

STATE OF NORTH CAROLINA
GRAHAM COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
08 CVS 7

PHILLIPS AND JORDAN, INC.,

Plaintiff,

v.

JOSEPH E. BOSTIC, JR., JEFFREY L.
BOSTIC, MELVIN MORRIS, JAMES
BOWMAN, TYLER MORRIS, BOSTIC
DEVELOPMENT, LLC, AND BOSTIC
DEVELOPMENT AT ASHEVILLE, LLC.

Defendants.

ORDER

Before the Court is the Motion of Defendants Joseph E. Bostic, Jr., and Jeffrey L. Bostic (collectively the “Bostic Defendants”) for Rule 11 Sanctions. After considering the Court file, the Motion, the parties’ briefs, the arguments of counsel presented by telephone, and the additional statements of counsel made during a 4 December 2009 in-chambers conference, the Court **GRANTS** the Motion. As a sanction in this case, the Court shall award the Bostic Defendants their reasonable attorney fees incurred in pursuing the Motion. In support of this Order, the Court enters the following:

FINDINGS OF FACT

1. Plaintiff Phillips and Jordan, Inc. (“Phillips and Jordan”) is a North Carolina corporation conducting business as a grading subcontractor.
2. In its Amended Complaint, Plaintiff alleges that the Bostic Defendants were, at all relevant times, officers and directors of non-party Bostic Construction, Inc. (“Bostic Construction”), which did business as a general contractor.

3. According to Plaintiff, the Bostic Defendants solicited Plaintiff to sign on as a subcontractor for a real estate development project (the “Westmont Commons Project”) to be built by Bostic Construction.

4. Plaintiff’s principal claim in this litigation is that the Bostic Defendants, while serving as officers and/or directors of Bostic Construction, used a web of sham entities to make preferential payments to creditors other than Plaintiff and also diverted, for their own purposes, loan funds that otherwise would have been available to pay Plaintiff for its work on the Westmont Commons Project.

5. Plaintiff further alleges that the Bostic Defendants took such actions at a time when Bostic Construction was either insolvent or nearly insolvent and under circumstances amounting to a winding up or dissolution of the corporation.

6. Plaintiff filed its original Complaint on 18 January 2008, asserting claims for common law fraud and a violation of the North Carolina Unfair and Deceptive Trade Practices Act.

7. With respect to Plaintiff’s fraud claim, the original Complaint alleged that “[o]n or about August 26, 2002 [sic] the Defendants using their alter ego, Bostic Construction, Inc., falsely represented to the Plaintiff that Bostic Construction Inc. [sic] had entered into a construction contract pertaining to property represented as being owned by a fictitious entity, Bostic Brothers Development, Inc.,” when in fact the true owner of the property was Defendant BDA.¹ (Compl. ¶ 12.)

8. Plaintiff alleged further that the Defendants “intentionally and willfully misrepresented the true owners of the property to the Plaintiffs’ [sic] in order to circumvent and

¹ Plaintiff did not identify who among the Defendants made this representation.

deprive them of lien rights, under N.C.G.S. 44A, against the property upon which the Plaintiffs provided material, labor, and services.” (Compl. ¶ 15.)

9. Plaintiff also contended that it did not discover the alleged fraud until sometime in 2005. (Compl. ¶ 28.)

10. On 24 March 2008, the Bostic Defendants answered the Complaint and moved to dismiss, alleging that the trial court lacked subject matter jurisdiction and that the Complaint was subject to dismissal pursuant to Rules 9(b) and 12(b)(6) of the North Carolina Rules of Civil Procedure.

11. On 17 July 2008, the trial court entered an order denying those motions.²

12. On 26 January 2009, Plaintiff filed an Amended Complaint, which asserted an additional claim for constructive fraud against the Bostic Defendants.

13. On 19 February 2009, the Bostic Defendants answered the Amended Complaint and renewed their Motions to Dismiss.

14. Defendant James Bowman also moved to dismiss the Amended Complaint on 19 March 2009.

15. In a later filing, the Bostic Defendants conceded that the trial court’s 17 July 2008 order foreclosed any further effort by them to seek dismissal of Plaintiff’s claims alleging fraud and a violation of the UDTPA. (Am. Br. Supp. Mot. Dism. 4, 10.) *See generally State v. Woolridge*, 357 N.C. 544, 549, 592 S.E.2d 191, 194 (2003) (“[N]o appeal lies from one Superior Court judge to another . . . and that ordinarily one judge may not modify, overrule, or change the judgment of another Superior Court judge previously made in the same action.”) (citing *Calloway v. Ford Motor Co.*, 281 N.C. 496, 501, 189 S.E.2d 484, 488 (1972)).

