

STATE OF NORTH CAROLINA
COUNTY OF WAKE

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
07-CVS-020852

MOORING CAPITAL FUND, LLC,
Individually and Derivatively as Minority
member of COMSTOCK NORTH
CAROLINA, LLC, a North Carolina Limited
Liability Company,

Plaintiff

vs.

COMSTOCK NORTH CAROLINA, LLC, a
North Carolina Limited Liability Company,
COMSTOCK SERVICE CORP, INC., a
Virginia Corporation, and COMSTOCK
HOMEBUILDING COMPANIES INC., a
Delaware corporation.

Defendants.

**BRIEF IN SUPPORT OF RESPONSE TO
DEFENDANTS' MOTION TO DISMISS
OR, IN THE ALTERNATIVE, FOR A
MORE DEFINITE STATEMENT WITH
REGARD TO PLAINTIFF'S AMENDED
COMPLAINT**

Plaintiff, Mooring Capital Fund, LLC ("Mooring Capital"), by and through counsel, files this brief as required by Rule 15.6 of the Business Court Rules in opposition to Defendants' Motion to Dismiss or, In the Alternative, for a More Definite Statement pursuant to Rules 12(b)(6) and 12(e) of the North Carolina Rules of Civil Procedure.

FACTS

Plaintiff agrees with the recitation of facts as set forth in the Brief of the Defendants, with the exception of the statement contained therein that all of the Plaintiff's claims should be dismissed.

ARGUMENT

I. Plaintiff's Amended Complaint states valid causes of action as against Defendants CSCI and CHCI as both do not enjoy limited liability for the acts and/or omissions alleged by Plaintiff in the instant case.

Defendants CSCI and CHCI contend that as members-managers of a limited liability company (LLC) they have absolute insulation from any liability in the case at bar. Defendants CSCI and CHCI contend that members-managers of an LLC are shielded by the Business Judgment Rule as well as Paragraph 6.2 of the Operating Agreement of CNC. Defendants contend that Plaintiff has “not alleged that any act by CSCI or CHCI was outside of their capabilities as members and/or managers of CNC.” (Defendants’ Brief at 3.)

Defendants cite *Hamby v. Profile Products, LLC*, 361 N.C. 630, 638, 652 S.E.2d 231, 236 (2007) for the proposition that absent an agreement to the contrary, member-managers are shielded from liability when acting on behalf of an LLC. In *Hamby*, when considering a workers’ compensation matter, our Supreme Court was careful to reiterate in a footnote that the liability of members or managers is not limited when they act outside the scope of managing the LLC. *Id.* at 637.

Contrary to the assertions of Defendants, N.C. Gen. Stat. §57C-3-30(a) does not provide absolute immunity for actions taken by the member-manager of an LLC acting in such capacity. In fact, N.C. Gen. Stat. §57C-3-30(a) expressly indicates that “[a] member, manager, director, or executive may, however, become personally liable by reason of that person’s own acts or conduct.” Further, N.C. Gen. Stat. §57C-3-32 does not allow an LLC’s operating agreement to “limit, eliminate, or indemnify against liability of a manager, director, or executive for (i) acts or omissions that the manager, director, or executive knew at the time of the acts or omissions were

clearly in conflict with the interests of the limited liability company, [or] (ii) any transaction from which the manager, director, or executive derived an improper personal benefit . . .”

The Operating Agreement in the instant matter expressly exempts member-managers for liability for any act or omission performed in good faith on behalf of the LLC and in a manner reasonably believed by them to be within the scope of the authority granted to them by the Operating Agreement and in the best interest of the LLC. (See 7.11(c) of the Operating Agreement.) It logically follows that member-managers are not shielded from liability for acts or omissions performed in bad faith and/or in a manner in which the member-managers could not have reasonably believed to be within the scope of authority granted to them. Further, member-managers are not shielded from liability for acts or omissions which are not in the best interests of the LLC as a whole. Thus, the Operating Agreement, in that regard, is consistent with the codification set forth in N.C. Gen. Stat. §57C-3-30(a) and N.C. Gen. Stat. §57C-3-32.

