NORTH CAROLINA

MECKLENBURG COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
08 CVS 27739

THE CHARLOTTE-MECKLENBURG HOSPITAL AUTHORITY d/b/a CAROLINAS HEALTHCARE SYSTEM,

Plaintiff,

vs.

WACHOVIA BANK, NATIONAL ASSOCIATION d/b/a WACHOVIA GLOBAL SECURITIES LENDING and METROPOLITAN WEST SECURITIES, LLC, d/b/a WACHOVIA GLOBAL SECURITIES LENDING,

Defendants.

DEFENDANTS' REPLY BRIEF IN SUPPORT OF MOTION TO DISMISS PLAINTIFF'S AMENDED COMPLAINT

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I. INTRODUCTION

To try to save its tort claims from dismissal, Plaintiff contends that this case is about whether Defendants, including Wachovia Bank, N.A. ("Wachovia"), gave Plaintiff competent investment advice and therefore should be responsible for Plaintiff's loss. That is not this case. As alleged in the Amended Complaint, this case concerns two sophisticated businesses that, as part of an arm's length negotiation, entered into a contract pursuant to which Wachovia facilitated securities lending transactions as Plaintiff's agent, including investing cash collateral pursuant to detailed investment guidelines, and Plaintiff agreed to accept any resulting loss. Wachovia complied with those investment guidelines, and Plaintiff does not contend otherwise. Further, Plaintiff was well aware of the Sigma Finance investment at issue and that a loss from this investment might occur. Now that Plaintiff may incur a loss – a result not yet determined – it wants to ignore the terms of the contract and shift any potential loss to Defendants under various tort theories. Plaintiff's tort claims fail as a matter of law.

Contrary to Plaintiff's repeated assertions, Wachovia is not contending that it did not owe Plaintiff a duty. Wachovia is contending that its duties and any resulting liability are set forth in and limited to the terms of the parties' contract. Plaintiff's attempt to expand Wachovia's duties and potential liability beyond the terms of the contract is without any legal basis, and because Plaintiff's negligence and breach of fiduciary duty claims are based on the same facts alleged to support Plaintiff's breach of contract claim, these claims are improper under North Carolina law.

Plaintiff's claims for alleged violations of North Carolina's Unfair and Deceptive Trade Practices Act ("UDTPA") and the North Carolina Securities Act and Investment Advisers Act should likewise be dismissed. It is undisputed that a party may not bring a UDTPA claim in a case involving a securities transaction. Notwithstanding Plaintiff's effort to recast its allegations in its opposition to this motion, the Amended Complaint confirms that Plaintiff's UDTPA claim involves a securities transaction. And because Plaintiff has not pled the who, how or when as to

the alleged misrepresentations, Plaintiff has not pled its state securities fraud claims with the required specificity.

II. ARGUMENT

A. Plaintiff's Negligence Claim (Count III) Should Be Dismissed Because Defendants Do Not Owe Plaintiff A Legal Duty Separate From The Contract.

Defendants are not arguing, as Plaintiff contends, that there can never be tort liability in a case involving a bank and a customer. Plaintiff's sweeping re-characterizations of Wachovia's positions are inaccurate and not the issues before this Court. Defendants are contending that under the circumstances here, where the parties entered into a detailed contract, that contract is controlling and not Plaintiff's after-the-fact, unilateral, one-sided characterization of Wachovia's duties and obligations under common law tort theories.

Indeed, under North Carolina law any alleged tort liability must be separate from any alleged contractual liability. *See Spillman v. American Homes of Mocksville, Inc.*, 422 S.E.2d 740, 741-42 (N.C. App. Ct. 1992) ("a tort action does not lie against a party to a contract who simply fails to properly perform the terms of the contract, even if that failure to properly perform was due to the negligent or intentional conduct of that party, when the injury resulting from the breach is damage to the subject matter of the contract"). That is not the case here. Plaintiff has not alleged that Defendants engaged in any negligence separate from their alleged breach of contract.