² Thereafter, the case was designated as a mandatory complex business case.

16. On 2 June 2009, the Court denied the Bostic Defendants' Motion to Dismiss the claim alleging constructive fraud.

17. The Court did, however, grant Defendant Bowman's Motion to dismiss the common law fraud and UDTPA claims, with leave to amend.

18. With respect to the fraud claim, the Court noted that Plaintiff had failed to comply with the pleading requirements of Rule 9(b) of the North Carolina Rules of Civil Procedure. The fraud claim simply lumped all of the individual Defendants together without identifying who made the misrepresentation as to the true owner of the property for which Plaintiff had been retained to provide construction materials and services, and also failed to identify the place where the purported misrepresentation was made. (Order on Mots. Dism. ¶¶ 57–58.)³

19. The Court also noted that it appeared Plaintiff was not misled by the alleged misrepresentation because its Claim of Lien filed on 28 July 2004 identified the correct owner of the real property (*see* Mot. Dismiss & Answer Bostic Defs., Ex. C.).

20. Accordingly, the Court suggested that Plaintiff and its counsel consider carefully their obligations under Rule 11 of the North Carolina Rules of Civil Procedure before continuing to pursue a common law fraud claim against the Bostic Defendants. (Order on Mots. Dism. ¶ 26 n.5.)

21. On 22 June 2009, Plaintiff amended its Complaint as to Bowman, but took no action as to its claim alleging fraud against the Bostic Defendants.

22. On 6 August 2009, the Bostic Defendants filed the Motion for Rule 11 Sanctions.

23. On 4 December 2009, the Court held an in-chambers conference with counsel to discuss a number of pending motions, including the Motion for Rule 11 Sanctions. At this

³ The Court dismissed the UDTPA claim as to Bowman because it was predicated on the same allegations supporting Plaintiff's fraud claim. (Order on Mots. Dism. ¶¶ 63–64.)

conference, the Court again suggested to Plaintiff's counsel that they consider the merits of the claim alleging fraud.

24. On 14 December 2009, Plaintiff voluntarily dismissed its fraud claim against the Bostic Defendants.

Based on the above findings of fact, the Court enters the following

CONCLUSIONS OF LAW

1. N.C.R. Civ. P. 11(a) provides, in relevant part:

The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose . . .

2. Thus, Rule 11 imposes on an attorney or party a duty of reasonable inquiry, both as to the facts and the law set out in the paper, and a separate obligation not to file papers for an improper purpose. "A breach of the certification as to any one of these three prongs is a violation of the Rule." *Bryson v. Sullivan*, 330 N.C. 644, 655, 412 S.E.2d 327, 332 (1992).

3. In assessing whether an attorney has made a "reasonable inquiry" into the facts and applicable law, the Court examines an attorney's conduct according to a standard of objective reasonableness. Thus, the applicable test is "whether a reasonable attorney in like circumstances could believe his actions to be factually and legally justified." *Cabell v. Petty*, 810 F.2d 463, 466 (4th Cir. 1987). *See also Turner v. Duke Univ.*, 325 N.C. 152, 164, 381 S.E.2d 706, 713 (1989) ("The standard is one of reasonableness under the circumstances.") (quoting Fed. R. Civ. P. 11 advisory committee's notes).

4. For purposes of Rule 11, a legal contention is unjustified when “a reasonable attorney would recognize [it] as frivolous.” *Forrest Creek Assocs., Ltd. v. McLean Sav. and Loan Ass'n*, 831 F.2d 1238, 1245 (4th Cir. 1987).

5. Put differently, a legal position violates Rule 11 if it “has ‘**absolutely no chance of success** under the existing precedent.’” *Brubaker v. City of Richmond*, 943 F.2d 1363, 1373 (4th Cir. 1991) (quoting *Cleveland Demolition Co. v. Azcon Scrap Corp.*, 827 F.2d 984, 988 (4th Cir. 1987)) (emphasis added).

6. The Court holds that Plaintiff has violated Rule 11 by filing and pursuing a claim of common law fraud against the Bostic Defendants that was deficient as a matter of law and had absolutely no chance of success.

7. At the heart of Plaintiff’s claims in this case is the contention that the Bostic Defendants (as officers of Bostic Construction) committed constructive fraud by creating a web of sham entities that have unlawfully diverted and misappropriated funds that would have otherwise been available to pay Plaintiff for its work on the Westmont Commons Project. Plaintiff also contends that the Bostic Defendants are individually liable to it on alter ego or piercing the corporate veil principles.

8. Indeed, Plaintiff’s First Claim for Relief in its original Complaint, although styled as a claim alleging common law fraud, did no more than parrot the facts supporting the claim for constructive fraud that Plaintiff alleged later in its Amended Complaint.

