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STATE OF SOUTH CAROLINA
In the Court of Appeals

MAY 31 2017

SC Court of Appeals

Appeal from Richland County
Court of Common Pleas

The Honorable Joseph M. Strickland, Master-in-Equity

Appellate Case No. 2016-001514

Tiffany's Café and Bakery on Devine, Inc., Respondent,

v.

James S. Archer.....Appellant.

BRIEF OF RESPONDENT

Adam T. Silvernail (Bar No. 80219)
Law Office of Adam T. Silvernail, LLC
1905 Marion Street (29201)
Post Office Box 7995
Columbia, South Carolina 29202-7995
(803) 779-1770
adam@silvernaillawfirm.com

Carlos W. Gibbons
Ashley & Gibbons, P.A.
712 Calhoun Street, Suite B
Columbia, South Carolina 29201
(803) 771-4488
cgibbons@aglawsc.com

Counsel for Respondent

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Statement of Issues on Appeal

- I. The lower court properly proceeded with trial and entry of the judgment where Appellant had never moved for dismissal and, in fact, consented to continuance of the case months before trial.
- II. The lower court correctly determined that Appellant was liable for his share of the debt incurred by the corporation as a result of his negligence, breach of fiduciary duty and/or breach of contract.
- III. The lower court appropriately considered the \$3,500 paid by Appellant to cover the bad checks he wrote from Respondent's account to be loans to the corporation, rather than payments on the promissory note.
- IV. The lower court correctly found that Appellant had presented no evidence to support his counterclaims and, as an additional sustaining ground, would have been justified in finding that none of Appellant's counterclaims was appropriate for a direct action.

Statement of the Case

This action was commenced by the filing and service of a Summons and Complaint on May 1, 2008. Plaintiff Tiffany's Café and Bakery on Devine, Inc. ("Respondent") sought damages against James S. Archer ("Appellant") for collection of a promissory note, breach of contract, negligence, and breach of fiduciary duty. Appellant answered and counterclaimed on May 16, 2008, seeking offset against his obligations to Respondent and damages for alleged breaches of fiduciary duty. Respondent replied on June 16, 2008, denying any liability.

This action was referred by consent to the Master-in-Equity, with direct appeal to this Court. On July 29, 2015, the Master held a final hearing in this matter.

By Order dated September 25, 2015, the Master initially found that Appellant had no liability to Respondent. Respondent moved to alter or amend the Master's initial Order, and the Master subsequently entered an Amended Order awarding Respondent a judgment against Appellant in the amount of \$43,373.27.

Appellant moved to alter or amend the Amended Order, and the Master heard Appellant's motion on June 13, 2016. By Order dated July 7, 2016, the Master denied Appellant's motion. This appeal follows.

Statement of Facts

Tiffany's Café and Bakery on Devine, Inc. is a corporation organized under the laws of South Carolina, and it was created in 1997 (R. 73-4) Prior to July 24, 2003, James M. McMillan was the sole shareholder and officer of Respondent. Shortly before that date, Appellant began to take on management of the day-to-day business of Respondent. On July 24, 2003, the parties entered into a Stock Purchase Agreement, whereby Appellant would purchase a 49% ownership in Respondent. The purchase price was \$40,000, with Appellant paying \$30,000 and financing the remainder by giving a promissory note to respondent in the amount of \$10,000. By its terms, the promissory note began to earn interest at 10% per year on July 24, 2005. (R. 76, l. 18 – 77, l. 23; 327)

Appellant continued to manage the day-to-day business of Respondent until around the end of 2006. During that time, the business was mismanaged; ran out of money to pay its bills; and fell behind on State and Federal tax obligations. (R. 83, l. 15 – 84, l. 2; 97, ll. 15-19; 153, ll. 7-14) Mr. McMillan, Respondent's other owner and officer, was unaware of the debts until Appellant resigned his positions and left the business in January 2007 (R. 84, ll. 13-18)

