEEN MET.

In *Hormel v. Helvering,* 312 U.S. 552, 557, 61 S.Ct. 719, 721, 85 L.Ed. 1037 (1941), the Court stated: *"Rules of practice and procedure are devised to promote the ends of justice, not to defeat them.* A rigid and undeviating judicially declared practice under which courts of review would invariably and under all circumstances decline to consider all questions which had not previously been specifically urged would be out of harmony with this policy. *Orderly rules of procedure do not require sacrifice of rules of fundamental justice."* (emphasis added). Respondents have asserted that Rule 23, and its construction in *Carolina First Corp. v. Whittle,* 343 S.C. 176, 539 S.E.2d 402 (Ct. App. 2000), should control in this case. However, the facts of *Whittle* are not on point with this case, and the pleading requirements have been met.

The Federal Rules of Civil Procecure "reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and [which instead] accept the principle that the purpose of pleading is to facilitate a proper decision on the merits." *Foman v. Davis,* 371 U.S. 178, 181-82 (1962) (citation and quotations omitted). See also *Surowitz v. Hilton Hotels Corp.,* 383 U.S. 363, 373 (1966) ("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.").

The first rule of civil procedure explains that the federal rules are to be "construed and administered to secure the just, speedy, and inexpensive determination of every action." Fed. R. Civ. P. 1. "[T]hese 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." *Surowitz,* 383 U.S. at 373.

As lower courts have said, "it would ... be a harking back to the formalistic rigorism of an earlier and outmoded time ... to hold that the extremely simple procedure required by the rules is itself a kind of Mumbo Jumbo, and that the failure to comply formalistically with them defeats substantial rights." *Alley v. Dodge Hotel,* 501 F.2d 880, 884 (D.C. Cir. 1974) (quoting *Crump v. Hill,* 104 F.2d 36, 38 (5th Cir. 1939)).

Respondents assert that the reference in the Complaint to Appellant's pre-suit demand fails to satisfy the pleading requirements of Rule 23(b), and that the court could not consider the letter referenced in the complaint. (Respondents' Initial Brief, p.20; R. _____). However, the court may consider documents referenced in the plaintiff's Complaint when testing the legal sufficiency of a pleading even if those documents are not attached.

Most circuit courts of appeal have concluded that "documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the pleading, may be considered." *Branch v. Tunnell,* 14 F.3d 449, 453–54 (9th Cir. 1994) *overruled on other grounds by Galbraith v. County of Santa Clara,* 307 F.3d 1119 (9th Cir. 2002); *Watterson v. Page,* 987 F.2d 1, 3 (1st Cir. 1993) (recognizing narrow exception to conversion rule for documents the authenticity of which are not disputed by the parties, official public records, documents central to the plaintiffs' claim and documents sufficiently referred to in the complaint); *Pension Benefit Guar. Corp. v. White Consol. Indus., Inc.,* 998 F.2d 1192, 1196 (3d Cir. 1993) ("[A] court may consider an indisputably authentic document that a defendant attaches as an exhibit to a motion to dismiss if the plaintiff's claims are based on the document."); *Venture Assoc. Corp. v. Zenith Data Systems Corp.,* 987 F.2d 429, 431 (7th Cir. 1993) (documents

attached to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to his claim); *Cortec Indus. Inc. v. Sum Holding L.P.,* 949 F.2d 42, 48 (2d Cir. 1991) (finding conversion not required "[w]here plaintiff has actual notice of all of the information in the movant's papers and has relied upon these documents in framing the complaint"); *Teagardener v. Republic–Franklin Inc. Pension Plan,* 909 F.2d 947, 949 (6th Cir. 1990) (finding complaint's extensive quotation of unattached document permitted court to consider language and interpretation of document when defendant tendered it on motion to dismiss). South Carolina District Courts agree that documents such as these should be considered. *Cobin v. Hearst-Argyle Television, Inc.,* 561 F. Supp. 2d 546, 552 (D.S.C. 2008) (finding that the court could consider authentic documents referenced in a motion to dismiss).

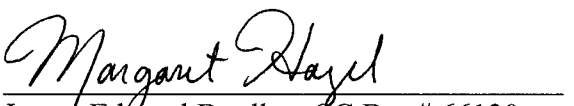
In the hearing before Judge Cooper on January 14, 2014, attorney for the Respondents stated that he would "accept this January 30th, 2013 letter that the Plaintiff styled [as] its demand letter [and] accept it as being received." (Hearing Transcript, p.28; R. _____). The Respondents have accepted the letter as authentic. Therefore, the letter should have been considered as part of the pleadings.

Even if the letter was not considered, the complaint 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. Therefore, the requirements of Rule 23(b) have been met.

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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PROOF OF SERVICE

I certify that I have served the Initial Reply Brief of Appellants' on the Respondents by depositing a copy of it in the United States Mail, postage prepaid, on October 13, 2014, addressed to their attorneys of record as follows:

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