

THE STATE OF SOUTH CAROLINA  
In the Supreme Court

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APPEAL FROM RICHLAND COUNTY  
Court of Common Pleas

**RECEIVED**

G. Thomas Cooper, Jr., Circuit Court Judge

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JAN -3 2017

S.C. SUPREME COURT

Case No. 2013-CP-40-2655  
Appellate Case No. 2016-002343

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Allen Patterson, Steve Tilton, Richard Sandler, Lincoln Privette, Marc Ellis, Joey Carter, Barry Davis, Michael Nieri, Allen Patterson Residential LLC, Tilton Group, Sandler 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 ..... Petitioners,

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.

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**RETURN TO PETITION FOR WRIT OF CERTIORARI**

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## INTRODUCTION

Respondents submit this Return in Opposition to the Petition for Writ of Certiorari. The Petition should be denied.

A writ of certiorari is not a matter of right, but of sound judicial discretion, and will be granted only where there are special and important reasons. *See generally Ellison v. State*, 382 S.C. 189, 676 S.E.2d 671 (2009); *In re Exhaustion of State Remedies in Criminal and Post-Conviction Relief Cases*, 321 S.C. 563, 564, 471 S.E.2d 454 (1990) (holding that this Court reviews decisions of the court of appeals by way of writ of certiorari only where special reasons justify exercise of that power). In determining whether special reasons for review exist, this Court considers the following five criteria: (1) where there are novel questions of law; (2) where there is a dissent in the decision of the court of appeals; (3) where the decision of the court of appeals is in conflict with a prior decision of the Supreme Court; (4) where substantial constitutional issues are directly involved; and (5) where a federal question is included and the decision of the court of appeals conflicts with a decision of the United States Supreme Court. *Haggins v. State*, 377 S.C. 135, 137 n.2, 659 S.E.2d 170, 170 n.2 (2008); Rule 242(b), SCACR.

Furthermore, the Supreme Court will only review errors of law, and factual findings will not be reviewed “unless wholly unsupported by the evidence.” *Hollman v. Woolfson*, 384 S.C. 571, 577, 683 S.E.2d 495, 498 (2009); *Lewis v. Lewis*, 392 S.C. 381, 400, 709 S.E.2d 650, 660 (2011) (Pleicones, J., dissenting); *City of Columbia v. S.C. Pub. Serv. Comm’n*, 242 S.C. 528, 532, 131 S.E.2d 705, 707 (1963) (“The Superior Court, in considering the record of the inferior tribunal, must confine its review to the correction of

errors of law only and not review findings of fact except when such findings are wholly unsupported by the evidence.”).

In their attempt to meet the required standard, Petitioners continuously use the phrase that “[t]he Court of Appeals misapprehended the facts and the law.” But, Petitioners never point to any specific misapprehension of fact or law by the court of appeals. Instead, the entire Petition is nothing more than a re-argument of the same points from: (a) the Petition for Rehearing and Rehearing *En Banc*, (App. p. 605), and (b) the original Brief of Petitioners (App. p. 519). Absolutely none of the criteria under Rule 242(b) for special review are met.

As opposed to the court of appeals, it is Petitioners who continue to misapprehend the facts and law in each of the arguments set forth in their Petition. Petitioners’ submission makes clear that they seek to reargue a case in which their Complaint was dismissed by the trial court, the underlying decision was affirmed by the court of appeals without the need for oral arguments, a petition for rehearing of the decision was denied, and the petition for rehearing *en banc* was rejected.

The Opinion of the court of appeals does not contain any error of law nor include any unsupportable evidence. This Petition does not address a novel question of law. Furthermore, the Opinion of the court of appeals did not contain a dissent, it did not conflict with a prior decision of this Court, and it did not include a federal question. In short, this Court has not been presented with any ground that would justify a decision to grant the Petition.

## COUNTER-STATEMENT OF THE CASE

This appeal is from a derivative action filed against the South Carolina Home Builders Self Insurers Fund (“Fund”) and its Board of Trustees (“Board”).

The Fund was created by a document entitled Agreement and Declaration of Trust dated September 27, 1995. (Agreement and Declaration of Trust, App. p. 351). Its sole purpose is to provide a fund to meet and fulfill a home builder/member’s obligations and liabilities under the South Carolina Workers’ Compensation Act. (Order Dismissing Complaint, App. p. 21 (block quote)). If a home builder wants to become a member of the Fund, the home builder must apply for membership. (App. p. 20). A member pays a predetermined premium for worker’s compensation coverage. (App. p. 21). Importantly, each member is also jointly and severally liable for all obligations of the Fund.<sup>1</sup> (App. p. 21). The Fund is operated by a chief administrator and his staff, and is governed by the Board, which is elected by the members. (App. p. 20).

