

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,)
)
v.)
)
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
DEFENDANTS' MOTION TO
DISMISS THE AMENDED
COMPLAINT OR, IN THE
ALTERNATIVE, FOR A MORE
DEFINITE STATEMENT

Defendants Comstock North Carolina, LLC ("CNC"), Comstock Service Corp., Inc. ("CSCI") and Comstock Homebuilding Companies, Inc. ("CHCI") by and through counsel, file this brief as required by Rule 15.2 of the Business Court Rules in support of their Motion to Dismiss Or, In The Alternative, For A More Definite Statement pursuant to North Carolina Rules of Civil Procedure 12(b)(6) and 12(e).

FACTS¹

CNC is a North Carolina limited liability company with its principal place of business in Wake County, North Carolina. Its members' rights and responsibilities are set forth in its Second Amended and Restated Operating Agreement (the "Operating

¹ All facts stated herein are based on the allegations of the Amended Complaint, even when Defendants may foreseeably contest those allegations. Defendants reserve all rights, claims and remedies and do not concede the accuracy or completeness of the Amended Complaint's factual allegations.

Agreement”), which was attached to the Amended Complaint as Exhibit A.² CNC’s members - which have included Plaintiff, CSCI and CHCI - hold varying amounts of interest in CNC. Plaintiff held a 2.3788% interest in CNC as of June 28, 2001 due to its capital contributions. CSCI was the initial Manager of CNC and CHCI is the current Manager of CNC.

Plaintiff has brought the following claims against Defendants: (1) declaratory judgment; (2) accounting and inspection of corporate records; (3) derivative and individual action for breach of fiduciary duty, duty of good faith and duty of loyalty and due care; and (4) dissolution and frustration of minority shareholder expectations. All of these claims should be dismissed.

ARGUMENT

Under North Carolina Rule 12(b)(6), a case should be dismissed if the plaintiff’s complaint fails to state a claim upon which relief can be granted. N.C. R. Civ. P. 12(b)(6). A complaint fails under a 12(b)(6) motion if: (1) the complaint on its face reveals that no law supports the plaintiff’s claim; (2) the complaint on its face reveals the absence of facts sufficient to make a good claim; or (3) the complaint discloses some fact that necessarily defeats the plaintiff’s claim. *Harrold v. Dowd*, 149 N.C. App. 777, 780, 561 S.E.2d 914, 916 (2002).

I. Defendants CSCI and CHCI have Limited Liability.

Plaintiff has commenced litigation not only against CNC, but also against CSCI and CHCI. As members and managers of a limited liability company, CSCI and CHCI are insulated from a suit against them individually when a suit is brought against CNC.

² In deciding a Rule 12(b)(6) Motion, the Court may review and consider the contents of any attached exhibit, as well as any other documents specifically identified in the complaint. *Robertson v. Boyd*, 88 N.C. App. 437, 441, 363 S.E.2d 672, 675 (1988).

Plaintiff has not identified any specific or particular act by CSCI or CHCI that was outside of their capacities as members and/or managers of CNC.

Under North Carolina law, a member or a manager (or both) of a limited liability company enjoys immunity for actions undertaken on behalf of the limited liability company. N.C. Gen. Stat. § 57C-3-30(a). Without an agreement to the contrary, member-managers are shielded from liability when acting for the LLC. *Hamby v. Profile Products, LLC*, 361 N.C. 630, 638, 652 S.E.2d 231, 236 (2007). This shield is also created by the Business Judgment Rule which recognizes that business decisions are best left in the hands of the managers of the business and limits the court's interference with the business. *Hammonds v. Lumbee River Elec. Membership Corp.*, 178 N.C. App. 1, 20-21, 631 S.E.2d 1, 13-14 (2006). The managers of North Carolina limited liability companies, such as CSCI and CHCI in this case, are entitled to the protections of the Business Judgment Rule. See *Wachovia Capital Partners LLC v. Frank Harvey Investment Family Limited P'ship*, 2007 NCBC 7, 2007 WL 2570838 (N.C. Super. 2007) (applying business judgment rule to acts of a Delaware LLC).

Additionally, limited liability companies are primarily creatures of contract and an LLC's operating agreement can give it additional or different rules than the default rules in the LLC statute, Chapter 57C. *Id.* at 636, 652 S.E.2d at 235. In this case, CNC's Operating Agreement sets forth the following provisions regarding the potential liability of its members, including CSCI and CHCI:

6.2(a) Except as provided in this Section and/or in Sections 6.2(b) and (c) below, no Member shall have any personal liability whatever in his capacity as a Member, whether to the Company, to any of the Members or to the creditors of the Company, for the debts, liabilities, contracts, or any other obligations of the Company or for any losses of the Company.

