NORTH CAROLINA GASTON COUNTY	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 06-CVS-4626
JERRY W. WEBB, DARLEEN WEBB, LLOYD ALWRAN, DOROTHY ALWRAN, AMERICAN CORD & TWINE, INC., & ROYAL CORDAGE CORPORATION, Plaintiffs, v. ROYAL AMERICAN COMPANY, L.L.C., WALL INDUSTRIES, INC., ROYAL ACQUISITION CORPORATION, FCC, L.L.C. D/B/A FIRST CAPITAL, STANLEY J. SWIDER, SAMUEL B. FORTENBAUGH III, Defendants.	**REPLY AND BRIEF OF PLAINTIFFS IN OPPOSITION TO FCC'S MOTION TO DISMISS OR FOR JUDGMENT ON THE PLEADINGS**

NOW COME Plaintiffs Jerry W. Webb, Darleen Webb, Lloyd Alwran, Dorothy Alwran, American Cord & Twine, Inc. ("American Cord"), and Royal Cordage Corporation ("Cordage"), by and through undersigned counsel, and respond to the Motion to Dismiss or in the Alternative Motion for Judgment on the Pleadings of FCC L.L.C. d/b/a First Capital ("FCC") and its brief filed on January 19, 2007 ("FCC's Brief").

FCC's Brief Should Be Stricken and its Motion to Dismiss Denied

Plaintiffs move to strike FCC's brief for failure to comply with Rule 15.8 of the N.C. Business Court, which provides in pertinent part that "briefs in support of motions … shall be double-spaced and limited in length to a maximum of seven thousand, five

hundred (7,500) words" and "[e]ach brief shall include a certificate by the attorney that the brief complies with this Rule 15.8." FCC's brief exceeds the permitted word length, is not double spaced, and contains no certification of compliance. FCC's motion, unaccompanied by a required brief may, in the discretion of the Court, be summarily denied. N.C.B.C., Rule 15.11.

FCC's Motion for Judgment on the Pleadings is Premature and Should be Denied

Under N.C. GEN. STAT. § 1A-1, Rule 12(c), a Motion for Judgment on the Pleadings is only appropriate "*[a]fter the pleadings are closed* but within such time as not to delay the trial… ." N.C. Gen. Stat. § 1A-1 Rule 12(c)(emphasis added). Plaintiffs' have not yet answered or otherwise responded to FCC's counterclaim for breach of the Subordination Agreement and the time in which to respond has not yet expired. Therefore, the pleadings are not closed and FCC's Motion for Judgment on the Pleadings is premature and should be denied.

Introduction

Within weeks of financing the acquisition of "Royal American Company, L.L.C. ("Royal") by Wall Industries, Inc. ("Wall") in April of 2006, FCC declared a default under their Loan Agreement, recommended, funded and approved the decisions of a "work-out specialist," and began liquidating Royal's assets and collecting the company's receivables, to the exclusion of all other creditors. Within several months, FCC opened a line of credit to Yale Rope Technologies, Inc. ("Yale Rope"), a competitor of Royal and Wall, and financed the sale of Wall's assets for $925,000.00. FCC is believed to have collected in excess of $1.7 Million on its original loan balance of $1.3 Million. The loan balance is presently undeterminable, as FCC is increasing the loan balance by adding the

ongoing costs of defending the present lawsuit while continuing to liquidate Royal's assets, all to the great detriment of all the creditors, Royal's receiver, and Plaintiffs.

Facts Deemed to Be True

Plaintiffs adopt by reference all verified allegations and related exhibits described in the original and amended complaints (collectively, the "Complaints"), pursuant to N.C. Rule of Civ. Pro 10(c), which are deemed to be true for the purpose of FCC's motion. *E.g.*, *Hyde v. Abbot Labs.*, 123 N.C.App. 572, 575 (1996). The following specific facts demonstrate that plaintiffs have properly stated claims upon which relief can be granted and that FCC is not entitled to judgment as a matter of law:

1. On April 5, 2006, Wall and Royal Acquisition entered into a written "Limited Liability Company Membership Interest Purchase Agreement" (the "Agreement") to purchase interests in an existing manufacturing operation, Royal American Company, L.L.C. ("Royal") which was owned by Plaintiffs. (Am. Comp. ¶ 15 & Ex. A.)
2. Prior to the sale, Plaintiffs represented to the defendants the true financial condition of Royal American, including the fact and status of existing equipment leases. (Am. Comp. ¶ 18.)
3. Under the terms of the Agreement, Plaintiffs' companies, Cordage and American Cord sold their Membership Interests in Royal to Royal Acquisition, with 80% of their interests transferred at closing. As consideration for the purchase of 80% of the Membership Interests, and as provided in section 3 of the Agreement, plaintiffs received $75,000 at closing. The remaining 20% interests were to be purchased through "Earnout Cash Payments" as outlined in section 3.2 of the

Agreement. The "Earnout Cash Payments" were to consist of annual payments of 10% of the Consolidated Net Income before income taxes of Wall, Royal, and Royal Acquisition up to a maximum of $1,700,000. Section 3.2 of the Agreement additionally stipulated that if Wall, Royal, or Royal Acquisition ever changed control through a sale of all or substantially all of the assets of those entities or if Wall, Royal, or Royal Acquisition were ever liquidated, that the full amount of "Earnout Cash Payments" under section 3.2 would be immediately due. (Am. Comp. ¶ 19-20)

4. Pursuant to the Loan and Security Agreement, also dated April 5, 2006 (the "Loan Agreement"), FCC agreed to finance the purchase of Royal by Royal Acquisition and Wall (collectively the "Borrowers") and to provide a revolving credit facility "in order to facilitate the financing of Borrowers' working capital needs." FCC acknowledged that such financing was for the "direct and indirect benefits… to Borrowers… by virtue of Borrowers' various inter-relationships as joint guarantors or joint obligors and the beneficiaries thereof, as lessors and lessees, as suppliers and customers, and as joint venturers" and was extended "in furtherance of Borrowers' mutual and collective enterprise." Said Loan Agreement specifically referenced and defined the acquisition by Royal Acquisition of at least eighty percent (80%) of the membership interests of Royal by virtue of the April 5, 2006 Agreement with Plaintiffs. (See, FCC Brief, p. 3, Exhibit 1.)

