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' REPLY MEMORANDUM IN SUPPORT OF THEIR MOTIONS TO DISMISS PURSUANT TO RULE 12(b)(6)

Benjamin N. Thompson
Sarah M. Johnson
WYRICK ROBBINS YATES & PONTON LLP
Post Office Drawer 17803
Raleigh, NC 27619

David J. Woolf
Daniel H. Aiken
DRINKER BIDDLE & REATH LLP
One Logan Square
18th & Cherry Streets
Philadelphia, PA 19103

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I. INTRODUCTION

Plaintiff cannot escape the fact that his is an employment and securities-related contract claim; nothing more. Although he attempts to deny it, he spends most of his brief explaining how Hatteras and Mr. Perkins have not abided by the terms of various agreements, and how he is entitled to more under those agreements. No matter what tort he seeks to couch them as, there is no getting around the fact that Mr. Palles' claims all seek to enforce rights emanating from his private agreements with Hatteras.

Apparently recognizing the flaws in his Complaint, Plaintiff now asks leave to amend it. Doing so would be futile. In addition to still being inadequate as a matter of law, his proposed amendments serve to place even more emphasis on the inter-workings of his alleged employment agreement, his Hatteras membership interests, and the Hatteras company operating agreements. The proposed amendments also fail to fix the basic deficiencies Defendants identified in Plaintiff's initial Complaint.

Defendants address their discussion in this reply to new points raised by Plaintiff and also to the futility of Plaintiff's proposed amendments to the complaint. Because his proposed amendments do not change the ultimate analysis on Defendants' Motion to Dismiss, Defendants submit that Claims for Relief Eight, Nine, Ten, Eleven, Thirteen, and Fourteen remain ripe for dismissal, even as modified by Plaintiff's proposed amended complaint.[1]

[1] In light of Plaintiff's proposed amendments to Claim Six, which amendment Defendants do not oppose, Defendants no longer move to dismiss Claims Six and Seven. Defendants' proposed order, along with Defendants' Memorandum of Law in Opposition to Plaintiff's Motion to Amend the Complaint, sets forth more directly Defendants position on Plaintiff's proposed amended complaint.

II. DISCUSSION

Defendants' discussion tracks the order they followed in their opening brief, addressing the following issues: (1) the UDTPA does not cover employment and securities-related claims; (2) Mr. Perkins cannot be held individually liable; (3) Plaintiff's tort claims are indistinguishable from his contract claims; and (4) Plaintiff has failed adequately to plead a claim for fraud, constructive fraud, negligent misrepresentation, and wrongful interference with contract.

A. The UDTPA Does Not Extend to Employment or Securities Disputes Such as This One.

Plaintiff does not address the long lines of authority cited in Defendants' opening brief holding that both employer/employee disputes and disputes over securities are generally beyond the scope of the UDTPA.[2] Plaintiff, instead, relies entirely on *Walker v. Sloan*, 137 N.C. App. 387, 395, 529 S.E.2d 236, 243 (2000), a case that is distinguishable on its facts.

Walker involved a dispute between a group of individual investors who sought to purchase a company from its existing owners and the company, including its board of directors. Although the would-be purchasers consisted of current and former officers of the company, the alleged harm arose out of a wholly separate context—the purchase negotiations and alleged attempts by the would-be sellers to thwart the purchase. *See Id.* at 395-96, 529 S.E.2d at 242-44. Indeed, the Court never even addressed the line of authority holding that employer/employee disputes are outside the scope of the UDTPA. *See Id.*

The dispute between the parties in this case, by contrast, is a purely internal one and not "in or affecting commerce," as the UDTPA requires. All of Mr. Palles' claims arise solely by

[2] Plaintiff's statement at page 14 of his opposition that "Defendants do not argue Palles' contention that they committed unfair and deceptive acts which caused injury to Palles," is both wrong as a factual matter – Defendants denied in their Answer all of Plaintiff's allegations of fraud, unfair and deceptive acts, etc. – and, more importantly, fails to appreciate that Defendants may not, under the Rule 12(b)(6) standard, challenge such allegations in their Motion.

virtue of his employer/employee relationship and the benefits provided thereunder, and he seeks only compensation, benefits and equity that he maintains he was entitled to as a former executive, and related damages. Although Plaintiff attempts to amplify his claims with allegations of fraudulent conduct, false statements, and an intent to self-deal, such allegations do not elevate an internal dispute to one that falls within the scope of the UDTPA.

