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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM RICHLAND COUNTY
Court of Common Pleas

G. Thomas Cooper, Jr., Circuit Court Judge

Appellate Case No. 2016-002343
Opinion No. 27841 (S.C. Sup. Ct. filed September 5, 2018)

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.

PETITION FOR REHEARING

The Court **misapprehended** the mandatory pleading requirements of Rule 23(b)(1) by holding that incorporation of Petitioners' January 30 demand letter into the Complaint operated to comply with the heightened pleading requirements of this critical rule. An instructive analysis of Rule 23(b)(1) requires much more. Rule 23(b)(1) operates as a citadel against excessive shareholder lawsuits. The Court's Opinion eviscerates Rule 23(b)(1) rendering its corporate governance protections meaningless. Pursuant to Rule 221, SCACR, Respondents submit this Petition for Rehearing.

Distilled to its core, Rule 23(b)(1) mandates that the Complaint meet certain specific requirements:

1. "The Complaint shall . . . allege with **particularity** the efforts . . . made by the plaintiff to obtain the action he desires from the directors"; **and**

2. "[The Complaint shall also allege with **particularity**] the reasons for his failure to obtain the action or for not making the effort."

SCRCP 23(b)(1) (emphasis added); *accord Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008) ("A stockholder may not pursue a derivative suit to assert a claim of the corporation unless the stockholder . . has first demanded that the directors pursue the corporate claim **and** the directors have wrongfully refused to do so . . . .") (emphasis added)).

As will be discussed below, the second prong was not met ("the reasons for his failure to obtain the action"). Neither the Complaint nor the incorporated demand letter contain the mandatory particularized allegations setting forth the reasons why Petitioners were unable to obtain the actions sought in the demand letter. When a board of directors rejects a demand, the law **presumes** that the decision was a good faith exercise of the board's business judgment. In order to survive a motion to dismiss, a plaintiff's complaint must rebut that presumption by alleging particularized facts which create a reasonable doubt that the board's decision was a good faith

exercise of the board's business judgment. This Complaint, even with the incorporation of the demand letter, does not meet this mandatory pleading requirement. The pleading defect is fatal and mandates dismissal of the derivative claims.

The Court further misapprehended the causes of action in the Complaint when it concluded that Petitioners alleged direct claim(s). The gravamen of Petitioners' Complaint alleges damages to the Fund and challenges to the management of the Fund. As a result, this Court should grant the petition for rehearing, and re-issue an Opinion affirming the circuit court's order dismissing the Complaint *without* prejudice.

I. TIMELINE

An analysis of this Court's recent Opinion should begin with a clear timeline of events:

June 1, 2012	Second Amended Class Action Complaint is filed. ***No*** pre-suit demand had been made. No acknowledgement, nor recognition that case implicated the pleading requirements of Rule 23(b)(1). The complaint essentially mirrored the Complaint before this Court, save the claim seeking a $5,000,000 dividend and paragraph 8.
July 3, 2012	Respondents moved to dismiss original action for the following reasons: 1. Failure to meet pleading requirements of Rule 23(b)(1), 2. Business judgment rule protection, 3. Complaint did not state facts to support a breach of contract claim, 4. Complaint did not state facts to support breach of contract with fraudulent intent, 5. "in the alternative" this action involves a trust, 6. "in the alternative" matter should be before Workers' Compensation Commission.
Mid Jan. 2013	Respondents submitted a proposed order to Judge Manning dismissing complaint based **solely** on Petitioner's failure to comply with Rule 23(b)(1). In footnote one of the proposed order, Respondents noted alternatively that the Fund was an unincorporated association. (App. 314).
Mid Jan. 2013	Petitioners submitted a proposed order to Judge Manning dismissing their complaint because it did not "originate in the Probate Court."
Jan. 30, 2013	Before the circuit court ruled on the motion to dismiss, 6 months **after** the Second Amended Complaint had been filed, Petitioners sent a **belated "demand letter,"** dated January 30. (App. 324). "We are just