Petitioners repeatedly and incorrectly refer to the Fund’s members (home builders) as “beneficiaries.” *Not correct.* The Fund is comprised of members who pay premiums to the Fund. The Agreement and Declaration, which established the Fund, refers to all fund participants as “members.” Reference to the members as “beneficiaries” is not found in any document and is simply a made-up term used by Petitioners.

In a prior action filed on February 16, 2012 (2012-CP-40-4311), in which Petitioners purported to represent *all* members of the Fund, Petitioners asserted various derivative claims, including allegations that the Board had removed and misused assets of

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<sup>1</sup> See S.C. CODE ANN. § 15-35-170 (“On judgment being obtained against an unincorporated association[,] . . . the individual property of any copartner or member thereof found in the State shall be liable to judgment and execution for satisfaction of any such judgment.”).

the Fund. (App. pp. 37-44). Petitioners filed that action without making a Rule 23(b)(1), SCRCF, pre-suit demand upon the Fund's Board. Furthermore, the complaint did not contain any allegations regarding a pre-suit demand or the futility of the same, nor did it include the required verification of each plaintiff. *See* Rule 23(b)(1).

On or about July 3, 2012, Respondents moved to dismiss Petitioners' amended complaint<sup>2</sup> for, among other grounds, failure to meet the pleading requirements of Rule 23(b)(1) in their pursuit of derivative claims. (App. pp. 148-53). Following that motion, and before the court ruled upon the motion, on January 30, 2013, Petitioners wrote a belated letter to counsel for Respondents making certain demands of the Board. (App. pp. 324-25). Roughly a month after Petitioners sent this untimely demand letter, the Court ruled upon the motion to dismiss the prior action by signing an order *proposed by Petitioners*. (App. pp. 319-20). That order was based upon an alternative legal argument made by Respondents, that *if* the Fund was subsequently determined to be a trust, the circuit court did not have subject matter jurisdiction because such a claim would need to be filed first in the probate court.

After dismissal of the first action, on or about April 9, 2013, Petitioners filed the second action in the Richland County probate court. (App. pp. 53-61). Petitioners immediately removed that action to the circuit court. (App. p. 62). Like the first action, Petitioners' second action pursued the same derivative claims on behalf of the Fund. Unlike in the first action, though, in the second action (after having learned of Respondents primary defense) Petitioners' inserted a paragraph in their complaint

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<sup>2</sup> The complaint had subsequently been amended to change the names of the plaintiffs.

(paragraph 8) that purported to comply with the pleading requirements of Rule 23(b)(1). (App. p. 54, ¶8).

Respondents moved to dismiss the subject action for, among other reasons, failure to comply with Rule 23(b)(1). (App. pp. 154-56). The motion was heard by the Honorable G. Thomas Cooper, and after oral argument, he issued an order denying the motion. (App. pp. 10-18). In the order, the Court concluded that the Complaint did not allege a derivative action and was not subject to Rule 23(b)(1). (*See id.*) Respondents filed a motion for reconsideration. (App. pp. 157-63). Judge Cooper heard the motion for reconsideration and again held oral argument. (App. pp. 94-118). Judge Cooper subsequently granted Respondents' motion to reconsider, and dismissed Petitioners' Complaint, without prejudice (the "Order"). (App. pp. 19-27).

The Order concluded that the Fund was an unincorporated association, that the complaint alleged derivative claims on behalf of the Fund, and that Petitioners' Complaint failed to comply with the pleading requirements of Rule 23(b)(1). (App. pp. 22-24). The Order also provided that Respondents agreed during oral argument to accept Petitioners' January 30, 2013 letter as a demand under Rule 23 for any *subsequent* litigation, but not the present litigation. (App. p. 26). Furthermore, the Order provided that Respondents had 60 days to provide a response to the January 30 letter. The Order further provided that, "[o]nce the Defendants provide a response to the Plaintiffs' demand, then, if necessary, the Plaintiffs may pursue whatever legal action they determine is appropriate." (App. pp. 26-27).

Petitioners' filed a motion to reconsider the Order dismissing the Complaint. (App. pp. 164-67). That motion was denied without oral argument. (App. p. 28). Pursuant

to the Order dismissing the Complaint, Respondents then provided a written response to the January 30 demand letter. (App. pp. 320-44). Petitioners did not engage Respondents following their response to the demand letter or file a third action; instead, Petitioners filed a notice of appeal from the dismissal of their Complaint in the second action.

A panel of the court of appeals handed down a unanimous published decision affirming the Order dismissing their Complaint. (App. pp. 591-604). The panel determined that it did not need oral argument. (App. p. 604). Petitioners subsequently moved for rehearing and rehearing *en banc*. (App. pp. 605-23). The panel denied the petition for rehearing. (App. p. 624). Further, after the Clerk of the Court circulated the petition for rehearing *en banc* to the judges of the court of appeals, it was rejected. (App. p. 627). The petition before this Court followed.