In *Mauer v. SlickEdit, Inc.*, 2005 NCBC 1, 2005 NCBC LEXIS 2 (Sup. Ct. 2005), a case with very similar facts, the plaintiff, the former chief executive officer and a 42.5 percent shareholder of the corporate defendant, alleged, *inter alia*, that she was improperly fired from her position, was duped into giving up entitlement to her royalty payment in exchange for a bonus that the company refused to honor, was lied to, and was slandered internally. This Court dismissed the plaintiff's UDTPA claim on a Rule 12(b)(6) motion, holding that "[t]hese matters involve internal governance rather than extramural commerce." *Id.* at P40, 2005 NCBC LEXIS at *21 (and cases cited therein); *see also Durling v. King*, 146 N.C. App. 483, 486-89, 554 S.E.2d 1, 3-5 (2001) (court rejects UDTPA claim, even though plaintiffs alleged that defendant engaged in "efforts to conceal [information] from the plaintiffs" and "willfully and unfairly [used] his position of power to retain funds due and owing to [p]laintiffs," because "no evidence was presented that the subject transactions had any impact beyond the parties' employment relationships" and "[t]here is no indication that defendant's behavior was 'in or affecting commerce'"); *and* Def. Opening Br. at 8-10.

Accordingly, Plaintiff's UDTPA claim remains ripe for dismissal.

B. Mr. Perkins Cannot Be Held Individually Liable.

Defendants seek dismissal of all claims against Mr. Perkins other than the claim for breach of fiduciary duty. In their opening brief, they argued that, as a managing member of an LLC, Mr. Perkins cannot be held personally liable for actions he took while acting on behalf of that LLC. Plaintiff opposes this argument by suggesting that the North Carolina LLC Act provides an exception whereby "[a] member, manager, director, or executive may . . . become liable by reason of their own acts." (Pl. Br. at 5). Plaintiff cites no case law in support. And, in fact, the North Carolina Supreme Court has already resolved this issue in Defendants' favor.

In *Hamby v. Profile Prods., L.L.C.*, 361 N.C. 630, 637, 652 S.E.2d 231, 236 (2007), the North Carolina Supreme Court interpreted the very language on which Mr. Palles now seeks to rely. The Court explained that this apparent exception is limited to those instances where a member takes an action that is truly outside the scope of managing the LLC, such as by personally guaranteeing a loan:

> The . . . statute also states that members or managers may be held personally liable for their "own acts or conduct." *See* N.C.G.S. § 57C-3-30(a). However, this language appears to simply clarify the earlier principle: the liability of members or managers is not limited when they act outside the scope of managing the LLC. For example, personal guaranties executed by LLC members or managers are binding . . .

Id. at 361 N.C. 630, 637, 652 S.E.2d 231, 236.

All of Mr. Perkins' alleged acts were taken, if at all, while managing the affairs of the Hatteras companies. Namely, Plaintiff alleges that Mr. Perkins promised not to redeem Mr. Palles' HCIM, HCIP, and HCD interests; that he breached an employment contract by terminating Mr. Palles; and that Mr. Perkins' decisions to redeem Mr. Palles' interests, and the value Mr. Perkins attributed to those interests, violated the terms of the respective operating

agreements. No matter what nefarious motive Plaintiff would like to ascribe to Mr. Perkins, the fact remains that these are decisions and actions—entering contracts, redeeming shares, terminating employees—that fall squarely within the realm of Mr. Perkins' duties in managing the Hatteras companies. Plaintiff's claims (except for the claim for breach of fiduciary duty) against Mr. Perkins are thus subject to dismissal.