5. Additionally, the Loan Agreement required that certain items be "delivered, in form and substance satisfactory to" FCC as a condition to FCC's obligation to fund the initial loan or extend the first financial accommodation to Borrowers."

Such items included: articles of organization and a limited liability company agreement for Royal; evidence that the Acquisition had been consummated in accordance with the Acquisition Documents (which were required to be acceptable to FCC); and, a Borrowing Base Certificate, together with schedules of Accounts and Inventory and other supporting documentation, in each case as of a date acceptable to FCC, demonstrating that, after giving effect to the initial loans thereunder and to the payment of all of each Borrower's trade payables, Borrowers have at least $500,000 of unused borrowing availability under the Loan Agreement. (FCC Brief, Ex. 1, Schedule 1, pp.2-3.)

6. First Capital's Borrowing Base Certificate represented that Wall, Royal Acquisition Corporation and Royal had "Accounts Receivables" of $1,594,963.04 and "Inventory" of $2,654,543.83 for a total of $4,249,506.87. FCC represented that the amount of $1,111,856.12 was available to be borrowed from FCC and $500,000.00 would be established as "reserves" for the purpose of acquiring and operating the combined businesses. (FCC Brief, Ex. 1, Ex. A.)
7. Royal and Wall pledged substantially all their assets to FCC pursuant to the Loan Agreement. Plaintiffs, as owners of minority membership interests in Royal American (following the acquisition financed by FCC) entered into a Debt Subordination Agreement granting FCC priority with respect to the assets of the companies. (*See*, FCC Brief, p. 2.)
8. As memorialized and reflected in sections 3.2 and 5 of the Agreement, the new majority owners of Royal, along with First Capital, promised to continue the normal manufacturing business of the company such that Royal could fulfill its

commitments under a 7 year lease and the "Earnout Cash Payments." (Am. Comp. ¶ 21)

9. Defendants made numerous statements to Plaintiffs and their counsel declaring that Defendants would continue to conduct the manufacturing business of Royal American after the Agreement closing. (Am. Comp. ¶ 25)

10. Under section 18.4(c) of the Agreement, Royal American, Royal Acquisition, and Wall promised to not sell or dispose of the assets and properties of their respective entities, except in the ordinary course of business. Further, under section 18.4(d) of the Agreement, Royal, Royal Acquisition, and Wall promised to not liquidate or enter any transaction that has the similar effect of liquidation of any of the assets of Royal American, Royal Acquisition, or Wall or any of their subsidiaries. (Am. Comp. ¶ 26)

11. In entering the agreements with Defendants (including the Subordination Agreement with FCC) Plaintiffs reasonably relied on the statements and representations of Defendants including FCC as to the financing of the transaction, including the representation and inducement that the working capital amount would be used to fund the continued operation of Royal. (Am. Comp. ¶ 30)

12. As part of the Agreement and transaction, Cordage and American Cord became minority members in Royal American, while Royal Acquisition became the majority member/owner. An "Amended and Restated Limited Liability Company Agreement of Royal American LLC" as required by FCC as a condition to

financing the acquisition (hereinafter "Amended LLC Agreement") was enacted on April 5, 2006. (See, Complaints, "Exhibit E.")

13. Under section 13.1-13.3 of the Amended LLC Agreement, Cordage and American Cord as members of Royal are entitled to full indemnification, including advance payment, for any past, current, or threatened proceedings brought against them for expenses related to the business of Royal. (Am. Comp. ¶ 39)
14. At the time of the closing of the Agreement, Royal had approximately $1,400,000 in work orders and contracts for business. (Am. Comp. ¶ 43)
15. Within weeks of Defendants taking control of Royal, all production was stopped, most employees were laid off, and debts were left unpaid. Defendants did not, and have not continued to operate the business in a manner consistent with the parties' agreements. FCC entered into an agreement with a workout specialist to put Royal into a sort of receivership and began liquidating the inventory and assets of Royal in a manner not in accordance with the ordinary course of business. (Am. Comp. ¶ 44-56)
16. The $500,000 dedicated to working capital was never intended to be applied, nor was it applied to the day-to-day operations of Royal, rendering Defendants' prior statements (including the representations of FCC) false and misleading. (Am. Comp. ¶ 53.)
17. In approximately September, 2006, FCC sold and transferred all of the assets of Wall to Yale Rope for approximately $925,000.00. Plaintiffs received no formal notice of the acquisition. FCC has also seized and wrongfully disposed of the assets of Royal. Such transfers triggered an acceleration of the Subordinated

Promissory Note and Earnout Cash Payments, and created a breach of contract as to the Agreements. No provisions have been made for the payment of the full amount of the Subordinated Promissory Note or Earnout Cash Payments. (Am. Comp. ¶¶ 55, 61-63)

Legal Standard for Motion to Dismiss

> In general, "a complaint should not be dismissed for insufficiency *unless it appears to a certainty that plaintiff is entitled to no relief under any state of facts which could be proved in support of the claim***.**" *Stanback v. Stanback,* 297 N.C. 181, 185, 254 S.E.2d 611, 615 (1979) *quoting* 2A Moore's Federal Practice, § 12.08, pp. 2271-74 (2d ed. 1975) (emphasis original).

Harris v. NCNB, 85 N.C.App. 669, 670-71 (1987).