	sending this to you to make clear to you that under Rule 23 of the S.C. Rules of Civil Procedure we are asking that these actions be taken."
February 11, 2013	Referencing their demand letter, Petitioners' counsel stated to the circuit court during the motions hearing. App. 89:6-9: "Judge, but it was sent to them and I assume their lawyer got it because he responded to it and said basically, no, we're not going to do it, in a nice way, not in an unpleasant way."
March 7, 2013	Judge Manning signed order **submitted by Petitioners** dismissing their Complaint for lack of subject matter jurisdiction, expressing his concern that the complaint should have been filed in probate court.
April 9, 2013	Petitioners filed a new class action in probate court and removed it to circuit court. This complaint now contained the conclusory paragraph 8. Petitioners alleged that Rule 23(b)(1) did not apply but, **in the alternative**, they had complied with Rule 23(b)(1).
July 8, 2013	Respondents moved to dismiss for failure to comply with Rule 23(b)(1).
Nov. 8, 2013	Judge Cooper denied this motion to dismiss.
Nov. 27, 2013	Respondents filed a motion to reconsider.
Jan. 14, 2014	Judge Cooper held a hearing on Respondents' motion to reconsider.
Feb. 11, 2014	Judge Cooper granted Respondents' motion to dismiss, held that the Complaint alleged derivative claims and Petitioners had ***not*** complied with Rule 23(b)(1). In his Order, Judge Cooper stated that the Jan. 30, 2013 letter would serve as "a demand under Rule 23" and gave Respondents 60 days to respond, which had the effect of starting the process over again. The circuit court noted 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. 26-27).
April 16, 2014	Respondents provided a timely response to the demand as directed. (App. 326-50).
April 30, 2014	Petitioners elected not to file a complaint that would set up a proper wrongful refusal case, but rather elected to pursue years of appellate litigation.

II. OVERVIEW OF DEMAND AND RULE 23(b)(1)

When a plaintiff seeks to usurp the board's responsibility and authority to decide whether a corporation should pursue legal claims, that plaintiff must meet a significantly heightened pleading burden greater than that set forth in Rule 8. Notice pleading is not sufficient; a derivative plaintiff must provide **particularized** factual pleadings setting forth what demands were made **and**

why they were wrongfully refused.[1] *See Carolina First Corp. v. Whittle*, 343 S.C. 176, 188-90, 539 S.E.2d 402, 409-10 (Ct. App. 2000) (quoting Delaware law); *accord In re Am. Int'l Group, Inc. Deriv. Litig.*, 700 F. Supp. 2d 419, 430 (S.D.N.Y. 2010) (noting that "Rule 23.1 is not satisfied by conclusory statements or mere notice pleading" but that "it imposes a pleading standard higher than the normal standard applicable to the analysis of a pleading challenged under Rule 12(b)(6).") (citations omitted).

"The demand requirement in shareholder derivative suits emerges from the basic principle of corporate governance providing that the board of directors retains the power to direct a business's policies and actions." *Morefield v. Bailey*, 959 F. Supp. 2d 887, 897 (E.D. Va. 2013). "This power includes decisions of whether to pursue lawsuits in the interest of the corporation or shareholders." *Id.* And, "[t]his principle operates hand-in-hand with the business judgment rule, which presumes that the 'board made its decision on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company.'" *Id.* (quoting *In re Merrill Lynch & Co. Sec. Deriv. & Erisa Litig.*, 773 F. Supp. 2d 330, 345 (S.D.N.Y. 2011)).

A. Wrongful Refusal Background

In a wrongful refusal case, the following should occur:

1. The shareholder makes a demand upon the Board by submitting a demand letter.
2. If a determination that meeting the demand is not in the best interests of the corporation, the Board declines to act and issues a response to the demanding shareholder.
3. Upon receipt of the declination letter, derivative litigation is commenced by the filing of a complaint.