C. Plaintiff Cannot Distinguish His Tort Claims From His Contract Claims.

The ultimate outcome of this case will turn on the interpretation of a handful of Hatteras operating agreements and the determination whether Mr. Palles actually had a new employment contract with Hatteras. Plaintiff cites *Food Lion, LLC v. Schuster Mktg. Corp.* as support for his position that he has stated tort claims that are distinct from his contract claims. That opinion provides Plaintiff no help.

In *Food Lion*, the court found that the counter-claim plaintiff had adequately alleged detrimental reliance on misrepresentations. *Food Lion, LLC v. Schuster Mktg. Corp.*, 382 F. Supp. 2d 793, 798 (E.D.N.C. 2005). Based on the court's estimation that the plaintiff had adequately alleged a claim of fraud, the court concluded that the plaintiff had stated a sufficiently separate tort claim. *Id.* at 800-01. In doing so, the court distinguished the case before it from one involving "'assertions that under the [agreement], [plaintiff] failed to meet it's obligations,'" which is precisely the category into which Mr. Palles' allegation fall. *See Id.* (quoting *Capital Factors, Inc. v. Fryday Club, Inc.*, 209 F. Supp. 2d 583 (W.D.N.C. 2002)).

Unlike the counter-claim plaintiff in *Food Lion*, Mr. Palles has not adequately alleged reliance on an actionable misstatement. (*See* § II.D.1, below). Rather he makes a series of interwoven accusations about the circumstances leading up to and surrounding his alleged employment contract—all of which relate to rights under other contracts—and attempts to piece

together allegations that amount to fraud. As set out in section II.D.1, when one untangles Mr. Palles' fraud allegations, it is apparent that he is simply seeking to enforce his rights under various agreements. Because he cannot adequately untangle his fraud allegations from his contract allegations, Mr. Palles cannot pursue his claims in tort.

D. Plaintiff's Allegations of Fraud, Constructive Fraud, Negligent Misrepresentation, and Wrongful Interference with Contract Fail As a Matter of Law

1. *Fraud*

In response to Defendants' Motion, Mr. Palles does not suggest that he has met the pleading requirements for a fraud claim. Instead, he attempts to defend his fraud claim with the amended allegations in his proposed amended complaint. In doing so, he creates a legally untenable construct, and his claim must fail.

First, Plaintiff's theory of detrimental reliance—a necessary element for any fraud claim—is backwards. He claims that the detriment he suffered was his entering the employment contract that he is simultaneously attempting to enforce. Specifically, Mr. Palles claims that, in the negotiations over his employment contract, Mr. Perkins told Mr. Palles that he would "retain his current membership interests in HCIP and HCIM . . . ." (Proposed Am. Cmplt. at ¶ 31). Mr. Palles goes on to allege that Mr. Perkins also refused to include in the employment contract a reaffirmation of Mr. Palles' membership interests in HCIP, HCIM, and HCD, insisting instead "that Palles' membership interests in these entities were covered under their respective operating agreements." (Proposed Am. Cmplt. at ¶ 32).

Mr. Palles now claims that Mr. Perkins' alleged refusal to memorialize the terms in writing and concurrent oral commitment led Mr. Palles to "enter into the amended employment agreement that did not specifically include a *restatement* of Palles' then existing membership

interests in HCIM, HCIP and HCD . . . ." (Proposed Am. Cmplt. at ¶84) (emphasis added). But where is the alleged detriment? Mr. Palles is not alleging he had another employment opportunity or contract that he rejected in reliance on what Mr. Perkins supposedly said to him. To the contrary, he alleges that he had no such opportunity because Mr. Perkins refused to include the purported HCIP, HCIM, and HCD terms in any new employment contract.

