THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM SPARTANBURG COUNTY
Court of Common Pleas

J. Mark Hayes, II, Circuit Court Judge

Case No. 2008-CP-42-3397

Quentin S. Broom, Jr., ... Respondent,

V.

Ten State Street, LLP, Timothy D, Scranton,
Mark Broadwater, and H. Hugh Andrews ..... Defendants,

OF WHOM

H. Hugh Andrews, Individually
and on behalf of Tri-Star
Communications, Inc. is the,.....Appellant,

V.

Quentin S. Broom, Jr., ... Third-party Defendant.

FINAL BRIEF OF RESPONDENT

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I. Did the circuit court properly determined that Hugh Andrews brought a derivative action when his third-party complaint asserted identical counterclaims both individually and on the behalf of Tri-Star Communications, Inc. against Quentin S. Broom, Jr., thereby triggering the procedural requirements of Rule 23, of the South Carolina Rules of Civil Procedure?

II. Did Hugh Andrews waive his right to appeal the amendment to pleading issue when the circuit court never ruled on his Newmotion to amend, and Andrews failed to file a motion pursuant to Rule 59(e), of the South Carolina Rules of Civil Procedure, requesting that the circuit court issue a ruling?

COUNTER-STATEMENT OF THE CASE

Broom initiated a lawsuit on September 15, 2005, against Andrews, Ten State Street L.L.P., Timothy D. Scrantom, and Mark Broadwater. (R. 19-35). Defendant Andrews filed an Answer on November 16, 2005, generally denying Broom's allegations. (R. 36-39). The remaining Defendants answered separately on November 18, 2005. (R. 40-52). In May 2006, Andrews moved to amend his Answer to assert certain claims individually and on behalf of Third-Party Plaintiff, Tri-Star Communications, Inc. ("Tri-Star"). (R. 53-68).

Tri-Star was not named as a Defendant in the 2006 Amended Answer. (R. 55). However, Andrews alleged that Tri-Star failed to pay debts owed to Andrews (shareholder loan) and/or his company, Drews, Inc. (Gaming Machine financing). (R. 55)[1] Specifically, Andrews alleged the

[1] According to the 2006 Answer filed by Andrews, he loaned Tri-Star one hundred thirty thousand dollars ($130,000) on or before August 31, 2005. (R. 59,¶ 25). Tri-Star purchased "Pot-O-Gold" video gaming machines ("Gaming Machines") and other goods and services from Drews Distributing, Inc., a South Carolina corporation ("Drews, Inc.") owned 100% by Defendant Andrews. Drews, Inc. distributed by assignment to Andrews all rights to payments from Tri-Star. (R 59., ¶ 26). According to the 2006 Answer, as of October 31, 2005, Tri-Star owed Andrews the sum of three million six hundred twenty-six thousand, three hundred ninety-three and 17/100ths dollars ($3,626,393.17) for Gaming Machines and other goods and services sold to Tri-Star, of which one million one hundred ninety-four thousand three hundred sixty-two and 83/100ths dollars ($1,194,362.83) is for the actual unpaid portion of the purchase price (the remaining amounts being accrued and unpaid finance charges). (R.59, ¶ 27).

distributions Broom made to himself were made at a time when Tri-Star owed Andrews substantial sums of money both as a shareholder, holder of a shareholder loan, and as a creditor of Tri-Star. (R. 59., ¶¶ 25-27, 35). On September 26, 2006, Broom filed a Reply to the 2006 Amended Answer with general denials to the counterclaims. (R. 69-89).

Pursuant to Rule 40(j) of the South Carolina Rules of Civil Procedure, the parties filed a Stipulation of Dismissal with regard to the entire case. (R. 1). On June 27, 2008, Broom restored the case by filing a Complaint within one year of the dismissal. (R. 90-108). Andrews never filed an answer, counterclaim and/or third-party claim with regard to the 2008 Complaint filed by Broom.[2]

On September 14, 2011, Broom filed a motion to dismiss the counterclaims by Andrews and the third-party claims by Tri-Star. (R. 109-134). On October 5, 2011, the circuit court conducted a hearing on the motion to dismiss. (R. 214-278). On October 7, 2011, the court issued a Form 4 order granting the motion, but requested submission of a formal written order from Broom's counsel. (R. 4-5). On October 24, 2011, Andrews filed a motion to reconsider, however, the court had not yet entered its formal, written Order. (R.135-144). On November 1, 2011, the circuit court entered the formal Order, dismissing all claims by Tri-Star and dismissing all overlapping claims by Andrews. (R. 6-14).

Ten causes of action are set forth in the 2006 Amended Answer: (1) Breach of Fiduciary Duty; (2) Breach of Contract; (3) Breach of Contract Accompanied by a Fraudulent Act; (4) Breach of the Covenant of Good Faith and Fair Dealing; (5) Conversion; (6) Violation of S.C. Code of Laws § 33-8-300; (7) Violation of S.C. Code of Laws § 33-8-420; (8) Promissory Estoppel; (9) Fraud; and (10) Negligent Misrepresentation. (R. 58-67).

[2] Pursuant to Rule 220(c), SCRAP, Andrews's failure to file could serve as an additional sustaining ground to affirm the circuit court.