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[1] Sometimes referred to as a "wrongful refusal" case.

4. The complaint sets forth the demand by repeating with particularity what the demand letter requested and addressing with particularity the "reason for his failure to obtain the action" by reference to the board's response.
5. Before an answer is filed, the defendant often moves to dismiss pursuant to Rules 23(b)(1) and 12(b)(6) for failure to rebut the business judgment rule presumption.
6. The circuit court analyzes the complaint for alleged wrongful refusal, employing a quasi-merits analysis, similar to a summary judgment proceeding.
7. The circuit court's analysis is based on the allegations set forth with particularity within the four corners of the complaint (of what was demanded and why was it refused) as to whether the litigation is proper.
8. If the circuit court determines that the plaintiff has not rebutted the business judgment rule presumption, then the case is dismissed.
9. If the circuit court determines that the plaintiff has rebutted the business judgment rule presumption, then the case proceeds.

Zapata Corp. v. Maldonado, 430 A.2d 779 (1981) is directly on point. In *Zapata*, the Delaware Supreme Court reversed the lower court, which had erroneously held, that a stockholder had an absolute right to pursue derivative litigation over the objection of a corporation once a demand was made and refused. *Id.* at 781. The Delaware Supreme Court held that "[a] determination that a stockholder, once demand is made and refused, possesses an independent, individual right to continue a derivative suit for breaches of fiduciary duty over objection by the corporation . . . as an absolute rule, is **erroneous**." *Id.* at 782 (emphasis added). *Zapata* went on to note that a "demand, when required and refused (if not wrongful), terminates a stockholder's legal ability to initiate a derivative action." *Id.* at 784. Of course, this does not mean that a stockholder

cannot file a derivative action. Indeed, in a footnote immediately following the above quoted sentence, the Court noted that, "it may take litigation to determine the stockholder's lack of power." *Id.* at 784 n.12 The Court's reference to a "lack of power" is a reference to a finding that the complaint should be dismissed because the board acted properly (*i.e.*, not wrongfully) when it refused the demand. The Delaware courts also refer to a lack of power as a lack of "standing." *Id.* at 784 n.12.

Turning to the inquiry for how to police wrongful refusal cases from proper refusal cases the Delaware Supreme Court stated that, "[a]t the risk of stating the obvious, the problem is relatively simple. If, on the one hand, corporations can consistently wrest bona fide derivative actions away from well-meaning derivative plaintiffs through the use of the committee mechanism, the derivative suit will lose much, if not all, of its generally-recognized effectiveness as an intra-corporate means of policing boards of directors." *Id.* at 786. On the other side of the equation, it also stated that if "corporations are unable to rid themselves of meritless or harmful litigation and strike suits, the derivative action, created to benefit the corporation, will produce the opposite, unintended result." *Id.* at 786-87. Accordingly, the Delaware Supreme Court deemed it necessary to "find a balancing point where bona fide stockholder power to bring corporate causes of action cannot be unfairly trampled on by the board of directors, but the corporation can rid itself of detrimental litigation." *Id.* at 787.

The Delaware Supreme Court chose business judgment as the prudent balancing point:

> [T]he question has been treated by other courts as one of the "business judgment" of the board committee. If a "committee, composed of independent and disinterested directors, conducted a proper review of the matters before it, considered a variety of factors and reached in good faith, a business judgment that (the) action was not in the best interest of (the corporation)", the action must be dismissed.

Id. at 787 (citation omitted); *see also Dockside Ass'n, Inc. v. Detyens*, 294 S.C. 86, 87, 362 S.E.2d 874, 874 (1987) ("[T]he business judgment rule precludes judicial review of actions taken by a corporate governing board absent a showing of a lack of good faith, fraud, self-dealing or unconscionable conduct.").

