STATE OF NORTH CAROLINA

COUNTY OF WAKE

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
08-CVS-14393

LEE N. PALLES,
Plaintiff,

v.

HATTERAS INVESTMENT PARTNERS LLC, HATTERAS INVESTMENT MANAGEMENT LLC, HATTERAS CAPITAL DISTRIBUTORS, LLC, HATTERAS CAPITAL INVESTMENT MANAGEMENT, LLC, HATTERAS CAPITAL INVESTMENT PARTNERS, LLC, DAVID B. PERKINS, ROBERT LANCE BAKER, ROBERT L. WORTHINGTON, ROBERT B. BROWN, ANDREW CHICA, JAMES MICHAEL FIELDS, MICHAEL J. HUTTEN, NICOLE L. PARKER, AND MILLISSA S. ALLEN,

Defendants

DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS PURSUANT TO RULE 12(b)(6)

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Defendants Hatteras Investment Partners, LLC ("HIP"), Hatteras Investment Management, LLC ("HIM"), Hatteras Capital Distributors, LLC ("HCD"), Hatteras Capital Investment Management, LLC ("HCIM"), Hatteras Capital Investment Partners, LLC ("HCIP") (also referred to collectively as "Hatteras Companies"), David Perkins, Robert Baker, Robert Worthington, Robert Brown, Andrew Chica, James Michael Fields, Michael Hutten, Nicole Parker, and Millissa Allen, by and through their undersigned counsel, hereby file this Memorandum of Law in Support of Defendants' Motion to Dismiss the Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, Thirteenth, and Fourteenth Claims for Relief in the Complaint filed by Plaintiff, Lee Palles ("Lee Palles" or "Mr. Palles") pursuant to North Carolina Rule of Civil Procedure 12(b)(6).

I. INTRODUCTION

Lee Palles has taken a relatively straightforward dispute over his entitlements under a purported employment contract and his alleged rights to security interests in three of the Hatteras Companies and turned it into a fourteen-count, fourteen-defendant complaint alleging almost every business tort in the book: violation of the North Carolina Unfair and Deceptive Trade Practices Act, fraud, constructive fraud, negligent misrepresentation, and wrongful interference with contract. An examination of Plaintiff's Complaint reveals that many of his claims are not supported by the allegations of the Complaint and that others simply fail as a matter of law. Defendants now move for dismissal of these claims.

II. BACKGROUND

The following factual discussion is based on Mr. Palles' allegations as well as the terms of the various agreements to which he refers in his Complaint.[1] Mr. Palles' Complaint can be

[1] As they must, Defendants recite the background accepting Mr. Palles' allegations as true—except where allegations are clearly contradicted by the terms of the various relevant agreements. *Wachovia Capital Partners,*

dissected into two general topics: (1) allegations concerning contractual entitlements (specifically, unpaid salary and bonus) under his claimed employment agreement and (2) allegations that he is entitled to retain member interests in three of the five Hatteras Companies and associated rights.

A. Mr. Palles' Employment With Hatteras

From September 1, 2006 until February 6, 2008, Mr. Palles worked for Hatteras Investment Partners ("HIP") as its Chief Operating Officer pursuant to an employment agreement entered on June 21, 2006 and amended September 1, 2006 ("COO Agreement"). (Complaint at ¶¶ 22 & 31 & COO Agreement, Ex. A of Complaint). Under the COO Agreement, Mr. Palles' employment was terminable at-will by either party. (*See* COO Agreement at ¶ 8).

On February 6, 2006, HIP's Managing Member, David Perkins, informed Mr. Palles that HIP desired Mr. Palles to cease working as its COO and to begin working as the Managing Director for Hatteras's venture funds. (Complaint at ¶ 31). Negotiations ensued over the terms of Mr. Palles' employment in this new position. (Complaint at ¶¶ 31 & 32). In the first step of negotiations, Mr. Palles presented to Mr. Perkins a proposed amendment to the COO Agreement, which Mr. Perkins marked-up by hand and discussed with Mr. Palles during a subsequent meeting. (Complaint at ¶ 32 & Ex. C). Although Defendants deny it, Mr. Palles alleges that Mr. Perkins' handwritten notations constituted a counteroffer and that Mr. Palles accepted, at the meeting, all of Mr. Perkins' changes to the proposed amendment to the COO Agreement, including a provision that HIP would employ Mr. Palles for a three-year term. (Complaint at ¶ 32). At the conclusion of this meeting, Mr. Perkins informed Mr. Palles that he would be

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LLC v. Frank Harvey Inv. Family Ltd. Partnership, No. 05 CVS 20568, 2007 WL 2570838, at *3 (N.C. Super. Mar. 5, 2007).

sending him a new employment agreement that reflected the purportedly agreed upon proposed amendment to the COO Agreement ("New Draft Employment Agreement"). On February 15, 2008, Mr. Perkins provided to Mr. Palles the New Draft Employment Agreement, which contained a one-year rather than three-year employment term. (Complaint at ¶ 34).

Mr. Palles claims he did not agree with or accept the one-year term. (Complaint at ¶ 34). Nevertheless, Mr. Palles continued working in his new position and was paid a salary for doing so. (Complaint at ¶ 33).

On March 15, 2008, Mr. Perkins informed Mr. Palles that HIP had decided to end their employment relationship. (Complaint at ¶ 35). Mr. Perkins also told Mr. Palles that Mr. Palles' membership interests in various Hatteras Companies would be redeemed. (Complaint at ¶ 35).

Mr. Palles now claims that the termination of his employment breached the New Draft Employment Agreement and that Defendants must pay him (a) for the remainder of the alleged three-year term (Complaint at ¶¶ 46-50) and (b) bonuses for his 2007 and 2008 employment under the COO Agreement and other documents, to the extent unpaid (Complaint at ¶¶ 51-55).