Claims (1) through (7) were brought by Andrews as third-party claims on behalf of Tri-Star, and were brought as identical counterclaims on behalf of Andrews, individually. (R. 58-65, ¶¶ 21 to 70). For these claims, the circuit court found that:

> "all claims brought by Andrews individually which overlap any claim made by Tri-Star for damages arising out of allegations of Broom's mismanagement or breach of duties arising out of the shareholder relationship between Andrews and Broom are dismissed, because these claims also require compliance with Rule 23."

(R. 5, 6)(emphasis added).

Claims (8) through (10) were brought solely in the name of Andrews. (R. 65-67, ¶¶ 71 to 95). These claims re-allege the mismanagement and dissipation of Tri-Star's assets as set forth in the previous seven claims. (R. 67 at ¶¶ 71, 78, and 88). These "individual" claims clearly reference Tri-Star. (R. 65-66 at ¶ 72) ("Plaintiff promised Defendant Andrews that he would [act] in the best interest of Tri-Star and Defendant Andrews at all times regarding the management of the same"); (R. 66 at ¶ 79) ("Plaintiff represented to [Defendant] that he would manage the assets of Tri-Star and act in the best interest of Tri-Star and Defendant Andrews"); (R. 67 at¶ 88) ("Defendant Andrews realleges each above paragraph . . . .").

The circuit court's Order dismissed "all claims brought by Andrews individually which overlap any claim made by Tri-Star for damages arising out of allegations of Broom's mismanagement or breach of duties arising out of the shareholder relationship between Andrews and Broom . . . because these claims are also require compliance with Rule 23." (R. 6).

On November 11, 2011, Andrews filed a supplemental motion to reconsider the formal, written Order. (R. 143-171). On December 17, 2012, Broom filed an opposition to the supplemental motion to reconsider. (R. 190-213).

On November 14, 2011, Andrews filed a motion to amend and/or supplement the answer and counterclaims. (R. 172-189).

On December 17, 2012, the circuit court heard arguments from counsel with regard to Andrews's supplemental motion for reconsideration and his 2011 motion to amend the answer. (R. 279). On January 14, 2013, the circuit court issued a Form 4 order denying the supplemental motion for reconsideration. (R.15). On February 1, 2013, the circuit court issued a formal, written order denying the motion for reconsideration. (R. 17). On February 7, 2013, Andrews received written notice of the entry of the final order, and filed his Notice of Appeal on March 8, 2013.

The circuit court never ruled on Andrews's 2011 motion to amend his pleadings. Andrews never filed a motion requesting a specific ruling on the 2011 motion to amend.

COUNTER-STATEMENT OF FACTS

Tri-Star is a South Carolina corporation with its principal place of business in Spartanburg County, South Carolina. (R. 58). Andrews was a 50% shareholder and a creditor of Tri-Star. *Id.* Broom was a director, officer, and 50% owner of Tri-Star. (R. 58). Andrews alleged that he had "standing to bring [these] claims individually and on behalf of Third-party Plaintiff [Tri-Star] for losses and damages sustained to both via the malfeasance and nonfeasance of the plaintiff [Broom] in his dealings with and on behalf of Tri-Star." (R. 58).

There are no allegations in Andrews's 2006 Amended Answer that Tri-Star lacked outside creditors.[3] Andrews's own pleading references debt owed to the Dominican Republic: "Plaintiff was reckless in the manner the [sic] Gaming Machines were imported, and such

[3] Rule 210(c) of the South Carolina Rules of Appellate Practice states that the Record shall not include matter which was not presented to the lower court or tribunal. Despite this rule, Andrews seeks to insert "facts" or factual allegations that do not appear anywhere in his 2006 Amended Answer. For example, the 2006 Amended Answer does not allege that Tri-Star lacked a board of directors. (*See* Appellant's Initial Brief, pp. 5, 8).

importation was documented so as to pace Tri-Star's Gaming Machines at grave risk of confiscation or penalties to be payable to the Dominican Republic governmental authorities by Tri-Star or the DR Businesses. Plaintiff has recklessly failed to cause the DR Businesses to pay all applicable charges to the Dominican Republic, which put Tri-Star's Gaming Machines at risk of confiscation . . . ." (R. 60).

STANDARD OF REVIEW

"In reviewing the dismissal of an action pursuant to Rule 12(b)(6), SCRCP, the appellate court applies the same standard of review as the trial court." *Rice-Marko v. Wachovia Corp.*, 398 S.C. 301, 307, 728 S.E.2d 61, 64 (Ct. App. 2012). "In considering a motion to dismiss a complaint based on a failure to state facts sufficient to constitute a cause of action, the trial court must base its ruling solely on allegations set forth in the complaint." *Id.*, 398 S.C. at 307, 728 S.E.2d at 64-65. "If the facts and inferences drawn from the facts alleged in the complaint, viewed in the light most favorable to the plaintiff, would entitle the plaintiff to relief on any theory, then the grant of a motion to dismiss for failure to state a claim is improper." *Id.*

Although Broom denies all of the wrongful acts alleged in the 2006 Amended Answer and Counterclaims, a 12(b)(6) motion tests the legal sufficiency of the complaint (or counterclaim) on the assumption that all well-pled allegations are true. *Hambrick v. GMAC Mortg. Corp.*, 370 S.C. 118, 122, 634 S.E.2d 5, 7 (Ct. App. 2006). A motion under Rule 12(b)(6) or Rule 12(c) admits the well-pleaded facts in the complaint, but it does not admit the inferences drawn by the plaintiff from such facts, nor does it admit conclusions of law. *Carolina Winds Owners' Ass'n, Inc. v. Joe Harden Builder, Inc.*, 297 S.C. 74, 76, 374 S.E.2d 897, 899 (Ct. App. 1988), *rev'd on other grounds, Kennedy v. Columbia Lumber & Mfg. Co., Inc.*, 299 S.C. 335, 341, 384 S.E.2d 730, 734 (1989).