The allegations in the Amended Complaint bear this out – the exact same alleged conduct which forms the basis for Plaintiff's negligence claim also forms the basis for its breach of contract claim, and both claims concern Wachovia's alleged failure to comply with its contractual duties under the Securities Lending Agency Agreement. *Compare* Amended Complaint at ¶ 55(a)-(e) *with* ¶ 51(a)-(f). Even Plaintiff does not dispute this point. In its Opposition, Plaintiff concedes that "there is some similarity of claims at the initial pleading

stage" between its breach of fiduciary duty and breach of contract claims and then goes on to describe its negligence claim by alleging that Defendants failed to meet their contractual obligations. *See* Plaintiff's Opposition at p. 12. Plaintiff's negligence and breach of contract claims are virtually indistinguishable.

Plaintiff attempts to circumvent this well-established principle that contractual and tort liability must be separate by contending that Defendants owed Plaintiff a separate negligence duty, independent from their contractual duties, but arising from the parties' contract. The few cases Plaintiff cites are inapplicable because those cases recognized a duty *imposed by law* in entirely different contexts and typically where third parties were involved. *See, e.g., Davidson and Jones, Inc. v. County of New Hanover*, 255 S.E.2d 580, 584 (N.C. App. Ct. 1979) (finding that although an architect may create a design pursuant to the terms of a contract, and thus be liable for breach of contract for a faulty design, it may also be liable to third-parties for negligence for any design fault that leads to a foreseeable injury); *Dixie Fire & Cas. Co. v. Esso Standard Oil Co.*, 143 S.E.2d 279, 285 (N.C. 1965) (finding that a lessor may bring an action for the tort of waste under landlord-tenant law, in additional to for breach of contract, arising from a lease contract when a lessee or a sub-lessee damages rental property).[1]

Here, Plaintiff has pointed to no legal duty imposed by law, nor does the Amended Complaint support the finding of any duty separate from the parties' contract. Without the contractual relationship set forth in the Securities Lending Agency Agreement, Plaintiff has not and cannot allege any other relationship giving rise to an independent duty between the parties. Plaintiff has not cited any authority holding that a contractual agency relationship (or even a common law agency relationship) can create a separate legal duty that can give rise to a negligence claim between the parties because none exists. Under Plaintiff's argument, every

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1 Plaintiff also cites to a dissenting opinion in a third case, *Livingston v. Essex Invest. Co.*, 14 S.E.2d 489 (N.C. 1941). *Livingston* also involved a duty imposed by law – in the landlord-tenant context.

contract would also create a separate legal duty that would give rise to a negligence claim. That clearly is not and should not be the law in North Carolina.

Finally, Plaintiff points to the exculpatory clause in paragraph 12.2 of the Securities Lending Agency Agreement as a basis for a separate negligence duty arising from the contract. But the exculpatory provision, which is set forth below, does not support Plaintiff's argument:

> The Agent [Wachovia] shall not be liable to the Lender [Plaintiff] or any third party for any loss occasioned by reason of action taken or omitted to be taken by the Agent ***hereunder or in connection herewith***, except insofar as such loss is occasioned by the Agent's negligence or willful misconduct.

Exhibit A to Defendants' Memorandum (Securities Lending Agency Agreement) at ¶ 12.2 (emphasis added). As evidenced by the phrase "hereunder or in connection herewith" (which language was omitted by Plaintiff in its Opposition), the exculpatory provision in paragraph 12.2 does nothing more than identify the bargained for standard of care ***under the contract***. That provision does not provide a basis for Plaintiff to seek to impose a separate negligence duty on Wachovia for an alleged breach of their agreement. Moreover, Plaintiff's contention, that a party may liable in tort for failing to comply with the terms of contract, is inconsistent with North Carolina law. *See Spillman*, 422 S.E.2d at 740.

Plaintiff's negligence and breach of contract claims do not exist independently. Both are predicated on the same relationship arising from the Securities Lending Agency Agreement and both are based on alleged breaches of the terms of the contract. Accordingly, Plaintiff's negligence claim should be dismissed.