B. Mr. Palles' Alleged Security Interest in the Five Hatteras Companies

Mr. Palles claims entitlement to equity interests in the Hatteras Companies and certain rights by virtue of purportedly being a member of each. At the heart of each of his security-interest related claims is his contention that the Hatteras Companies' redemption of his interests was unlawful and should be reversed. The background and Operating Agreements pertaining to each of these interests are addressed separately below.

1. Hatteras Capital Distributors ("HCD")

In January 4, 2007, Hatteras formed HCD to act as a broker-dealer to a new Hatteras venture fund called Hatteras Late Stage VC Fund ("LSVC"). (Complaint at ¶ 25). Mr. Palles

contributed $1,000 as an initial capital contribution and received 100 out of the 2100 units that were issued at the time (4.74%). (*Id.*).

On July 1, 2008, by majority approval, the HCD Operating Agreement was amended to provide that the Managing Member "may redeem the interest of any Member … at any time, for any or no reason, at a price equal to the fair value of the interest, by giving written notice to the Member stating the date of redemption." (Complaint at Ex. F).[2] As HCD's Managing Member, Mr. Perkins elected to redeem Mr. Palles' interest in HCD effective July 10, 2008 and notified Mr. Palles of the decision. (Complaint at ¶ 44; Ex. G). HCD is in the process of obtaining the fair value of Mr. Palles' HCD interests so that it can pay Plaintiff for the full value of his interests. (Complaint at Ex. G).

Mr. Palles now contends in the Complaint that Mr. Perkins had no right to amend the HCD Operating Agreement; that HCD may not redeem his units in exchange for their fair value; that, notwithstanding the fact that additional capital has been contributed to HCD, he is entitled to retain a 4.74% interest in HCD in perpetuity; and that the individual Defendants may not be added as HCD members without Plaintiff's consent and approval. (Complaint at ¶ 60). Plaintiff also demands the right to inspect HCD's books. (*Id.* at ¶ 65).

2. Hatteras Capital Investment Partners ("HCIP") and Hatteras Capital Investment Management ("HCIM")

HCIP and HCIM are the Hatteras entities established to act as the general partner and investment manager, respectively, of the newly formed LSVC Fund. (Complaint at ¶ 26; Ex. B). Mr. Palles did not invest any money in these companies to receive his HCIP and HCIM interests. Mr. Perkins is the majority interest holder and is one of two Managing Members, along with

[2] The HCIP and HCIM operating agreements (attached below) already provided similar discretionary authority to the managing members to redeem membership interests.

Robert Worthington, of HCIP and HCIM. (HCIP/HCIM Operating Agreements, § 1.05, Exs. A & B respectively).

Under the HCIP and HCIM Operating Agreements, the Managing Members are vested with "full control" of the business affairs of the Company and "the authority on behalf of and in the name of the Company to take any action or make any decisions on behalf of the Company…." (HCIP/HCIM Operating Agreements, §§ 2.01 and 2.02). Further, the HCIM/HCIP Operating Agreements vest the Managing Members with "*complete discretion* to require the full or partial withdrawal of any Member …." (HCIP/HCIM Operating Agreements, § 4.03)(emphasis added).

Notwithstanding this language, Mr. Palles alleges that the decision of the HCIP and HCIM Managing Members to redeem Mr. Palles' interests in HCIP and HCIM constituted a breach of the Operating Agreements, and he asks the Court to allow him to retain such interests. (Complaint at ¶ 69).[3] He also demands the right to inspect HCIP's and HCIM's books. (*Id.* at ¶ 74).

3. Hatteras Investment Partners ("HIP") and Hatteras Investment Management ("HIM")

HIM is the general partner of the Hatteras Master Fund. (Complaint at ¶ 19). HIP is the investment manager of the Master Fund and provides the Master Fund with day-to-day investment management services. (Complaint at ¶ 20).

Mr. Palles alleges in the Complaint that he is entitled, by virtue of his HIP and HIM membership interests, to continue receiving various payments that are pegged to operating and profitability benchmarks of HIM and HIP. (Complaint at ¶ 23). The Complaint does not allege

[3] The Court will note that neither the HCIP nor the HCIM Operating Agreement is signed by Mr. Palles. Defendants have not been able to locate any version signed by Mr. Palles. For purposes of this Motion, Defendants will not contest Mr. Palles' status as an interest holder in those companies.

or otherwise suggest that either HIM or HIP is in breach of whatever payment obligations it owes to Mr. Palles.

III. STANDARD OF REVIEW

Motions brought under Rule 12(b)(6) "'test[] the legal sufficiency of the pleading against which it is directed.'" *Hudson-Cole Dev. Corp. v. Beemer*, 132 N.C. App. 341, 345-46, 511 S.E.2d 309, 312 (N.C. App. 1999) (citing *Derwort v. Polk County*, 129 N.C. App. 789, 791, 501 S.E.2d 379, 380-81 (1998)). "'When the factual allegations of a complaint fail as a matter of law to state the substantive elements of some legally recognized claim,' a Rule 12(b)(6) motion is properly allowed." *Id.* "In deciding a motion to dismiss under Rule 12(b)(6), the trial court must accept the allegations of the complaint as true." *Id.* (citing *Miller v. Henderson*, 71 N.C. App. 366, 322 S.E.2d 594 (1984)).

The Court may consider documents the moving party attaches to a 12(b)(6) motion that are the subject of the challenged pleading and specifically referred to in that pleading, even though they are presented to the Court by the moving party. *Oberlin Capital, L.P. v. Slavin*, 147 N.C. App. 52, 60, 554 S.E.2d 840, 847 (2001). Further, "the court is not required to accept as true any conclusions of law or unwarranted deductions of fact," *Oberlin Capital, L.P.*, 147 N.C. App. at 56, 554 S.E.2d at 844, and thus "can reject allegations that are contradicted by the supplementary documents presented to it," *See East Shore Mkts., Inc. v. J.D. Assocs. Ltd. P'ship*, 213 F.3d 175, 180 (4th Cir. 2000).