"[W]hen the defendant demonstrates the plaintiff has failed to state facts sufficient to constitute a cause of action in the pleadings filed with the court," the case should be dismissed. *Doe v. Marion*, 361 S.C. 463, 469, 605 S.E.2d 556, 559 (2004). Plaintiffs who fail to allege a legally recognized theory of causation or damages also subject their complaint to dismissal. *See id.* at 475, S.E.2d at 562 (affirming dismissal when plaintiff failed to allege any legal basis for damages); *Brown v. Theos*, 338 S.C. 305, 526 S.E.2d 232, (Ct. App. 1999) (upholding dismissal where the plaintiff failed to allege a valid theory of causation).

South Carolina law requires dismissal of a complaint for failure to satisfy the pleading requirements of Rule 23(b)(l), SCRCP: "[a] derivative action that does not meet the pleading requirements of Rule 23(b)(l), SCRCP, is properly dismissed pursuant to Rule 12(b)(6)." *Clearwater Trust v. Bunting*, 367 S.C. 340, 351, 626 S.E.2d 334, 339 (2006) (quoting *Carolina First Corp. v. Whittle*, 343 S.C. 176, 539 S.E.2d 402 (Ct. App. 2000)). A plaintiff who fails to satisfy the particularity requirements of Rule 23(b)(1), lacks standing. *Strickland v. Flue-Cured Tobacco Co-op. Stabilization Corp.*, 643 F. Supp. 310, 316 (D.S.C. 1986) ("Since the plaintiffs . . . have not complied with the requirements for a derivative action, they lack standing to bring the action before this Court.").

ARGUMENTS

I. DISMISSAL OF TRI-STAR'S CLAIMS IS THE LAW OF THE CASE BECAUSE ANDREWS DID NOT CHALLENGE THAT RULING.

third-party claims were asserted on behalf of Tri-Star for injuries allegedly suffered by Tri-Star. (R. 58-65). In the proceeding below, Andrews offered no argument with regard to the dismissal of Tri-Star as a Third-Party Plaintiff, except to say that judicial economy would be served to allow Tri-Star's claims to proceed. (R. 166). Andrews has not appealed the circuit court's determination that Tri-Star's claims were derivative. Andrews also did not appeal the

circuit court's dismissal of Tri-Star's Third-Party claims for failure to comply with Rule 23(b)(1), SCRCP.

It is a fundamental rule of law that an appellate court will affirm a ruling by a lower court if the offended party does not challenge that ruling. *See Biales v. Young*, 315 S.C. 166, 432 S.E.2d 482 (1993); *Lindsay v. Lindsay*, 328 S.C. 329, 491 S.E.2d 583 (Ct. App. 1997). Failure to challenge the ruling is an abandonment of the issue and precludes consideration on appeal. *Id.*

The Court of Appeals should affirm the dismissal of all third-party causes of action by Tri-Star for failure to meet the requirements of Rule 23 and/or for failure to plead with particularity the applicability of the exceptions to Rule 23(b)(1). (R. 58-65).

II. THE CIRCUIT COURT CORRECTLY HELD THAT HUGH ANDREWS'S CLAIMS WERE PLED AS DERIVATIVE CLAIMS, AS OPPOSED TO DIRECT CLAIMS.

As the circuit court found in its Order, "[i]t is not contested that SCRCP 23 was not complied with prior to the filing of Andrews's counterclaims. It is also not contested, if Rule 23, SCRCP, is applicable, that dismissal is the appropriate remedy . . . no argument was presented that even an attempt was made to comply with Rule 23." (R. 4). Andrews does not appeal these findings by the circuit court. Instead he argues that Rule 23 is not applicable to his counterclaims because those claims are direct, as opposed to derivative.

South Carolina adheres to the internal affairs doctrine and applies the law of the state of incorporation to disputes involving relations among shareholders, directors, and officers of a corporation. *See* S.C. Code § 33-15-105(c) (2006) (providing that this title "does not authorize this State to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state"). As the Official Comment to Section 33-15-105(c) of the South

Carolina Code notes, this section "preserves the judicially developed doctrine that internal corporate affairs are governed by the state of incorporation even when the corporation's business and assets are located primarily in other states."

Because Tri-Star is a South Carolina corporation with its principal place of business in Spartanburg County, the law of South Carolina governs. *Id.* (R. 58). Andrews's alleged injury flows not from what happened to him, but from what happened to Tri-Star.