### **ARGUMENT BASED ON QUESTIONS PRESENTED**

#### **I. DID THE COURT OF APPEALS ERR IN HOLDING THAT THE FUND IS NOT A TRUST?**

The court of appeals affirmed, as the Respondents maintained, that the Fund is an unincorporated association and not a trust. Rather than look to mere labels, in making this determination the court of appeals correctly analyzed the essence of both entities.

##### **A. What is the Essence of a Trust?**

A trust is an arrangement whereby property is transferred to another with the intent that it be administered by the trustee for the benefit of the transferor or a third party. *State v. Jackson*, 338 S.C. 565, 570, 527 S.E.2d 367, 370 (Ct. App. 2000). To prove the existence of a trust, the following elements must be shown: (1) a declaration creating the trust, (2) a trust *res*, and (3) designated beneficiaries. *Whetstone v. Whetstone*, 309 S.C. 227, 231, 420 S.E.2d 877, 879 (Ct. App. 1992) (holding that no trust existed because there was no initial trust *res*). “It is an axiomatic principle of law that a

person or entity must hold title to property in order to declare that it is held in trust for the benefit of another or transfer legal title to one person for the benefit of another.” *All Saints Parish Waccamaw v. Protestant Episcopal Church in Diocese of S. Carolina*, 385 S.C. 428, 449, 685 S.E.2d 163, 174 (2009).

For a private, non-charitable trust, the beneficiaries normally must be ascertainable. *Restatement (Third) of Trusts* § 44 (2003). Such beneficiaries are normally named, or can be derived from, the formational document of the trust. Furthermore, it is a fundamental element of a trust that its beneficiaries *are not* jointly and severally liable for the actions of the trust or its trustees. For example, a beneficiary is not liable as the constructive owner of the underlying trust property, is not liable in contract or tort, and is not liable as a stockholder (*i.e.*, for a capital call for stock that is held by the trust). *See 3 Law of Trusts*, Scott, Austin Wakeman, 4th ed. §§ 265.2, 274, 274.1, 275, 276.

#### **B. What is the Essence of an Unincorporated Association?**

As opposed to a trust, an unincorporated association is a body of individuals organized for the pursuit of some common enterprise. *Graham v. Lloyds of London*, 296 S.C. 249, 255, 371 S.E.2d 801, 804 (Ct. App. 1988). An unincorporated association is not a legal entity separate from the individuals who compose it. *Id.* The liability of members of an unincorporated association is joint and several. *Elliott v. Greer Presbyterian Church*, 181 S.C. 84, 186 S.E. 651, 658 (1936); S.C. CODE ANN. § 15-35-170 (“On judgment being obtained against an unincorporated association[,] . . . the individual property of any copartner or member thereof found in the State shall be liable to judgment and execution for satisfaction of any such judgment.”); *accord Hall v.*

*Walters*, 226 S.C. 430, 437, 85 S.E.2d 729, 732 (1955). Members freely and voluntarily choose to join an unincorporated association. A common example of such an association is a labor union. See *Int'l Association of Machinists v. Gonzales*, 356 U.S. 617 (1958). An unincorporated association is the predecessor to the many statutory business organizations common in today's world, such as corporations, limited partnerships, and limited liability companies.

**C. Is the Fund an Unincorporated Association?**

Analyzing this Fund in accordance with the respective elements of a trust on the one hand and an unincorporated association on the other hand allows for a ready identification of the Fund as an unincorporated association—not a trust, as the court of appeals correctly concluded.

The Fund is missing several essential characteristics of a trust:

- At inception, an identifiable trust *res* was not provided by a grantor. The Fund's property does not come from a third-party grantor or benefactor, but from membership dues and workers' compensation premiums.
- The formational document did not contain ascertainable beneficiaries. The Agreement states generally that home builders can voluntarily become members of the Fund, but no specific grouping is derived as normally exists with a trust (for example, a trust created for the benefit of all children of Mr. Smith).
- The Fund does not hold property transferred from one person for the benefit of another. There is no transfer of property, in the sense of a grantor providing property to the Fund and then relinquishing his rights to have some form of control over the property. Instead, money is voluntarily contributed to the fund by each member to provide a pool of money for workers' compensation coverage.
- The members of the Fund do not operate without any risk of liability for the actions of the Fund. If there is a shortfall in assets, every member faces joint and several liability for the Fund's losses.

The Fund is an unincorporated association:

- The Fund is comprised of members who voluntarily joined together for a common purpose of belonging to a self-insurance fund that provides lower costs for workers' compensation coverage for South Carolina home builders.
- Each home builder wishing to become a member of the Fund does so through an application process. Every application for membership must be approved by the Workers' Compensation Commission.
- Liability for the members of the Fund is joint and several.