B. Legal Framework for a Motion to Dismiss Wrongful Refusal Complaint

A complaint that does not meet the heightened pleading requirements of Rule 23(b)(1) is properly dismissed at the pleading stage of litigation. *Clearwater Trust v. Bunting*, 367 S.C. 340, 351, 626 S.E.2d 334, 339 (2006). "Rule 23[]'s command that a derivative complaint 'allege with particularity the efforts . . . made by the plaintiff to obtain the action he desires from the directors . . . **and** the reasons for his failure to obtain the action . . .' cannot be parsed to permit conclusory reasons alone to suffice." *Levine v. Smith*, 591 A.2d 194, 211 (Del. 1991) (emphasis added) overruled on unrelated grounds regarding standard of review, *by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). "The requirements of **particularity** apply both to plaintiff's efforts to obtain the desired action **and** the reasons for failing to secure redress." *Id.* (emphasis added).

"If the board refuses the shareholder's demand, the derivative suit may proceed only if the shareholder shows that the board's refusal was wrongful." *Espinoza ex rel. JPMorgan Chase & Co. v. Dimon*, 797 F.3d 229, 234 (2d Cir. 2015). Under Delaware law[2], allegations of wrongful refusal are reviewed under the business judgment rule. *Espinoza*, 797 F.3d at 234. Under this analysis, there is a "'**presumption** that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the

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[2] This Court has recognized that Delaware is the preeminent forum for corporate litigation. *Menezes v. WL Ross & Co., LLC*, 403 S.C. 522, 534 n.5, 744 S.E.2d 178, 185 n.5 (2013). Further, the leading South Carolina case regarding Rule 23(b)(1) relies extensively, as does almost every case in the Nation, on Delaware court decisions. *Whittle*, 343 S.C. 176, 539 S.E.2d 402.

best interests of the company." *Id.* (emphasis added). In order for a plaintiff to defeat a motion to dismiss, he must **rebut this presumption** by "pleading particularized facts that create a reasonable doubt that the board was informed and validly exercised its business judgment." *Morefield*, 959 F. Supp. 2d at 898; *Levine*, 591 A.2d at 211 (noting "requirement of well-pleaded allegations of fact which create a reasonable doubt that a board of directors' decision is protected by the business judgment rule"). Accordingly, "[a]bsent an abuse of discretion, that judgment will be respected by the courts." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), overruled on unrelated grounds regarding standard of review, *by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

Delaware's law of deference to corporate boards is in complete accord with South Carolina law. Under South Carolina law, "the business judgment rule precludes judicial review of actions taken by a corporate governing board absent a showing of a lack of good faith, fraud, self-dealing or unconscionable conduct." *Dockside Ass'n*, 294 S.C. at 87, 362 S.E.2d at 874. Accordingly, following *Dockside Association*, in order to rebut the business judgment rule's bar from judicial review of a board decision, a derivative plaintiff must plead with particularity those facts indicating the presence of a lack of good faith, fraud, self-dealing, or unconscionable conduct by the board in refusing the demand.

III. APPLICATION OF RULE 23(b)(1) AND THE LAW TO THIS CASE

This Court held that Petitioners complied with Rule 23(b)(1) because "the January 30, 2013 letter *does* constitute an adequate demand in this case." *Patterson et al. v. Witter et al.*, S.C. Sup. Ct. dated Sept. 5, 2018, at 37 (Shearouse Adv. Sh. No. 36) (hereinafter "Op. at __"). The Court's ruling is in direct conflict with the plain language of Rule 23(b)(1) and contrary to court decisions interpreting the rule. A shareholder does not receive authorization to usurp the authority of the board to make litigation decisions for the corporation by merely making a demand upon a board

and nothing more. The shareholder must also plead with particularity "the reasons for his failure to obtain the action." Rule 23(b)(1), SCRCP. He must do so, in order for a reviewing court to determine whether he can **rebut** the **presumption** that the board's denial of the demand was protected by the business judgment rule. *Dockside Ass'n*, 294 S.C. at 87, 362 S.E.2d at 874 ("[T]he business judgment rule precludes judicial review of actions taken by a corporate governing board absent a showing of a lack of good faith, fraud, self-dealing or unconscionable conduct.").