IV. LEGAL DISCUSSION

Defendants seek dismissal of Claims Six, Seven, Eight, Nine, Ten, Eleven, Thirteen, and Fourteen of Mr. Palles' Complaint. This motion is supported on several grounds. First, because Mr. Palles' claims constitute a dispute over (a) his entitlement, or not, to additional employee

compensation and (b) the extent of his interest in Hatteras securities, the Unfair and Deceptive Trade Practices Act ("UDTPA") does not apply. Second, there is no basis for naming Mr. Perkins individually as a Defendant in the Complaint inasmuch as all of his alleged acts were done in his capacity as the Managing Member of various Hatteras companies. Third, the contractual nature of Mr. Palles' claims forecloses him from transforming his contractual claims into ones that sound in tort. Fourth, the torts set forth in Mr. Palles' Complaint are all either improper as a matter of law or insufficiently alleged. Fifth, Mr. Palles' claim against Mr. Perkins for wrongful interference with contract fails as a matter of law because Mr. Perkins was acting solely in his capacity as an agent for Hatteras when he terminated Mr. Palles' contracts. Sixth, because Mr. Palles' fraud-based claims fail as a matter of law, his claim for punitive damages must also fail. Finally, Mr. Palles' claim that HCIP and HCIM breached a contractual obligation to him is contrary to the terms of the Operating Agreements on which that claim is based. Each of these arguments is set forth in detail below.

A. The Unfair and Deceptive Trade Practices Act Does Not Extend to the Employment and Securities-Related Claims of the Kind Plaintiff Raises.

With his Thirteenth Claim for Relief, Plaintiff alleges that the conduct of the Hatteras Companies and Mr. Perkins violated the Unfair and Deceptive Trade Practices Act ("UDTPA"). The UDTPA, which was designed to protect consumers,[4] provides that "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful." N.C.G.S. § 75-1.1(a).

[4] *See Bhatti v. Buckland*, 328 N.C. 240, 245, 400 S.E.2d 440, 443-44 (1991) ("[t]he purpose of G.S. 75-1.1 is to provide a civil means to maintain ethical standards of dealings between persons engaged in business and the consuming public in this State"); *Schlieper v. Johnson*, 2007 NCBC 29, ¶43, 2007 WL 2580120, *8 (N.C. Super. August 31, 2007) (citing, *inter alia*, *Lindner v. Durham Hosiery Mills, Inc.*, 761 F.2d 162, 165 (4th Cir. 1985)).

To survive a motion under Rule 12(b)(6) with respect to a UDTPA claim, a plaintiff must allege (1) the defendant committed an unfair or deceptive act or practice, (2) the action in question was "in or affecting commerce," and (3) the act proximately caused injury to the plaintiff. *See Pleasant Valley Promenade v. Lechmere, Inc.*, 120 N.C. App. 650, 464 S.E.2d 47 (1995). "The UDTPA does not govern 'all wrongs;' accordingly, [a] plaintiff[]must 'first establish that defendants' conduct was 'in or affecting commerce before the question of unfairness or deception arises.'" *Sterner v. Penn*, 159 N.C. App. 626, 633, 583 S.E.2d 670, 675 (2003) (quoting *HAJMM Co. v. House of Raeford Farms, Inc.*, 328 N.C. 578, 592-93, 403 S.E.2d 483, 492 (1991)). "Whether an act is 'in or affecting commerce' is a question of law for the Court to decide." *Schlieper v. Johnson*, 2007 NCBC 29, ¶43, 2007 WL 2580120, *8 (N.C. Super. August 31, 2007) (citation omitted). "If the complaint does not allege acts in or affecting commerce, a plaintiff cannot establish a prima facie claim and dismissal under Rule 12(b)(6) is appropriate." *Id.* (citation omitted).

North Carolina courts have interpreted the "in or affecting commerce" requirement to dictate dismissal of most internal disputes on a Rule 12(b)(6) motion as outside the scope of the UDTPA. This includes disputes over an individual's rights with respect to securities. *See Sterner*, 159 N.C. App. at 633 ("[O]ur Supreme Court has explicitly held that 'securities transactions are beyond the scope' of the UDTPA") (quoting *Skinner v. E.F. Hutton & Co.*, 314 N.C. 267, 275, 333 S.E.2d 236, 241 (1985); *Garlock v. Hilliard*, 2000 NCBC 11, ¶24, 2000 WL 3394616, *5 (N.C. Super. August 22, 2000) ("The North Carolina courts have consistently held that the provisions of the UDTPA do not apply to securities transactions") (citations omitted).

For example, in *HAJMM v. House of Raeford Farms*, a case similar to the case at bar, the *HAJMM* plaintiff was entitled to, and had demanded, payment on a revolving fund certificate,

but the defendant refused, allegedly because he believed that it "wasn't good business" to make payment. *HAJMM*, 328 N.C. at 582, 403 S.E.2d at 486. According to the plaintiff, the defendant also conceded that he "might never pay the certificate," even though defendant had sufficient cash on hand to do so and had purchased a jet airplane and made a personal loan, each of which separately exceeded the retirement cost of the certificate. *Id.*