> The essential question on a motion to dismiss pursuant to Rule 12(b)(6) "is whether the complaint, when liberally construed, states a claim upon which relief can be granted on *any* theory." *Oberlin Capital, L.P. v. Slavin,* 147 N.C.App. 52, 56, 554 S.E.2d 840, 844 (2001) (citation omitted) (emphasis in original). On a motion to dismiss, the complaint's material factual allegations are taken as true. *Id.* (citing *Hyde v. Abbot Labs* ., 123 N.C.App. 572, 575, 473 S.E.2d 680, 682 (1996)).

Mascaro v. Mountaineer Land Group, LLC, 2006 WL 3334535, 7 (N.C.Super., 2006).

The Exculpatory Clause in the Subordination Agreement Does Not Bar Plaintiffs' Claims

In its brief, FCC contends that the Subordination Agreement between the Plaintiffs and FCC bars all of the Plaintiffs claims. First, Plaintiffs Darleen Webb and Dorothy Alwran were never parties to the Subordination Agreement and would not be bound by said agreement. (FCC Ex. 2, ¶1) Therefore none of Darleen Webb or Dorothy

Alwran's claims in the Amended Complaint would be affected or negated by the terms of the Subordination Agreement.

Second, the Subordination Agreement has been terminated pursuant to its own terms. Under § 3.10 of the Subordination Agreement, "this Agreement shall terminate upon the Senior Creditor Repayment." (FCC Ex. 2, § 3.10) According to Plaintiffs' calculations, FCC has been completely repaid on the loan balance, and "the commitment of the Senior Creditor to make loans under the Senior Creditor Loan Agreement has been terminated,"[1] triggering a termination of the Subordination Agreement.

Third, Plaintiffs' clearly allege that they were induced into signing the Subordination Agreement based on representations by FCC to perform certain duties in good faith under several agreements involving the acquisition of Royal, specifically including the Loan Agreement. (Am. Comp. ¶¶ 29-31, 87, 100-102, 134-139, 152-154). Plaintiffs Jerry Webb, Lloyd Alwran, Cordage, and American Cord, have sufficiently alleged claims against FCC for fraud in the inducement, unfair and deceptive trade practices, breach of the implied covenant of good faith and fair dealing, and facilitating fraud. Such allegations, which are presently deemed to be true, effectively void the Subordination Agreement and serve as a defense to FCC's breach of contract counterclaim. FCC would have the Court believe that the Subordination Agreement gives them the privilege and immunity from Plaintiffs' claims. Obviously, in a fraudulent inducement case, a Plaintiff must be allowed to proceed in derogation of the

[1] FCC, declared a default of the loan in August of 2006 and terminated any and all of its commitments to make loans to the borrowers at that time or before. Currently, FCC disputes that they have been fully repaid under the loan agreement and, continues to wrongfully add expenses and costs to the loan balance, incurring significant detriment to the Receiver and all of the creditors.

express provisions of the fraudulent contract, as otherwise a victim of such a fraud would have no recourse whatsoever.

Further, the Subordination Agreement may not be a valid and enforceable contract.[2] FCC's position is that they owed no duties to Plaintiffs. (FCC Brief, p. 10.) If so, the Subordination Agreement would necessarily lack any consideration. A contract lacking consideration is not a valid and enforceable contract. *Sessler v. Marsh*, 144 N.C.App. 623 (2001) *writ denied, review denied* 354 N.C. 365 (2001). *In re Sepco, Inc.*, 36 B.R. 279 (Bkrtcy S.D. 1984) (a subordination agreement requires consideration, a lack of which renders it unenforceable, finding subordination agreement unenforceable); 9D AmJur.2d Bankruptcy § 3391. Further, the Courts will look beyond the face of a document to determine the adequacy of the consideration where such document may constitute a fraud upon the party sought to be restrained. *Sessler, supra*. In the absence of any duties owed to the Plaintiffs under the Loan Agreement, there is no actual consideration for the Subordination Agreement, as nothing of value was otherwise exchanged. If FCC owes no duties to Plaintiffs, then the lack of consideration for the Subordination Agreement renders said agreement invalid and unenforceable.

Several provisions of the Subordination Agreement violate public policy or are inequitable. This Court has already invalidated one provision of the Subordination Agreement on equitable grounds. (Order Granting in Part and Denying in Part Preliminary Injunction and Order Appointing a Receiver ¶ 4.e. – holding that provision forbidding the prosecution of a receivership action is overruled.) Additionally, § 3.7 of

[2] Plaintiffs' have not yet filed an answer to FCC's counterclaims alleging breach of the subordination agreement as the time to answer has not yet expired. In their forthcoming response, Plaintiffs' intend on pleading several affirmative defenses to the subordination agreement, including lack of consideration, frustration of purpose, fraud, misrepresentation, unconscionability, and being void as against public policy.

the Subordination Agreement, purporting to waive Plaintiffs' rights to a jury trial, is unconscionable and automatically void by statute. N.C.G.S. § 22B-10. Plaintiffs' contend that the remaining provisions of the Subordination Agreement that forbid them from bringing any suit or claim against FCC, including claims of fraud and bad faith involving the document's execution, are also void as against public policy. In general, contract provisions which severally limit the right of persons to have their grievances and disputes determined by any possible method of legal process (including arbitration) are suspect. *See. e.g. Cody v. Dept. of Transportation*, 60 N.C.App. 724 (1983). The full determination of these issues is premature at the 12(b)(6) stage and Defendants' motion should be denied.

The following causes of action have been properly stated by the Plaintiffs against FCC:

Breach of Contract

Plaintiffs' claims for breach of contract against FCC arise from FCC's breaches of the Loan Agreement and the covenant of good faith and fair dealing implied in both the Subordination Agreement and the Loan Agreement.