After Appellant's departure, Respondent owed substantial tax and other debts, which threatened Mr. McMillan's personal assets and those of a separate corporation in a similar business. (R. 86, ll. 16-23) Additionally, Appellant was personally liable for the unpaid payroll taxes, as he had been the responsible party issuing paychecks without submitting tax payments. (R. 152, ll. 3-24) Mr. McMillan therefore undertook to satisfy Respondent's liabilities, including those on which Appellant was personally

liable, by loaning it money. (R. 88, l. 16 – 90, l. 6) These debts were incurred by Appellant during his management of Respondent. (R. 90, l. 7-16) Respondent's accountant prepared coupons to facilitate Appellant's payment of the taxes as they became due, but Appellant nonetheless failed to pay them. (R. 90, l. 17 – 26, l. 2) Respondent's accountant testified at trial that Appellant and Mr. McMillan could both be personally liable on Respondent's tax debts, and the loans from Mr. McMillan to satisfy those debts was to the benefit of all owners of Respondent. (Tr., p. 92, l. 21 – 93, l. 10)

In all, Respondent incurred more than \$36,000 in loans to cover the debts and expenses incurred during Appellant's management. (R. 90, ll. 3-6) Appellant did not contribute any funds to cover these loans. (R. 92, l.2 – 93, l. 10) Appellant did pay \$3,500 to IFH Foods to cover two checks he wrote from Respondent's bank account for which there were insufficient funds. (R. 140, ll. 8-14; 121, l. 17 – 124, l. 9)

Although Respondent attempted to continue its business, it was unable to recover sufficiently to do so. Respondent ceased its business in late 2007. (R. 93, ll. 8-19) Thereafter, the tangible assets of the company were liquidated in an effort to pay its debts, although the proceeds were insufficient to repay Mr. McMillan for his loans. (R. 93, l. 24 – 96, l. 14)

In addition to the debts and liabilities incurred by Respondent during Appellant's management, Appellant never made a payment on the \$10,000 promissory note. (R. 157, ll. 5-16)

The Master determined that Appellant owed Respondent the entire unpaid principal on the promissory note, as well as interest due under the note and attorneys' fees paid in collection, for a total judgment of \$23,800 on that cause of action. (R. 13)

On the remaining causes of action for breach of fiduciary duty, negligence and breach of contract, the Master found that Appellant's management of Respondent had caused it to incur \$47,088.30 in debt (mostly loaned by Mr. McMillan, plus the \$3,500 Appellant had paid to cover the bad checks he had written from the corporate account). (R. 15) The Master determined that Appellant should pay to Respondent 51% of that amount, since that was the portion of Respondent not owned by Appellant. (R. 15)

Argument

I. The lower court properly proceeded with trial and entry of the judgment where Appellant had never moved for dismissal and, in fact, consented to continuance of the case months before trial.

Appellant argues that the lower court should have dismissed Respondent's action for its alleged "unreasonable neglect" in failing to seek an earlier trial. Although Appellant asserts that this argument was raised at trial, he neglects to note that it was the Court itself which inquired about the length of time between filing and trial. (R. 69, l. 11-15) Despite the lower court's inquiry, Appellant did not request dismissal or argue this point at trial.

Further, Appellant failed to raise this issue in his motion to alter or amend the Amended Order (R. 52)

Respondent notes that Appellant consented to the continuance of the merits hearing in this matter scheduled nearly a year before the trial took place, and never once raised the issue of delay to the lower court. (R. 3) After that hearing was continued, Appellant noticed and took Mr. McMillan's deposition on April 7, 2015 (R. 369)

"It is axiomatic that an issue cannot be raised for the first time on appeal, but must have been raised to and ruled upon by the trial judge to be preserved for appellate review." *Wilder Corp. v. Wilke*, 330 S.C. 71, 76, 497 S.E.2d 731, 733 (1998)

Appellant's argument that the Court should, presumably, have *sua sponte* dismissed the case at the commencement of trial has no support in the record or the law.

II. The lower court correctly determined that Appellant was liable for his share of the debt incurred by the corporation as a result of his negligence, breach of fiduciary duty and/or breach of contract.

Appellant argues that he cannot be compelled to contribute to the corporation's debt, and he asserts that the lower court's judgment amounted to piercing the corporate veil. A reading of the complaint and the Amended Order herein shows that Respondent claimed, and the lower court awarded, damages against Appellant for the losses incurred by Respondent as a result of Appellant's mismanagement, breaches of duty and/or breaches of contract.