While the Fund was created by a document entitled a declaration of trust, the court of appeals correctly looked at substance over form and held that the declaration does not create a trust. *See Feeley v. NHAOCG, LLC*, 62 A.3d 649, 668 (Del. Ch. 2012) (noting, in a breach of fiduciary duty case, application of equitable maxim that "equity regards substance rather than form"). The court of appeals correctly concluded that because the Fund is an unincorporated association, the requirements of Rule 23(b)(1) *must* be met.

## **II. DID THE COURT OF APPEALS CORRECTLY HOLD THAT THE COMPLAINT WAS A DERIVATIVE ACTION SUBJECT TO RULE 23(b)(1), SCRCP?**

### **A. What is the Purpose of Rule 23(b)(1)?**

Rule 23(b)(1) addresses derivative actions filed by the shareholders of a corporation or members of an unincorporated association.<sup>3</sup> A derivative action is brought when one or more members of an unincorporated association, perceiving that the

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<sup>3</sup> The language of Rule 23(b)(1) makes clear that its requirements apply with equal force in lawsuits against both an unincorporated association and a corporation. Thus, if a prior decision uses the word "corporation" when identifying a named defendant, the holding of that decision applies to derivative suits against "unincorporated associations," as well. Also, in a derivative action against a corporation, the action will be brought by "shareholders" on behalf of the corporation. In a derivative action against an unincorporated association, the action will be brought by the "members" on behalf of the unincorporated association.

association has received an injury that management has failed to redress, seeks to institute a suit for the benefit of the association. Rule 23(b)(1) is a departure from the Rule 8 pleading standards in that it explicitly provides additional pleading requirements for a derivative action. Rule 23(b)(1) provides, in part, that “[t]he complaint *shall* also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors . . . and the reasons for his failure to obtain the action or for not making the effort.” Rule 23(b)(1), SCRCP (emphasis added). The drafters of the rules of civil procedure rightly determined, building from common law jurisprudence, that derivative lawsuits must meet the *additional* requirements of a pre-suit demand to first allow an unincorporated association to address the demand before a lawsuit may be brought. *Latimer v. Richmond & D.R. Co.*, 39 S.C. 44, 17 S.E. 258, 261 (1893) (stating 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”).

In *Carolina First Corp. v. Whittle*, the court of appeals affirmed the circuit court’s dismissal of plaintiff’s complaint because it failed to meet the pleading requirements of Rule 23(b)(1). 343 S.C. 176, 190, 539 S.E.2d 402, 410 (Ct. App. 2000). *Whittle* noted that the “protective principles underlying the pleading requirements of Rule 23(b)(1) have long been recognized as important gatekeepers in South Carolina corporate jurisprudence.” *Id.* at 176, 185, 539 S.E.2d at 407. The court noted that a “[d]emand is required in order to assure compliance with the most fundamental principle of corporate governance—directors are answerable to the shareholders and are charged with the duty

and responsibility to manage all aspects of corporate affairs.” *Id.* at 188, 539 S.E.2d at 409. A proper pre-suit demand alerts the Board so that it may exercise its reasonable business judgment as to whether any corrective action should be taken *before* litigation may commence. *Id.* at 188, 539 S.E.2d at 409. It is for that reason that a derivative action is referred to as a “remedy of last resort.” *Id.* at 187, 539 S.E.2d at 408.

Rule 23(b)(1) requires a plaintiff to allege *in the complaint* the details of his pre-suit demand with particularity. The pre-suit demand must specifically identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused, and the requested remedial relief. *Id.* at 189, 539 S.E.2d at 409. Further, the complaint must allege with particularity the corrective actions sought by the plaintiff, the efforts he has made to convince the Board to take those actions, and the resulting decision by the Board. *See* Rule 23(b)(1), SCRCPP. These particularized allegations are required because they are what a Court must review in exercising its gatekeeping authority. *E.g., Grimes v. Donald*, 673 A.2d 1207, 1219-20 (1996), *overruled on unrelated ground addressing standard of review* (holding that the bare allegation in plaintiff’s complaint that refusal could not have been the result of an adequate, good faith investigation failed to meet the requirements of Chancery Rule 23.1 because the complaint failed to include particularized allegations as to the Board’s refusal to act); *see also Steinberg ex rel. Bank of Am. Corp. v. Mozilo*, 135 F. Supp. 3d 178, 185 (S.D.N.Y. 2015) (holding that plaintiff’s complaint should be dismissed because it merely stated that plaintiff’s demand was refused and that the refusal was wrongful).<sup>4</sup> Thus, if a demand is rejected by the

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<sup>4</sup> This Court has noted that because the South Carolina Rules of Civil Procedure are “based on the Federal Rules, where there is no South Carolina law, we look to the

Board, then the particularized allegations of the demand set forth *in the complaint* allow the Court to determine whether the Board's decision deserves deference and, thus, whether a derivative suit should proceed.