A. Derivative Action: the General Rule in South Carolina

South Carolina adheres to the general rule that individuals may not sue corporate directors or officers for losses suffered by the corporation. *See Brown v. Stewart*, 348 S.C. 33, 51, 557 S.E.2d 676, 686 (Ct. App. 2001). This prohibition on individual suits for damages suffered by the corporation is a central tenet of corporate law. *See* Fletcher, Cyclopedia of Corporate Law § 5912 (stating the general rule and observing that "a diminution in the value of corporate stock resulting from some deprecation or injury to corporate assets is a direct injury only to the corporation; it is merely an indirect or incidental injury to an individual shareholder," even if "the act complained of was done with the specific intent of injuring plaintiff as a shareholder.").

Andrews's counterclaims represent an attempt to recover individually for an injury that was admittedly suffered by Tri-Star. Broom and Andrews chose the corporate structure and form to establish and operate Tri-Star. Andrews strategically determined the course of litigation by asserting identical claims in his name and on behalf of Tri-Star in the 2006 Amended Answer. (R. 58-66).

South Carolina law restricts shareholders from suing corporate directors or officers directly for losses suffered by the corporation. *Babb v. Rothrock*, 303 S.C. 462, 464, 401 S.E.2d

418, 419 (1991). "A corporation is a distinct legal entity." *Todd v. Zaldo*, 304 S.C. 275, 278 403 S.E.2d 666, 668 (Ct. App. 1991). "[A] cause of action for recovery of an asset of a corporation belongs to the corporation as opposed to the individual shareholders." *Id.* A plaintiff may not avoid the demand requirement of a derivative suit by merely styling his suit as an individual. *Id.* Characterizing an injury as personal does not make it so. It is the nature of the wrong alleged which controls whether the suit asserts a derivative or individual claim. *Id.*

A derivative action is brought when a corporation suffered an injury from actionable wrongs committed by its officers and directors. *Ward v. Griffin*, 295 S.C. 219, 221, 367 S.E.2d 703, 704 (Ct. App. 1988). The corporation or its shareholders can bring the cause of action on the corporation's behalf, so long as they comply with the applicable rules. *Id.* If any relief is granted, it goes to the corporation; shareholders cannot recover the damages in their individual capacities because their loss is the indirect result of the injury to the corporation. *Id.*

Where there are no allegations of a distinct injury to the shareholder, *Ward*, 295 S.C. at 221, 367 S.E.2d at 704, or where there is an action for misappropriation of corporate property, *Davis v. Hamm*, 300 S.C. 284, 291-92, 387 S.E.2d 676, 680 (Ct. App. 1989), the action is derivative.

"A shareholder may maintain an individual action only if his loss is separate and distinct from that of the corporation." *Hite v. Thomas Howard Company of Florence, Inc.*, 305 S.C. 358, 361, 409 S.E.2d 340, 342 (1991) (emphasis added), *rev'd on other grounds*, *Huntley v. Young*, 319 S.C. 559, 462 S.E.2d 860 (1995).

B. Application of South Carolina Law to Andrews's Counterclaims Leads to the Conclusion That His Claims Are Derivative.

A careful review of Andrews's 2006 Amended Answer shows that Andrews did not allege that his loss was separate and distinct from the injury allegedly sustained Tri-Star.

Therefore, as a matter of law, the claims alleged individually by Andrews are derivative and should have complied with the requirements of Rule 23(b)(1), SCRCP.

Paragraphs 23, 25, 26, 27, 34, and 35 of Andrews's Amended Answer do not reveal any particular loss suffered by him. (R. 58-61). Rather they clearly allege, in part, that Tri-Star owed money to Andrews; however Andrews did not sue Tri-Star to recover debts and cannot legally sue Broom individually for such debt. *See* S.C. Code Ann. §33-6-220 and §33-44-303 (2006) (explaining South Carolina provides by statute that an owner of a corporation or limited liability company is not personally liable for the acts or debts of the corporation or LLC). (R. 58-61).

Paragraphs 26 and 27 of the Amended Answer allege Tri-Star owed Andrews $1,194,362.83 for the sale of gaming machines. (R. 58). If the allegations were accepted as true, the only reason Tri-Star did not pay this debt is because it suffered a loss in corporate assets, allegedly at the hands of Broom. This conduct, if true, harmed Tri-Star directly, and its investors and creditors derivatively. *See In re Granite Partners, L.P.*, 208 B.R. 332, 344 (Bankr. S.D.N.Y. 1997) ("Claims of mismanagement, waste and breach of fiduciary duty describe conduct which harms an entity directly, and its investors and creditors derivatively . . . . The investors and creditors suffer an indirect injury because the wrongful conduct erodes the entity's assets, making it less likely that it will be able to pay creditors and distribute profits to investors.")(emphasis added). Tri-Star and Andrews allegedly suffered the same loss of money. This overlapping loss therefore is not separate and distinct

Further, paragraphs 34 and 35 allege that Broom made distributions to himself in the amount of $520,000.00 despite the fact that Tri-Star owed Andrews substantial sums of money as a shareholder and creditor. (R. 59-60). This alleged conduct harmed Tri-Star directly, and its

investors and creditors derivatively. The corporation and Andrews suffered the same loss of money.

A claim-by-claim analysis further demonstrates the overlap between Andrews and Tri-Star.