The trial court in *HAJMM* dismissed the plaintiff's UDTPA claim under Rule 12(b)(6), and the Supreme Court affirmed. Citing its decision in *Skinner v. E.F. Hutton & Co.*, the Court reiterated that "securities transactions are beyond the scope of N.C.G.S. § 75-1.1" because securities are "pervasively regulated by state and federal statutes and agencies" and because the North Carolina "legislature simply did not intend for the trade, issuance and redemption of corporate securities or similar financial instruments to be transactions 'in or affecting commerce' as those terms are used in [the UDTPA]." *HAJMM*, 328 N.C. at 593-94, 403 S.E.2d at 492-93; *see also Oberlin Capital*, 147 N.C. App. at 62, 554 S.E.2d at 848 (trial court's Rule 12(b)(6) dismissal of the plaintiff's UDTPA claim affirmed where plaintiff alleged fraudulent concealment of a critical fact because "[c]apital-raising devices, like corporate securities …, are not 'in or affecting commerce' and are not subject to [the UDTPA]"); *Garlock*, 2000 NCBC at ¶24, 2000, WL 33914616 at *5 (granting defendant's 12(b)(6) Motion and dismissing UDTPA because the allegations involved a dispute over a securities transaction); *City Nat'l Bank v. American Commonwealth Financial Corp*, 801 F.2d 714, 718-19 (4th Cir. 1986) (affirming dismissal of UDTPA claim where plaintiff alleged fraud and breach of fiduciary duty with regard to securities).

Likewise, the UDTPA does not apply to employer-employee disputes concerning the circumstances of the employee's separation or claims of unpaid wages or other compensation.

Accordingly, North Carolina courts have frequently dismissed such claims at the motion to dismiss stage. *See Liggett Group v. Sunas*, 113 N.C. App. 19, 31, 437 S.E.2d 674, 682 (1993); *see also Anderson v. Sara Lee Corp.*, 508 F.3d 181, 190 (4th Cir. 2007) (affirming trial court's dismissal of UDPTA claim on Rule 12(b)(6) motion because "the Supreme Court of North Carolina has not recognized [a] cause[] of action for … unfair trade practices in employer-employee disputes . . . ."); *Buie v. Daniel Int'l Corp.*, 56 N.C. App. 445, 448, 289 S.E.2d 118, 119-20 (1982) (affirming dismissal of UDPTA claim based on the court's finding "that employer-employee relationships do not fall within the intended scope of G.S. 75-1.1"); *Schlieper*, 2007 NCBC at ¶49, 2007 WL 2580120, *10 (granting Rule 12(b)(6) motion on UDTPA claim because the complaint alleged an employment-related dispute over compensation based on documents governing terms of employment); *Freeman v. Duke Power Co.*, Nos. 03-2146, 03-2147, 114 Fed. Appx. 526, 2204 WL 2151269, *21-23 (4th Cir. September 27, 2004) (unpublished opinion), *cert. denied* 544 U.S. 968 (2005) (affirming Rule 12(b)(6) dismissal of UDTPA claim based on the termination of plaintiff's employment).

For example, in *Brandis v. Lightmotive Fatman, Inc.*, 115 N.C. App. 59, 443 S.E.2d 887 (1994), the plaintiff alleged that the defendant promised him employment in a particular position, for a particular duration and at a particular rate, but that he was not permitted to complete the agreed upon employment. *Id.* at 67, 443 S.E.2d at 891. The Court of Appeals affirmed the 12(b)(6) dismissal of the plaintiff's UDPTA claim because "[o]ur Supreme Court has expressly stated that the [UDTPA] 'does not cover employer-employee relations.'" *Id.* (citing *HAJMM*, 328 N.C. at 593, 403 S.E.2d at 492).

Here, Plaintiff makes two relatively straightforward claims: (a) that he has been denied rights to which he claims to be entitled as a holder of Hatteras company securities, including the

right to continue to hold certain securities, and (b) that the Defendants have breached certain alleged employment contract obligations and failed to pay him compensation that he is owed (*i.e.*, bonuses and continued compensation under a purported three-year term agreement). Both claims fall squarely within two areas that the North Carolina courts, including the Supreme Court, have repeatedly held to be outside the scope of the UDTPA. Accordingly, Defendants respectfully submit that the Court should dismiss Claim Thirteen of the Complaint.

B. Claims Eight, Nine, Ten, Eleven, Thirteen and Fourteen of Plaintiff's Complaint Directed at Mr. Perkins Should Be Dismissed Because the Law Does Not Permit the Naming of an LLC Member as an Individual Defendant Under the Circumstances Presented.

The law does not support Mr. Palles' attempt to hold Mr. Perkins individually liable for the acts alleged in the Complaint, all of which are alleged to have been done in Mr. Perkins' capacity as the Managing Member of the various Hatteras limited liability companies. According to the North Carolina Supreme Court, both the Delaware[5] and North Carolina LLC Acts shield from liability LLC managers acting in their managerial capacity. *Hamby v. Profile Products, L.L.C.* 361 N.C. 630, 638, 652 S.E.2d 231, 236 (2007). Further, "when a member-manager acts in its managerial capacity, it acts for the LLC, and obligations incurred while acting in that capacity are those of the LLC. Accordingly, when a member-manager is managing the LLC's business, its liability is inseparable from that of the LLC." *Id.* Thus, in both Delaware and North Carolina, a managing member is not a proper party to proceedings against a limited liability company without some allegation that the managing member acted outside of his role in managing the company's affairs. *See Page v. Roscoe, LLC*, 128 N.C. App. 678, 687, 497 S.E.2d 422, 428 (1998) (holding that naming of individual LLC member "was not well-grounded in law

[5] All but one of the relevant Hatteras company operating agreements provide that Delaware law applies in interpreting them. The exception is the HCD Operating Agreement, which calls for North Carolina law. For purposes of this motion, the law is substantively identical.

and therefore a violation of Rule 11."); *see also Spaulding v. Honeywell, Int'l, Inc.*, 184 N.C. App. 317, 322, 646 S.E. 2d 645, 649 (2007) (holding managing member not proper party absent allegations of "'acts on the part of the member individually, which are not related to his status as a member of a North Carolina limited liability company.'") (quoting *Page*, 128 N.C. App. At 686-88, 497 S.E.2d at 428).