In *Mitchell Brewer et. al. v. Brewer et. al.*, 2007 NCBC 14 (2007), plaintiffs, members of an LLC, a law firm, filed suit asking for an accounting with respect to the LLC’s profits and losses and a distribution to reflect their claimed share of the net value of the assets of the LLC. Plaintiffs contended, among other things, that the defendants, the member-managers of the LLC, failed to provide a sufficient accounting and distribution which constituted a breach of fiduciary duty. The defendants contended that based upon the LLC’s Articles of Organization and N.C. Gen. Stat. §57C-3-32(a)(1) they were not personally liable for any breach of their duties as managers of a limited liability company. In *Mitchell*, similar to the Operating Agreement in the instant case, the LLC’s articles contained the following language:

To the full extent from time to time permitted by law, no person who is serving or has served as a manager of the limited liability company shall be personally liable in any action for monetary damages for breach of his or her duty as a manager, whether such action is brought by or in the right of the limited liability company

or otherwise. Neither the amendment or repeal of this Article, nor the adoption of any provision of these Articles of Organization inconsistent with this Article, shall eliminate or reduce the protection afforded by the Article to a manager of the limited liability company with respect to any matter which occurred, or any cause of action, suit or claim which but for this Article would have accrued or risen, prior to such amendment, repeal or adoption.

(*Id.* at p. 14.)

In *Mitchell*, after considering the LLC's Articles of Organization in conjunction with N.C. Gen. Stats. §57C-3-30(a) and §57C-3-32, the Court held that since the plaintiff's complaint contained allegations that could support a claim that the defendants either undertook actions or omissions that they knew at the time were clearly in conflict with the interests of the LLC or entered into transactions from which they derived an improper personal benefit, they were not shielded from liability. *Id.* Accordingly, defendants' motion to dismiss was denied.

In the case at bar, Plaintiff's Amended Complaint alleges that the "[m]anager appears to have made unauthorized distributions to itself and affiliated entities, as indicated on the internal statements for the year ended December 31, 2006. The statements indicate net distributions of \$1,781,000.00, while the Manager should instead have contributed on a net basis \$2,342,000.00 to purchase the interests of Priority Members other than Mooring Capital." (Paragraph 22 of Plaintiff's Amended Complaint, as well as the December 31, 2006 internal statement identified as Exhibit B thereto.) Plaintiff's Complaint further alleged that "CHCI has caused CNC to operate for CHCI's own benefit and protection and without regard to the interests of minority members including Mooring Capital." (Paragraph 24 of Plaintiff's Amended Complaint.) Further, Plaintiff's Complaint alleged that "CHCI and/or CSCI have grossly mismanaged CNC, by according themselves preferential treatment either in the repurchase of other equity interests in the company, or in the taking of compensation or profit to the detriment of Mooring Capital and other minority owners." (Paragraph 27 of Plaintiff's Amended Complaint.) Similarly,

Plaintiff's Complaint alleged that Defendant CHCI purchased certain other Priority Members' interests at a 6.5% per annum cash on cash return, whereas actual profits would have provided a substantially higher return. (Paragraph 20 of Plaintiff's Amended Complaint)