Claim No. 1 (breach of fiduciary duty): Andrews and Tri-Star allege they were injured by Broom "(1) paying himself from Tri-Star without consent or authority from Andrews; (2) selling substantially all of the assets of Tri-Star at below market value and without authority or consent of Andrews; and (3) converting Tri-Star's money and/or assets for Broom's own use and benefit." (R. 60) (emphasis added).

Claim No. 2 (breach of contract): Andrews and Tri-Star allege they were injured when Broom (1) "disposed of the assets of Tri-Star at substantially below their market value," and "paid himself approximately five hundred twenty thousand ($520,000) dollars in salary and/or distribution [from Tri-Star's assets]." (R. 62) (emphasis added).

Claim No. 5 (conversion): Andrews and Tri-Star allege they were injured when Broom took possession of "monies and equipment belonging to Tri-Star." (R. 64) (emphasis added).

Claim No. 3 (breach of contract accompanied by a fraudulent act), Claim No. 4 (breach of the covenant of good faith and fair dealing), Claim No. 6 (violation of S.C. Code 33-8-300), Claim No. 7 (violation of S.C. Code 33-8-420): Andrews and Tri-Star simply re-allege the mismanagement and dissipation of Tri-Star's assets as alleged in the prior derivative claims. (R. 62-65) (emphasis added).

Claim No. 8 (promissory estoppel), Claim No. 9 (fraud), and Claim No. 10 (negligent misrepresentation): Andrews, individually, asserts these claims. However, there are no allegations within these causes of action that Andrews suffered a particular loss that is separate

or different from the losses suffered by Tri-Star. These claims merely re-allege the mismanagement and dissipation of Tri-Star's assets as set forth in the previous claims. (R. 65-67) (emphasis added).

The crux of Andrews's argument is that he has suffered a personal loss; however characterizing an injury as "personal" does not make it so in South Carolina. As discussed above, each of Andrews's alleged "losses" were first and foremost losses to Tri-Star because it allegedly was unable to repay Andrews due to alleged dissipation of assets caused by Broom.

In *Todd v. Zaldo*, the counterclaim plaintiff "characterized the damages as personal because Georganne Apparel Company, Inc. and MIV Textile Sales, Inc. were small closely held corporations" and, as Mr. Zaldo put it, "[m]y corporation is totally my money . . . ." *Todd*, 304 S.C. at 277, 403 S.E.2d at 668. The *Todd* court stated the, "Mere characterization of damages by Zaldo as personal versus corporate does not prove their true nature." *Id.* The Court of Appeals analyzed the categories of claimed damages and found them to be "clearly corporate in nature." *Id.* 304 S.C. at 278, 403 S.E.2d at 668. This analysis and determination applies equally to the case at hand since Tri-Star's assets are corporate assets, not personal assets.

It is not uncommon for a court to label a claim "derivative," where a general partner or LLC manager is alleged to have (1) paid itself payments to which it was not entitled, (2) failed to monitor the operations of the business, (3) sold business assets to itself or an affiliate for less than fair market value, (4) made sweetheart deals with its affiliates, (5) mismanaged funds, (6) failed to perform obligations imposed in the partnership or operating agreement, (7) used firm assets as security for personal loans, (8) paid to itself an improperly high price when selling assets to the entity, or (9) failed to properly investigate a business opportunity.[4]

[4] *See*, e.g., *Litman v. Prudential-Bache Props., Inc.*, 611 A.2d 12, 16 (Del. Ch. 1992) (holding that failure to investigate and monitor partnership investments and placing interest in general partnership fees above

Based on the foregoing reasons, this court should affirm the circuit court's ruling that the claims alleged by Andrews are derivative in nature, thus requiring Andrews to comply with the pleading requirements of Rule 23(b)(1), SCRCP.

C. Rule 23, SCRCP Applies in Non-Class Action Settings.

Andrews asked the circuit court to find that Rule 23, SCRCP, is intended to apply to class actions only. None of the cases cited by Andrews actually hold that the derivative action requirements of Rule 23, SCRCP, must be applied only to class action cases. To the contrary, the Supreme Court of South Carolina has already applied the pleading and demand requirements of Rule 23 to a non-class case involving a closely held corporation. *See Clearwater Trust*, 367 S.C. at 351, 626 S.E.2d at 339 (dismissing an unjust enrichment claim brought by shareholder of closely held corporation for failure to comply with the pleading requirements of Rule 23(b)(1), SCRCP).