Before turning to a review of the Complaint, it is important to pause and make a number of observations about the circuit court's order and management of the litigation: (1) Judge Cooper dismissed Petitioners' Complaint **without** prejudice. He dismissed the Complaint because binding precedent (*Whittle*) mandated that result[3]; (2) After nearly a year of motions practice, the circuit court properly disregarded the manner in which Petitioners had styled their Complaint and instead analyzed the relief sought. This analysis led the circuit court to conclude that the Complaint should have been drafted in compliance with Rule 23(b)(1); and (3) Both sides submitted affidavits, and each did so without objection. Judge Cooper did not rely on the content of the affidavits in his

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[3] *Whittle*, the only Rule 23(b)(1) case in South Carolina, held that "the sufficiency of the allegations in the [Complaint] of a pre-suit demand **must** be determined from the **four corners** of the pleading." *Whittle*, 343 S.C. at 190, 539 S.E.2d at 410 (emphasis added). In a footnote to that sentence, *Whittle* noted that documents can be incorporated by reference. *Id.* at 190 n.7, 539 S.E.2d at 410 n.7. Judge Cooper faithfully applied precedent. The Petitioners simply failed to put together a viable Complaint, which is why Judge Cooper dismissed it. Unlike in *Whittle*, however, Judge Cooper exercised his discretion and dismissed Petitioners' Complaint *without* prejudice in order to allow Petitioners another opportunity to fix it.

order.[4] The only documents Judge Cooper relied upon to draft his order was the Complaint and the document that created the Fund.[5]

A. Petitioners' Complaint

The Petitioners' Complaint does not come close to meeting the requirement to rebut the presumption that the Board's actions are not protected by the business judgment rule.

- Paragraph 8 b. states only that prior efforts (including a wrongful lawsuit that Petitioners had no standing to bring) were "to no avail." (App. 54).
    - *To no avail* does nothing to rebut the presumption of the protection afforded by the business judgment rule.
        - This Court's *Dockside* factors are totally absent. *To no avail* does not indicate a lack of good faith, fraud, self-dealing, or unconscionable conduct by the Board.

Accordingly, Petitioner's Complaint was properly dismissed by the circuit court.

B. Petitioners' Demand Letter

Incorporating the January 30 demand letter, as this Court's Opinion did, does not *cure* the pleading defects. There are two vague references in the January 30 letter to the Board's decision.

- The last sentence of the second to last paragraph reads: "It is our understanding that your clients have refused to take these actions." (App. 330).
    - That sentence does nothing to rebut the presumption that the Board failed to act in good faith and in violation of the business judgment rule.

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[4] The opinion of the court of appeals relied upon the affidavits in making certain observations—96.5% of the Fund members ratified creating a successor mutual insurance company, and Respondents returned the $5,000,000 to the Fund after an agreement could not be reached with the Home Builders Association of South Carolina regarding the establishment of a successor mutual insurance company—but those observations were, of course, not the basis for the dismissal of the Complaint by the circuit court. (App. 593).

[5] Judge Cooper did note that members of the Fund were jointly and severally liable, but that is the law. S.C. Code of Regs. 67-1501(E)(5) ("An indemnity agreement which jointly and severally binds each member of the fund, signed by each proposed member.").

- That sentence does nothing to rebut the reasonableness of the Board's conduct.
    - This Court's *Dockside* factors are totally absent here, too. Stating only that "your clients have refused to take these actions" does not indicate a lack of good faith, fraud, self-dealing, or unconscionable conduct by the Board.
- Part of the last sentence of the last paragraph reads: "I will assume your clients refuse to take the actions as requested above . . . ." *Id.*
    - For the same reasons, this is grossly inadequate.