6.2(d) Neither the Manager nor any of its Affiliates shall have any personal liability for the return or repayment of the Capital Contribution of any Member.

7.11(c) The Manager and its Affiliates, as well as their respective directors, officers, shareholders, partners, members, employees or agents shall not be liable, responsible or accountable in damages or otherwise to the Company or any of the Members for any act or omission performed or omitted by it in good faith on behalf of the Company and in a manner reasonably believed by it to be within the scope of the authority granted to it by this Agreement and in the best interests of the Company. For purposes of this Section, any action or omission taken on advice of counsel for the Company or the certified public accountants for the Company shall be deemed to have been taken in good faith. Except as may otherwise 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. The Manager and its Affiliates, as well as their respective directors, officers, shareholders, partners, members, employees or agents shall be entitled to indemnification from the Company for any loss, damage, or claim (including any attorney's fees incurred by the Manager or its Affiliates, as well as their respective directors, officers, shareholders, partners, members, employees or agents, in connection therewith which shall be advanced by the Company) due to any act or omission made by it in good faith on behalf of the Company and in a manner reasonably believed by it to be within the scope of the authority conferred on it by this Agreement and in the best interests of the Company; *provided*, that any indemnity will be paid out of, and to the extent of, Company Assets only, and no Member will have any personal liability on account thereof.

The Amended Complaint fails to allege legally sufficient reasons for its naming of CSCI and CHCI as defendants in this matter. Plaintiff failed to allege any conduct beyond the protections afforded by the Business Judgment Rule. Further, Plaintiff has not alleged that any specific or particular act or omission attributable to CSCI or CHCI was taken in bad faith. Therefore, under the provisions of the statute, North Carolina case law and the Operating Agreement, CSCI and CHCI cannot be liable in this matter. Therefore, all claims should be dismissed as to CSCI and CHCI.

II. Plaintiff's First Claim (Declaratory Judgment) Should be Dismissed as there is no Controversy, as contemplated by N.C. Gen. Stat. § 1-253.

Plaintiff's first claim for a declaratory judgment should be dismissed as no genuine, actual and existing controversy exists as to the rights of each of the parties to enable Plaintiff to seek or obtain a Declaratory Judgment from this Court under the applicable statutes and common law. Due to Plaintiff's failure to demonstrate compliance with notice, demand and frustration necessary to state a legally cognizable derivative claim against any Defendant, the Court should not infer that such claims are justiciable at this time. Therefore, Plaintiff has failed to show any controversy exists. Furthermore, Plaintiff's declaratory judgment claim is not viable and should be dismissed pursuant to sections 6.2(a) and 7.11(c) the Operating Agreement, as discussed and quoted *supra*.

III. Plaintiff's Second and Third Claims for Relief Should be Dismissed as They are Brought Under North Carolina Business Corporations Act.

Plaintiff's second and third cause of action must be dismissed as, on its face, the Amended Complaint reveals that no law supports the Plaintiff's claims and the Amended Complaint has disclosed some fact that necessarily defeats Plaintiff's claims.

Plaintiff's second claim for relief is accounting and inspection of *corporate* records pursuant to N.C. Gen. Stat. § 55-16-02. (Am. Compl. ¶¶ 38-41) Paragraph 39 of the Amended Complaint specifically requests access to all corporate records and an accurate accounting of corporate revenues, income, debt, obligations, liabilities, distributions, and assets. (Am. Compl. ¶ 39) However, CNC is a limited liability company, not a corporation. (Am. Compl. ¶ 2) Limited liability companies are controlled by Chapter 57C of the North Carolina General Statutes. N.C. Gen. Stat. § 57C-1-01, *et*

seq. Therefore, Plaintiff's second claim for relief must be dismissed to the extent it is brought under the North Carolina Business Corporations Act.

Plaintiff's Amended Complaint has added that the second claim for relief is also brought pursuant to N.C. Gen. Stat. § 57C-3-04. While this statute provides that a member may demand "[i]nformation regarding the status of the business and the financial condition of the limited liability company," the act does not allow members to have access to *all* corporate records, corporate revenues, income, debt, obligations, liabilities, distributions, and assets. N.C. Gen. Stat. § 57C-3-04(a)(1). Further, the act specifically provides that "managers shall have the right to keep confidential from members who are not managers ... information the disclosure of which the managers in good faith believe is not in the best interest of the limited liability company." N.C. Gen. Stat. § 57C-3-04(e). Therefore, Plaintiff's second claim for relief must be dismissed as Plaintiff's are not entitled to the information they are requesting.