> "The elements of a claim for breach of contract are (1) existence of a valid contract and (2) breach of the terms of [the] contract." *Poor v. Hill*, 138 N.C.App. 19, 26, 530 S.E.2d 838, 843 (2000). This Court has held that where the complaint alleges each of these elements, it is error to dismiss a breach of contract claim under Rule 12(b)(6). *Toomer v. Garrett*, 155 N.C.App. 462, 481-82, 574 S.E.2d 76, 91, *disc. review denied*, 357 N.C. 66, 579 S.E.2d 576 (2003).

Woolard v. Davenport, 166 N.C.App. 129, 134 (2004).

Plaintiffs' have expressly stated both the existence of valid contracts – the Loan Agreement and Subordination Agreement, and a breach of the terms of those contracts. (Am. Compl. ¶¶ 97-105, 21, 30, 40, 54-55). Plaintiffs Jerry Webb, Lloyd Alwran,

Cordage, and American Cord are parties to the Subordination Agreement and have asserted claims against FCC for breach thereof. In addition, Plaintiffs, especially Cordage and American Cord, are intended beneficiaries of the Loan Agreement, as acknowledged therein and as the consideration for the Subordination Agreement. (FCC's Brief, Exhibit 1, p. 1, and Exhibit 2, ¶ 13-14). Plaintiffs are able to maintain a suit for breach as third party beneficiaries. *See, Snyder v. Freeman*, 300 N.C. 204, 221 (1980) (a third party can bring suit where 'the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance'); Restatement 2d of Contracts § 133.

Conspiracy and Facilitating Fraud

> In order to state a claim for civil conspiracy, a complaint must allege "a conspiracy, wrongful acts done by certain of the alleged conspirators, and injury." *Henry v. Deen*, 310 N.C. 75, 87, 310 S.E.2d 326, 334 (1984). *See also Holt v. Holt*, 232 N.C. 497, 61 S.E.2d 448 (1950); and *Muse v. Morrison*, 234 N.C. 195, 66 S.E.2d 783 (1951).

Norman v. Nash Johnson & Sons' Farms, Inc., 140 N.C.App. 390, 416 (2000).

Plaintiffs have expressly alleged all the necessary elements for a claim of civil conspiracy in their amended complaint (Am. Comp. ¶¶ 152-154, 134-139). While "conspiracy" has been challenged as an independent cause of action in North Carolina, it is cognizable as a claim and is often referred to as facilitating fraud, having the same elements. *Neugent v. Beroth Oil Co.*, 149 N.C.App. 38 (2002)(reversing trial court's dismissal of Plaintiff's claims for facilitating fraud). FCC cites the divided panel in *Jones v. City of Greensboro*, 51 N.C.App. 571 (1981) in support of their motion to dismiss Plaintiffs' conspiracy and facilitating fraud claims. In *Norman v. Nash*, the Court of Appeals specifically distinguished that part of the *Jones* decision dealing with the

dismissal of conspiracy claims, and found it error for the trial court to have dismissed said claims, holding that for 12(b)(6) purposes a Plaintiff could allege the same conduct for both an underlying tort and conspiracy as alternative claims for relief. *Norman* at 416.[3] Plaintiffs have sufficiently alleged their claims for conspiracy and facilitating fraud.

Tortious Interference with Contract

> The elements of tortious interference with contract are:
>
> (1) a valid contract between the plaintiff and a third person which confers upon the plaintiff a contractual right against a third person; (2) defendant knows of the contract; (3) the defendant intentionally induces the third person not to perform the contract; (4) and in doing so acts without justification; (5) resulting in actual damage to the plaintiff.
>
> *United Laboratories, Inc. v. Kuykendall,* 322 N.C. 643, 661, 370 S.E.2d 375, 387 (1988). *See also Peoples Security Life Ins. Co. v. Hooks,* 322 N.C. 216, 220, 367 S.E.2d 647, 649-50 (1988); *Wilson v. McClenny,* 262 N.C. at 132, 136 S.E.2d at 577-78; *Childress v. Abeles,* 240 N.C. 667, 674, 84 S.E.2d 176, 181-82 (1954), *reh'g dismissed,* 242 N.C. 123, 86 S.E.2d 916 (1955).

Embree Const. Group, Inc. v. Rafcor, Inc., 330 N.C. 487, 498 (1992).

Plaintiffs have alleged all of the five elements of their claim for tortiuous interference with contract (Am. Comp. ¶¶ 179-184). FCC, however, has alleged that Plaintiffs' claims are prone to dismissal at the 12(b)(6) phase due to the alleged existence of a legal justification.

> In the context of tortious interference with contract, the proper place in the pleadings for allegations of qualified privilege is in defendant's answer, as it is when a plaintiff alleges slander. When a complaint alleging slander "falls short of describing an occasion of qualified privilege," and when privilege applies at all, "the facts upon which it may be predicated must be specifically pleaded by way of affirmative defense in defendant's answer." *Presnell v. Pell*, 298 N.C. 715, 720, 260 S.E.2d 611, 614. Therefore, insofar as questions regarding the scope of

[3] The *Norman* court did not address facilitating fraud in their decision. As a separate and recognized cause of action, facilitating fraud does not appear to require any similar requirement for different and separate acts giving rise to liability.

> defendants' privilege are evoked by the allegation that defendants acted "without justification," plaintiff's complaint need not address such questions in order to withstand a motion to dismiss for failure to state a claim.

Embree at 500.