To the extent Mr. Palles is claiming that he was damaged by entering into the alleged new employment contract (as opposed to refusing it), then there is still no actionable detriment. As set forth in Defendants' initial brief, simply accepting employment and getting paid for doing so cannot constitute an actionable detriment. (*See* Def. Brief at pp. 16-17). Further, there can be no actual damage because Defendants are not seeking to hold Plaintiff to his alleged employment contract. The opposite is true: Defendants deny that Plaintiff has a new employment contract at all, and Plaintiff is fighting to establish that he does. Therefore, any theoretical detriment Plaintiff may suffer from having supposedly entered into and being bound by this alleged employment contract may be reversed without cost.

Second, Mr. Palles cannot claim reasonable reliance on an objectively illusory promise. Mr. Perkins is alleged to have promised what was already provided for and governed by contract; in particular, that Mr. Palles would continue to hold membership interests in HCIM, HCIP, and HCD, subject to the respective operating agreements of those companies. (Proposed Am. Cmplt at ¶ 32). Such an acknowledgement of existing contractual rights would be the classic illusory promise. *See* Williston on Contracts §§ 7:4, 7:25, 7:35; *see also Herr v. Heiman*, 75 F.3d 1509, 1514 (10th Cir. 1996) ("[A]n agreement to do or the doing of that which a person is already bound to do does not constitute a sufficient consideration for a promise."). Any such statement cannot be reasonably calculated to induce reliance; nor can one claim to rely reasonably on such

a statement. For the only thing Mr. Palles would have relied on would have been a statement concerning rights that already existed and were governed by contract. *Cf. Spooner v. Reserve Life Ins. Co.*, 47 Wn. 2d 454, 458, 287 P.2d 735, 738 (Wash. 1955) ("Action in reliance upon a supposed promise creates no obligation on an individual or corporation whose only promise is wholly illusory.").

Finally, with respect to the proposed amended complaint, Mr. Palles' amendments have made his allegations of fraud even less clear and less specific. "Where multiple defendants are asked to respond to allegations of fraud, the complaint should inform each defendant of the nature of his alleged participation in the fraud." *DiVittorio v. Equidyne Extractive Indus., Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987) (cited in *Juntti v. Prudential-Bache Securities, Inc.*, No. 92-2066, 1993 WL 138523, at * 2 (4th Cir. 1993) ("Further indicative of the insufficiently particular character of the complaint is its impermissible aggregation of defendants without specifically alleging which defendant was responsible for which act."). It is the Plaintiff's burden to plead with enough specificity and precision to "'enable a particular defendant to determine with what it is charged.'" *Junitti*, 1993 WL at *2 (4th Cir.) (quoting *Hoover v. Langston Equip. Assocs., Inc.*, 958 F.2d 742, 745 (6th Cir. 1992)).

In this case, Mr. Palles' original Complaint alleged fraud against only Mr. Perkins. Now he alleges fraud against Mr. Perkins and all "Hatteras Companies", without distinction. (*See* Ninth Claim for Relief of Proposed Am. Cmplt.). There are five Hatteras companies named in the Complaint. There are three (HCIP, HCIM, and HCD) identified within the Ninth Claim for Relief. With his proposed amendments, Mr. Palles does not allege the specific fraudulent acts of any of them, choosing instead to accuse the "Hatteras companies" of unspecified "fraudulent, intentional, and material misrepresentations." (Proposed Am. Cmplt. at ¶ 85). Although

affiliated, each company is a separate legal entity, entitled to specific notice of the nature of the fraud claims against it. Hence, the Court should deny Mr. Palles' attempt to add fraud claims against the Hatteras companies because the allegations fail for lack of specificity.

2. *Constructive Fraud*

Defendants moved to dismiss Mr. Palles' constructive fraud claim on the grounds that Mr. Palles failed to allege several of the claim's elements with the requisite specificity. Plaintiff responds on the strength of his proposed amended complaint and the vague assertion that the facts making up the constructive fraud claim were embedded in the 80 or so preceding paragraphs of the original Complaint. Plaintiff's attempt to save this claim fails.