Similarly, Plaintiff's third claim for relief, breach of fiduciary duty, duty of good faith, duty of loyalty and due care, is brought under Chapter 55 of the North Carolina General Statutes which governs corporations, not limited liability companies. Specifically, Plaintiff cites §§ 55-8-30(a) and 55-8-42(a) in support of its third claim for relief. To the extent Plaintiff's claim is based on duties owed by a corporation and its controlling members to minority shareholders, Plaintiff's third claim for relief fails to state a claim upon which relief can be granted.

IV. Plaintiff's Complaint and Claims Three and Four Fail to Comply with N.C. Gen. Stat. § 57C-8-01 and are Not Permitted Under the Operating Agreement.

Although it is unclear, in Plaintiff's claims for relief three and four, Plaintiff seems to be filing a members' derivative action for its claims of breach of certain duties and dissolution/frustration of minority shareholder expectations. A members' derivative action can only be filed pursuant to N.C. Gen. Stat. § 57C-8-01. Plaintiff has failed to meet the requirements of a members' derivative action.

First, Plaintiff has failed to state or show that it meets the conditions of N.C. Gen. Stat. § 57C-8-01(a) which requires a showing that Plaintiff does not have the authority to cause the limited liability company to sue in its own right. N.C. Gen. Stat. § 57C-8-01(a). In its Amended Complaint, Plaintiff has added a mere sentence alleging that Mooring "does not have the authority to cause CNC to sue in its own right given its minority membership." (Am. Compl. ¶43) This lone allegation is not a "showing" as required by N.C. Gen. Stat. § 57C-8-01(a). Secondly, the Amended Complaint fails to allege with particularity the efforts made by Plaintiff 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 as required by N.C. Gen. Stat. § 57C-8-01(b). N.C. Gen. Stat. § 57C-8-01(b). Third, the Amended Complaint fails to plead facts sufficient to overcome the presumption given by the Business Judgment Rule that Defendants' actions were valid. *Winters v. First Union Corp.*, 2001 NCBC 8, ¶ 17, 2001 WL 34000144 (N.C. Super. 2001). Fourth, it is unclear why a derivative action is being pursued in this matter. Finally, as explained above, pursuant to sections 6.2(a) and 7.11(c) the Operating Agreement, Defendants CSCI and CHCI cannot be held

liable for a members' derivative action suit as they cannot be liable to any member or the company for their acts. (Operating Agreement, 6.2(a) and 7.11(c))

As Plaintiff's claims fail to meet the requirements of N.C. Gen. Stat. § 57C-8-01 and are excluded by the Operating Agreement, the claims fail to state a claim upon which relief can be granted and, therefore, the derivative action claims for breach of fiduciary duty, duty of good faith, and duty of loyalty and dissolution/frustration of minority shareholder expectations must be dismissed.

In the alternative, Defendants request that their motion for a more definite statement be granted as to Plaintiffs' claims purporting to be members' derivative actions in order for the claims to comply with the requirements of N.C. Gen. Stat. § 57C-8-01.

V. Plaintiff's Fourth Claim for Relief Regarding Dissolution Must Be Dismissed.

In Plaintiff's fourth claim for relief, Plaintiff requests the Court to order liquidation or dissolution of CNC. A limited liability company, as a creature of contract, is controlled by its operating agreement. *Hamby*, 361 N.C. at 636, 652 S.E.2d at 235.

As discussed above, the Operating Agreement provides that "no suit or other action brought by a Member against the Manger or the Company shall cause the termination or dissolution of the Company." (Operating Agreement, 7.11(c)) Therefore, Plaintiff's fourth claim for relief must be dismissed to the extent the claim requests dissolution of the CNC.

- VI. In the Alternative, if the Court Dismisses Fewer than All of the Claims Against Defendants, Plaintiff should be Ordered to Amend Its Remaining Claim(s) to Clarify the Allegations Against Each Defendant.

The Amended Complaint seems to seek duplicate relief from multiple defendants who are alleged to have or have had differing responsibilities to Plaintiff. Therefore, the claims are facially defective and unfairly prejudice each Defendant's ability to defend itself.

CONCLUSION

Under Rule 12(b)(6), Plaintiff's claims should be dismissed because the Amended Complaint fails to state a claim upon which relief can be granted. In the Alternative, if the Court dismisses fewer than all of the claims against Defendants, Plaintiff should be ordered to amend its remaining claim(s) to clarify the allegations against each Defendant. Defendants also respectfully request that the Court grant them any and all such other and further relief, both at law and in equity, to which they may show themselves to be justly entitled.

This the 2nd day of May, 2008.

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing BRIEF IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE AMENDED COMPLAINT OR, IN THE ALTERNATIVE, FOR A MORE DEFINITE STATEMENT, was served on all counsel of record by the Business Court's electronic filing system and by mailing a copy, first-class, postage prepaid, this the 2nd day of May, 2008.

This the 2nd day of May, 2008.

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