

STATE OF NORTH CAROLINA
MECKLENBURG COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
07 CVS 12469

REGIONS BANK,

Plaintiff,

v.

REGIONAL PROPERTY DEVELOPMENT
CORP.,

Defendant,

And

REGIONS BANK,

Third-Party Plaintiff,

v.

LAWRENCE J. SHAHEEN AND J. MICHAEL
SHAHEEN, Individually,

Third-Party Defendants.

**REGIONS BANK'S SUPPLEMENTAL
BRIEF IN SUPPORT
OF MOTION TO DISMISS AMENDED
COUNTERCLAIM**

NOW COMES Plaintiff and Third-Party Plaintiff Regions Bank ("Regions"), through counsel, and pursuant to Rule 15 of the General Rules of Practice and Procedure for the North Carolina Business Court, and hereby submits its Supplemental Brief in Support of its Motion to Dismiss Regional Property's Amended Counterclaim.

INTRODUCTION AND BACKGROUND

This matter arises out of a Complaint for Declaratory Relief filed by Regions on June 22, 2007. Defendant Regional Property Development Corp. ("Regional Property") responded by filing a counterclaim against Regions on October 8, 2007. Regional Property's sole cause of action against Regions is a claim for aiding and abetting breach of fiduciary duty.

On December 10, 2007, Regions filed an Amended Motion to Dismiss Counterclaim pursuant to N.C.G.S. §1A-1, Rules 12(b)(6), 12(b)(7), 17 and 19 and a brief in support of its motion on the grounds that a claim for “aiding and abetting breach of fiduciary duty” is not recognized in North Carolina and that even if such a claim did exist, Regional Property, as a member of Lancaster Industrial Park, LLC (“Lancaster” or the “LLC”), lacks standing to bring the claim. Defendant Regional Property requested and received an Order from this Court allowing it leave to file a late response to Regions’ motion and brief. On January 11, 2008, Defendant Regional Property filed its response to Regions’ motion.

On February 21, 2008, and in reference to the pending Motion to Dismiss, this Court held a conference with the parties for the purpose of clarifying a potential factual disconnect between the original counterclaim and the briefing papers. Specifically, the original counterclaim appeared to plead that all three individual members of Regional Property joined in the purchase of the Promissory Note (“Note”) in question. Regions’ brief reflected the same facts. However, Regional Property’s papers suggested that only one member of Lancaster purchased the Note and received the distribution referenced by Regional Property in its counterclaim. Per an email sent to the parties on March 14, 2008, the Court requested clarification “because [the] distinction [between which members purchased the Note and ultimately received the distribution] may have some relevance to the question of whether any injury suffered by the Defendant was separate and distinct from the injury (if any) suffered by the other members of the LLC.”

Following the conference with the Court, on March 3, 2008, Regional Property moved for leave to file an Amended Answer and Counterclaim. The Court entered an Order allowing Regional Property’s Motion and requiring that Regional Property’s Amended Answer and

Counterclaim be filed and served “on or before 5 March 2008.” See, Order on Motion for Leave to Amend Answer and Counterclaim, March 4, 2008. Defendant filed and served its Amended Answer and Counterclaim a day late on March 6, 2008. On March 13, 2008, and in accordance with this Court’s Order, Regions filed its Motions to Dismiss Amended Counterclaim, Reply to Amended Counterclaims Subject to Motions, Counterclaims to Amended Counterclaim and Third-Party Complaint for Indemnity.

In light of the questions raised by the Court during the February 21, 2008 conference call, counsel for Regions requested an opportunity to file a supplemental brief on the issue of whether or not any purported injury suffered by Regional Property was “separate and distinct” such that Regional Property would be allowed to move forward on its individual claim, assuming that such a cause of action exists in North Carolina. By email dated March 14, 2008, the Court gave both parties an opportunity to address the issue through supplemental briefs.

As set forth in detail below, because Regional Property’s Amended Answer and Counterclaim fails to establish that it is entitled to assert an individual action against Regions, Regional Property’s claim against Regions should be dismissed pursuant to N.C.G.S. §1A-1, Rules 12(b)(6), 12(b)(7), 17 and 19.

ARGUMENT

I. Regional Property’s claims are derivative because Regional Property’s claims fail to meet any exception to N.C.G.S. §57C-3-30.