In this case, all of Mr. Palles' allegations against Mr. Perkins are a restatement of the allegations that make up his claims against HIP, HIM, HCD, HCIP, and HCIM (Claims One through Seven). There are no original allegations directed against Mr. Perkins personally. That is, Mr. Palles alleges he had an employment contract that he negotiated with HIP; that Mr. Perkins negotiated the contract on behalf of HIP and bound that company by virtue of his authority as Managing Member, and that Mr. Perkins, in the course of acting on behalf of HIP in terminating Plaintiff's employment, breached Plaintiff's contract and improperly stripped Mr. Palles of his interest in the Hatteras Companies. (*See* Complaint ¶¶ 29-32 & 34-36). Nowhere does Mr. Palles allege an act or omission by Mr. Perkins that is separate from Mr. Perkins' role as Managing Member of any of the Hatteras Companies. All claims against Mr. Perkins must, therefore, be dismissed. *See Hamby*, 361 N.C. at 638, 652 S.E.2d at 236 ("[W]hen a member-manager acts in its managerial capacity, it acts for the LLC, and obligations incurred while acting in that capacity are those of the LLC. Accordingly, when a member-manager is managing the LLC's business, its liability is inseparable from that of the LLC.").

C. Plaintiff's Tort Claims Should Be Dismissed Because They Are Based Solely on Allegedly Broken Contractual Promises.

Even the most favorable reading of Mr. Palles' complaint reveals only the claim that Hatteras, acting through Mr. Perkins, breached its contractual obligations to Mr. Palles. North Carolina law does not permit actions sounding in tort that are based on a mere unfulfilled contractual promise. *Food Lion, LLC v. Schuster Mktg Corp.*, 382 F. Supp. 2d 793, 799 (E.D.N.C. 2005) (citing *Strum v. Exxon Co.*, 15 F.3d 327, 330 (4th Cir. 1994) (applying North Carolina law)). Rather, to be actionable, the alleged tort must be independent from the plain breach of contract. *Id.* at 330-31. That is, the conduct underlying the alleged tort must be separately "identifiable" from the conduct making up the alleged breach of contract. *Id.* (citing *Newton v. Standard Fire Ins. Co.*, 291 N.C. 105, 229 S.E.2d 297, 301 (1976)).

In this case, Mr. Palles' claims of breach of contract are indistinguishable from his tort claims. He alleges that Hatteras had committed in contract to permit him to retain certain securities and provide certain employment-related compensation and that Hatteras has not lived up to those obligations. Mr. Palles does not allege that Hatteras or Mr. Perkins have made any representations independent of these contractual promises and does not allege any breach of duty beyond the alleged breach of contractual obligations and purported breach of fiduciary duty—both of which are based on the same operative facts. He, therefore, cannot proceed on his tort claims of fraud, constructive fraud, or negligent misrepresentation. *See Strum*, 15 F.3d at 329 ("This attempt to turn a contract dispute into a tort action with an accompanying punitive dimension is inconsistent both with North Carolina law and sound commercial practice.").

D. Plaintiff's Claims of Fraud, Constructive Fraud, Negligent Misrepresentation, and Wrongful Interference with Contract Should be Dismissed Because Plaintiff Has Failed Adequately to Plead These Claims

In addition to being indistinguishable from his contract claims and involving conduct within the scope of Mr. Perkins' employment (and hence subject to dismissal on those bases), Mr. Palles' purported allegations against Mr. Perkins of fraud, constructive fraud, negligent misrepresentation, and wrongful interference with contract are insufficient as a matter of law. Each claim is addressed below.

1. Fraud

Plaintiff's purported fraud claim fails as a matter of law. The elements of a claim of fraud are (1) a materially false representation or concealment of fact, (2) reasonably calculated to deceive, (3) made with intent to deceive, (4) which does in fact deceive, (5) resulting in damage to the plaintiff. *Myers & Chapman, Inc. v. Thomas G. Evans, Inc.*, 323 N.C. 559, 568, 374 S.E.2d 385, 391 (N.C. 1988) These elements must be pled with particularity. *See* N.C. Gen. Stat. § 1A-1, Rule 9(b) (1990) ("In all averments of fraud ... the circumstances constituting fraud ... shall be stated with particularity."); *Sharp v. Teague*, 113 N.C. App. 589, 597, 439 S.E.2d 792, 797 (1994) ("Material facts and circumstances constituting fraud must be plead in a complaint with particularity."). Thus, a plaintiff alleging fraud must set forth, at a minimum, "the time, place and contents of the fraudulent representation, the identity of the person making the representation and what was obtained by the fraudulent acts or representations." *Terry v. Terry*, 302 N.C. 77, 85, 273 S.E.2d 674, 678 (1981). Particularity cannot be achieved through "[m]ere generalities and conclusory allegations of fraud." *Moore v. Wachovia Bank & Trust Co.*, 30 N.C. App. 390, 391, 226 S.E.2d 833, 835 (1976); *accord Sharp*, 113 N.C. App. at 597, 439 S.E.2d at 797.

Further, a claim of fraud cannot be based on a mere broken promise or statement of future intent. *See Strum*, 15 F.3d at 331 ("The mere failure to carry out a promise in contract, however, does not support a tort action for fraud.") (citing *Hoyle v. Bagby,* 253 N.C. 778, 117 S.E.2d 760, 762 (1961); *Britt v. Britt*, 320 N.C. 573, 579-80, 359 S.E.2d 467, 471 (1987) *overruled on other grounds by Myers*, 323 N.C. at 567-68, 374 S.E.2d at 391-92 ("Mere proof of nonperformance is not sufficient to establish the necessary fraudulent intent"); *Braun v. Glade Valley Sch., Inc.*, 77 N.C. App. 83, 87, 334 S.E.2d 404, 407 (1985) (holding that breaching a promise to hire teacher for the upcoming year did not constitute fraud because "fraud cannot be based on an allegation of a promise of future intent"). Rather, fraud must be based on a statement of present or pre-existing fact that was made with knowledge of its falsity and with an intent to deceive. *Brandis*, 115 N.C. App. at 66, 443 S.E.2d at 891 (1994). Only when an unfulfilled promise is alleged to have been made with no present intention of carrying it out can that unfulfilled promise be actionable as fraud. *Id.*