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interests of limited partners, which reduced value and payout, stated a derivative claim); *Lenz ex rel. Naples Tennis Resort v. Associated Inns & Rests. Co. of Am.*, 833 F. Supp. 362, 380 (S.D.N.Y. 1993) (finding that misconduct and misappropriation of funds which reduce partnership's income and distributions states derivative claim); *P'ship Equities, Inc. v. Marten*, 443 N.E.2d 134, 138-39 (Mass. App. Ct. 1982) (stating that all limited partners and creditors have an interest in a claim that the general partner has prematurely reimbursed itself or engaged in other mismanagement, negligently diverted assets, acted beyond authority, or failed to perform partnership obligations); *Kenworthy v. Hargrove*, 855 F. Supp. 101, 105-06 (E.D. Pa. 1994) (holding that claim of improper governmental seizure of bank owned by partnership is a derivative claim under Pennsylvania law), *aff'd*, 27 F.3d 557 (3d Cir. 1994); *Re v. Weksel*, 515 N.Y.S.2d 568 (App. Div. 1987) (holding that claim for recovery of funds belonging to partnership is a derivative claim); *Larson v. First Interstate Bank of Kalispell*, 786 P.2d 1176, 1179-80 (Mont. 1990); *Caley Invs. Inc. v. Lowe Family Assoc.*, 754 P.2d 793, 795 (Colo. Ct. App. 1988); *Thomasson v. Mfrs. Hanover Trust Co.*, 657 F. Supp. 448, 453-54 (S.D. Tex. 1987) (applying Texas law in bankruptcy context), *aff'd*, 845 F.2d 1020 (5th Cir. 1988); *Hauer v. Bankers Trust N.Y. Corp.*, 509 F. Supp.168, 175 (E.D. Wis. 1981), aff'd, 671 F.2d 1020 (7th Cir. 1982); *Field Enters. v. Gresser*, No. 89-1234, 1990 WL 262001, at *8 (Wis. Ct. App. Dec. 27, 1990) (holding that limited partners in an Illinois limited partnership may only sue derivatively for breaches of duties owed to partners or the partnership).

South Carolina and other jurisdictions apply Rule 23 derivative suit requirements to non-class cases involving partnerships with as few as three, four or five members.[5]

As other jurisdictions note, the number of shareholders is irrelevant. *Morris v. Hennon & Brown Properties, LLC*, 1:07CV780, 2008 WL 2704292 (M.D.N.C. July 3, 2008) ("But, if the plaintiff shareholder in a closely held corporation owns a 50% interest in the stock, then such shareholder would not be allowed to bring an individual action and can only bring a derivative action.").

D. Even if the ALI *Thomas* Exception Were Adopted in South Carolina, It Would Not Be Applicable Under the Facts of This Case.

Andrews argues that some foreign jurisdictions have applied an exception to the general rule that derivative claims always belong to the corporation. (Andrews's Initial Brief, pp. 11-12)

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[5] *Ono v. Itoyama*, 884 F. Supp. 892, 895 (D.N.J. 1995) *aff'd sub nom*; *Keiko Ono v. Itoyama*, 79 F.3d 1138 (3d Cir. 1996); *Executive Leasing Company, Inc. v. Leder*, 191 A.D.2d 199, 200, 594 N.Y.S.2d 217 (1993) ("[W]here there are only two stockholders each with a 50% share, an action cannot be maintained in the name of the corporation by one stockholder against another with an equal interest and degree of control over corporate affairs; the proper remedy is a stockholder's derivative action."); *L.W. Kent and Co., Inc. v. Wolf, et al.*, 143 A.D.2d 813, 533 N.Y.S.2d 119, (1988) (holding where a president and 50% shareholder initiates corporate lawsuit against other 50% shareholder, presumption of president's authority to initiate corporate lawsuit does not apply and appropriate avenue of relief is a derivative action); *Abelow v. Grossman*, 91 A.D.2d 553, 554, 457 N.Y.S.2d 30 (1982) ("[A]n action could not be maintained in the name of the corporation, where brought by one stockholder against another with an equal stock interest and degree of control over corporate affairs. The appropriate remedy in such a case is a stockholder's derivative action."); *Blasberg v. Oxbow Power Corp.*, 934 F. Supp. 21 (D. Mass. 1996) (two partners: sole limited partner brought claims against sole general partner); *Cabrini Dev. Council v. LCA-Vision, Inc.*, 197 F.R.D. 90 (S.D.N.Y. 2000) (involving three LLC members); *Golden Tee, Inc. v. Venture Golf Sch., Inc.*, 969 S.W.2d 625 (Ark. 1998) (dismissing complaint by four partners against the fifth, who had control of the partnership, for failure to bring action as a derivative suit); *N.Y. Life Ins. Co. v. Ramco Holding Corp.*, 938 F. Supp. 754 (N.D. Okla. 1996) (involving three partners; noting that complaining limited partner owning 96.5% of the partnership); *Whalen v. Connelly*, 545 N.W.2d 284 (Iowa 1996) (involving three partners; dismissing one of the limited partner's claims (brought directly) because he had failed to make demand on the general partner (defendant)), *aff'd*, 593 N.W.2d 147 (Iowa 1999); *S.B. McLaughlin & Co., Ltd. v. Cochrane*, No. C4-92-2081, 1993 WL 231672 (Minn. Ct. App. June 29, 1993), *aff'd*, *Cochrane v. Tudor Oaks Condominium Project*, 529 N.W.2d 429 (Minn. Ct. App. 1995); *Chamarac Props., Inc. v. Pike*, No. 86 Civ. 7919, 1992 WL 332234 (S.D.N.Y. Nov. 12, 1992) (three partners); *Burstin Investors, Inc. v. K.N. Investors, Ltd.*, 657 N.Y.S.2d 743 (App. Div. 1997) (involving two partners).

First, the exceptions referenced by Andrews are applicable only when the claims at issue are deemed derivative. Therefore, an argument by Andrews that an exception applies is a concession that the circuit court properly found that the claims were derivative, but improperly failed to consider whether an exception to the general rule applied.