South Carolina's Rule 23(b)(1) mirrors Federal Rule of Civil Procedure 23.1. The federal rule, from which South Carolina's rule is derived, was designed to protect against the potential abuses stemming from derivative actions. *Whittle*, 343 S.C. at 185, 539 S.E.2d at 407. Rule 23.1 seeks to prevent unrestrained use of derivative actions by shareholders of a corporation or members of an unincorporated association which would undermine the basic principles of corporate governance that certain decisions should be made by management of the entity. *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 530 (1984) (noting the requirements for bringing a derivative action were designed to limit actions to situations in which there is an unjustified failure by the entity to act for itself); *Renfro v. FDIC*, 773 F.2d 657, 659 (5th Cir. 1985) (noting heightened pleading requirements for bringing a derivative action exist because such an action impinges on the inherent role of management to conduct the affairs of the entity). Again, mandatory compliance with Rule 23(b)(1) provides the circuit court, as gatekeeper, with a roadmap to follow in determining whether an unincorporated association's management has been given an opportunity to properly employ its business judgment to address the alleged wrong *before* allowing it to be forced into litigation.

**B. Are the Claims Sought by Petitioners Derivative?**

Petitioners brought claims that are clearly derivative and thus subject to the mandatory requirements of Rule 23(b)(1). Petitioners assert claims for the association as

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construction placed on the Federal Rules of Civil Procedure.” *Gardner v. Newsome Chevrolet-Buick, Inc.*, 304 S.C. 328, 330, 404 S.E.2d 200, 201 (1991).

opposed to wrongs allegedly suffered separately by individual members. For example, paragraph 41 of the Complaint states:

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. (emphasis added).

(Complaint, ¶41, App. p. 58). Petitioners did not allege that any individual member's alleged loss was separate and distinct from that of the Fund itself. In fact, the Complaint alleges just the opposite. For example, at paragraph 13 of the Complaint, Plaintiffs allege that their injuries are typical of the claims of the other members. (Complaint, ¶13, App. p. 54). The Complaint identifies no personal, individualized damage to any Petitioner, or any unnamed member of the Fund.

A member of an association may maintain an individual action *only* if his alleged loss or injury is separate and distinct from that of the association. *Hite v. Thomas & Howard Co. of Florence, Inc.*, 305 S.C. 358, 361, 409 S.E.2d 340, 342 (1991), *overruled on other grounds by Huntley v. Young*, 319 S.C. 559, 462 S.E.2d 860 (1995); *Rice-Marko v. Wachovia Corp.*, 398 S.C. 301, 308, 728 S.E.2d 61, 65 (Ct. App. 2012). "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." *Hite*, 305 S.C. at 361, 409 S.E.2d at 342. Allegations of corporate malfeasance that result in identical harm to all shareholders constitute a "breach of fiduciary duty [claim that] gives rise to a classic shareholders' derivative suit." *Clearwater Trust*, 367 S.C. at 351, 626 S.E.2d at 339; *Babb v. Rothrock*, 303 S.C. 462, 464, 401 S.E.2d 418, 419 (1991) ("It is firmly

established by our decisions that individual shareholders may not sue corporate directors or officers directly for losses suffered by the corporation.”).

The gravamen of Petitioners’ Complaint alleges that the Fund has been injured and that the members collectively may be liable for a shortfall in the assets of the Fund. Petitioners do not allege particularized losses that the individual members of the Fund suffered or might suffer; instead, it is a collective loss that has been (or could be) allegedly suffered by all members.

### C. Do Petitioners Allege Direct Claims?

In an effort to evade the Rule 23(b)(1) requirements of a derivative lawsuit, Petitioners argue for the right to bring direct claims. (Petition, at 12-14). Petitioners did not raise this issue to the circuit court; they raised it for the first time in their opening brief to the court of appeals. Accordingly, it is not preserved for appellate review. *Queen’s Grant II Horizontal Property Regime v. Greenwood Development Corp.*, 368 S.C. 342, 372, 628 S.E.2d 902, 919 (Ct. App. 2006) (“In order for an issue to be properly preserved for appeal, it must have been both raised to and ruled upon by the trial court.”). Issue preservation aside, Petitioners’ argument fails as a matter of law. They take the position that the *general* fiduciary duties the Board owes to *all* of the members of the Fund should be labeled as a *special duty* to each individual member, and thus convert their otherwise derivative claims into direct claims. (Petition, at 13). That argument was rejected by the very decision upon which Petitioners rely.

In *Rice-Marko v. Wachovia Corp.*, 398 S.C 301, 728 S.E.2d 61 (Ct. App. 2012), former shareholders sought to bring direct claims against officers and directors of Wachovia for losses to their investment in Wachovia stock. The shareholders alleged

they had a right to bring a direct claim for these losses based, in part, upon the special duty exception to the rule that “shareholders do not have standing to bring direct claims for wrongs that diminish the value of their shares in a corporation.” *Id.* at 307, 728 S.E.2d at 65. Affirming the circuit court’s dismissal of the shareholders’ complaint, the court of appeals noted that “Appellants have failed to allege any facts from which it may be inferred that Respondents owed Appellants a duty that was personal to Appellants and distinct from the duty Respondents owed Wachovia and its shareholders.” *Id.* at 309, 728 S.E.2d at 65.