Accordingly, Petitioners' Complaint was properly dismissed by the circuit court. Indeed, if the circuit court had done otherwise it would have totally disregarded binding precedent and the requirements of, and the sound policy reasons behind, Rule 23(b)(1). It would have also abdicated its role as the gatekeeper tasked with strictly enforcing the pleading requirements of Rule 23(b)(1).

IV. DERIVATIVE CLAIMS VERSUS DIRECT CLAIMS

This Court held that "Petitioners' complaint includes both direct and derivative claims." Op. at 34. To the extent a complaint contains a mixture of direct and derivative claims, a reviewing court should dismiss all derivative claims that do not comply with Rule 23. *See, e.g., In re General Motors Class E. Stock Buyout Sec. Litig.*, 790 F. Supp. 77, 78, 81 (D. Del. 1992) (dismissing "Counts V and VI"). Nevertheless, Respondents submit that when each claim in the Complaint is scrutinized, a fair reading of those claims is that they are derivative.

"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) (emphasis added), *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 Tr.*, 367 S.C. at 351,

626 S.E.2d at 339. Further, "the authority to direct the business and affairs of a corporation is delegated to a board of directors, not the shareholders." *Whittle*, 343 S.C. at 185, 539 S.E.2d at 407. "A derivative action is, in essence, a challenge to the board's managerial authority." *Id.* at 187, 539 S.E.2d at 408.

This Court's reliance on *Accredited Aides Plus, Inc. v. Program Risk Management, Inc.*, 147 A.D.3d 122 (N.Y. App. Div. 2017) for the proposition that the Complaint alleges direct claims is misplaced. *Accredited Aides* addressed a failed workers compensation trust that was taken over by the New York State Workers' Compensation Board ("State Board") after it was determined that the trust was insolvent. Indeed, a forensic analysis revealed that the "trust had an accumulated deficit of over $188 million." *Id.* at 127. As a result of its insolvency, on behalf of the trust, the State Board issued monetary assessments against individual employer members of the trust—that is, the State Board sent the employer members a bill to make up for the shortfall. *Id.* Following those assessments, the employer members later filed a complaint in their individual capacity as a plaintiff (and based on our reading of the case) appeared to have filed a mass action[6] against the claims administrator, program administrator, and several former trustees to recover the monies they were required to pay into the trust to cover the shortfalls. Furthermore, employer members entered into an agreement with the State Board that it (the State Board) would have "sole standing to pursue claims on behalf of the trust in [a separate] action, while the causes of action in the instant action would be limited to 'only **non-derivative** or non-associational direct or third-party beneficiary claims.'" *Id.* at 127-28 (emphasis added).

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[6] "Unlike a class action, a mass action has no representative or absent members because all plaintiffs in a mass action are named in the complaint and propose a joint trial of their claims. A mass action is more akin to an opt-in than it is to a class action." *Abraham v. St. Croix Renaissance Grp., L.L.L.P.*, 719 F.3d 270, 272 n.1 (3d Cir. 2013).

Unlike the *Accredited Aides* case, the Complaint before the Court does not address a failed or an insolvent fund. There are no allegations in the Complaint of unpaid employee workers compensation claims. There are no allegations in the Complaint that an employer member of the Fund has received an assessment notice and is seeking to recover those assessments in this case. Moreover, the Complaint does not allege injury to the employer members based upon a claims administrator or program administrator's failure to properly manage the Fund. *Accredited Aides* addressed those fact patterns and those allegations in ruling on the motion to dismiss.[7]

In *Accredited Aides*, the appellate court reversed the lower court's decision to dismiss a breach of contract claim by the employer members against the claims administrator and program administrator. *Id.* at 129-30. The lower court had concluded these claims were derivative—that they belonged to the worker's compensation trust. *Id.* at 129. The *Accredited Aides* court concluded that the employer members could assert direct, third-party beneficiary claims as the agreements provided an "obligat[ion] to indemnify the trust and its members for loss sustained due to, among other things, 'any and all claims, losses [and] liabilities . . . arising out of' acts or omissions by [the administrator]." *Id.* at 130. Similarly, the court held that the employer members could assert direct claims against the trustees for breach of contract under the same third-party beneficiary theory, as the "plaintiffs were consequentially injured by unpaid employee claims and other damages." *Id.* at 131.