A. The general rule and the exceptions.

In North Carolina, “a member of a limited liability company is not a proper party to proceedings by or against a limited liability company, except where the object of the proceeding is to enforce a member’s right against or liability to the limited liability company.” N.C.G.S.

§57C-3-30 (2001). A member may bring a derivative action on behalf of a limited liability company (“LLC”), provided that the member meets certain threshold requirements prescribed by statute. N.C.G.S. §57C-8-01 (2001). In this case, it is undisputed that a derivative claim has not been alleged and that Regional Property seeks individual recovery. See, Defendant’s Answer and First Amended Counterclaim.

In general, a derivative action on behalf of an LLC is governed by the same rules that apply to a derivative action on behalf of a corporation. See, Robinson on North Carolina Corporation Law, §34.04[5]. See also, Energy Investors Fund v. Metric Constructors, Inc., 351 N.C. 331, 333-335, 525 S.E.2d 441, 443-445 (2000)(analogizing the role of a limited partner to that of a shareholder in the limited liability partnership context and for purposes of determining what should and should not constitute a derivative action); Crouse v. Mineo, -- N.C. App. --, -- S.E. 2d --, 2008 WL 706612 (NO. COA07-334) (March 18, 2008) (applying general corporate rule in context of a professional limited liability company).

It is well-established that “shareholders cannot pursue individual causes of actions against third parties for wrongs or injuries to the corporation that result in the diminution or destruction of the value of their stock.” Energy Investors, 351 N.C. at 333, 525 S.E. 2d at 444. However, under certain limited circumstances, a shareholder may bring an individual claim against a third party. Specifically, a shareholder might be able to recover individual damages if the shareholder can allege a wrong peculiar to himself by virtue of some special circumstances or special relationship to the wrongdoers. Howell v. Fisher, 49 N.C. App. 488, 272 S.E. 2d 19 (1980).

The North Carolina Supreme Court has adopted and embraced the rule set forth in Howell:

We . . . hold that a shareholder may maintain an individual action against a third party for an injury that directly affects the shareholder, even if the corporation also has a cause of action arising from the same wrong, if the shareholder can show that the wrongdoer owed him a special duty or that the injury suffered by the shareholder is separate and distinct from the injury sustained by the other shareholders or the corporation itself.

346 N.C. 650, 658-59, 488 S.E.2d 215, 219 (1997).

Therefore, under established N.C. jurisprudence, unless a shareholder can show that it meets the exception to the general rule, it cannot proceed with an individual lawsuit against a third-party.

B. The exceptions are inapplicable in this case.

Even after being given the opportunity to amend its counterclaim, Regional Property has completely failed to make any allegation whatsoever – either factual or conclusory – that would place it squarely within either exception to the general rule against individual actions. Specifically, Regional Property has not alleged that there is any special relationship between Regional Property and Regions that would entitle it to bring an individual action against Regions. To the contrary, Regional Property has alleged that the Note between the corporate entity, Lancaster, and Regions is the “basis of this lawsuit.” Defendant’s Answer and First Amended Counterclaim at ¶1. Furthermore, Regional Property has completely failed to allege that it suffered any separate and distinct injury that would justify an individual action.

1. Regional Property did not suffer an individual injury.

In determining whether or not an individual injury exists, the North Carolina Supreme Court has held that “an injury is peculiar or personal to the shareholder if ‘a legal basis exists to support plaintiffs’ allegations of an individual loss, separate and distinct from any damage suffered by the corporation.’” Energy Investors, 351 N.C. at 335, 525 S.E. 2d 444 (citation

omitted). The claimant's loss must be "different from the loss to the corporation." Outen v. Mical, 118 N.C. App. 263, 265, 454 S.E. 2d 883, 885 (1995).

In determining whether or not the claimant's loss is "different than the loss to the corporation," our courts have generally looked to two separate inquiries: (1) which party suffered the injury; and (2) which party should receive the benefit of any recovery. See, Outen, 118 N.C. App. at 266, 454 S.E. 2d at 865 (holding that where plaintiff failed to show that he suffered a loss different than the loss to the corporation, plaintiff could not maintain an individual action); Underwood v. Stafford, 270 N.C. 700, 155 S.E. 2d 211 (1967) (holding that "[i]f the cause of action were founded on injuries peculiar or personal to plaintiff himself, so that any recovery would not pass to the corporation and indirectly to other creditors, the cause could have been properly asserted by plaintiff").