When Andrews raised this issue with the circuit court, he relied on *Thomas v. Dickson.* 250 Ga. 772 (1983). ((R. 156-163). In *Thomas*, the Supreme Court of Georgia allowed minority shareholders in closely held corporations to pursue direct actions against majority shareholders for injuries done to the corporation strictly in "exceptional situations." *Id.* at 774. According to *Thomas,* a shareholder in a closely held corporation may bring a direct action when the four reasons for requiring a derivative suit do not apply: (1) preventing a multiplicity of lawsuits; (2) protecting corporate creditors by putting the proceeds of the recovery back in the corporation; (3) protecting the interests of all shareholders by increasing the value of their shares; and (4) adequately compensating the injured shareholder by increasing the value of their shares. *Id.* If none of these reasons are applicable, the shareholder may circumvent the requirements of a derivative action and bring a direct action, which tenders any recovery to the shareholder alone rather than to the corporation which has suffered the harm.

While the court allowed a direct action in *Thomas*, it specifically did so because of evidence indicating that the corporation has been paying its debts as they became due and that there was no outstanding or dissatisfied creditor. However, the Georgia Supreme Court expressly disapproved of permitting direct actions if allowing this course "does not consider the possibility of prejudice to other interested parties, such as creditors," and ruled that "if such a possibility [of prejudice to creditors] exists, a direct recovery should not be allowed." *Id.* at 775. (emphasis added). Thus, the *Thomas* court strictly construed the corporate creditor factor and

made clear Georgia's policy favoring priority recovery to corporate creditors as opposed to corporate shareholders, like Andrews. The *Thomas* court held that if "a possibility exists" of prejudice to other interested parties such as "outstanding or dissatisfied creditors" then "a direct recovery should not be allowed." *Thomas* at 775.

There are no allegations in Andrews's 2006 Amended Answer that Tri-Star lacked outside creditors. Andrews's own pleading references debt owed to the Dominican Republic: "Plaintiff was reckless in the manner the [sic] Gaming Machines were imported, and such importation was documented so as to place Tri-Star's Gaming Machines at grave risk of confiscation or penalties to be payable to the Dominican Republic governmental authorities by Tri-Star or the DR Businesses. Plaintiff has recklessly failed to cause the DR Businesses to pay all applicable charges to the Dominican Republic, which put Tri-Star's Gaming Machines at risk of confiscation . . . ." (R. 60). Andrews asserts in his Initial Brief that "[it] may take discovery and a trial to determine whether the particular corporation has outside creditors who need to be protected or whether equity otherwise favors the corporation itself getting the recovery." Andrews, as a 50/50 shareholder, knows whether Tri-Star has outside creditors. It is disingenuous to allege that discovery is needed on that fact when Andrews's own pleadings reference outside creditors.

Because the four corners of the Andrews's own pleading show a possibility of prejudice to outstanding or dissatisfied creditors, the *Thomas* exception is inapplicable even if this Court chose to adopt the exception.

South Carolina has a similar policy of favoring priority recovery to corporate creditors as opposed to corporate shareholders. *See, e.g.*, S.C. Code Ann. § 33-6-400(c) (2006) (stating no distribution may be made corporate shareholders if "[t]he corporation would not be able to pay

its debts as they become due in the usual course of business" or "the corporation's total assets would be less than the sum of its total liabilities . . ."). *See also Babb*, 303 S.C. at 464-65, 401 S.E.2d at 418 (1991) (finding a direct action was disallowed in a lawsuit involving misappropriation of corporate property; where corporation had disposed of its assets and was bankrupt, assuming the *Thomas v. Dickson* exception to derivative actions was applied, "[t]he claims of corporate creditors may be jeopardized if individual shareholders are permitted to satisfy their personal debts by raising a claim which can only be asserted by the corporation. As between creditors and shareholders, the interest of the creditors must prevail").

"Because a corporate recovery in a derivative action will benefit creditors while a direct recovery by a shareholder will not, the protection of creditors principle could well be implicated in a shareholder suit against a closely held corporation with debt." *Barth v. Barth*, 659 N.E. 2d 559, 562 (Ind. 1995) ("Barth II"); *Barth v. Barth*, 693 N.E.2d 954 (Ind. App. 1998) ("Barth III") (holding the trial court properly dismissed direct action brought by shareholder for misappropriation of assets of closely held corporation; complaint seeking corporate dissolution and asking that damages be paid to corporate shareholder, not to creditors, could result in "potentially prejudice" to creditors); *Maki v. Estate of Ziehm*, 55 A.D.2d 454 (N.Y. App. Div. 1977) (refusing to permit 50% shareholder of dissolved corporation to bring direct action for misappropriation of corporate assets; "[p]etitioner may not be permitted to circumvent the rights of creditors by maintaining a direct action, the potential benefits of which would inure solely to himself").

E. The ALI Exception Has Not Been Adopted in South Carolina.

Allowing an exception challenges the fundamental operation of the corporate form in South Carolina. While Andrews raises interesting policy concerns, there are serious ramifications for allowing such a relaxed standard for pleadings, as suggested by the ALI

exception, when bringing derivative actions. Our current rule exists for the purpose of protecting the rights of all entities that place a trust in a business, be it customers, shareholders, creditors, officer, etc.