Palles' complaint falls well-short of meeting these pleading requirements. His allegations are set forth in paragraphs 82 through 85 of the Complaint and are largely conclusory:

> 82. Perkins made false representations to Palles, which were materials and false at the time they were made, specifically that Palles was going to continue to own membership interests in HCD, HCIM and HCIP as set forth in their respective operating agreements. These representations were made with actual knowledge of their falsity or with reckless indifference as to their veracity or falsity.
>
> 83. Perkins made these material and false representation with the intent to deceive Palles and to deliberately deprive Palles of property rights and interests to which Pales was lawfully entitled.
>
> 84. Palles relied on these false representations to his detriment, and such reliance was reasonable because, *inter alia*, Perkins controlled all Hatteras companies and had heretofore given Palles no indication that Perkins was planning to wrongfully seek to deprive

> Palles of Palles' right to continuing interests in these Hatteras companies.
>
> 85. As a direct and proximate result of the Perkins' fraud and intentional misrepresentations, Pales has been damaged in an amount in excess of $10,000.00 to be proven at a trial or hearing of this matter.

These allegations identify only a broken promise by Perkins—"that Palles was going to continue to own membership interests in HCD, HCIM, and HCIP as set forth in their respective operating agreements." Such broken promises are not actionable in a claim for fraud, as they are not false statements of material fact. *See Strum*, 15 F.3d at 329. The lack of an actionable false statement notwithstanding, the Complaint also fails to allege any specific facts with respect to the other key elements of fraud: (1) when Perkins made the alleged statement, (2) where he made the statement, and (3) how Mr. Palles acted in reliance on this alleged statement.

Although each failure of pleading provides independent support for dismissal, the most glaring pleading deficiency is Mr. Palles' failure to allege that he changed position in reliance on Mr. Perkins' alleged promise. As stated by the North Carolina Supreme Court, "[t]he gravamen of a claim for fraud is the damage to a person for a change in position based on the reliance on a false statement. The damage is caused by this change of position and not the lost bargain." *Britt*, 320 N.C. at 580-581, 359 S.E.2d at 472. This reliance element requires that the "plaintiff acted or refrained from acting in a certain manner due to defendant's representations." *Pleasant Valley Promenade*, 120 N.C. App. at 663, 464 S.E.2d at 57.

Mr. Palles does not allege that he took any action in reliance on Mr. Perkins' alleged promise. Instead, he worked, and was paid for working, in the new position of Managing Director until terminated. *See Britt*, 320 N.C. at 580, 359 S.E.2d at 471 ("[Plaintiff] cannot say she was injured by relying on a promise to her which caused her to continue working on the farm

when she received compensation to which she had agreed for the employment."). Mr. Palles' failure to plead the facts and circumstances constituting his alleged reliance is a fundamental flaw and requires dismissal. *Perry v. Carolina Builders Corp.*, 128 N.C. App. 143, 150, 493 S.E.2d 814, 818 (1997) (affirming trial court's dismissal of fraud claim where "[p]laintiffs' third claim alleged CBC engaged in fraudulent misrepresentation, but included no allegation of plaintiffs' reasonable reliance thereon.") (citing *inter alia Odom v. Little Rock & I-85 Corp.*, 299 N.C. 86, 91-92, 261 S.E.2d 99, 103 (1980) (fraud claim must allege certain essential elements including "that the plaintiff reasonably relied upon the representation and acted upon it")).

2. Constructive Fraud

Mr. Palles' constructive fraud claim also fails for lack of particularity and otherwise insufficient pleading. Constructive fraud encompasses a situation where there was no specific misrepresentation but rather the defendant used his relationship of trust and confidence with the plaintiff to take advantage of the plaintiff with respect to a transaction, to plaintiff's detriment, and to the defendant's advantage. *See Barger v. McCoy Hillard & Parks*, 346 N.C. 650, 666 488, S.E.2d 215, 224 (1997). Constructive fraud must be pled with particularity; generalized or conclusory allegations do not suffice. *Sharp*, 113 N.C. App. at 597, 439 S.E.2d at 797.

To adequately allege a claim of constructive fraud, a plaintiff must allege "that [he] and defendants were in a relation of trust and confidence . . . [which] led up to and surrounded the consummation of the transaction in which defendant is alleged to have taken advantage of his position of trust to the hurt of plaintiff." *Barger*, 346 N.C. at 666, 488 S.E.2d at 244 (quoting (quoting *Rhodes v. Jones*, 232 N.C. 547, 549, 61 S.E.2d 725, 726 (1950)). The North Carolina Supreme Court has specifically held that allegations of constructive fraud must include an alleged benefit to the defendant. *See Barger*, 346 N.C. at 666-67, 488 S.E.2d at 244; *see also Sterner*, 159 N.C. App. at 632, 583 S.E.2d at 674 (2003) ("[W]e affirm the dismissal of

plaintiff's constructive fraud claim based on her failure to allege that defendants sought a benefit through that relationship.").

Despite these pleading requirements, Mr. Palles' complaint devotes only three general sentences to alleging constructive fraud:

> 89. Since Perkins was the managing, majority and controlling member, and Palles was the minority, non-managing member in the Hatteras companies, a relationship of trust and confidence existed between Palles and Perkins.
>
> 90. Perkins used his position of trust and confidence to bring about transactions that were detrimental to Palles and beneficial to Perkins.
>
> 91. As a direct and proximate result of Perkins' actions, Palles has been damaged in an amount in excess of $10,000.00 to be proven at a trial or hearing of this matter.