Plaintiffs have alleged that FCC "intentionally and without lawful justification induced and enabled Royal, Royal Acquisition, and Wall to breach the known Agreements," (Am. Comp. ¶ 183). Further, Plaintiffs plead nothing in their Amended Complaint that admits any lawful motives for FCC's interference with the contracts between Plaintiffs and others. *See e.g. Filmar Racing, Inc. v. Stewart*, 141 N.C.App. 668 (2001)(dismissing claim for tortious interference with contract, where only interference was a single letter from lawyer and complaint stated on face the existence of lawful litigation which prompted letter). Plaintiffs' allegations that FCC was the financier of the acquisition and liquidated Royal are not admissions of a *legitimate* business justification. Unlike *Filmar*, the Plaintiffs' allegations of interference are not dependant on a single letter where justification is straightforwardly determined at an early stage, and further discovery in this case is likely to reveal the details and illegitimate nature of FCC's conduct. Plaintiffs' claims have always been that although FCC had a business relationship with Royal American, Wall, and Royal Acquisition, their actions in said relationship were not legitimate and went beyond a lawful business purpose, but instead were unlawful, conspiratorial, and fraudulent. (*See, e.g.* Am. Comp. ¶¶ 60, 101, 111, 114, 134-139, 149-150, & 152-154,) Although, FCC now claims that it had a *legitimate* business justification for inducing Royal American, Wall, and Royal Acquisition to default on numerous agreements with Plaintiffs and other creditors, determination of such justification is not appropriate at the 12(b)(6) phase and Plaintiffs have alleged and plead

the necessary averments to withstand a motion to dismiss. *See, Embree, supra*, 330 N.C. 487 (1992).

Royal Cordage and American Cord have Standing to Bring their Derivative Claims

While FCC is correct in pointing out that the futility exception for derivative actions has been abolished, the case law also dictates that there is no requirement that a derivative Plaintiff specifically plead what demand has been made. *See Norman v. Nash*; *Bridges v. Oates*, 167 N.C.App. 459 (2004). In *Norman*, the court upheld the Plaintiff's derivative action where they only stated in very general terms that all conditions precedent to suit had been met and that they brought issues to the attention of the officers and no suitable action was taken by said officers. *Norman* at 411-412. Our Plaintiffs alleged in their Amended Complaint at ¶ 169 "Webb, Alwran, Cordage, American Cord, and their counsels and agents have made repeated demands on Swider and Fortenbaugh to correct the above mentioned matters and such demands have been ignored". In lieu of any specific statutory mandate that the demand be pleaded or requiring specific detail, Plaintiffs have complied with the minimal requirements as espoused by *Norman*.[4] Taking the allegations of Plaintiffs as true, Plaintiffs' derivative claims are sufficiently stated for 12(b)(6) purposes. *See also, Barger v. McCoy Hillard & Parks*, 346 N.C. 650 (1997) (claims as guarantors properly stated.)

Fraudulent Transfers

The fraudulent transfer statutes do not require that the person being sued be the original debtor. N.C.G.S. § 1-39-23 et seq. The portion of the statute dealing with a

[4] N.C.G.S. § 55-7-42 which abolished the futility requirement, and contains the prerequisites for bringing a derivative suit, has no requirement that the demand be pleaded at all.

creditor's remedies makes no requirement that only a debtor may be sued for recovery of a fraudulent conveyance and comment 4 to that section states:

> (4) As under the Uniform Fraudulent Conveyance Act, *a creditor is not required to obtain a judgment against the debtor-transferor or to have a matured claim in order to proceed under subsection (a).* See § 1(3) & (4) *supra*; American Surety Co. v. Conner, 251 N.Y. 1, 166 N.E. 783, 65 A.L.R. 244 (1929); 1 G. Glenn, Fraudulent Conveyances and Preferences 129 (Rev.ed. 1940).

N.C.G.S. § 39-23.7 cmt. 4 (emphasis added).

In fact, in most circumstances, the person holding the assets wrongfully transferred is not the original debtor, but a third party transferee to whom the assets were transferred, and from whom the creditors need to recover the assets. Yet, FCC actually did become a debtor of the Plaintiffs when they stepped into the shoes of Royal, Royal Acquisition, and Wall by controlling and converting the assets of said companies throughout the summer and fall of 2006. Additionally, FCC seized and sold the assets of Wall pursuant to their alleged rights as secured creditors under UCC Art. 9. At the time they succeeded to the position and assets of Wall, FCC became a debtor of Plaintiffs. As such, FCC is a debtor, a transferee, and a conduit of the fraudulently conveyed assets, and should properly be a party to any action under § 39-23.[5]

Regarding FCC's argument that Plaintiffs failed to adequately plead intent, § 39-23.5 does not require any intent, only an insolvent debtor, a concurrent claim, knowledge of the insolvency in the case of an insider, and lack of equivalent value. N.C.G.S. § 39-23.5. Plaintiffs have stated all said allegations sufficiently in their Amended Complaint (¶¶ 107-114). Similarly, § 39-23.4(a)(2)(a) does not require any intent, but only a pre-

[5] FCC may be able to claim an UCC Art. 9 defense as to the Wall assets that they privately sold to Yale, but such defense is contingent on a finding that FCC acted in good faith and conducted the sale of Wall in a commercially reasonable manner and for a reasonable equivalent value. N.C.G.S. § 25-1-203; § 25-9-617; § 25-9-610. These determinations are usually reserved for the jury.

existing creditor claim, a lack of reasonable equivalent value, and a debtor that "[w]as engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction." Plaintiffs have alleged, and the facts of this case strongly show that Plaintiffs had a claim against Wall, Royal, and Royal Acquisition before and at the latest by April 5, 2006, and that the transfer of any assets from said companies might trigger the protections of § 39-23.4(a)(2)(a). As to Plaintiffs' remaining claims under § 39-23.4(a)(1) and § 39-23.4(a)(2)(b), Plaintiffs' have alleged throughout the Amended Complaint, the fraudulent, bad faith, and conspiratorial nature of FCC's conduct (Am. Comp. ¶¶ 101, 137, 152-153, 199), and such allegations are sufficient under *Mascaro* for 12(b)(6) purposes.