(a) *Which party suffered the injury?*

Although not binding on this Court, the Supreme Court of Delaware, in Tooley v. Donaldson, offered helpful guidance for determining which party suffered the injury at issue. 845 A.2d 1031, 1035-36 (Del. 2004). The court held that where "a stockholder has demonstrated that he or she has suffered an injury that is not dependent on an injury to the corporation," an individual action may be maintained. Id. Therefore, according to the Delaware court, the relevant inquiry should be, "[l]ooking at the body of the complaint and considering the nature of the wrong alleged and the relief requested, has the plaintiff demonstrated that he or she can prevail without showing an injury to the corporation?" Id. In this case, the answer to the question is plainly "no." Regional Property's own allegations make it clear that it cannot state its claim without also showing an injury to Lancaster.

Looking specifically at Regional Property's Amended Answer and Counterclaim, it is apparent that Regional Property's damages allegations pertain directly to the issue of Carpenter's use of the Note against *Lancaster*. Regional Property's allegations are as follows:

- (1) Carpenter "intended to call the Note" **against *Lancaster***;
- (2) Carpenter used the Note to amend *Lancaster's* Operating Agreement;
- (3) Carpenter refused to provide financial statements in order to "**frustrate *Lancaster's* ability** to refinance" the Note;
- (4) Carpenter and the Jacobsens "called the [N]ote and used the threat of default and foreclosure which would have wiped out" Regional Property's *equity in Lancaster*.
- (5) Carpenter and the Jacobsens used the threat of default and foreclosure to force Regional Property to agree to allow "over \$600,000 in distributions to Carpenter and the Jacobsens **from *Lancaster*** that were not otherwise due to them."

Defendant's Answer and First Amended Counterclaim at ¶¶12, 15, 16, 18.

According to Regional Property's own damages allegations, the injuries that it alleges it suffered were contingent only upon damages to the corporate entity, Lancaster, and would not exist outside its membership in the LLC. The Amended Counterclaim alleges that Carpenter used threat of default on the Note to force modifications to Lancaster's operating agreement, which consisted of \$600,000 in improper distributions directly from Lancaster, thus causing injury to Regional Property only through a loss in value of Regional Property's interest in Lancaster. Defendant's Answer and First Amended Counterclaim at ¶18.

Regional Property has argued that the injury to it was “separate and distinct” because it alone suffered from a “power shift” among members and from the “unfair advantage” that Mark Carpenter obtained over Regional Property. See, Defendant’s Response to Plaintiff’s Motion to Dismiss at ¶4. Despite this, Regional Property’s only allegation pertaining to the purported “power shift” or “unfair advantage” relate to the \$600,000 distribution from Lancaster. In an analogous case just decided by the North Carolina Court of Appeals on March 18, 2008, the court held that where the only claim relates to an individual’s “rights under the company,” and where “[a]ll of the allegations alleging breach of fiduciary duty . . . relate to the parties’ relationship through [the PLLC],” there is no individual cause of action. Crouse v. Mineo, -- N.C. App. --, -- S.E. 2d --, 2008 WL 706612 *8-9 (NO. COA 00-334) (2008). Similarly, in this case, all of Regional Property’s allegations stem from its purported rights in the LLC – the Note between Lancaster and Regions made “the basis of this lawsuit,” the “unfavorable” terms of the modifications of Lancaster’s operating agreement, Lancaster’s inability to refinance, the threat of wiping out Regional Property’s equity in Lancaster, and Carpenter’s breach of fiduciary duty to Regional Property and Lancaster. See, Defendant’s Answer and First Amended Counterclaim at ¶15-19.

It is anticipated that Regional Property will argue that because the other members of Lancaster purchased the Note and received the distributions, the injury was separate and distinct to Regional Property. However, the analysis on the issue of which party suffered the injury remains the same – even if all of the other members benefited from the changes to the modification agreement and the distribution, Regional Property cannot allege that it suffered an injury that the corporation itself did not also suffer. In this respect, Regional Property’s claim is