B. Plaintiff's Breach Of Fiduciary Duty Claim (Count II) Should Be Dismissed Because Plaintiff Has Not Alleged A Fiduciary Duty Separate From Defendants' Contractual Duties.

Plaintiff's breach of fiduciary duty claim, like its negligence claim, is nothing more than an improper attempt to impose tort liability for Wachovia's alleged breach of contract. Again, the parties' relationship is set forth in the Securities Lending Agency Agreement – without that contract there would be no relationship, fiduciary or otherwise. Plaintiff concedes this point in its Opposition when it states that the breach of fiduciary duty claim is a claim "that Wachovia breached a duty arising from the relationship ***created by*** the [Securities Lending Agency Agreement]." Plaintiff's Opposition at p. 14 (emphasis added).

Plaintiff attempts to avoid dismissal by contending that a fiduciary relationship exists between the parties – separate from their contractual relationship – because Wachovia is acting as Plaintiff's agent pursuant to the terms of their agreement. *See* Plaintiff's Opposition at pp. 13-14. Neither the law nor Plaintiff's allegations support Plaintiff's contention that it has a fiduciary relationship with Defendants separate from the contract.

Plaintiff begins by citing a number of cases setting forth the standard for finding an agency relationship; however, Defendants have never denied that Wachovia has an agency relationship with Plaintiff. Defendants have only alleged that the agency relationship is solely a contractual one governed by the terms of the Securities Lending Agency Agreement. Plaintiff's authority is not to the contrary. As Plaintiff concedes in the Opposition, parties to a contract do not become each other's fiduciaries owing special duties to each other outside the terms of the contract. *See* Plaintiff's Opposition at p. 14; *see also Branch Banking v. Thompson*, 418 S.E.2d 694, 699 (N.C. App. Ct. 1992); *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331, 347 (4th Cir. 1998). This is especially true when, as here, the parties include an integration clause in the contract disclaiming any other understanding or agreement except their contractual obligations. *See* Exhibit A to Defendants' Memorandum (Securities Lending Agency Agreement) at ¶ 22 (integration clause); *Broussard*, 155 F.3d at 347 (finding no fiduciary

relationship between parties to a contract based, in part, on integration clause); *Sara Lee Corp. v. Quality Manuf., Inc.*, 201 F. Supp. 2d 608 (M.D. N.C. 2002) (same), *aff'd*, 61 Fed. Appx. 836 (4th Cir. 2003).

Nevertheless, Plaintiff argues that a fiduciary duty exists between the parties because a "special confidence" exists between the parties and there is a contractual agency relationship, but the allegations in the Amended Complaint do not provide a basis for a fiduciary relationship. As Plaintiff's own authority demonstrates, a fiduciary relationship arises "[o]nly when one party figuratively holds all the cards – all the financial power or technical information[.]" *S.N.R. Mgmt. Corp. v. Danube Partn.*, 141, LLC, 659 S.E.2d 442, 453 (N.C. App. Ct. 2008). "North Carolina law requires a degree of 'superiority and influence' to have developed as a result of this interdependence in order to hold one party to a fiduciary's responsibilities." *Broussard*, 155 F.3d at 348 (citing *Tin Originals, Inc. v. Colonial Tin Works, Inc.*, 391 S.E.2d 831, 833 (N.C. Ct. App. 1990)). Further, North Carolina courts have declined to find a fiduciary relationship where parties negotiate a contract with equal bargaining power and at arm's length, even when those parties are mutually interdependent businesses. *See Tin Originals*, 391 S.E.2d at 833; *Broussard*, 155 F.3d at 348. That is precisely the case here.

Here, two sophisticated businesses with equal bargaining power entered into an arm's length transaction. Plaintiff attempts to portray the relationship as one in which Wachovia had unfettered control over its investments, but the Securities Lending Agency Agreement shows that simply is not true. Under the contract, Plaintiff had the authority to determine to whom Wachovia could lend its securities and had the right to terminate any loan to any borrower at any time. *See* Exhibit A to Defendants' Memorandum (Securities Lending Agency Agreement) at ¶¶ 1, 7. The investments made pursuant to the agreement were made in accordance with very specific investment guidelines, not in Wachovia's sole discretion. *Id.* at ¶ 6. There are no facts pled to sustain Plaintiff's contention in its Opposition that Wachovia had a position of superiority or influence over Plaintiff to give rise to a fiduciary duty.