Defendants contend that the Amended Complaint fails to allege legally sufficient reasons for naming CSCI and CHCI as defendants. (Defendants' Brief at 3.) To the contrary, Plaintiff's Amended Complaint alleges 1) that CHCI and/or CSCI have grossly mismanaged CNC, by according themselves preferential treatment either in the repurchase of other equity interests in the company, or in the taking of compensation or profit to the detriment of Mooring Capital and other minority owners; 2) that neither CHCI nor CSCI has made any distributions to Mooring Capital as a Priority Member of CNC (instead, CHCI and CSCI intentionally made wrongful and unauthorized distributions of company funds to themselves or related entities in violation of the terms of the Operating Agreement); 3) that the aforesaid acts and omissions of CHCI and/or CSCI were in bad faith, were in direct conflict with and against the best interests of CNC, and have resulted in CHCI and/or CSCI deriving an improper personal benefit; and 4) that the aforesaid acts and omissions of CHCI and/or CSCI were not within the scope of authority granted to CHCI and/or CSCI and CHCI and/or CSCI could not have reasonably believed the same to be within the scope of authority granted to them by CNC and/or the Operating Agreement. (Paragraphs 27-29 of Plaintiff's Amended Complaint.) If these facts are treated as true, as they must be on a motion to dismiss under Rule 12(b)(6), then Plaintiff has stated multiple valid claims for relief. A motion to dismiss is properly granted only if there is "no set of facts" upon which Plaintiff could be entitled to relief. *See, e.g., Wood v. Hollingsworth*, 166 N.C. App. 637, 640, 603 S.E.2d 388, 391 (2004) (citing *Dixon v. Stuart*, 85 N.C. App. 338, 340, 354 S.E.2d 757, 758 (1987)).

Accordingly, Plaintiff has pled, in other than conclusory terms, sufficient facts in its Amended Complaint as against Defendants CHCI and CSCI to give them notice of its claims against each in the case at bar. As such, Defendants CHCI and CSCI's Motion to Dismiss based upon member-manager immunity should be denied in its entirety.

II. Plaintiff has properly alleged facts which permit the seeking of a Declaratory Judgment in the instant case.

Defendants contend that Plaintiff's First Claim for Relief should be dismissed as no genuine, actual and existing controversy exists which would enable Plaintiff to seek a Declaratory Judgment. To the contrary, Plaintiff's Amended Complaint alleges that a dispute exists as to the value of Plaintiff's ownership interest in CNC and further alleges that Defendants have failed to respond to the allegations of Plaintiff and have denied them in written and oral communications. (Paragraph 35 of Plaintiff's Amended Complaint.) Plaintiff's Amended Complaint also alleges that there is a dispute between the parties with respect to the interpretation of the Operating Agreement of the LLC. (Paragraph 36 of Plaintiff's Amended Complaint.) Declaratory judgment actions are appropriate to interpret written instruments. *See, e.g., LDDC, Inc. v. Pressley*, 71 N.C. App. 431, 322 S.E.2d 416 (1984). As such, Plaintiff has stated sufficient facts to support that a real and justiciable controversy exists between the parties such that a declaratory judgment action is appropriate pursuant to N.C. Gen. Stat. §1-253.

III. Plaintiff's claims are proper under Chapter 57C of the North Carolina General Statutes, as well as other applicable North Carolina law.

Defendants contend that Plaintiff's Second Claim for Relief should be dismissed since Plaintiff references a provision of Chapter 55 of the North Carolina General Statutes rather than a similar provision in Chapter 57C of the North Carolina General Statutes regarding the same

basic issue, access to records. Plaintiff's Second Claim for Relief as contained in Plaintiff's Amended Complaint seeks access to all LLC records pursuant to N.C. Gen. Stat. §57C-3-04. Plaintiff alleges that "as a member of CNC, pursuant to N.C. Gen. Stat. §55-16-02 and N.C. Gen. Stat. §57C-3-04, Mooring Capital is entitled to access to all corporate records and an accurate accounting of corporate revenues, income, debt, obligations, liabilities, distributions, and assets." (Paragraph 39 of Plaintiff's Amended Complaint.)

N.C. Gen. Stat. §57C-3-04 provides:

Each member has the right, subject to such reasonable standards (including standards governing what information and documents are to be furnished, at what time and location and at whose expense) as may be set forth in the articles of organization or a written operating agreement, to obtain from the limited liability company from time to time upon reasonable demand for any purpose reasonably related to the member's interest as a member:

- (1) Information regarding the status of the business and the financial condition of the limited liability company;
- (2) Promptly after becoming available, a copy of the limited liability company's federal, State, and local income tax returns for each year;
- (3) A current list of the name and last known business, residence, or mailing address of each member;
- (5) Information regarding the amount of cash and a description and statement of the agreed value of any other property or services contributed by each member, and the property and services that each member has agreed to contribute in the future, and the date on which each became a member; and
- (6) Such other information regarding the affairs of the limited liability company as is just and reasonable.