similar to claims brought by shareholders to recover on personal guarantees of corporate debt. Like Regional Property's claims in this case, a shareholder who makes a personal guarantee for corporate debt may suffer injuries that are not suffered by other shareholders who are not personal guarantors of corporate debt. Regardless, under these circumstances, the North Carolina Supreme Court has held that because the damage to the guarantor shareholder is not separate from the injury sustained by the corporation itself, the shareholder cannot bring an individual action. Barger, 346 N.C. at 660, 488 S.E.2d at 222. See also, Allen v. Ferrera, 141 N.C. App. 285, 290, 540 S.E.2d 761 (2000) (“[n]ot even plaintiff’s liability for his personal guarantees is a personal injury, for one who pays a personally guaranteed corporate debt has not suffered an injury separate and distinct from the corporation because he is ‘made whole if the corporation recovers’”). Accordingly, because none of damages allegedly suffered by Regional Property are separate and distinct from any injuries suffered by the corporation, Regional Property has not alleged, and cannot allege, that it suffered any individual injury that would justify a direct action against Regions.

(b) *Which party would be entitled to recover?*

From the discussion above, it is clear that any damages suffered as a result of the actions alleged by Regional Property belong to Lancaster because the injuries alleged were injuries to Lancaster. Hence, the recovery, if any, would properly belong to the corporate entity. See, Underwood v. Stafford, 270 N.C. 700, 703, 155 S.E. 2d 211, 213 (1967) (holding that where the alleged breach or injuries are based on duties owed to the corporation and not to any particular shareholder, the shareholder may not maintain an individual action). As shown through Regional Property's specific allegations, the corporate entity suffered the \$600,000 loss in improper

distributions and losses as the result of the alleged mismanagement by Carpenter. See, Defendant’s Answer and First Amended Complaint at ¶ 18. Any recovery would properly go to the corporate entity for a determination – in the context of the LLC’s operating agreement – of how the proceeds should be applied.

The justification for this rule is that the court should protect the rights of possible creditors to the corporate entity. Outen, 118 N.C. App. 263, 267, 454 S.E. 2d 883, 886 (1995). In this case, assuming that the \$600,000 distributions were, indeed, improper, any recovery should go to the corporate entity for a determination of distribution of the funds – including distribution to any outstanding creditors of Lancaster.

II. Regional Property’s claims are derivative because a claim for aiding and abetting a breach of fiduciary duty belongs exclusively to the corporate entity.

Regional Property’s sole cause of action against Regions is for “aiding and abetting breach of fiduciary duty.” See, Defendant’s Answer and First Amended Counterclaim at ¶¶20-27. Our courts have long held that a claim for breach of fiduciary duty of a corporate officer is a claim that belongs to the corporate entity and not to the individual members or shareholders. See, Underwood v. Stafford, 270 N.C. 700, 155 S.E.2d 211 (1967); Fulton v. Talbert, 255 N.C. 183, 120 S.E.2d 410 (1961); Outen v. Mical, 118 N.C. App. 263, 454 S.E.2d 883 (1995). “One of the clearest examples of a derivative action is a suit against the officers or directors of a corporation for mismanagement of its affairs as constituting a breach of their fiduciary obligations to the corporation.” Robinson on North Carolina Corporation Law §17.01[1].

While North Carolina courts have plainly held that a claim for breach of fiduciary duty against an officer or director is derivative in nature, our courts have never addressed the specific issue of whether or not a claim for aiding and abetting a breach of fiduciary duty is also a

derivative claim. However, the Court of Chancery of Delaware has considered the issue and has held that aiding and abetting claims are “necessarily subject to the same analysis” as the underlying claims. In re First Interstate Bankcorp Consol. Shareholder Litigation, 729 A.2d 851 (Del. Ch. October 7, 1998) (No. 14623). Accordingly, in the First Interstate Bankcorp matter, the Delaware Court of Chancery held that where the claims of primary liability against the defendant directors belong to the corporation and could only be maintained in a derivative capacity, such finding “logically applies with equal force to the alleged claims of secondary liability.” Id., 729 A.2d at 864.