Moreover, Plaintiff has not alleged a breach of a purported fiduciary duty independent of its breach of contract claim, and for this independent reason, Plaintiff's breach of fiduciary duty claim fails. As with Plaintiff's negligence claim, Plaintiff's six specific allegations of breach of fiduciary duty are nothing more than allegations that Wachovia failed to comply with its contractual duties, and mirror Plaintiff's breach of contract claim. *Compare* Amended Complaint at ¶ 46(a)-(c) *with* ¶ 51(c), (e), (f). Tort claims based on a breach of contract, even if done negligently or intentionally, are not actionable under North Carolina law. *See Spillman*, 422 S.E.2d at 740. Accordingly, Plaintiff's breach of fiduciary duty claim should be dismissed.

C. Plaintiff's Claim For An Alleged Violation Of North Carolina's Unfair and Deceptive Trade Practices Act, N.C. Gen. Stat. § 75-1.1 (Count IV), Concerns Securities Transactions And Should Be Dismissed.

Plaintiff does not dispute that North Carolina's UDTPA excludes claims involving securities transactions. *See* Plaintiff's Opposition at p. 15. In opposing Defendants' argument for dismissal of its UDTPA claim on the basis that it falls within this exclusion, Plaintiff contends that its claim does not involve securities transactions but rather involves investment advice and an investor/investment advisor relationship. *See* Plaintiff's Opposition at pp. 15-16. Again, neither North Carolina law nor Plaintiff's allegations supports Plaintiff's contention.

Plaintiff's cited authority is wholly inapplicable. *Eastover Ridge, LLC v. Metric Constructors, Inc.*, 533 S.E.2d 827, 833 (N.C. App. Ct. 2000), was a construction case and did not involve any securities, and contrary to Plaintiff's description, the *Eastover* Court ***dismissed*** the UDTPA claim. *Sullivan v. Chase Invest. Serv. of Boston, Inc.*, 434 F. Supp. 171 (N.D. Cal. 1977), did not involve the UDTPA or North Carolina law.

In case after case, North Carolina courts have consistently held that a party may not bring a UDTPA claim when the allegations involve a securities transaction. *See, e.g., Skinner v. E.F. Hutton & Co., Inc.*, 333 S.E.2d 236, 241 (N.C. 1985) (affirming dismissal of UDTPA claim based on securities transactions); *Hajmm Co. v. House of Raeford Farms, Inc.*, 403 S.E.2d 483,

493 (N.C. 1991) (affirming trial court dismissal of UDTPA claim based on securities transactions); *Oberlin Capital, L.P. v. Slavin*, Civ. No. 99-CVS-03447, 2000 NCBC LEXIS 8, at *31 (N.C. Super. Ct. Apr. 28, 2000) ("North Carolina courts have repeatedly held that the provisions of [the UDTPA] do not apply to securities transactions."). And while Defendants disagree with Plaintiff's characterization of the UDTPA claim as only involving investment advice and an investor/investment advisor relationship, North Carolina courts have dismissed UDTPA claims in that context as well. *See Sterner v. Penn*, 583 S.E.2d 670, 672-73 (N.C. App. Ct. 2003) (affirming dismissal of UDTPA claim arising from allegations of improper investment advice and securities fraud).

The allegations in the Amended Complaint, as opposed to Plaintiff's characterization of those allegations in its Opposition, confirm that Plaintiff's UDTPA claim involves securities transactions. *See* Amended Complaint at ¶ 58(a)-(e). Indeed, much of the alleged improper conduct that forms the basis for Plaintiff's UDTPA claims also forms the basis for its state ***securities*** fraud claims. *Compare* Complaint ¶ 58(a) *with* ¶¶ 64(a), 72(a); and ¶ 58(d) *with* ¶¶ 64 (c), 72 (c).