Analyzing a separate set of claims for fraud and fraud in the inducement against the claims administrator, the *Accredited Aides* court again reversed the lower court's finding that those claims

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[7] The Court's reference to the absence of discovery as an indicator of whether a claim is direct or derivative is misplaced. Op. at 36. Whether a claim is direct or derivative has nothing to do with discovery. The question is whether the stockholder seeks to recover damages that belong to the corporation.

were derivative. *Id.* at 135. The court noted that, while the claims were wrapped in allegations of corporate mismanagement, the "causes of action are premised upon the theory that the [claims administrator] misrepresented material facts pertaining to, among other things, the trust's solvency in order to induce plaintiffs to join the trust and continue their membership." *Id.* Accordingly, those claims were properly categorized as direct.

The thrust of the *Accredited Aides* court's finding that the employer members alleged certain direct claims flowed directly from the injury sustained by each member separate from the workers compensation trust. *Accredited Aides* has no bearing upon the allegations in this Complaint. The *Accredited Aides* complaint focused on recovering losses sustained by individual employer members (*e.g.*, assessments levied against the employer members and unpaid employee claims as a result of the insolvency) not losses sustained by the trust itself.

A review of the Complaint draws out the distinction between this case and the *Accredited Aides* cases for it highlights the difference between the direct claims in that case and the derivative claims in this case.

Petitioners' first cause of action alleges breach of fiduciary duty and breach of trust. (App. 53). The allegations that support that claim are generally found at Paragraphs 20-41 of the Complaint. At Paragraphs 20-23, Petitioners complain about Respondents' decision to transfer $5,000,000 for the purpose of creating a successor mutual insurance company, and the manner of advising the members of the Fund regarding the process.[8] At Paragraphs 24-27, Petitioners complain about purported acts that were allegedly taken in furtherance of creating the successor

[8] It is undisputed that prior to the filing of the first action, an agreement could not be reached with the Home Builders Association of South Carolina regarding the creation of a successor mutual insurance company, that the account created with a deposit of $5,000,000 was closed, and those funds returned to the general account of the Fund.

mutual insurance company. At Paragraph 28, Petitioners complain about the alleged use of funds used for Board meetings. At Paragraphs 33-36, Petitioners allege the Board members have acted in violation of their fiduciary duties. At Paragraph 37, Petitioners again make complaints about creating the successor mutual insurance company. At Paragraph 38, Petitioners attack the veracity of statements issued by the Board. At Paragraph 40, Petitioners allege they have been injured by "loss of funds, attorneys fees, harassment and aggravation, loss of trust assets, higher payments into the Trust[9], and other damages." (App. 57). At Paragraph 41, Petitioners allege they are entitled to an order directing 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." (App. 58). The allegations that make up this cause of action are derivative.

Petitioners' second and third causes of action allege breach of contract and breach of contract accompanied by a fraudulent act, respectively. *Id.* at 58. To support those causes of action, Petitioners incorporate the allegations that serve as the basis for the breach of fiduciary duty and breach of trust claim. *Id.* Importantly, for both causes of action, Petitioners allege they are entitled to the relief requested in the breach of fiduciary duty and breach of trust cause of action. (App. 58 ¶44; App. 59 ¶49). All of the alleged damages from these claims are damages allegedly suffered by the Fund, not the members. These are derivative claims.