In support of their special duty argument, Petitioners do not even cite to their Complaint. This omission is telling. Petitioners’ Complaint does *not* identify any special duty between the Board and Petitioners that is personal and distinct from the general fiduciary duties that the Board owes to all members. In fact, the Complaint repeatedly refers to the duties that the Board owed to the membership in terms of its general fiduciary duties. (App. p. 57, ¶33).

Petitioners also rely upon *In re: Greenwood Supply Co.*, 295 B.R. 787 (D.S.C. 2002) for their argument that they allege direct claims. *Greenwood Supply* stands for the proposition that “a direct action is one where misconduct by the management of a corporation causes a particular loss to an individual shareholder.” *Id.* at 795. Petitioners argue they have direct claims because they “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.” (Petition, at 13). In *Greenwood Supply*, however, the Court found that a “cause of action for an accounting based upon a diversion of corporate assets is a derivative action” because it “closely mirrors . . .

misappropriation of corporate property, a cause of action that South Carolina courts have treated as derivative.” *Id.* at 795-96.

Petitioners do not allege direct claims. The court of appeals correctly held that the Complaint is derivative and that Rule 23(b)(1) applied.

### **III. DID THE COURT OF APPEALS CORRECTLY HOLD THAT THE COMPLAINT DID NOT COMPLY WITH THE PLEADING REQUIREMENTS OF RULE 23(b)(1), SCRCP?**

#### **A. Did Petitioners Fail to Satisfy the Pleading Requirements of Rule 23(b)(1)?**

A derivative action must meet the mandatory pleading requirements of Rule 23(b)(1), SCRCP. “A derivative action that does not meet the pleading requirements of Rule 23(b)(1), SCRCP, is properly dismissed pursuant to Rule 12(b)(6).” *Clearwater Trust*, 367 S.C. at 351, 626 S.E.2d at 339. The pleading requirements of Rule 23(b)(1) require particularized, detailed, and heightened allegations, and are a departure from the liberal pleading requirements of Rule 8. *Whittle*, 343 S.C. at 188, 539 S.E.2d at 409. This Rule seeks to prevent the unrestrained use of derivative actions. *Id.* at 185, 539 S.E.2d at 407.

Recognizing that *Whittle* compels denial of the petition, Petitioners resort to the only course available to them: they ask this Court to grant the petition and *overrule Whittle*. (Petition, at 18 (language of header VI)). This Court should summarily reject Petitioners’ argument. The *Whittle* decision correctly based its holding on South Carolina jurisprudence as well as federal case law. The “protective principles” of Rule 23(b)(1) have been adopted because a proper pre-suit demand alerts the Board so that it may exercise its reasonable business judgment as to whether any corrective action should be taken. *Id.* at 188, 539 S.E.2d at 409. A plaintiff must allege *in his complaint* the details of his pre-suit demand with *particularity*. A Court is able to exercise its gatekeeping

authority and decide whether to allow a case to move forward only when a plaintiff pleads with particularity in the complaint the corrective actions sought by the plaintiff *before* the complaint was filed, the efforts he made to convince the Board to take those actions, and the resulting decision by the Board. *E.g., Grimes*, 673 A.2d at 1219-20. Petitioners have clearly failed to meet these requirements.

1. *Paragraph 8 Does Not Meet the Pleading Requirements of Rule 23(b)(1)*

Petitioners claim that they have met the requirements of Rule 23(b)(1) by the allegations set forth in paragraph 8 of their Complaint. (Petition, at 14). They clearly have not. Paragraph 8 states in its entirety:

- 8.
- 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.

(Complaint, ¶ 8; App. p. 54).

To make the determination of whether the pleading requirements of Rule 23(b)(1) have been met, a court may look *only* to the four corners of the complaint. *Whittle*, 343 S.C. at 190, 539 S.E.2d at 410. Petitioners failed to satisfy the following requirements:

- Petitioners failed to allege with particularity the demands they made on the Board prior to filing suit—*i.e.*, what corrective actions they sought from the Board.
- Petitioners failed to allege with particularity the pre-suit efforts they made to convince the Board to meet their demands.
- The pre-suit demand must specifically identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused, and the requested remedial relief. *Whittle*, 343 S.C. at 189, 539 S.E.2d at 409.

- Petitioners failed to allege with particularity the reasons for their failure to obtain the actions they sought from the Board.
- Petitioners also failed to allege with particularity any reasons for not making an appropriate pre-suit demand on the Board.