First, with respect to the original Complaint, Plaintiff cannot satisfy the requirements of Rule 9 by referring generally to the allegations in his Complaint. He must marshal those facts and plead their significance as it relates to the claim. *See Martin v. Prudential-Bache Sec., Inc.*, 820 F. Supp. 980, 982 (W.D.N.C. 1991) ("[T]he complaint must allege specific facts for the fraud along with sources that support the specific facts alleged and a basis from which an inference of fraud may fairly be drawn . . . . The twenty-three page complaint contains a wealth of allegations; however, even these voluminous allegations fail to provide the indicia of fraud required by Rule 9(b)").

Plaintiff's original Complaint fails to meet this pleading standard. Indeed, in his brief, Plaintiff still cannot point to allegations that set forth a claim for constructive fraud. He offers only the conclusion that "[t]he Complaint read as a whole answers the specific questions defendants argue must be answered to properly state a claim." (Pl. Opp. Br. at p. 9). Plaintiff thus defends his conclusory allegations with a conclusory assurance that the appropriate allegations are somewhere in the Complaint. This is insufficient.

Plaintiff now directs the Court's attention to his proposed amended complaint, which, he claims, "leaves no question as to how Perkins used his position to benefit himself to Palles' detriment." (*Id.*). Mr. Palles still does not allege any link between Mr. Perkins' alleged position of trust and confidence and the grievances he lists. That is, on the one hand, he alleges the ways in which he has not received what he believes he is owed under various contracts. (Proposed Am. Cmplt. ¶ 90). On the other hand, he alleges that Mr. Perkins was in a position of trust and confidence to him. (Proposed Am. Cmplt. at ¶ 89). But Mr. Palles does not explain what the one has to do with the other. How did Mr. Perkins use that position to bring about those transactions? The essence of a constructive fraud claim is that the defendant has "taken advantage of his position of trust to the hurt of the plaintiff." *Barger v. McCoy Hillard & Parks*, 346 N.C. 650, 666, 488, S.E.2d 215, 224 (1997). His failure to plead such facts is fatal to his claim.

Further, even if not technically deficient on its face, Mr. Palles' claim of constructive fraud is still subject to dismissal due to the fact that it is based entirely on his alleged contractual entitlements. (*See* § II.C.). Paragraph 90 of the proposed amended complaint lists all of the alleged transactions on which Mr. Palles purports to base his constructive fraud claim. Each is a restatement of his contractual claims. Specifically paragraph 90(i) relates to Mr. Palles' alleged membership interests in HCIP, HCIM, and HCD; paragraph 90(ii) relates to the alleged notice period for redemption of those membership interests; and paragraphs 90(iii)-(vi) relate to Hatteras's redemption of Mr. Palles' membership interests and Mr. Palles' claim that doing so was contrary to his contractual rights. Mr. Palles cannot separate tort from contract. For his tort claims to survive, he must. Therefore, his claim for constructive fraud cannot go forward.

3. *Negligent Misrepresentation*

Plaintiff makes no effort to convince the Court that he adequately pled a negligent misrepresentation claim. His brief does not address at all Defendants' argument that Plaintiff's Complaint suffers from several pleading deficiencies with respect to this claim. (Def. Br. at 19 and cases cited therein). Nor does Plaintiff attempt to fix his allegations in the proposed amended complaint. (*See* Tenth Claim for Relief, Proposed Am. Cmplt.). This claim is ripe for dismissal.

4. *Wrongful Interference With Contract*

In their opening brief, Defendants argued that the law does not support Mr. Palles' attempt to hold Mr. Perkins liable for wrongful interference in light of the fact that Mr. Perkins is not a third-party to the alleged contracts but rather acted on behalf of Hatteras with respect to Mr. Palles' alleged contracts. In response, Mr. Palles cites a case that addresses the defense of qualified privilege for a corporation's officers and directors. Mr. Palles misses the point.