Marshalling of the Assets

Plaintiffs' claim for Marshalling of the Assets is made with the true equitable considerations of the Court in mind. Marshalling applies when there are two or more funds of a common debtor that are encumbered by liens or claims and where a senior creditor's actions as against said funds could negatively impact a junior creditor(s), where the senior creditor may have recourse to funds that the junior does not. *Page Trust Co. v. Godwin*, 190 N.C. 512 (1925); 53 AmJur.2d § 1. FCC, as a senior creditor, claims a lien over several funds of Royal American, Wall Industries, and Royal Acquisition, including accounts receivable, liens on equipment, and liens on other assets. Currently, Plaintiffs' are junior creditors with claims against all three debtors. The actions of FCC against certain funds could negatively impact Plaintiffs, but it is currently undetermined what

specific funds Plaintiffs will have claims upon.[6] To the extent that Plaintiffs' (and other creditors') claims are at peril from FCC, Plaintiffs' have sufficiently pleaded marshalling of the assets. FCC's concerns as to injustice or prejudice are not appropriate for a 12(b)(6) determination, but should be equitably determined by the Court at a later date.

Fraud

FCC made a false representation of and/or concealed a material fact with respect to the amount of credit that was actually available to Royal Acquisition (and its parent company, Wall Industries, Inc.) for the purchase and capitalization of the combined operations of Wall and Royal. "A fact is material 'if the fact untruly asserted or wrongfully suppressed, if it had been known to the party, would have influenced [its] judgment or decision in making the contract at all.'" *Godfrey v. Res-Care, Inc*., 165 N.C.App. 68, 75 (2004) (quoting *Machine Co. v. Bullock*, 161 N.C. 1, 7 (1912)), as cited in NCPI, Civil § 800.00, "Fraud" fn. 2. Clearly, plaintiffs would not have agreed to sell their company, largely for future payments, if the company was to be cannibalized and liquidated, rather than financed and operated for a profit. FCC's false representations and/or concealment of the amounts and permitted uses of the money being lent, in order to gain unassailable control of the assets of both Royal and Wall fraudulently induced plaintiffs to sell 80% of their company and to subordinate the consideration for such a sale to FCC.

FCC also misrepresented the permissible uses to which the money advanced to Wall could be put (or the absence of any restrictions), as it retained oversight and recourse

[6] For example, currently, Plaintiffs are informed that UPS Business Capital, Inc. and FCC both have liens and claims on several sources of funds of Royal American, where FCC is believed to have recourse to all the assets as senior creditor, including the accounts receivable and equipment, while UPS has liens on only certain equipment. Plaintiffs' as guarantors of the UPS debt ask that the Court, with the assistance of the Receiver apportion and marshal the assets to best do justice to all creditors.

while promising to finance the continuation of the normal manufacturing business of the company, such that Royal could fulfill its commitments under a 7 year lease and the "Earnout Cash Payments." (*See*, Am. Comp., ¶ 21.) FCC promised to finance the acquisition of Royal by Wall, conditioned upon FCC's approval of the "Acquisition Documents," Articles of Organization and a new Limited Liability Company Agreement for Royal. FCC required plaintiffs to subordinate their debt, and retained immediate self-help remedies over all assets of the combined companies, while agreeing to provide up to $500,000 based upon its formula for the continued operation of the business enterprise. (See FCC Brief, Exhibit 1, "Schedule 1" and "Exhibit A.")

FCC's promise constitutes a false representation of fact since, at the time the representations were made, FCC had no intention of carrying out its promises. *See generally*, *Britt v. Britt*, 320 N.C. 573, 579 (1987), *overruled on other grounds by Myers & Chapman, Inc.*, 323 N.C. at 569; *Johnson*, 300 N.C. at 255, *as cited in* NCPI, Civil § 800.00, "Fraud" fn. 4. (The allegations as to FCC's state of mind must be deemed true at this stage of the litigation, and may be proven by circumstantial evidence, given the curiously short time between making the loan, declaring the default, disposing of Royal's assets and selling Wall to Yale Rope.)

FCC further failed to disclose that which, under the circumstances, it should have disclosed. FCC had the obligation to disclose the unavailability of operating funds, since it had made partial or incomplete representations to Plaintiffs to induce them to enter the Subordination Agreement and consent to FCC's financing of the acquisition. *Compare*, NCPI, Civil Jury Instructions, "Fraud" fn. 6, *citing*, *Ragsdale v. Kennedy*, 286 N.C. 130, 139 (1974), *with*, FCC Brief, Exhibit 1, "Schedule 1" and "Exhibit A."

FCC's false representations and/or concealments were calculated to deceive, since FCC either knew the representations concerning the available amounts and permitted purposes of the funding were false, or made them recklessly, without any knowledge of their truth or falsity. *See, Tarlton v. Keith*, 250 N.C. 298 (1959); *Atkinson v. Charlotte Builders, Inc.*, 232 N.C. 67, 68 (1950), *as cited in* NCPI, Civil § 800.00, "Fraud" fn. 8.

FCC had the intent to deceive Plaintiffs, as FCC had acknowledged Plaintiffs' interests as creditors and joint venturers with Royal and Wall, required prior approval of the Acquisition Documents, and insisted on Plaintiffs' subordination to FCC's plenary rights of immediate recourse under the Loan Agreement. *Cf., Myers & Chapman, Inc. v. Evans, Inc.*, 323 N.C. 559, 568, 374 S.E.2d 385, 391 (1988), *as cited in* NCPI, Civil § 800.00, "Fraud" fn. 10.