A simple review of the Complaint confirms Petitioners' failure to comply with the requirements of Rule 23(b)(1). Comparing the facts alleged in the Complaint to the allegations set forth in the *Whittle* complaint establishes that the Complaint clearly failed to meet the heightened pleading requirements of Rule 23(b)(1):

- In *Whittle*, the complaint alleged that plaintiffs demanded "certain information"; *Id.* at 189, 539 S.E.2d at 409. In the instant matter, Petitioners' Complaint states that they sent "correspondence to counsel for defendants." (Complaint, ¶ 8; App. p. 54).
- In *Whittle*, the complaint alleged that plaintiffs demanded that "certain actions" be taken; *Id.* at 189, 539 S.E.2d at 409. In the instant matter, the Complaint alleged that Petitioners had "meetings with counsel for defendants." (Complaint, ¶ 8; App. p. 54).
- In *Whittle*, the complaint alleged that plaintiffs made a "supplemental demand"; *Id.* at 189, 539 S.E.2d at 409. In the instant matter, the Complaint alleges that Petitioners "sent correspondence to the Trust." (Complaint, ¶ 8; App. p. 54).

As in *Whittle*, this Complaint did "not allege what the [members] demanded and what the Board rejected." *Id.* at 189, 539 S.E.2d at 409. Petitioners alleged they sent "correspondence" without stating what was in the correspondence. Petitioners allege they "had a meeting with counsel for defendants" without even hinting at what may have been said at the meetings. Petitioners claim they sent "correspondence to the trust" without even summarizing what was in the correspondence. And finally, Petitioners did not allege the reasons for their failure to obtain the actions they sought from the Board. In fact, it was impossible for Petitioners to make the latter allegations because they never followed the required pre-suit demand process whereby a demand is made and a Board response is

provided, before any litigation is commenced. (*See supra* pp. 5-7; *see also* App. p. 26 (discussing procedural history)).

2. *Other Paragraphs in the Complaint Do Not Meet the Pleading Requirements of Rule 23(b)(1)*

Petitioners argue they have complied with Rule 23(b)(1) because the relief requested in the January 30 letter matched many of the allegations in the Complaint. (Petition, at 14-17). This argument fails as a matter of law for a number of reasons.

First, and as noted above, Rule 23(b)(1) requires that a plaintiff plead with particularity, among other things, the “efforts, if any, made by the plaintiff to obtain the action he desires from the directors . . . and the reasons for his failure to obtain the action.” Petitioners seek to obfuscate these essential requirements by selectively quoting other requirements of Rule 23(b)(1). (Petition, at 16-17 (arguing they are only required to “identify the alleged wrongdoers,” “describe the factual basis of the alleged wrongful act,” the “harm caused,” and “request remedial relief”). The law is clear, however, that a plaintiff must also plead with particularity the efforts he has made to obtain corrective action and the reasons for his failure. Indeed, the latter requirement is particularly essential because those particularized allegations are what a court must rely on in exercising its gatekeeping function. *E.g., Grimes*, 673 A.2d at 1219-20 (holding that the bare allegation in plaintiff’s complaint that refusal could not have been the result of an adequate, good faith investigation failed to meet the requirements of Chancery Rule 23.1 because the complaint failed to include particularized allegations as to the Board’s refusal to act); *see also Levine v. Liveris*, No. 16-CV-11255, 2016 WL 6092731, at \*9 (E.D. Mich. Oct. 19, 2016) (holding that the mere fact that the members of the investigation committee unanimously rejected plaintiff’s demands is not a particularized fact which

creates a reasonable doubt that the refusal was wrongful); *Mozilo*, 135 F. Supp. 3d at 185 (holding that plaintiff's complaint should be dismissed because it merely stated that plaintiff's demand was refused and that the refusal was wrongful); *Baron v. Siff*, No. 15152, 1997 WL 666973, at \*2-3 (Del. Ch. Oct. 17, 1997) (holding that plaintiff failed to plead with particularity facts that would create a reasonable doubt as to the good faith or reasonableness of a board's investigation when plaintiff's complaint merely stated that plaintiff's demand was refused and that the refusal was wrongful); *Bezirdjian v. O'Reilly*, 183 Cal. App. 4th 316, 328, 107 Cal. Rptr. 3d 384, 395 (2010) ("Since plaintiff has not pled that the Committee members either lacked independence or failed to act in good faith after reasonable inquiry, he has failed to clear the initial hurdle of an adequate pleading so as to provide a basis for discovery."). Petitioners' Complaint contains none of these essential and mandated allegations.