Plaintiff's request for access to information and documentation regarding the business and financial information of the company of which it is a member plainly falls within that which is permissible pursuant to N.C. Gen. Stat. §57C-3-04.

Defendants further contend that since N.C. Gen. Stat. §57C-3-04(e) allows for managers of LLCs to keep certain information confidential from members, Plaintiff is not entitled to the information it is requesting. However, Defendants have never previously raised a defense that the information sought by Plaintiffs was confidential. In fact, Plaintiff received absolutely no response from Defendants despite written requests for financial information. (Paragraph 40 of Plaintiff's Amended Complaint.) Further, N.C. Gen. Stat. §57C-3-04(e) only allows managers to keep from members information which the managers believe to be "trade secrets or other information the disclosure of which the managers in good faith believe is not in the best interest of the limited liability company." Since the disclosure of financial information is expressly allowed by N.C. Gen. Stat. §57C-3-04(a)(1-6), Defendants reliance upon N.C. Gen. Stat. §57C-3-04(e) is improper. Plaintiff has stated a cognizable claim under N.C. Gen. Stat. §57C-3-04 and, as such, Defendant's Motion to Dismiss Plaintiff's Second Claim for Relief should be denied.

Defendants next contend that Plaintiff's Third Claim for Relief for breach of fiduciary duty, duty of good faith, duty of loyalty, and due care should be dismissed since Plaintiff has referenced certain provisions of Chapter 55 of the North Carolina General Statutes in support of the same. Defendants do not appear to be contending that such claims are not viable within a limited liability company context, but rather simply that Plaintiff's reference to Chapter 55 was erroneous. To that end, N.C. Gen. Stat. §57C-10-05 provides that "[i]n any case not provided for in this Chapter, the rules of law and equity shall govern." Therefore, to the extent that parallel statutory provisions do not exist in Chapter 57C, Plaintiff is entitled to reference in its Amended Complaint the "rule of law" as it relates to intra-corporate disputes, as a corporation certainly bears some similarity to an LLC. In fact, it is quite ironic, on this note, that the Business

Judgment Rule upon which Defendants repeatedly rely is primarily a creature of Chapter 55, in particular N.C. Gen. Stat. §55-8-30 et. seq.. See, e.g., *Winters v. First Union Corp.*, 2001 N.C.B.C. 8, pp. 15-16 (2001). Further, as reflected in *Mitchell*, this Court has allowed a claim for breach of fiduciary duty to proceed in the context of a limited liability company. *Mitchell Brewer et. al. v. Brewer et. al.*, *supra*.

Plaintiff's Third Claim for Relief is brought pursuant to N.C. Gen. Stat. § 57C-3-22, as well as North Carolina law and principles of equity and therefore states a valid claim for which relief can be granted. As such, Defendants' Motion to Dismiss on the basis of mere referral by Plaintiff to anything other than Chapter 57C is without merit and should be denied in its entirety.

IV. Plaintiff's Complaint and Amended Complaint set forth all requirements of N.C. Gen. Stat. §57C-8-01(a) such that a members' derivative action by Plaintiff is viable and appropriate.

Defendant contends that Plaintiff has failed to satisfy the prerequisites enumerated in N.C. Gen. Stat. §57C-8-01(a) such that it would be prevented from commencing a members' derivative action. In particular, the prerequisites that Defendants contend Plaintiff failed to meet are: 1) a showing that Plaintiff does not have authority to cause the LLC to sue in its own right; and 2) a showing of the particular efforts made by Plaintiff in order to obtain the action Plaintiff desires from the managers, directors, or other applicable authority and the reasons for Plaintiff's failure to obtain the action, or for not making the effort required. These contentions are without merit.