Appellant cites *Hunting v. Elders*, 359 S.C. 217, 597 S.E.2d 803 (Ct.App. 2004) in support of his argument, but a review of that case shows that it dealt with a third party's attempt to reach the assets of a corporation's owner in satisfaction of the corporation's liability to the third party. Here, Respondent sought damages against Appellant for his mismanagement. The debts incurred by Respondent were presented as evidence as to the measure of damages, not in an attempt to make Appellant liable on the debts themselves.

Respondent borrowed money to pay the tax debts on which both Appellant and Mr. McMillan were personally liable and which had been the subject of aggressive collection efforts by the taxing authorities. (R. 14) The lower court's calculation of these damages flows from its introduction of Respondent's claims for negligence, breach of contract and breach of fiduciary duty. (R. 14)

The essential elements in a negligence action are: (1) a duty of care owed by the defendant to the plaintiff; (2) a breach of that duty by a negligent act or omission;

and (3) damage proximately caused by a breach of duty. *Rickborn v. Liberty Life Ins. Co.*, 321 S.C. 291, 468 S.E.2d 292 (S.C.1996).

There is abundant evidence in the record below that Appellant was negligent in his management of Respondent. Appellant had a duty to pay taxes and other expenses as they came due or, alternatively, to notify the shareholders that capital contributions were needed. His failure to do so was a breach of his duty to Respondent, and Respondent incurred substantial debts in resolving the emergency situation in which it was left.

Additionally, Appellant violated statutes requiring the payment of payroll and sales taxes, amounting to negligence *per se*. *Trivelas v. South Carolina Dep't of Transp.*, 348 S.C. 125, 134, 558 S.E.2d 271, 275 (Ct.App. 2001). Abundant testimony was given at trial to support Respondent's assertion that the tax debts brought with them the risk of collection against not only Respondent's assets, but also the assets of Mr. McMillan, Appellant and Mr. McMillan's other business.

Likewise, the record contains adequate evidence of Appellant's breaches of fiduciary duty. A fiduciary relationship is founded on the trust and confidence reposed by one person in the integrity and fidelity of another. *Ellis v. Davidson*, 358 S.C. 509, 519, 595 S.E.2d 817, 822 (Ct.App. 2004); *Regions Bank v. Schmauch*, 354 S.C. 648, 670, 582 S.E.2d 432, 444 (Ct.App. 2003); *Redwend Ltd. P'ship v. Edwards*, 354 S.C. 459, 476, 581 S.E.2d 496, 505 (Ct.App. 2003), cert. denied (Mar. 18, 2004). A fiduciary relationship exists when one imposes a special confidence in another, so that the latter, in equity and good conscience, is bound to act in good faith and with due regard

to the interests of the one imposing the confidence. *Hendricks v. Clemson Univ.*, 353 S.C. 449, 458, 578 S.E.2d 711, 715 (2003).

Additionally, S.C. Code Ann. § 33-8-420 requires that a corporate officer act in good faith; with the care of an ordinarily prudent person; and in a manner he reasonably believes to be in the best interest of the corporation.

Testimony at trial showed that the other owner of Respondent entrusted its management with Appellant, who accepted management of Respondent. Only at the time of Appellant's resignation did Mr. McMillan learn that substantial tax debts had been incurred and were in collection.

Because the complaint herein did not seek to pierce the corporate veil, but rather to hold Appellant responsible for his mismanagement, his argument that the lower court erred in entering judgment against him is without merit.

III. The lower court appropriately considered the \$3,500 paid by Appellant to cover the bad checks he wrote from Respondent's account to be loans to the corporation, rather than payments on the promissory note.

Appellant contends that he is entitled to have \$3,500 credited against his indebtedness on the promissory note as a result of his personally paying a vendor to cover checks he wrote from the corporate account at a time when there were insufficient funds to cover the checks.

The evidence shows that Appellant had taken a job with the vendor to whom he wrote the bad checks, and was pressed by his new employer to make the checks good. Additionally, both Appellant and Mr. McMillan testified that Appellant was criminally liable for having written the checks on insufficient funds.