Because Plaintiff's UDTPA claim concerns securities transactions, Count IV should be dismissed.

D. Plaintiff Has Failed To Plead Its Securities Fraud Claims (Counts V and VI) With Particularity.

Plaintiff does not dispute that fraud is an element of its North Carolina Securities Act and the Investment Advisers Act claims or that allegations of fraud pursuant to those statutes must be pleaded with sufficient particularity to satisfy North Carolina Civil Rule 9(b).[2] *See* Plaintiff's

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2 In the Legal Standard Section of the Opposition, Plaintiff suggests, but then never goes on to argue, that it can satisfy Rule 9(b)'s pleading requirements with "less particularity" because of its relationship with Wachovia. *See* Plaintiff's Opposition at p. 9. As support for this argument, Plaintiff cites constructive fraud cases, not securities fraud cases. Plaintiff does not cite any authority supporting the proposition that pleading constructive fraud is sufficient to satisfy the specificity requirement of Rule 9(b) for a ***securities*** fraud

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Opposition at pp. 17, 19. Further, Plaintiff concedes that to satisfy this requirement it must allege the time, place and content of the alleged false representation, the identity of the person making the representation, and what was obtained as a result of the fraudulent act or representation. *Id.* at p. 17; *see also Terry v. Terry*, 273 S.E.2d 674, 678 (N.C. 1981). The question for the Court is whether Plaintiff has pled enough.

Although the Opposition focuses exclusively on Plaintiff's contention that Wachovia made misrepresentations about the value of the Sigma Finance investment, Plaintiff asserts three generalized themes of fraud in the Amended Complaint. First, Plaintiff alleges that Wachovia misrepresented that securities lending was "low risk" and that the cash collateral from the securities lending investment would only be invested in "safe, liquid investments." Amended Complaint at ¶¶ 64(a), 72(a). Second, Plaintiff contends that Wachovia misrepresented that the objective of the investment of cash collateral was to provide for "safety of principal." *Id.* at ¶¶ 64(b), 72(b). Finally, Plaintiff avers that Wachovia on "multiple occasions" misrepresented the true value of the Sigma Finance investment and/or failed to timely notify Plaintiff of the material changes to the investment. *Id.* at ¶¶ 41, 64(c), 67, 72(c), 75.

Plaintiff, however, never identifies any one who allegedly made any misrepresentations or how the misrepresentation was made and when. Plaintiff attempts to side-step its pleading obligation by contending that the Wachovia employee who made the alleged misrepresentations is "unknown to [Plaintiff], and is, in any event, immaterial to [Plaintiff]'s claims," *see* Plaintiff's Opposition at p. 18; however, the law does not support Plaintiff's arguments. The "who" requirement is essential to pleading fraud with particularity. When a plaintiff alleges fraud

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claim. Rather, courts have held that "rigorous application" of Rule 9(b) is necessary in securities fraud cases and that the plaintiff must allege the time, place, speaker and contents of any allegedly false representation, as well as the manner in which the representations were false and the specific facts giving rise to the fraud. *See In re First Union Corp. Securities Litigation*, 128 F. Supp. 871, 884 (W.D.N.C. 2001).

against a corporation, it must identify the employee who made the alleged misrepresentation. *See Trull v. Central Carolina Bank & Trust Co.*, 450 S.E.2d 542, 545 (N.C. App. 1994) (citing *Coley v. North Carolina Nat'l Bank*, 254 S.E.2d 217, 220 (1979)).[3] Further, if Plaintiff contends that a misrepresentation was made in a document, then Plaintiff should plead the document containing the alleged misrepresentation and how Plaintiff came into possession of that document. Plaintiff's failure to identify who made the alleged misrepresentations is fatal to its securities fraud claims.