Plaintiff has alleged that "Mooring Capital is a minority member of CNC, and accordingly is a proper party to bring a derivative action to enforce the rights of CNC." Further, Plaintiff has alleged that Mooring Capital does not have the authority to cause CNC to sue in its own right given its minority membership. (See Paragraph 43 of Plaintiff's Amended Complaint.)

Defendants contend, without citation to any authority, that this allegation does not constitute a “showing” as required by N.C. Gen. Stat. §57C-8-01(a). Plaintiff points out that North Carolina is a notice pleading jurisdiction and at this stage of the litigation a “showing” is not necessary. All that is required in the pleadings of a party is “a short and plain statement of the claim sufficiently particular to give the court and the parties notice of the transactions, occurrences, or series of transactions or occurrences, intended to be proved showing that the pleader is entitled to relief.” N.C. R. Civ. P., Rule 8(a)(1). On their face, the allegations of Plaintiff establish that Plaintiff does not have authority to cause CNC to sue in its own right.

With respect to the showing of particular efforts made by Plaintiff in order to obtain the action desired by Plaintiff, Plaintiff’s Amended Complaint alleges that the actions of CHCI and CSCI have operated to frustrate the expectations of Plaintiff. Plaintiff’s Amended Complaint further alleges that Plaintiff has not received complete information with regard to accounting of CNC from CHCI and CSCI despite repeated written demands and after having waited for the required 90-day period for Defendants to respond to such demands. (See demand letter identified as Exhibit C to Plaintiff’s Amended Complaint, as well as Paragraphs 39 and 40 of Plaintiff’s Amended Complaint.)

To some extent, Defendants are contending that Plaintiff does not have sufficient documentation or facts to support a cause of action and therefore Plaintiff’s Amended Complaint should be dismissed due to this current lack of information and/or documentation. To the extent that Plaintiff is currently lacking appropriate documentation and information, it is well settled that the discovery rules provide procedures adequate to supply information not furnished by a complaint. *See, e.g., Sutton v. Duke*, 277 N.C. 94, 106, 176 S.E.2d 161, 168 (1970) (holding, in part, that a complaint should not be dismissed for insufficiency unless it appears to be a certainty

that a plaintiff is entitled to no relief under any statement of facts which could be proved in support of the claim.)

In this instance, Plaintiff alleges that it made a pre-litigation demand upon Defendants for certain documentation to support its various cause of action, consistent with N.C. Gen. Stat. §57C-3-04 and the Operating Agreement. (Paragraphs 39-40 of Plaintiff's Amended Complaint.) It seems illogical that Defendants can withhold documentation and information that they are required by statute to produce and then argue that Plaintiff does not, at this early stage, have sufficient documentation and/or information upon which to assert a valid cause of action for, among other things, Defendants' conduct in failing to produce the requested documentation and/or information.

Finally, Defendants contend that Plaintiff has failed to overcome the presumption of the Business Judgment Rule. As set forth more specifically above, Plaintiff has pled, in other than conclusory terms, sufficient facts in its Amended Complaint as against Defendants to support valid claims against each in the case at bar. The business judgment rule, if applicable, can be applied once the facts have been discovered and can be considered by the Court; the business judgment rule is not a shield that prevents there from being any inquiry whatsoever into a corporate manager or director's acts of self-dealing. Accordingly, Defendants' Motion to Dismiss should be denied in its entirety.