Plaintiffs were, in fact, deceived by FCC's false representations and/or concealment, as evidenced by their reliance on future payments for the execution of the Acquisition Documents and the Subordination Agreement. Plaintiffs' reliance was reasonable insofar as, under the same or similar circumstances, reasonable persons, in the exercise of ordinary care for their own welfare, would have relied on the false representations and would not have discovered the concealment. *See Little v. Stogner*, 162 N.C.App. 25, 30, (2004); *Fox v. Southern Appliances, Inc.*, 264 N.C. 267, 271 (1965); *Johnson*, 263 N.C. at 758, *as cited in* NCPI, Civil § 800.00, "Fraud" fn. 11.

Plaintiffs have suffered substantial damages as a result of their reliance on FCC's false representations and/or concealment. Ironically, FCC argues that Plaintiffs' execution of the Subordination Agreement was binding on Plaintiffs, yet unconnected to its own obligations under the Loan Agreement. (*See* FCC's Brief at p. 3, § II, ¶ 2

(Plaintiffs not parties to, and Loan Agreement makes no representations toward Plaintiffs); *and at* p. 7, § III A(a) ("only written agreement entered into among Plaintiffs and FCC was the Subordination Agreement" containing "exculpatory provisions" which are "valid and fully enforceable")). If that were so, then there existed an appalling absence of consideration flowing to plaintiffs for the subjugation of their rights to FCC in the Subordination Agreement. Our courts have held that inadequacy of consideration alone, if it is shockingly insufficient, will support a finding of fraud without other evidence. *Wall v.* Ruffin, 261 N.C. 720, 723 (1964); *Garris v. Scott*, 246 N.C. 568, 575, (1957); *Carland v. Allison*, 221 N.C. 120, 122 (1942). *See also* N.C.P.I.--Civil § 501.50, *and* NCPI, Civil § 800.00, "Fraud" fn. 12.

In pleading actual fraud the particularity requirement is met by alleging time, place and content of the fraudulent representation, identity of the person making the representation and what was obtained as a result of the fraudulent acts or representations, while a constructive fraud claim requires even less particularity because it is based on a confidential relationship rather than a specific misrepresentation. *Terry v. Terry*, 302 N.C. 77 (1981). The Plaintiffs have sufficiently alleged such fraud.

Breach of Fiduciary Duty Owed to Minority Shareholders/Members

Plaintiffs Cordage and American Cord had reasonable expectations as minority shareholders/members that, *inter alia*, the business and operations of Royal American would continue in the agreed upon normal course of business and that the managers, and majority shareholders would operate the business in such a way as to make the company provide the largest possible return on Plaintiffs' investment.

As a mere lender, FCC may not have acquired fiduciary duties to Plaintiffs

under the Loan Agreement. However, under the Subordination Agreement, and certainly, after FCC took over and controlled Royal, Royal Acquisition, and its parent Wall, it stepped into the shoes of the majority members, officers and directors of the companies, and owed to the Plaintiff-minority members, if not to Royal's and Wall's other creditors, a duty of good faith, care, and diligence to protect the interests of the companies, including the holders of the minority of the stock, and to secure and pay over to them their just proportion of the income and proceeds of the corporate property.

FCC breached the duties owed to the minority member/shareholder Plaintiffs by disregarding the terms of the Agreement and imposing, facilitating and/or funding a self-appointed receivership and liquidation of Royal, mere weeks after the closing. FCC thereafter managed Royal in such a way that the company produced no significant income, lost all of its inventory (believed to be worth approximately $2,000,000.00), ignored $1,400,000 in back orders, and thus significantly wasted and damaged Plaintiffs' ownership interests in the company, exposing plaintiffs to significant liability and costs on their guarantees. Such management frustrated and eliminated the Plaintiffs' potential for "Earnout Cash Payment"s under the Agreement. Further, as a result of FCC's failing to make or direct equipment lease payments and to satisfy other known accounts payable and debt obligations, plaintiffs have been subjected to numerous lawsuits by equipment lessors upon Plaintiffs' guarantees, with no indemnity provided, as promised.

No explanation is offered as to where the $500,000 in working capital (much less the approximately $2 Million of inventory) went, except FCC's insistence that the condition for the required reserves was "not an obligation running from FCC to Plaintiffs that those funds would be used for any specific purpose." (FCC Brief at p. 4.) By taking

the above actions, FCC frustrated the reasonable expectations of the minority member/shareholder Plaintiffs.

Negligent Misrepresentation

FCC had a duty to exercise reasonable care or competence in obtaining or communicating information to plaintiffs, as a group of persons who it knew would rely on the information supplied in its Subordination Agreement, Loan Agreement and attached Schedules and Exhibits. FCC's breach of that duty was a "negligent misrepresentation" under North Carolina law. *See, Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 322 N.C. 200, 206, 210, 214 (1988), *as cited in* NCPI, Civil § 800.10, "Negligent Misrepresentation" fn. 2.

In the course of its business as a lender, and with respect to transactions in which it had a financial interest, FCC supplied information to Plaintiffs regarding the status, future plans/intentions, and financing of the transactions involved in this suit, upon which FCC intended for Plaintiffs to rely. FCC made representations, directly or indirectly, to Plaintiffs that Royal and Wall had combined inventories and receivables with sufficient value that they would have certain funding to continue their normal course of manufacturing, following the proposed acquisition. In fact, FCC may be held to the standard of care of appraisers in supplying such information. *See generally, Ballance v. Rinehart*, 105 N.C.App. 203 (1992); *Alva v. Cloninger*, 51 N.C.App. 602 (1981)) *as cited in* NCPI, Civil § 800.10, "Negligent Misrepresentation" fn. 3.) FCC specifically represented, as a condition precedent to financing the acquisition, the availability of and intended use of the $500,000 as working capital to be made available by FCC through the loan. Such information as supplied by FCC was false. FCC either knew such

information was false, or failed to exercise reasonable care or competence in obtaining or communicating the false information.