It is anticipated that Regional Property may attempt to argue that its claims are contingent upon Carpenter’s duties to it, individually, as a fellow member and manager of Lancaster and that accordingly, the general proposition that claims for breach of fiduciary duties to the corporate entity are derivative in nature do not apply. Essentially, the argument would be that because there was a “special duty” between Carpenter and Regional Property by virtue of their status as fellow member/managers, the underlying claim (breach of fiduciary duty by Carpenter to Regional Property) would be individual in nature, making the contingent claim of aiding and abetting breach of fiduciary duty also individual.¹

This argument fails for two main reasons. First, Regional Property is still required to show an individual injury to it that is separate and distinct from those of the corporate entity in

¹ The only other context where our courts have held that an individual may show a “special duty” from a shareholder to the corporation involves a claim by minority shareholders against majority shareholders. See, Norman v. Johnson, 140 N.C. App. 390, 537 S.E. 2d 248 (2000). This exception is inapplicable to lawsuits against third parties, and therefore would be inapplicable in this case. Id., 140 N.C. App. at 395, 537 S.E. 2d at 253. Furthermore, even if it were applicable in this case, Regional Property has not alleged (and cannot allege) that they were minority shareholders in Lancaster, as Regional Property owned a 50% interest in the LLC.

order to survive a motion to dismiss. Howell, 49 N.C. App. 488, 492, 272 S.E. 2d 19, 22 (1980). As explained in the previous section, Regional Property cannot make the requisite showing of an individual injury.

Second, in order to prove that there was some “special duty” owed to the individual member (Regional Property) by the wrongdoer (Carpenter), the claim must originate from circumstances that are “independent of the [claimant’s] status as stockholder.” Id. In situations where the substance of the alleged wrongdoing originates from communications among members, in their capacity as members, there is no separate or special duty that would qualify as an exception to the general rule that an individual shareholder may not bring a claim against the corporate entity. Energy Investors, 351 N.C. at 336, 525 S.E. 2d at 444. In order to meet the exception, there must be a relationship *outside the corporation* that would create a separate duty to the individual claimant. Id. “The existence of a special duty [] would be established by facts showing that defendants owed a duty to plaintiffs that was personal to plaintiffs as shareholders and was separate and distinct from the duty defendants owed the corporation.” Livingston v. Adams Kleemeier, 163 N.C. App. 397, 405, 594 S.E. 2d 44, 50 (2004) (citation omitted). In the Livingston matter, plaintiff claimed that the fiduciary duty owed to her was a “special duty” because the defendant law firm owed her a fiduciary duty by virtue of an attorney client relationship. Id. However, despite this, the court held that because a fiduciary duty was owed to “all individuals and entities involved,” there was no special duty separate to her individually such that she had standing to pursue her claim individually. Id.

Just this week, the North Carolina Court of Appeals reiterated the requirement that the “special duty” exception does not apply from one member of an LLC to another for purposes of

bringing an individual action. In Crouse v. Mineo, one partner in a PLLC attempted to sue another partner for breach of fiduciary duty and anticipatory breach of fiduciary duty. -- N.C. App. --, -- S.E. 2d --, 2008 WL 706612 (NO. COA 07-334) (March 18, 2008). Plaintiff alleged that there was a fiduciary relationship between the two partners by virtue of their partnership and co-membership in the PLLC. Id. The Court of Appeals held that because the claims related to the parties' relationship through the corporate entity, there was no individual action. Id., 2008 WL 706612 at *8-9.

Similarly, in this case, Regional Property's claims against Regions are all contingent on claims that Carpenter breached his fiduciary duty to *both* Regional Property and Lancaster. See, Defendant's Answer and First Amended Counterclaim at ¶27. Because those claims are based entirely on the relationships of the members, and in the context of their membership in the LLC, the claims are derivative. Carpenter owed the same fiduciary duties to Regional Property as he did to the corporate entity and the other members of the LLC. Accordingly, Regional Property lacks standing to bring this lawsuit.

CONCLUSION

For the reasons set forth above, Regions respectfully prays that Regional Property's Claims against it be dismissed, with prejudice, pursuant to N.C.G.S. §1A-1, Rule 12(b)(6), Rule 12(b)(7), Rule 17 and Rule 19.

CERTIFICATE OF COMPLIANCE WITH BCR 15.8

The undersigned hereby certifies that this Brief in Support of Amended Motion to Dismiss Counterclaim is in compliance with BCR 15.8.

This 21st day of March, 2008.

/s/ Tricia Morvan Derr
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CERTIFICATE OF SERVICE

I hereby certify that **REGIONS BANK'S SUPPLEMENTAL BRIEF IN SUPPORT OF MOTION TO DISMISS AMENDED COUNTERCLAIM** was served on the parties in this matter as follows:

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This 21st day of March, 2008.

/s/ Tricia Morvan Derr _____