Petitioners' fourth cause of action seeks a declaration that the Board must comply with its fiduciary duties and not make any efforts to create a member owned mutual insurance company. While this claim does not allege damages to the Fund, it is a challenge to the board's managerial

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9 Although this allegation has a direct claim sound to it, it is an aberration in the Complaint, for there is no other allegation that supports the conclusory claim that Petitioners' workers compensation premiums have increased as a result of the Fund's management. The ***gravamen*** of this Complaint alleges injury to the Fund.

authority. *Whittle*, 343 S.C. at 187, 539 S.E.2d at 408. ("A derivative action is, in essence, a challenge to the board's managerial authority."). The claim also fits hand-in-glove with the claim that the Board allegedly breached its fiduciary duty by seeking to create a successor mutual insurance company. Accordingly, when viewing this claim within the context of the entire Complaint, the claim is properly categorized as derivative.

Petitioners' fifth cause of action alleges an accounting, and it incorporates every allegation that forms the basis for the breach of fiduciary duty and breach of trust cause of action. In *In re: Greenwood Supply Co.*, 295 B.R. 787, 795-96 (D.S.C. 2002), 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." (citing *Davis v. Hamm*, 300 S.C. 284, 291, 387 S.E.2d 676, 680 (Ct. App. 1989)). The alleged harm is to the Fund. This claim is derivative.

Petitioners' sixth cause of action seeks a termination of the trust and a distribution of its assets. Like the declaratory judgment claim, this claim is nothing more than an effort to have a Court dictate the internal corporate governance of the Fund. This claim is likewise derivative. *Whittle*, 343 S.C. at 187, 539 S.E.2d at 408. ("A derivative action is, in essence, a challenge to the board's managerial authority.").

Petitioners' seventh cause of action seeks attorney's fees. This is not a claim, and can be disregarded for purposes of the Court's analysis.

Petitioners' eighth cause of action seeks a distribution of $5,000,000, which Petitioners label as "excess funds." Under South Carolina law, a claim seeking to declare a dividend is derivative. *Johnson v. Brandon Corp.*, 221 S.C. 160, 164-65, 69 S.E.2d 594, 595-96 (1952). "The surplus profits of a corporation are a part of its assets and do not belong to the stockholders

individually. The stockholders have no right to demand such profits until they have been set apart for the payment of dividends." *Id.* at 164-65, 69 S.E.2d at 595. The *Johnson* court noted that, "[o]f course, if the directors of a corporation abuse their discretion and fraudulently or arbitrarily refuse to pay a dividend, when the condition of the corporation makes it their duty to do so, a court of equity will compel them to do so at the suit of a stockholder." *Id.* at 165, 69 S.E.2d at 596. And this is the key language: "Such an action by a stockholder is one ***in the right of the corporation***." *Id.* (emphasis added). Accordingly, the eighth cause of action is derivative.

V. CONCLUSION

The Petitioners are the masters of their Complaint. From the inception of this litigation, they were put on notice that the relief sought in their Complaint implicated the heightened pleading requirements mandated by Rule 23(b)(1). The circuit court faithfully applied precedent and dismissed their Complaint without prejudice. Rather than attempt to draft a Complaint that complied with Rule 23(b)(1), Petitioners opted for years of protracted appellate litigation. This Court's decision to reverse the circuit court's faithful application of the law was in error. It eviscerated the corporate governance protections of Rule 23(b)(1) and should be corrected. The Respondents respectfully request that the Court grant this Petition for Rehearing, withdraw the current Opinion, issue an Opinion that faithfully analyzes the mandatory pleading requirements of Rule 23(b)(1), and affirm the dismissal of Petitioners' Complaint.

[SIGNATURE PAGE FOLLOWS]

Respectfully submitted,

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September 24, 2018

THE STATE OF SOUTH CAROLINA
In The Supreme Court

RECEIVED
SEP 24 2018
S.C. SUPREME COURT

APPEAL FROM RICHLAND COUNTY
Court of Common Pleas

G. Thomas Cooper, Jr., Circuit Court Judge

Appellate Case No. 2016-002343
Opinion No. 27841 (S.C. Sup. Ct. filed September 5, 2018)

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 Petition for Rehearing by depositing a copy of it in the United States mail, postage prepaid, addressed to the below counsel of record.

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September 24, 2018
Greenville, South Carolina