THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM RICHLAND COUNTY
Court of Common Pleas

G. Thomas Cooper, Jr., Circuit Court Judge

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

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.

BRIEF OF RESPONDENTS

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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). If approved for membership, a member pays a predetermined premium for workers' compensation coverage. (App. p. 21). Importantly, each member is jointly and severally liable for all obligations of the Fund.[1] (App. p. 21). The Fund is operated by a chief administrator and staff, and is governed by the Board, which is elected by the members.[2] (App. p. 20).

The named plaintiffs brought this action as a putative class action on behalf of themselves and all other members of the Fund. (App. p. 47). In their Complaint, they primarily challenged the following business decisions of the Fund and its Board: (1) to

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[1] *See* S.C. CODE ANN. § 15-35-170 (2005) ("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.").

[2] Petitioners incorrectly refer to the Fund's members (home builders) as "beneficiaries." 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.

create a member owned insurance company (mutual insurance company[3]); (2) to allocate Five Million Dollars (as required by the Insurance Commission) as a step toward the establishment of a successor member owned mutual insurance company;[4] (3) to purchase a building; (4) to purchase certain software; and (5) to hire professionals to assist in the creation of the mutual insurance company. (App. pp. 49-50 (¶¶20,21,24,26)). In addition, the named plaintiffs are asking a court to order the Fund to pay a dividend to all members. Specifically, they ask a court to (i) determine that the Fund has "at least Five Million Dollars" in excess capital reserves and (ii) then force the Fund to issue a dividend to all members, which collectively would equal that amount. (App. p. 55 (¶¶66-67)).

In a prior action filed on February 16, 2012 (2012-CP-40-4311), in which Petitioners also purported to represent all members of the Fund, Petitioners asserted various derivative claims, including the allegations identified above (excluding the claim for a dividend). (App. pp. 37-44). Petitioners filed that action without making a Rule 23(b)(1), SCRCP, pre-suit demand upon the Fund's Board. 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[5] for, among other grounds, failure to meet the pleading requirements of Rule

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[3] Mutual insurance companies are, like an unincorporated association, owned by their members. However, members of a mutual insurance company are not jointly and severally liable for the obligations of a mutual insurance company. *See* S.C. CODE ANN. § 38-19-410 (1976).

[4] The Five Million Dollars was returned to the Fund once a challenge to the formation of the mutual insurance company arose. *Patterson v. Witter*, 418 S.C. 66, 74 n.3, 791 S.E.2d 294, 299 n.3 (Ct. App. 2016).

[5] The Complaint had subsequently been amended to add more plaintiffs.

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 ***submitted by Petitioners***. (App. pp. 319-20). That order granting the motion 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 derivative claims on behalf of the Fund. Unlike in the first action, however, in the second action (after having learned of Respondents' primary defense) Petitioners inserted a paragraph in their complaint (paragraph 8) that purported to comply with the heightened pleading requirements of Rule 23(b)(1). (App. p. 54, ¶8).

Respondents moved to dismiss the second 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, Jr., 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 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).

In his Order, Judge Cooper 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 Order dismissing the second action.

In a unanimous decision, the court of appeals affirmed the circuit court's Order dismissing Petitioners' second action. (App. pp. 591-604). The court of appeals 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 court of appeals denied the

petition for rehearing. (App. p. 624). The petition for rehearing *en banc* was subsequently denied. (App. p. 627).

I. The Court of Appeals Correctly Held That the Fund is Not a Trust.

The court of appeals affirmed the circuit court's ruling 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 group 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.* Although an unincorporated association is not a legal entity that is separate from the individuals who compose it, an "unincorporated association may be sued and proceeded against under the name and style by which . . . [it is] usually known without naming the individual members of the association." S.C. CODE ANN. § 15-5-160 (2005). 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 (2005) ("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). While still in use today for business purposes, an unincorporated association is the predecessor to the many statutory business organizations more commonly used in today's world, such as corporations, limited partnerships, and limited liability companies.

C. The Fund is 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 identify any 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 John Doe).

- 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 and contains references to trust law, the court of appeals correctly looked at substance over form and held that the Declaration in fact created an unincorporated association. *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.[6]

II. The Court of Appeals Correctly Held 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. The language of Rule 23(b)(1) makes clear that its requirements apply with equal force to both an unincorporated association and a corporation. Rule 23(b)(1), SCRCP (noting that the rule applies when "one or more shareholders or members [seek] to enforce a right of a corporation or of an unincorporated association"). 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. Shareholders will file a derivative action on behalf

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[6] The circuit court's correct finding that the Fund is an unincorporated association, and the court of appeals' correct holding affirming that finding aside, the Fund is an operating business comprised of members who pay for the opportunity to receive a benefit of membership. Courts from other jurisdictions that label this type of business as a trust have concluded that derivative suits against these businesses entities must comply with Rule 23. *See, e.g., Ex parte Callan Assocs., Inc.*, 87 So. 3d 1161 (Ala. 2011); *Cote v. Levine*, 754 N.E.2d 127 (Mass. Ct. App. 2001).

of a corporation; whereas, members will file a derivative action on behalf of an unincorporated association.

A derivative action is brought when one or more members of an unincorporated association, perceiving that management has acted wrongly or that the 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 mandatory 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." *Id.* (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 demand 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 made to convince the Board to take those actions, and the resulting decision by the Board. *See* Rule 23(b)(1), SCRCP. 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 (Del. 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).[7] Thus, if a demand is rejected by the Board, then the particularized allegations of the demand set forth ***in the complaint*** allow a 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 road map 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.

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[7] 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 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).