V. Plaintiff's Fourth Claim for Relief is proper under N.C. Gen. Stat. §57C-6-02.

The Operating Agreement, which is incorporated by reference in Plaintiff's Amended Complaint, plainly states "*[e]xcept as may be provided by the Act*, no suit or other action brought by a Member against the Manager or the Company shall cause the termination or dissolution of

the Company.” (Operating Agreement, 7.11 (c) *emphasis added*.) The “Act” is defined by the Operating Agreement as the “North Carolina Limited Liability Company Act, General Statutes of North Carolina Section 57C-1-01, et. seq., as amended from time to time, and any successor laws.” (Operating Agreement, 1.1.) The Act, and more specifically, N.C. Gen. Stat. §57C-6-02, gives the Superior Court the unbridled power to dissolve a limited liability company in a proceeding by:

a member if it is established that (i) the managers, directors, or any other persons in control of the limited liability company are deadlocked in the management of the affairs of the limited liability company, the members are unable to break the deadlock, and irreparable injury to the limited liability company is threatened or being suffered, or the business and affairs of the limited liability company can no longer be conducted to the advantage of the members generally, because of the deadlock; (ii) liquidation is reasonably necessary for the protection of the rights or interests of the complaining member, (iii) the assets of the limited liability company are being misapplied or wasted; or (iv) the articles of organization or a written operating agreement entitles the complaining member to dissolution of the limited liability company.

Further, N.C. Gen. Stat. §57C-6-02.1 provides an alternative remedy where dissolution is appropriate. Pursuant to N.C. Gen. Stat. §57C-6-02.1(d), a limited liability company “can elect to purchase the membership interest of the complaining member at its fair value, as determined in accordance with any procedures the court may provide.”

Based upon a full and complete reading of the Operating Agreement in conjunction with the Act, and contrary to the assertions of Defendants, Plaintiff’s Amended Complaint states a valid cause of action for judicial dissolution. Plaintiff has alleged facts that suggest that dissolution may be reasonably necessary for the protection of its rights and interests, and that the assets of the limited liability company are being misapplied or wasted. The Complaint alleges that CHCI and CSCI have engaged in acts of self-dealing and have either shorted CNC cash contributions owed, or taken from CNC

significant amounts of cash to which they were not entitled. Either ground, which must be taken as true at the Rule 12(b)(6) stage, would entitle Plaintiff to an order of dissolution, or an order that its interest be bought back at fair market value as determined by the Court, under N.C. Gen. Stat. §57C-6-02.1. Accordingly, Defendants' motion to dismiss should be denied on this issue as well.

VII. In the event the Court finds Plaintiff's pleadings factually deficient, Plaintiff contends that the Court should grant Defendants' Motion for a More Definite Statement rather than dismissing Plaintiff's Amended Complaint outright.

To the extent that the Court finds merit to the contentions of Defendants that Plaintiff's Amended Complaint is devoid of certain factual allegations, the equitable remedy would be for the Court to grant the Defendants' Motion for a More Definite Statement rather than to dismiss Plaintiff's Amended Complaint outright. This would be the appropriate means to allow Plaintiff to remedy any deficiencies in its Complaint. *See, e.g., Page v. Mandel*, 154 N.C. App. 94, 98, 571 S.E.2d 635, 638 (2002)(holding that a trial court can, *sua sponte*, treat a Motion to Dismiss as a Motion for a More Definite Statement with said decision reviewable only for an abuse of discretion.)

CONCLUSION

Based upon the foregoing, Defendants' Motion to Dismiss should be denied in its entirety as to Plaintiff's Amended Complaint. Alternatively, to the extent that the Court finds merit to the contentions of the Defendants, the Plaintiff respectfully requests that the Court grant solely Defendants' Motion for a More Definite Statement, and grant Plaintiff leave to file a Second Amended Complaint.

This the 22nd day of May, 2008.

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CERTIFICATE OF SERVICE

I, Keith Nichols, do hereby certify that service of the foregoing **BRIEF IN SUPPORT OF RESPONSE TO DEFENDANTS' MOTION TO DISMISS OR, IN THE ALTERNATIVE, FOR A MORE DEFINITE STATEMENT WITH REGARD TO PLAINTIFF'S AMENDED COMPLAINT** was this date served upon the parties herein by electronic filing with the Business Court and was also served on the parties and counsel of record by depositing a copy of same in the United States Mail, postage prepaid, addressed as follows:

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This 22nd day of May, 2008.

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