In addition, Plaintiff fails to identify the date of each alleged misrepresentation. Again, Plaintiff is alleging multiple misrepresentations on multiple dates, particularly as it relates to the value of the Sigma Finance investment. It is insufficient for Plaintiff to allege in a conclusory, vague manner that these misrepresentations were made in "monthly statements". *See* Plaintiff's Opposition at pp. 17-18. Plaintiff argues that "Wachovia did not provide it with accurate information regarding the value of the Sigma Finance" investment, but never identifies when Wachovia provided that inaccurate information or on how many occasions. *Id.* at p. 18. Plaintiff should at least identify which monthly statements. Absent pleading the time or date of each alleged misrepresentation, Plaintiff has not met the pleading requirements of Civil Rule 9(b). *See Terry*, 273 S.E.2d at 678.

Plaintiff has not alleged the specific content of the alleged misrepresentations. Plaintiff claims that Defendants misrepresented that securities lending was "low-risk" and that the securities lending collateral would be invested in "safe, liquid investments", but never alleges the specific statement allegedly made by Wachovia or how that statement was allegedly false. *See* Amended Complaint at ¶¶ 64(a), 72(a). The same is true of Plaintiff's allegation that Wachovia

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3 *Payne v. North Carolina Farm Bureau Mut. Ins. Co.*, 313 S.E.2d 912 (1984) and *Dickinson v. Pastor*, No. 01-372, 2002 WL 372861 (N.C. App. Ct. Mar. 5, 2002), cited by Plaintiff, support Defendants' argument. Contrary to this case, the plaintiffs there identified the corporate employee by name who made the alleged misrepresentation. *See Payne*, 313 S.E.2d at 695; *Dickinson*, 2002 WL 372861, at *3.

misrepresented that the primary objective of the investment of cash collateral is to provide for "safety of principal." *Id.* at ¶¶ 64(b), 72(b). And Plaintiff has not stated how Wachovia misrepresented the value of the Sigma investment (*i.e.*, what the investment was worth and what did Wachovia represent it was worth) or identify the "material changes" in the Sigma investment that Wachovia failed to report and what Wachovia should have reported. *Id.* at ¶¶ 64(c), 72(c).

The Opposition also shows that Plaintiff's allegations of misrepresentations concerning the value of the Sigma Finance investment should be dismissed for failing to meet the "in connection with" requirement of N.C. Gen. State. § 78A-8. Plaintiff confirms in the Opposition that its allegations of misrepresentations about the value of the Sigma Finance investment allegedly were made in monthly statements that Wachovia sent to Plaintiff. *See* Plaintiff's Opposition, pp. 17-18. Any alleged misrepresentation made in monthly statements could not have been "in connection with the offer, sale or purchase of" the Sigma Finance investment, as required by N.C. Gen. State. § 78A-8, because those misrepresentations necessarily would have taken place ***after*** the purchase of the Sigma Finance investment. *See Roots Partnership v. Lands' End, Inc.*, No. 90-907, 1991 U.S. Dist. LEXIS 21856, at *11 (W.D. Wis. 1991) ("activities and statements that occur after a plaintiff's purchase of a security cannot form the basis for liability under Rule 10b-5.") (citations omitted). Accordingly, Plaintiff's Securities Act claim should be dismissed for this additional reason.

The Amended Complaint fails to identify a single person that made the alleged fraudulent statements, a single date on when an alleged fraudulent statement was made, or the specific facts surrounding any of the alleged fraud. The particularity requirement of Rule 9(b) is rigorously applied in securities fraud cases and Plaintiff has not met that standard here. *See In re First Union Corp.*, 128 F. Supp.2d at 884. Plaintiff's securities claims – Counts V and VI – should be dismissed.

III. CONCLUSION

Accordingly, the Court should dismiss Counts II-VI of the Amended Complaint with prejudice.

DATED this the 16th day of June, 2009.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of June 2009, I caused a true and correct copy of Defendants' Reply Brief In Support of Motion to Dismiss Plaintiff's Amended Complaint to be served upon the following counsel of record through the Court's electronic filing system, pursuant to BCR 6.5, and by depositing a copy thereof, postage prepaid, by first class U.S. mail, addressed as follows:

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