9. The Court has no quarrel with Plaintiff seeking recovery on a theory of constructive fraud, or on the related theory alleging a violation of the North Carolina Unfair and Deceptive Trade Practices Act.⁴ What Rule 11 does not allow Plaintiff to do, however, is to waste judicial resources pursuing a claim for common law fraud that, as pled, had absolutely no chance of success.

10. The elements of a fraud claim under North Carolina law are: ““(1) False representation or concealment of a material fact, (2) reasonably calculated to deceive, (3) made with intent to deceive, (4) which does in fact deceive, (5) resulting in damage to the injured party.” *Rowan County Bd. of Educ. v. U.S. Gypsum Co.*, 332 N.C. 1, 17, 418 S.E.2d 648, 658 (1992) (citations omitted).

11. In contrast, to make out a claim for constructive fraud, a plaintiff need only show (1) a relationship of trust and confidence akin to that of a fiduciary, (2) that the defendant took advantage of that position of trust in order to benefit himself, and (3) that the plaintiff was injured as a result. *See Sterner v. Penn*, 159 N.C. App. 626, 631, 583 S.E.2d 670, 674 (2003).

12. Importantly, constructive fraud differs from actual fraud in that “it is based on a confidential relationship rather than a specific misrepresentation.” *Terry v. Terry*, 302 N.C. 77, 85, 273 S.E.2d 674, 678–79 (1981).

13. In this case, Plaintiff’s sole allegation of an affirmative misrepresentation or concealment of a material fact amounting to common law fraud is the contention that one of the Defendants, whom Plaintiff has never identified in its pleadings, misrepresented the true owner

⁴ The Bostic Defendants contend that Plaintiff’s UDTPA claim also warrants Rule 11 sanctions because it is predicated solely on the frivolous fraud claim. The Court disagrees. Paragraph 36 of Plaintiff’s Amended Complaint alleges that “[t]he Defendants made misrepresentations **and engaged in misappropriations, of funds owed to the Plaintiff** under the contract . . . , and used those funds for personal purposes and in other business transactions.” (Am. Compl. ¶ 36.) (emphasis added). These allegations are sufficient to relate the UDTPA claim to Plaintiff’s claim alleging constructive fraud, which the Court has found to be legally viable.

of the property upon which Plaintiff was to provide materials and services, so as “to circumvent and deprive [Plaintiff] of lien rights, under N.C.G.S. 44A[.]” (Compl. ¶ 15; Am. Compl. ¶ 15.)

14. Plaintiff alleged further that it did not discover this fraud until sometime in 2005. (Am. Compl. ¶ 28.)

15. But Plaintiff and its counsel have been on notice since the Court entered its Order on 2 June 2009 dismissing the common law fraud claim as against Defendant Bowman (if not before) that these allegations are simply not well grounded in fact because Plaintiff in fact timely filed a claim of lien on 28 July 2004, which identified the true owner of the property. (*See* Mot. Dismiss & Answer Bostic Defs., Ex. C.)

16. In other words, Plaintiff either knew or should have known that its claim alleging common law fraud had absolutely no chance of success because Plaintiff was not deceived by this particular misrepresentation.

17. Plaintiff’s brief in opposition to Rule 11 sanctions spills substantial ink reciting the breadth and depth of its investigation into the web of sham entities purportedly created by the Bostic Defendants to misappropriate construction funds and deny payment to Plaintiff and other contractors.

18. Plaintiff’s papers, however, betray a misunderstanding between a claim alleging constructive fraud, which Plaintiff has alleged properly and is entitled to pursue, and one asserting common law fraud.

19. As to the latter claim, Plaintiff offers no reasonable explanation for why it has continued to pursue a claim for an alleged misrepresentation (1) made by a mystery party, and (2) that in fact **did not** deceive Plaintiff.

20. Accordingly, on this record, Plaintiff's decision to file and pursue its claim of common law fraud warrants sanctions under Rule 11 of the North Carolina Rules of Civil Procedure.

21. As a sanction, the Court shall award the Bostic Defendants their reasonable attorney fees in pursuing the Motion.

22. Within **(5) five** days of the entry of this Order, the Bostic Defendants shall submit an affidavit as to amount of attorney fees incurred in pursuing the Motion. Plaintiff shall have **(5) five** days thereafter to file a response. The Bostic Defendants shall not file a reply unless requested to do so by the Court.

23. In determining the amount of the sanction in this case, the Court will consider that Plaintiff voluntarily dismissed its fraud claim on 14 December 2009.

SO ORDERED, this the 8th day of February, 2010.

/s/ Albert Diaz
Albert Diaz
Special Superior Court Judge