Plaintiffs actually relied on the false information supplied by said Defendants, and Plaintiffs' reliance was justifiable, causing Plaintiffs to incur substantial financial damage. *See, Forbes v. Par Ten Group, Inc.*, 99 N.C.App. 587, 598 (1990), *as cited in* NCPI, Civil § 800.10, "Negligent Misrepresentation" fn. 4.

Unfair Trade Practices

To state a claim for unfair and/or deceptive trade practices, the plaintiffs must allege that (1) the defendants committed an unfair or deceptive act or practice, or an unfair method of competition, (2) in or affecting commerce, (3) which proximately caused actual injury to the plaintiffs or to the plaintiffs' business. *Walker v. Sloan*, 137 N.C.App. 387 (2000); *Pleasant Valley Promenade v. Lechmere, Inc.*, 120 N.C.App. 650 (1995). The statute defines "commerce" as "all business activities, however denominated." N.C.G.S. § 75-1.1(b). There is no doubt that FCC's business is in and effects commerce. FCC's conduct, whether denominated as fraud, misrepresentation, conspiracy, or as just as an immoral and unethical practice would constitute an unfair and deceptive act. *See e.g. Opsahl v. Pinehurst Inc.*, 81 N.C.App. 56 (1986). Plaintiffs have adequately alleged an unfair and deceptive trade practice claim (Am. Comp. ¶¶ 148-150).

Constructive Fraud

Plaintiffs agree with the legal authorities cited by FCC, but disagree with FCC's conclusions. Plaintiffs have alleged facts and circumstances which demonstrate the creation of a relationship of trust and confidence that existed between plaintiffs and FCC as the financier for the purchase of their 80% interest in Royal. This is especially

true (even if Plaintiffs are viewed as third-party beneficiaries of the Loan Agreement) since the vast majority of the consideration to Plaintiffs for the sale was to be supplied from future earnings, and since FCC was an "asset-based" lender who would serve as a kind of super-factor to provide funding for future operations (with both receivables and assets pledged as collateral). That relationship led up to and surrounded the Subordination Agreement, in which FCC took advantage of its special relationship of trust and confidence in requiring Plaintiffs to subordinate the obligations to FCC, in exchange for FCC's purported financing of the continued operation of Royal and Wall (from which Plaintiffs would receive future payments.) *See, Barger v. McCoy Hillard & Parks,* 346 N.C. 650 (1997) (to maintain claim for constructive fraud, Plaintiffs must show "relation of trust and confidence which led up to and surrounded consummation of transaction in which defendant is alleged to have taken advantage of position of trust to the hurt of plaintiff") *citing, Rhodes v. Jones*, 232 N.C. 547, 549 (1950); *Sidden v. Mailman,* 137 N.C.App. 669 (2000) (claim for constructive fraud requires "less particularity" than for fraud; there is no requirement there be allegations of dishonesty or intent to deceive, as fraud is presumed from the nature of the relationship.)

Punitive Damages

> "…[P]unitive damages may be awarded … if a claimant proves that the defendant is liable for compensatory damages and that the defendant is guilty of fraud, malice, or willful or wonton conduct. *Combs & Associates, Inc. v. Kennedy*, 147 N.C.App. 362, 374… (2001) (citing N.C. Gen.Stat. § 1D-15(a)(1999)). …
>
> "Punitive damages may be awarded …if, in the case of a corporation, the officers, directors, and managers of the corporation participated in or condoned the conduct constituting the aggravating factor giving rise to punitive damages." *Phillips v. Restaurant Management of Carolina, L.P.*, 146 N.C.App. 203, 215-16 … (2001) (citing N.C. Gen.Stat. § 1D-15(c) (1999)).

Pack Bros. Body Shop, Inc. v. Nationwide Mut. Ins. Co., 2003 NCBC 1, 2003 (2003) (Unpublished Opinion).

Plaintiffs' Amended Complaint sufficiently alleges that FCC and FCC's officers, directors or managers participated in or condoned egregiously wrongful conduct directed toward Plaintiffs, including fraud, conspiracy, breach of fiduciary duties, constructive fraud and other willful, wonton, and malicious acts. (*See e.g.,* Am. Comp. ¶¶ 21, 24, 28, 29, 44, 53, 54, 109, 114, 134 – 139). Whether the alleged facts rise to the level of aggravated conduct necessary to support punitive damages is a question for the trier of fact to determine; Plaintiffs' claims for punitive damages should not be dismissed under Rule 12(b)(6). *See, Smith v. Nationwide Mut. Fire Ins. Co.*, 96 N.C.App. 215 (1989).

Other Claims and Remedies

FCC did not directly address the remaining claims and remedies against it in its brief, including declaratory judgment, constructive trust, injunction and receivership, and exoneration, indemnification, and subrogation. These remedies and causes of action are appropriate and should be preserved pending the ultimate outcome of this suit. *See, Allen ex rel. Allen & Brock Const. Co., Inc. v. Ferrera,* 141 N.C.App. 284, 291-292 (2000) (reversing trial court's dismissal of Plaintiff's declaratory judgment claims).

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CERTIFICATION OF ATTORNEY UNDER N.C.B.C. RULE 15.8

The undersigned attorney hereby certifies that the foregoing brief of Plaintiffs' complies with N.C. Business Court Rule 15.8. Said attorney relies on the word count of the "Microsoft Word" Word Processing Software in making this certification pursuant to Rule 15.8.

This the 14th day of February, 2006.

_s/___William E. Moore, Jr._____
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CERTIFICATE OF SERVICE

The undersigned, does hereby certify that he has this day duly served a copy of the foregoing **Reply and Brief of Plaintiffs** has been served on the party/parties in interest via electronic mail and by sending a copy by United States Mail:

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