Defendants' arguments on this point addressed the paradox in Mr. Palles' legal position, not the defense of qualified privilege. Mr. Perkins, as managing member, and the contractual decisions of Hatteras in this case are inseparable, both factually and theoretically. Indeed, Defendants cited *Wagoner v. Elkin City Sch. Bd. of Educ.*, 113 N.C. App. 579, 587, 440 S.E.2d 119, 124 (1994), for this very reason.

The facts of *Wagoner* are analogous to this case. In *Wagoner*, the plaintiff, a teacher, entered a contract with the school board. *Id.* at 582, 440 S.E.2d at 121. After several years of the plaintiff working under this contract, the superintendent suspended her for insubordination. *Id.* Plaintiff resigned, suing the school board and the superintendent for, among other things, wrongful interference with contract. *Id.* There, as here, the person who decided to terminate the contract was the managing agent of the actual party to the contract. There, as here, the managing

agent was not himself an actual party to the contract with the plaintiff. *Id.* Nevertheless, the *Wagoner* court held that the superintendent was in effect a party to the contract and thus not liable for interference with the contract. *Id.* at 587, 440 S.E.2d at 124.

The same result follows here. Mr. Perkins' liability is barred because he is not distinguishable from the party to the contract in this situation. As the managing member, he is essentially the superintendent, in *Wagoner* terms. His decisions are Hatteras' decisions. He cannot induce himself to breach a contract. This truism is best articulated by the cases Defendants cite at pages 21-22 of their brief (i.e., *McCarthy; Hubner; and Mills*). Further, the case cited by Plaintiff, *Embree Const. Group, Inc. v. Rafcor, Inc.*, does not apply for two reasons. First, that case deals with the defense of qualified privilege, a concept Defendants neither discussed nor relied on in their opening brief. Second, that case does not involve the liability of a person who was solely responsible for managing a company's affairs, including the very decision to terminate the employment contract at issue. Rather, *Embree* dealt with a group of officers and directors of a corporation who influenced but were not responsible for the challenged decision. In light of *Wagoner*, this is a critical distinction.

III. CONCLUSION

For the foregoing reasons, as well as those set forth in Defendants' opening brief, the Court should dismiss with prejudice the Eighth, Ninth, Tenth, Eleventh, Thirteenth (Fourteenth in the proposed amended complaint), and Fourteenth (Fifteenth in the proposed amended complaint) Claims for Relief in Plaintiff's Complaint.

In addition, Plaintiff's attempt to amend the claims on which Defendants seek dismissal is futile because his proposed changes do not save these claims. Even as amended, they are subject to dismissal.

This the 8th day of December, 2008

WYRICK ROBBINS YATES & PONTON LLP

By: /s/ Benjamin N. Thompson
Benjamin N. Thompson
NC Bar No. 9005
Sarah M. Johnson
NC Bar No. 32752
Post Office Drawer 17803
Raleigh, NC 27619
Telephone: (919) 781-4000
Facsimile: (919) 781-4865
bthompson@wyrick.com
sjohnson@wyrick.com

DRINKER BIDDLE & REATH LLP

By: /s/David J. Woolf (with permission)
David J. Woolf
PA State Bar No. 76484
Daniel H. Aiken
PA State Bar No. 93870
One Logan Square
18th & Cherry Streets
Philadelphia, PA 19103
Telephone: (215) 988-2614
Facsimile: (215) (88-2757
David.Woolf@dbr.com
Daniel.Aiken@dbr.com

COUNSEL FOR DEFENDANTS

CERTIFICATE OF SERVICE

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

VIA U.S. MAIL

Keith A. Satisky, Esquire
Howard P. Satisky, Esquire
John M. Silverstein, L.L.P.
900 Ridgefield Drive, Suite 250
Raleigh, NC 27609

Dated: December 8, 2008

/s/ Daniel H. Aiken
Daniel H. Aiken

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 Reply Brief in Support of Defendants' Motions to Dismiss, is less than 3,750 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 eighth day of December, 2008.

/s/ Daniel H. Aiken
Daniel H. Aiken