

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 PLAINTIFF'S
RESPONSE TO DEFENDANT CNC'S
MOTION TO STAY PROCEEDINGS
PURSUANT TO
N.C. GEN. STAT. § 57C-8-01(b)**

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 the Motion to Stay of Defendant Comstock North Carolina, LLC ("CNC").

FACTS

For purposes of the instant motion, Mooring Capital agrees with the recitation of facts as set forth in the Brief of the CNC.

ARGUMENT

N.C. Gen. Stat. § 57C-8-01 provides that in a members' derivative action, if a limited

liability company commences "an investigation of the charges made in the demand or complaint, the court *may* stay any proceedings until the investigation is completed." As set forth herein, a stay of the instant proceedings is not appropriate and, in the Court's discretion, the motion of CNC should be denied in its entirety.

A. To the substantial prejudice of Mooring Capital, CNC did not commence an investigation into the claims and/or allegations of Mooring Capital for a period of almost eight (8) months.

CNC contends that a stay of the proceedings will not prejudice Mooring Capital since Mooring Capital will save time and money it would have to expend for discovery and litigation. (Brief of CNC at p. 3.) On September 18, 2007, Mooring Capital, through counsel, sent a formal demand letter to CNC. On that date, Mooring Capital reiterated and officially raised a number of concerns with respect to the profit distributions, or lack thereof, with respect to Mooring Capital's interest in CNC and further demanded certain documents and information with respect to the same. (See Exhibit C to the Amended Complaint.)

After waiting the required ninety (90) day period and receiving no response to its letter of September 18, 2007, Mooring Capital filed a Complaint in this Court on December 20, 2007. Defendants were served with the Complaint on or about January 16, 2008. Thereafter, Defendants filed a Motion for Extension of Time to Respond to Plaintiff's Complaint on January 24, 2008. Following an Order granting said Motion, Defendants filed a Motion to Dismiss or, in the alternative, a Motion for a More Definite Statement on March 14, 2008. Mooring Capital then filed an Amended Complaint and responded to Defendants' Motion to Dismiss on April 7, 2008. Subsequently, Mooring Capital has participated in an initial pretrial conference regarding the matter and has served extensive Interrogatories and Requests for Production of Documents

upon all three Defendants. Mooring Capital has also, at significant expense, responded to a Second Motion to Dismiss, and filed a Motion to Appoint a Receiver.

The evidence reflects that it was not until May 15, 2008 (after all of the foregoing procedural maneuvers) that CNC officially commenced an investigation into the claims and allegations of Mooring Capital, despite having the cause, means, and opportunity to do so well prior to that date. (See Exhibit B to CNC's Motion.) Mooring Capital has already incurred significant expenses in this litigation and an indefinite stay of the proceedings will have minimal effect upon the further litigation expenditures of Mooring Capital. Defendant's delay and non-responsiveness up to the present time suggests that its new-found concern for providing Mooring Capital with complete disclosure is somewhat less than genuine.

B. The purported investigation of CNC is merely a "review" of financial statements of the company as of December 31, 2007 and will not adequately and completely address the non-derivative charges and/or allegations of Mooring Capital.

In its Amended Complaint, Mooring Capital seeks declaratory relief as to the rights, duties and obligations of the parties; an accounting as to Mooring Capital's ownership stake (and the value of same) in CNC; an order compelling the inspection and copying of the corporate records of CNC; damages for Defendant CHCI and/or CSCI's breaches of its fiduciary duties to Mooring Capital as a minority member, and its duties of good faith, loyalty and due care; an order of dissolution of CNC pursuant to N.C.G.S. § 57C-6-02, or purchase of CNC's share at its fair value pursuant to N.C.G.S. § 57C-6-02.1; and costs and attorneys' fees. Mooring Capital further contends in its Amended Complaint that:

Section 17.3 of the Operating Agreement provides that 45 days after the close of each fiscal quarter, a member such as Mooring Capital is to be provided with internally prepared unaudited income statements and balance sheets. In addition, the Manager is required to distribute annual income statements reviewed by an independent accounting firm to Members no later than the 30th day of May of the

following year, and monthly sales reports no later than 30 days after the end of each month. Mooring Capital further contends that despite repeated requests, it has not received the following materials or documents: annual income statements reviewed by an independent accounting firm for the years ended December 31, 2003, 2004, 2005, and 2006; consistent or regular distribution of monthly sales reports (the only one in the current year having been received July 20, 2007 following a specific request); and consistent or regular distribution of quarterly statements.

(Amended Complaint at ¶ 15-16.)

Therefore, contrary to the assumptions of CNC, this matter does not exclusively involve derivative claims as defined in N.C. Gen. Stat. § 57C-8-01. The "investigation" of CNC, by and through PriceWaterhouseCoopers, pursuant to said statute will not address all of the charges and/or allegations of Mooring Capital.

Further, the proposed undertaking by PriceWaterhouseCoopers is merely a review of financial statements of CNC as of December 31, 2007. Mooring Capital points out that its Amended Complaint was based, in large part, upon information contained within the financial statement of CNC for the year ending December 31, 2006. Further, the Affidavit of Bruce Labovitz of CHCI establishes that Mooring Capital had requested that distributions be made as early as December of 2004. (Affidavit of Labovitz, ¶9.) Thus, the "review" of PriceWaterhouseCoopers will not adequately address Mooring Capital's allegations with respect to the financial condition of CNC in the years prior to 2007.