Although Appellant asserts that Respondent caused the checks to bounce, Mr. McMillan's undisputed testimony at trial (and the bank statement introduced during his testimony) showed that only \$1,300 remained in Respondent's bank account at the time the checks were written, and they would have bounced regardless of the closing of the account. (R. 121, l. 4 - 122, l. 18)

Earlier in his brief, Appellant argues that Mr. McMillan's loans to the corporation should be characterized as gifts, since they were paid directly to the creditors. (App. Brief at 8) He asserts this despite having personally benefitted from Respondent's borrowing funds to satisfy tax debts on which Appellant was personally liable. It is disingenuous for Appellant to suggest that his payment of \$3,500 should be reclassified to give him a dollar-for-dollar reduction in his debt, where his own testimony shows that he paid those funds to avoid potential criminal prosecution and/or to avoid issues with his subsequent employer.

The lower court did credit Appellant with the entire \$3,500 by reducing the amount owed on the claims related to Respondent's payment of the debts with which Appellant left it saddled. Since his payments to cover the bad checks was made under similar circumstances to Mr. McMillan's loans to cover the corporate debts and liabilities, the lower court correctly treated them in the same manner.

IV. The lower court correctly found that Appellant had presented no evidence to support his counterclaims and, as an additional sustaining ground, would have been justified in finding that none of Appellant's counterclaims was appropriate for a direct action.

Appellant argues that the lower court erred in not awarding him damages for alleged breaches of fiduciary and other duties owed to him as a shareholder of Respondent.

The lower court correctly observed that Appellant had presented only speculation, without supporting evidence, that he had been damaged by any of the alleged acts or omissions by Respondent's remaining officer.

First Appellant asserts that the liquidation of the corporation's assets was for less than fair-market value. Mr. McMillan, however, testified that he had engaged a well-known auctioneer who had carried out a professional sale, and he did not know another way the assets could have been liquidated. The proceeds were insufficient to pay Respondent's debts, including those to Mr. McMillan himself. (R. 94, l. 4 - 97, l. 8)

Appellant introduced no evidence to suggest that the auction of Respondent's tangible assets fell below any standard of care and acknowledged at trial that he had no proof. (R. 245, l. 24 - 246, l. 2)

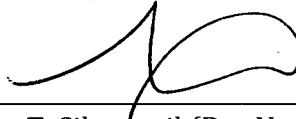
As to the particular assets sold, Appellant introduced no evidence to suggest they could have been sold for more than Respondent received.

Although not noted by the lower court, its judgment should additionally be sustained because Appellant, as a shareholder of Respondent in 2008, did not have the right to bring a direct action against the corporation for breaches of duty. "[U]nder South Carolina case law, a breach of this fiduciary duty must be pursued through a derivative, and not an individual, action." *Rivers v. Wachovia Corp.*, 665 F.3d 610, 617 (4th Cir. 2011). Although Appellant alleges that Mr. McMillan, as the remaining officer of Respondent, breached duties to Appellant, Mr. McMillan is not a party to this action. In order to bring his claims, applicable law requires that Appellant proceed with a derivative action.

Conclusion

For the reasons set forth above, Respondent respectfully submits that the lower court's Amended Order was correct; that Appellant has not identified any error justifying reversal or vacation of any portion of the Amended Order; and that the Amended Order should be affirmed in its entirety.

Respectfully submitted,



Adam T. Silvernail (Bar No. 80219)
Law Office of Adam T. Silvernail, LLC
1905 Marion Street (29201)
Post Office Box 7995
Columbia, South Carolina 29202-7995
(803) 779-1770
adam@silvernaillawfirm.com

Carlos W. Gibbons
Ashley & Gibbons, P.A.
712 Calhoun Street, Suite B
Columbia, South Carolina 29201
(803) 771-4488
cgibbons@aglawsc.com

Counsel for Respondent

May 31, 2017

Other Counsel of Record:

T. Jeff Goodwyn, Jr., Esquire
2519 Devine Street, Suite A
Columbia, South Carolina 29205
Counsel for Appellant

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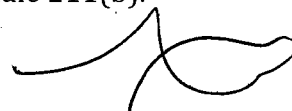
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v.

James S. ArcherAppellant.

CERTIFICATE OF COUNSEL

The undersigned counsel for Respondent hereby certifies that the Final Brief of Respondent filed herewith complies with Rule 211(b).



Adam T. Silvernail (Bar No. 80219)
Law Office of Adam T. Silvernail, LLC
1905 Marion Street (29201)
Post Office Box 7995
Columbia, South Carolina 29202-7995
(803) 779-1770
adam@silvernailfirm.com

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