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' Complaint is a clear effort to challenge the business judgment of the Fund and its Board. For example, consider the following paragraphs of the Complaint:

> 20. The Defendants have voted to remove assets from the [Fund] in order to incorporate a new member owned insurance company . . .
>
> 21. The Defendants have removed approximately five million dollars from the [Fund] for the purpose of establishing a separate member owned insurance company . . .
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> . . . .
>
> 24. The [Board] ha[s] purchased a building as well as . . . software programs for the purpose of creating a member owned insurance company. . .

(App. p. 58). These allegations plead a classic derivative suit for those business decisions equally affect all members of the Fund. "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 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). 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. 340, 351, 626 S.E.2d 334, 339 (2006); *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.").

In addition, Petitioners' Complaint seeks judicial intervention into the Fund and its Board's financial decision-making. They seek to force the Board to distribute a dividend to all members of the Fund. The following paragraphs of the Complaint make this clear:

> 66. Pursuant to the [Fund's] actions in transferring out Five Million Dollars for the establishment of a . . . mutual fund, there is at least Five Million Dollars available to distribute to [members] of the [Fund].
>
> 67. The Court should award a distribution of excess funds to the [members] of the [Fund] of at least Five Million Dollars.

(App. p. 61). Whether to distribute a dividend is a core business decision vested in the sound business judgment of a business's board of directors. *Gabelli & Co. v. Liggett Grp. Inc.*, 479 A.2d 276, 280 (Del. 1984) ("It is settled law in this State that the declaration and payment of a dividend rests in the discretion of the corporation's board of directors in the exercise of its business judgment; that, before the courts will interfere with the judgment of the board of directors in such matter, fraud or gross abuse of discretion must be shown."). Shareholder or member challenges to these types of business decisions must comply with Rule 23(b)(1) as a condition precedent to filing a lawsuit. *See Whittle*, 343 S.C. at 187-88, 539 S.E.2d at 408-09 (noting that a "derivative action is, in essence, a challenge to a board's managerial authority" and noting that it is for that reason that the "law imposes certain prerequisites on a stockholder's right to sue derivatively").

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. (Petitioners' Br. at 12-14). Petitioners did not raise this issue with the circuit court; they raised it for the first time in their opening

brief to the court of appeals.[8] 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.

A member of an association may maintain a direct claim ***only*** if the alleged loss or injury is separate and distinct from that of the association. *Hite*, 305 S.C. at 361, 409 S.E.2d at 342; *Rice-Marko v. Wachovia Corp.*, 398 S.C. 301, 308, 728 S.E.2d 61, 65 (Ct. App. 2012). As discussed above, the allegations in the Complaint do not state direct claims.

Petitioners argue their claims should be characterized as direct claims, notwithstanding their derivative nature. (Petitioners' Br. at 12-13). 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. (Petitioners' Br. at 12-13 (citing *Rice-Marko*, 398 S.C. 301, 728 S.E.2d 61)). That argument was rejected by the very decision upon which Petitioners rely.

In *Rice-Marko*, 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 purported 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,

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[8] *Patterson*, 418 S.C. at 81, 791 S.E.2d at 303.

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 purported special duty argument, Petitioners do not even cite to their Complaint. This omission is telling. Petitioners' Complaint does ***not*** identify any special duty owed by the Board to 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 mistakenly 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 that 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. The Court of Appeals Correctly Held That the Complaint Did Not Comply with the Pleading Requirements of Rule 23(b)(1), SCRCP.

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.

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 the complaint*** the details of his pre-suit demand with ***particularity***. Again, a court is only able to exercise its gatekeeping authority and decide whether to allow a case to move forward beyond the pleading stage by reviewing the particularized facts in the complaint—that is, the corrective actions sought by the plaintiff ***before*** the complaint was filed, the efforts made to convince the Board to take those actions, and the resulting actions by the Board. *E.g.*, *Grimes*, 673 A.2d at 1219-20. Petitioners have clearly failed to meet these requirements.

A. Paragraph 8 of the Petitioners' Complaint 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. (Petitioners' Br. 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.
- 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 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 the 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 the 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 meetings with counsel for the 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. 3-5; *see also* App. p. 26 (discussing procedural history)).

B. 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. (Petitioners' Br. 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 this essential pre-suit requirement by selectively quoting other requirements of Rule 23(b)(1). (Petitioners' Br. 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 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 (Cal. Ct.App. 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.[9] 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 approach to comply with Rule 23(b)(1) is 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

[9] 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).

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).

IV. Judicial Estoppel Does Not Apply to this Case.

Petitioners argue that Respondents should be judicially estopped from maintaining that the Fund is an unincorporated association. The court of appeals properly rejected this 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 set forth in the first action that it should be dismissed

also 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 their Complaint 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 estopped from asserting that the Fund is an unincorporated association.

V. Conclusion

The circuit court correctly analyzed the form of the Fund and identified it as an unincorporated association. Having done so, the circuit court then correctly analyzed whether Petitioners' Complaint complied with Rule 23(b)(1), correctly concluded that it did not, and correctly dismissed the Complaint. The court of appeals correctly analyzed the circuit court's order and legal reasoning and affirmed the order dismissing the Complaint.

Respondents respectfully submit that this Court should affirm the decision of the court of appeals.

Respectfully submitted,

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December 4, 2017

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM RICHLAND COUNTY
Court of Common Pleas

G. Thomas Cooper, Jr., Circuit Court Judge

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

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.

PROOF OF SERVICE

I certify that on this day I have served the Brief of Respondents on Petitioners by depositing a copy of it in the United States mail, postage prepaid, addressed to the below counsel of record.

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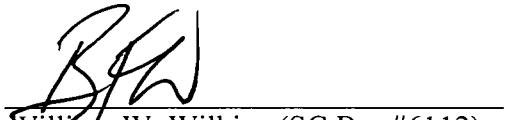

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