Second, the January 30 letter was only sent after Petitioners filed the first action and after they were put on notice that their complaint failed to satisfy Rule 23(b)(1). After the first action was dismissed, rather than await a response to their January 30 letter, Petitioners filed the second (and subject) action.<sup>5</sup> In that action, and as noted above regarding the discussion of Paragraph 8, Petitioners only alleged that they had complied with Rule 23(b)(1) by vaguely referring to correspondence, a meeting, and a prior lawsuit. Petitioners' cursory, check-the-box approach to comply with Rule 23(b)(1) is

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<sup>5</sup> During the hearing on Respondents Motion for Reconsideration to dismiss the second action, as an accommodation to Petitioners, Respondents represented to the Court that rather than require Petitioners to formally send a demand letter, that they would accept the January 30 letter as Petitioners' demand letter in anticipation of filing a third action. (App. p. 120, ln. 19 - p. 121, ln. 15). As noted above, the Court subsequently issued an order dismissing the second action and stated that, "[o]nce the Defendants provide a response to the Plaintiffs' demand, then, if necessary, the Plaintiffs may pursue whatever legal action they determine is appropriate." (App. pp. 26-27).

contrary to well-settled law. *Whittle*, 343 S.C. at 190, 539 S.E.2d at 410 (“The particularized allegations must support an earnest, **and not a simulated**, effort with the managing body of the corporation to induce remedial action on their part.” (emphasis added)); *see also Latimer*, 39 S.C. at 52, 17 S.E. at 261 (stating 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”).

As in *Whittle*, Petitioners brought a derivative action that failed to comply with the requirements of Rule 23(b)(1) and, thus, the circuit court properly dismissed it, and the court of appeals properly affirmed. *Clearwater Trust*, 367 S.C. at 351, 626 S.E.2d at 339. The circuit court and court of appeals correctly held that the Complaint failed to allege with particularity the efforts the Petitioners made to satisfy the pre-suit demand requirements of Rule 23(b)(1).

**B. Are Respondents Judicially Estopped from Maintaining that the Fund is an Unincorporated Association?**

Petitioners argue that Respondents should be judicially estopped from maintaining that the Fund is an unincorporated association. The court of appeals properly rejected his argument.

“Judicial estoppel precludes a party from adopting a position in conflict with one earlier taken in the same or related litigation.” *Hayne Fed. Credit Union v. Bailey*, 327 S.C. 242, 251, 489 S.E.2d 472, 477 (1997). The purpose of the doctrine is to protect the integrity of the judicial process. *Id.* at 251, 489 S.E.2d at 477. Significantly, “[j]udicial

estoppel generally applies only to inconsistent statements of fact,” and “the doctrine does not apply to . . . assertions of alternative legal theories.” *Id.* at 251, 489 S.E.2d at 477.

Below, and in both actions filed by Petitioners, Respondents’ first ground to dismiss each complaint was based on Petitioners’ failure to comply with the mandatory pleading requirements of Rule 23(b)(1). Only as an alternative for Respondents’ Rule 23(b)(1) ground for dismissal, Respondents argued in the first action that it should be dismissed for lack of subject matter jurisdiction as the complaint made allegations concerning the internal affairs of a trust. In the first action, after having learned of the Rule 23(b)(1) deficiencies in their complaint, Petitioners embraced the trust concept and submitted a proposed order to the circuit court stating the case concerned a trust, and should be dismissed without prejudice. The lower court in the first action signed that order. (App. p. 7-8). Petitioners then filed the second (and current) action.

Judicial estoppel does not apply to this case. Alternative legal theories contained in a motion to dismiss are not inconsistent statements of fact; instead, they represent the normal practice of providing multiple legal theories to a court. Petitioners cannot use an alternative legal argument made by Respondents to prevent Respondents from pursuing their primary basis for dismissal. As the court of appeals concluded, Respondents did not misrepresent any facts or change their version of the events to gain an advantage in the instant litigation. (App. p. 596; *see also id.* (finding “Respondents argued alternative legal theories concerning the essence of the Fund” and holding that the “doctrine of judicial estoppel is inapplicable to this case.”)). Accordingly, the court of appeals correctly held that Respondents are not precluded from asserting that the Fund is an unincorporated association.

CONCLUSION

For the foregoing reasons, Respondents respectfully request that this Court deny the Petition for a Writ of Certiorari.

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December 29, 2016

THE STATE OF SOUTH CAROLINA  
In the Supreme Court

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APPEAL FROM RICHLAND COUNTY  
Court of Common Pleas

G. Thomas Cooper, Jr., Circuit Court Judge

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Case No. 2013-CP-40-2655  
Appellate Case No. 2016-002343

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Allen Patterson, Steve Tilton, Richard Sendler, Lincoln Privette, Marc Ellis, Joey Carter, Barry Davis, Michael 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  
..... Petitioners,

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.

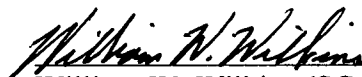
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**PROOF OF SERVICE**

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I certify that I have served the Return to Petition for Writ of Certiorari on Petitioners by depositing a copy of it in the United States Mail, postage paid, on December 29, 2016 to the following:

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