In *Davis v. Hamm*, the Court of Appeals expressly refused to apply an exception to the general rule concerning when a claim must be brought derivatively. *Davis*, 300 S.C. at 288, 387 S.E.2d at 678. Two years later, the Court of Appeals again had an opportunity to adopt this exception for closely held corporations, and in declining to do so, the court stated as follows:

> As an additional theory, Zaldo argues he may recover damages personally because Georganne Apparel Company, Inc. was a close corporation with only three stockholders. He seeks to have Georganne Apparel viewed more as a partnership than a corporation. *See Johnson v. Gilbert, Davis v. Hamm.* This record does not support application of these principles. Mr. Zaldo did business in the corporate form. He testified the business operated as a corporation. He recognized it was owned by the shareholders. This record does not present a factual scenario sufficient to ignore the corporate nature of Georganne Apparel, Inc.

Todd, 304 S.C. at 279, 403 S.E.2d at 668-69 (internal citations omitted).

In the years since the *Davis* and *Todd* cases, our appellate courts have consistently rejected exceptions to the general rule, even when those cases involved closely held corporations. *See Babb*, 303 S.C. at 464, 401 S.E.2d at 419-20; *Brown*, 348 S.C. at 51, 557 S.E.2d at 685.

This record does not present a factual scenario sufficient to ignore the corporate nature of Tri-Star. As such, this case does not support the application of any exception for closely held corporations.

III. THE CIRCUIT COURT DID NOT RULE ON ANDREWS'S MOTION TO AMEND SUCH THAT THERE IS NO ERROR TO REVIEW.

A. This Issue Was Not Preserved For Appellate Review

On November 14, 2011, Andrews filed a motion to amend and/or supplement the answer and counterclaims. (R. 172-189). The circuit court never ruled on that motion to amend, and Andrews failed to obtain a ruling.

Where a party raises an issue, but the issue is never ruled on by the circuit court, and the party fails to attempt to obtain a ruling on the issue by way of a motion to alter or amend, the issue is not preserved for appellate review. *I'On, L.C.C. v Town of Mt. Pleasant*, 338 S.C. 406, 421-22, 526 S.E.2d 716, 724 (2000) ("An appellate court may not, of course, reverse for any reason appearing in the record. The losing party must first try to convince the lower court it is has ruled wrongly and then, if that effort fails, convince the appellate court that the lower court erred."). Andrews has waived his right to appeal this issue because the circuit court never ruled on his 2011 motion to amend his pleadings. *See Harkins v. Greenville County*, 340 S.C. 606, 533 S.E.2d 886 (2000) (holding an issue not ruled upon by the trial judge is not preserved for appeal).

B. Even If Andrews Had Not Waived This Issue, The Argument Fails On The Merits.

Andrews cites *Spence v. Spence*, 368 S.C. 106, 628 S.E.2d 869 (2006), and requests that this Court grant him the opportunity to amend his pleadings. (Andrews's Initial Brief, at p. 16). In *Spence*, the plaintiff appealed the lower court's denial of plaintiff's request to amend her complaint. *Spence*, 368 S.C. at 128, 628 S.E.2d at 880. Before affirming the lower court's dismissal with prejudice, the South Carolina Supreme Court noted that, when affirming a motion to dismiss with prejudice, appellate courts have the discretion to allow the plaintiff to amend his

complaint. *Id.* at 130, 628 S.E.2d at 881. Furthermore, the Supreme Court noted that an appellate court should follow the "procedure when the plaintiff presents additional factual allegations or an alternative theory of recovery which, taken as true in a well-pleaded complaint, may state a claim upon which relief may be granted." *Id.* at 130, 628 S.E.2d at 881-82. Finding that the appellant had not alleged sufficient facts to state a cause of action, the Supreme Court affirmed the lower court's dismissal with prejudice. *Id.*

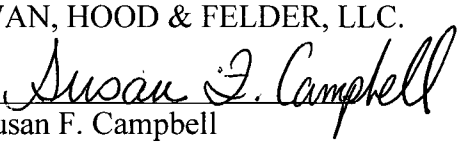
If this Court disagrees on preservation, Broom contends that the Supreme Court's holding in *Spence* cautions against granting Andrews the right to amend his pleadings. Andrews has failed to suggest any additional facts that, if alleged, would properly support a direct action against Broom. His allegations continue to support a loss suffered by Tri-Star. An attempt to re-file for the purposes of styling the claim solely in Andrews's name does not negate the fact that the alleged harm was a corporate loss, thus still causing Andrews's claims to be subject to a derivative action. *Todd*, 304 S.C. at 278, 403 S.E.2d at 668. Therefore, the circuit court should be affirmed.

CONCLUSION

For the reasons stated, this Court should affirm the judgment of the circuit court.

Respectfully submitted

McGOWAN, HOOD & FELDER, LLC.

BY: 

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CERTIFICATE OF COUNSEL

The undersigned counsel certified that this Final Brief complies with Rule 211(b), SCACR.

November 21, 2013

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PROOF OF SERVICE

I certify that I have served **Respondent's Final Brief** on Blake A. Hewitt and John S. Nichols, attorneys for Appellant, by depositing a copy of it in the United States Mail, postage prepaid, addressed to P.O. Box 7965, Columbia, South Carolina 29202, on this **22nd day of November, 2013**.

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