These allegations fail to set forth any facts or circumstances that describe in any way Mr. Perkins' alleged breach of his position of trust and confidence. Rather, Paragraph 90 merely offers the generalized conclusion that Mr. Perkins used his position to "bring about" some unspecified "transactions" detrimental to Mr. Palles and beneficial to Mr. Perkins.

The law requires more. It requires Mr. Palles to allege facts answering, at a minimum, the following questions: what transaction?; what were the facts and circumstances leading up to that transaction?; how did Mr. Perkins use his position to take advantage of Mr. Palles?; how was Mr. Palles injured?; and how did Mr. Perkins benefit? *See Barger*, 346 N.C. at 666, 488 S.E.2d at 224. Having failed to allege facts and circumstances answering any of these basic questions, Mr. Palles has failed adequately to allege constructive fraud. Mr. Palles' constructive fraud claim should therefore be dismissed.

3. Negligent Misrepresentation

Plaintiff's claim of negligent misrepresentation is merely a recasting of his fraud claim premised on the alternate theory that if Mr. Perkins did not make a false statement knowingly, then he made one negligently. (Complaint at ¶ 87) This claim must fail because it ignores the requirements for pleading, as well as the basic nature of, the tort of negligent misrepresentation: "a party [1] justifiably relies [2] to his detriment [3] on information prepared without reasonable care [4] by one who owed the relying party a duty of care.'" *Bob Timberlake Collection, Inc. v. Edwards*, 176 N.C. App. 33, 40, 626 S.E.2d 315, 322 (2006) (quoting *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 322 N.C. 200, 206, 367 S.E.2d 609, 612 (1988)). This is not an omnibus tort—one applicable whenever there may be a misstatement—but rather is limited to instances "'where pecuniary loss results from the supplying of false information to others for the purpose of guiding them in their business transactions.'" *Michael v. Huffman Oil Co., Inc.*, ___ N.C. App. ___, ___, 661 S.E.2d 1, 11 (2008) (quoting *Driver v. Burlington Aviation, Inc.*, 110 N.C. App. 519, 525, 430 S.E.2d 476, 480 (1993)). Further, in order adequately to allege justifiable reliance, "the complaint must allege that the plaintiff was denied the opportunity to investigate or that the plaintiff could not have learned the true facts by exercise of reasonable diligence." *Eastway Wrecker Serv. v. City of Charlotte*, 165 N.C. App. 639, 645, 599 S.E.2d 410, 414 (2004). If a complaint fails to allege such facts, it must be dismissed. *Id.*

Mr. Palles failed to allege any of the elements of this claim. He does not allege that Mr. Perkins prepared or supplied to him any information in guiding a particular business transaction. Rather, the misrepresentation that purports to anchor this claim is the same alleged broken promise that anchors the fraud claim, *i.e.*, that Palles would "continue to own membership interests in HCD, HCIM and HCIP as set forth in their respective operating agreements." He

also does not allege that he actually relied on information supplied by Mr. Perkins in making any decision concerning a business transaction, or that such reliance was reasonable.

Nor Mr. Palles does not allege that Mr. Perkins owed Mr. Palles a duty to provide accurate information in guiding a business transaction or that Mr. Perkins breached any such duty in providing information. *See Bob Timberlake*, 176 N.C. App. at 40, 626 S.E.2d at 322 (affirming dismissal of negligent misrepresentation claim where the plaintiff "failed to allege [defendant] or its 'representatives' owed any duty to [the plaintiff] or breached any duty owed. Further, there was no allegation that the information provided was prepared without reasonable care, or that any supposed breach was a proximate cause of the injury.").

Finally, Mr. Palles fails to allege that he was denied the opportunity to investigate the veracity of the statement at issue or that he could not do so with reasonable diligence.

Each of these pleading deficiencies provides independent bases on which to dismiss Mr. Palles' claim of negligent misrepresentation. Therefore, Defendants respectfully submit that the Court should dismiss the Tenth Claim for Relief.

4. *Wrongful Interference with Contract*

Mr. Palles' claim against Mr. Perkins for wrongful interference with contract suffers from insolvable circular logic. The purpose of the wrongful interference tort is to provide a claim "against an outsider who knowingly, intentionally, and unjustifiably induces one party to a contract to breach it to the damage of the other party." *Childress v. Abeles*, 240 N.C. 667, 674, 84 S.E.2d 176, 182 (1954) (emphasis added). Accordingly, the elements of a wrongful interference claim are "First, that a valid contract existed between the plaintiff and a third person, conferring upon the plaintiff some contractual right against the third person . . . . Second, that the outsider had knowledge of the plaintiff's contract with the third person . . . . Third, that the

outsider intentionally induced the third person not to perform his contract with the plaintiff . . . . [and] Fourth, that in so doing the outsider acted without justification." *Id.* at 674, 84 S.E.2d at 181 (internal citations omitted); *see also Pleasant Valley Promenade*, 120 N.C. App. at 657, 464 S.E.2d at 54. Thus, a party to a contract, including the party's managing agent, cannot be liable for wrongful interference with that contract. *See Wagoner v. Elkin City Sch. Bd. of Educ.*, 113 N.C. App. 579, 587, 440 S.E.2d 119, 124 (1994) ("We initially note that plaintiff cannot maintain an action against the Board or Lassiter for malicious interference of contract because the Board and Lassiter, as superintendent of the Board, are parties to the contract."); *see also Waters v. Collins & Aikman Prods. Co.*, 208 F. Supp. 2d 593, 595 (W.D.N.C. 2002).

Mr. Perkins is not an outsider in this case. To the contrary, he is the person who Mr. Palles alleges acted on behalf of HIP in entering a valid and binding employment contract with Mr. Palles. (Complaint at ¶ 32). He is also the person who terminated Mr. Palles' alleged employment contract on behalf of HIP, thus subjecting Defendants to Mr. Palles' allegations of breach of contract. (Complaint at ¶¶ 47-50). In fact, Mr. Perkins (and in the case of HCIP and HCIM, Mr. Worthington) is the only person empowered to make any of the decisions on behalf of the Hatteras Companies that Plaintiff challenges in this case.