Finally, according to PriceWaterhouseCoopers:

[a] review is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we will not express such an opinion. A review does not contemplate obtaining an understanding of internal control over financial reporting or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidentiary matter, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that we will become aware of all significant matters that would be disclosed in an audit.

(See letter of PriceWaterhouseCoopers, Exhibit B to Motion of CNC.) CHCI contends that the financial statement of CNC merely reflects that certain legitimate inter-company transfers of cash between CHCI and CNC were made. (Affidavit of Labovitz, ¶ 12-13.) According to PriceWaterhouseCoopers' disclaimer, its review will not address the legitimacy of these inter-company transfers. Further, CHCI contends that the 2007 IRS Form 1065 (Schedule K-1) relating to Mooring's interest in CNC shows an erosion of 25% of the profit from the year prior based on deteriorating conditions in the housing market. Yet CHCI does not provide any evidence as to how it arrives at said "erosion" calculation, and the review of PriceWaterhouseCoopers will similarly not address that issue.

Based upon the foregoing, the proposed simple "review" of the financial statement of CNC for the year ending December 31, 2007 neither adequately nor completely addresses the charges and/or allegations of Mooring Capital. Therefore, any stay of these proceedings to allow for this review to be accomplished is not merited under N.C. Gen. Stat. § 57C-8-01 or otherwise.

C. In the event that the "investigation" of CNC reveals that the allegations of Mooring Capital are meritorious, CNC has not provided this Court with any assurance that CNC is willing to accept the findings of PriceWaterhouseCoppers and make appropriate monetary distributions to Mooring Capital to end this litigation.

Assuming arguendo that the review performed by PriceWaterhouseCoopers is comprehensive and addresses each and every one of the claims and/or allegations of Mooring Capital, CNC has not provided this Court with any indication as to how the report of PriceWaterhouseCoopers will govern CNC's further actions with respect to this litigation. CNC has not set forth for this Court the practical effect a stay of the proceedings will have on the litigation. Rather, CNC simply states "[i]f the investigation reveals any merit to [Mooring

Capital's] allegations, then [Mooring Capital] will not have to expend time and money on discovery and experts." (Brief of CNC at p. 3.) This statement is meritless absent some commitment by Defendants to honor the results of the "review." Moreover, the review itself may become the subject of controversy or contested discovery.

Given the extensive relief sought by Mooring Capital, Mooring Capital is hard pressed to find any evidence to support the assertion that a review by PriceWaterhouseCoopers will effectuate any meaningful resolution of this matter since, following the stay, any of the parties can still contest the validity of the report of PriceWaterhouseCoopers.

D. Given the public statements of CHCI with respect to its long-term viability, any delay in these proceedings will be to the detriment and prejudice of Mooring Capital.

CHCI, the current member-manager of CNC, which is alleged to have acted in bad faith with respect to CNC's profit and capital distributions, is currently experiencing financial difficulties of its own. (See Exhibits C through E attached to the Affidavit of Bhise, of which this Court should take judicial notice.) In a press release from CHCI dated April 1, 2007, PriceWaterhouseCoopers indicated that it believed that "due to declining market conditions and the significant amount of the [CHCI's] debt which matures in 2008," there was substantial doubt that CHCI would continue operating as a "going concern." (See Affidavit of Bhise, Exhibit C.) Further, CHCI's Chief Executive Officer has indicated that he could not rule out the possibility of the sale of CHCI. (See Affidavit of Bhise, Exhibit E.)

Mooring Capital is deeply concerned that a stay of this matter will allow an additional period of unfettered access by CHCI to the funds and assets of CNC to the detriment of Mooring Capital. Given the public statements of CHCI and its agents with respect to its own long-term

viability, any delay in these proceedings will be to the detriment and prejudice of Mooring Capital.

- E. Defendant Comstock Homebuilding Companies, Inc. (“CHCI”), the majority member and current manager of CNC, is already a client of the accounting firm retained by CNC to conduct the “investigation.”**

Defendant Comstock Homebuilding Companies Inc. ("CHCI") is the majority member and sole manager of CNC. PriceWaterhouseCoopers is CHCI's accounting firm. (See the Affidavit of Bhise, Exhibit C, which refers to an April 1, 2007 press release which states that CHCI's registered public accounting firm is PriceWaterhouseCoopers.) Curiously, CNC, which is controlled entirely by CHCI, is now asking this Court to stay the proceedings to allow CHCI's accounting firm to conduct a "review" of the financial statements of CNC at December 31, 2007. Such a review cannot truly be "independent" given PriceWaterhouseCoopers' prior involvement with CHCI and intimate knowledge regarding CHCI's accounting practices.

CONCLUSION

Based upon the foregoing reasons, Defendant CNC's Motion to Stay should be denied in its entirety.

This the 4th day of June, 2008.

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CERTIFICATE OF SERVICE

I, Keith Nichols, do hereby certify that service of the foregoing **BRIEF IN SUPPORT OF PLAINTIFF'S RESPONSE TO DEFENDANT CNC'S MOTION TO STAY PROCEEDINGS** 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 4th day of June, 2008.

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