Thus, Mr. Palles is alleging that Mr. Perkins induced himself to terminate the various agreements at issue. Such an allegation is deficient as a matter of law. *See McCarthy v. KFC Corp.*, 607 F. Supp. 343, 345 (W.D. Ky. 1985) (dismissing and criticizing as "a paradigm of inconsistency" wrongful interference claims brought against employer's agents); *Hubner v. Schoonmaker*, No. 89-3400, 1991 WL 60594, *3 (E.D. Pa. 1991) (unpublished opinion) ("An individual cannot tortiously interfere with a contract entered into by a corporation for whom the individual serves as an officer or director because such an officer or director is a representative

of the corporation, not a third party."); *Mills v. Viclen, Inc.*, No. 2006-CA-0017793-MR, 2007 WL 4553666 at *8 (Ky. App. Dec. 28, 2007) (unpublished opinion) ("In this case, it is undisputed that House was the CEO for Viclen. Thus, he was Viclen's agent and, as Viclen's agent, his actions were on behalf of the corporation. When House fired Mills, he was acting as Viclen's agent; thus, for all intents and purposes, Viclen, not House, fired Mills. As in *McCarthy*, House cannot be considered a third party who intentionally interfered with the contractual right that existed between Mills and Viclen."). Therefore, the Eighth Claim for Relief, which is brought solely against Mr. Perkins, should be dismissed.

E. Because Plaintiff's Fraud-based Claims Are Insufficient As a Matter of Law, His Claim for Punitive Damages Cannot Stand.

Punitive damages are available "only if a claimant proves that the defendant is liable for compensatory damages and that the defendant is guilty of fraud, malice, or willful or wanton conduct." *Combs &. Assocs., Inc. v. Kennedy*, 147 N.C. App. 362, 374, 555 S.E.2d 634, 642 (2001). Of these, Mr. Palles alleges only fraud. As set forth in sections IV.B, C, & D, *supra*, those claims are legally infirm for several reasons. If the Court agrees and dismisses Mr. Palles' claims of fraud and constructive fraud, then Mr. Palles' claim against Mr. Perkins for punitive damages must also be dismissed for there are no remaining claims that sufficiently allege the level of conduct required to impose punitive damages.

F. Plaintiff's Claims Related to HCIP and HCIM Should Be Dismissed Because He Fails to Allege Any Actionable Wrongdoing by Defendants.

The decision Mr. Palles challenges with respect to his interests in HCIP and HCIM is one that is vested in the Managing Members' "complete discretion." (*See* HCIP/HCIM Operating Agreements, § 4.03). With his Seventh Claim, Mr. Palles appears to allege that the alleged new employment agreement between himself and HIP acted as an affirmation of his alleged interests

in HCIP and HCIM. (Complaint at ¶ 68). Even if that were true, one still must look to the HCIP and HCIM Operating Agreements to determine Mr. Palles' legal rights, if any. And, as Mr. Palles acknowledges, those agreements "allow the managing member to redeem the membership interest of a member at any time." (Complaint at ¶ 67).

Mr. Palles also alleges—incorrectly—that such redemptions are subject to the strictures of good faith. (Complaint at ¶ 67). Such demonstrably false pleadings are not entitled to the normal deference of allegations granted under the Rule 12 standard. *See Oberlin Capital*, 147 N.C. App. at 56, 554 S.E.2d at 844 (in deciding a motion to dismiss "the court is not required to accept as true any conclusions of law or unwarranted deductions of fact."); *Wachovia Capital Partners, LLC*, 2007 NCBC at ¶20, 2007 WL 2570838 at *3 ("Thus the Court can reject allegations that are contradicted by the supplementary documents presented to it."). The Operating Agreements state unequivocally that the Managing Members may require redemption in their "complete discretion." (HCIP/HCIM Operating Agreements, § 4.03). The Operating Agreements are also clear in stating that "discretion" means that the Managing Members decisions can be based on no reason or any reason, including purely personal reasons. (HCIP/HCIM Operating Agreement at § 2.09).

In any event, regardless whether the "forced redemption" of which Mr. Palles complains is subject to a standard of good faith, his claim still fails. For the Sixth Claim for Relief does not allege that the decision to redeem Mr. Palles' interests in HCIP and HCIM was not made in good faith. The mere act of redeeming a member's interests cannot be actionable in itself when the Operating Agreement clearly contemplates such a situation. There must be a breach of a legal duty in making that particular decision. In this case, there is no such allegation. The Sixth Claim for Relief should therefore be dismissed. Also, Mr. Palles' Seventh Claim—for an

accounting—is derivative of his alleged right to interests in HCIP and HCIM and thus must also fail.

V. CONCLUSION

For all of the foregoing reasons, Defendants respectfully request that the Court dismiss with prejudice the Sixth, Seventh, Eighth, Ninth, Tenth, Eleventh, Thirteenth, and Fourteenth Claims for Relief in Plaintiff's Complaint.

This the 6th day of October, 2008

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Defendants' Memorandum of Law In Support of Motion To Dismiss Pursuant to Rule 12(b)(6) was served on the following as follows:

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This the 6th day of October, 2008.

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CERTIFICATE OF COMPLIANCE

Pursuant to Rule 15.8 of the General Rules of Practice and Procedure for the North Carolina Business Court, the undersigned hereby certifies that the foregoing Brief in Support of Defendants' Motion to Dismiss, is less than 7,500 words (excluding the case caption, signature blocks, this Certificate of Compliance and the Certificate of Service) as reported by the word-processing software.

This is the sixth day of October, 2008.

/s/ Daniel H. Aiken
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