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, LLC, WALL INDUSTRIES, INC., ROYAL ACQUISITION CORPORATION, FCC, L.L.C. D/B/A FIRST CAPITAL, STANLEY J. SWIDER, & SAMUEL B. FORTENBAUGH III, YALE CORDAGE, INC., & YALE ROPE TECHNOLOGIES, INC., Defendants.	**BRIEF OF FCC, LLC, D/B/A FIRST CAPITAL IN SUPPORT OF ITS MOTION TO DISMISS OR IN THE ALTERNATIVE MOTION FOR JUDGMENT ON THE PLEADINGS**

INTRODUCTION

Defendant FCC, LLC, d/b/a First Capital ("FCC" or "Lender") respectfully submits this Memorandum in Support of its Motion to Dismiss pursuant to Rule 12(b)(6) of the North Carolina Rules of Civil Procedure or in the alternative, Motion for Judgment on the Pleadings. The premise of these motions is that the facts alleged in the pleadings and the loan documents incorporated therein fail as a matter of law to support a viable claim against this Defendant.

I. NATURE OF THE CASE

FCC is a commercial lender, and its limited involvement in the circumstances surrounding this lawsuit merely amount to conducting business as a commercial lender. The underlying transaction was an arms length commercial transaction not unlike financial services that banks routinely provide to assist businesses with financing needs. Plaintiffs have added FCC as a Defendant in this action simply because FCC loaned money that was applied toward the acquisition of a company, Royal American Corporation ("Royal American"), and by virtue of said loan, Royal American's assets are encumbered by a security interest in favor of FCC. These

assets are currently unavailable to Plaintiffs to satisfy Plaintiffs' alleged claims against the other defendants in this case, and therefore Plaintiffs' added FCC to this proceeding. During a recent hearing, Plaintiffs' counsel admitted to this motivation. (Transcript of October 16, 2006 Hearing on Plaintiffs' Motion for Preliminary Injunction, Ex. 3 at 17, lns. 1-11 (hereinafter "Ex. 3").)

In April 2006, FCC agreed to finance the acquisition of a majority interest in Royal American by Defendant Royal Acquisition Corporation ("Royal Acquisition"). In support of the loan, various parties, including Royal Acquisition, Royal American, and Wall Industries, Inc. ("Wall") (collectively "Borrowers"), pledged substantially all their assets to FCC pursuant to a Loan and Security Agreement (the "Loan Agreement"). Plaintiffs, as owners of minority membership interests in Royal American, entered into a Debt Subordination Agreement (the "Subordination Agreement") with FCC subordinating any rights Plaintiffs might have with respect to Borrowers' assets to those of FCC. After the transaction was consummated, Borrowers repeatedly defaulted on the loan, whereupon FCC opted to exercise its rights to the collateral as expressly provided by the Loan Agreement and as recognized by the Subordination Agreement.

On October 3, 2006, Plaintiffs filed a Complaint in the above-captioned matter in the Superior Court of Gaston County asserting claims against Borrowers and FCC, and on November 29, 2006, Plaintiffs filed an Amended Complaint. FCC believes that the following causes of action have been asserted against it: Breach of Contract (Debt Subordination Agreement), Fraud, Fraudulent Transfers, Tortious Interference with Existing Contract, Negligent Misrepresentation, Conspiracy/Facilitating Fraud, Unfair Trade Practices, Marshalling of the Assets, and Punitive Damages.

FCC filed an Answer on January 2, 2007 asserting a number of defenses to Plaintiffs' claims and now files this Motion to Dismiss for Failure to State a Claim and alternative Motion for Judgment on the Pleadings. FCC addresses these claims in the current motion and memorandum.

II. STATEMENT OF THE FACTS BASED ON THE PLEADINGS AND DOCUMENTS INCORPORATED THEREIN

On April 5, 2006, Wall, Royal Acquisition, and Royal American entered into a written Limited Liability Company Membership Interest Purchase Agreement (the "Purchase Agreement") with Plaintiffs Jerry W. Webb ("Webb"), Lloyd Alwran ("Alwran"), American Cord & Twine, Inc. ("American Cord") and Royal Cordage Corporation ("Royal Cordage") for the sale of an 80% membership interest in Royal American. (Am. Compl. ¶ 15 & Ex. A.). FCC was not a party to the Agreement, which was entered exclusively among Plaintiffs Royal Cordage, American Cord, Webb and Lloyd Alwran, and defendants Wall, Royal Acquisition and Royal American. (Am. Compl., Ex. A at 1, 47-48.)[1]

FCC was approached by Borrowers to finance the purchase of Royal American. Borrowers entered into a Loan and Security Agreement (the "Loan Agreement",) with FCC, pursuant to which FCC provided a revolving credit facility to finance the purchase by Royal Acquisition of the membership interests of Royal American. The Loan Agreement is attached hereto as Exhibit 1. Plaintiffs were not parties to the Loan Agreement, and the Loan Agreement makes no representations toward Plaintiffs regarding the financing provided to Borrowers, Borrowers' use of those funds, or the continued operation of any Borrower's business. (Ex. 1 at 1, 31; Ex. 3 at 12, ln. 25.)

Consistent with industry standards, under the Loan Agreement, Borrowers pledged as collateral substantially all of their assets, including but not limited to the assets of the target entity Royal American, in effect creating a blanket lien on the assets of each Borrower. (Ex. 1 § 5(a).) Section 13 of the Loan Agreement lists the remedies available to FCC in the event of default by Borrowers, including but not limited to collecting Borrowers' accounts receivable, and the foreclosure and sale of Borrowers' inventory and equipment. (Ex. 1 § 13(b).) Pursuant to the Order entered on October 17, 2006 denying Plaintiffs' Motion for Preliminary Injunction against FCC, this Court recognized FCC's right to "pursue collection" of the loan from the collateral pledged as security under the Loan Agreement. *See* October 17, 2006 Order ¶¶ 3(a)-(b).

[1]At present, Royal Cordage is partly owned by Plaintiffs Jerry W. Webb ("Webb") and Lloyd Alwran (Alwran) and is a minority member/shareholder of Royal American. (Am. Compl. ¶¶ 1-2, 6.) American Cord is also partly owned by Plaintiffs Webb and Alwran and is a minority member/shareholder of Royal American. (Am. Compl. ¶¶ 1-2, 5.) Royal Acquisition now owns 80% of Royal American. (Am. Compl. ¶ 19.)

As a condition precedent to closing, in order to ensure that Borrowers did not exhaust their borrowing capacity on the closing date of the acquisition of Royal American, the Loan Agreement required Borrowers to "have at least $500,000 of unused borrowing availability" on the closing date as reflected by a Borrowing Base Certificate ("Borrowing Base Certificate"). (Ex. 1, Schedule A, pg. 3.) On the closing date, Borrowers in fact certified that they had unused borrowing availability of at least $500,000 after giving effect to the loan advances to be made on the closing date. However, this was a condition precedent for the protection of FCC in making the loans – not an obligation running from FCC to Plaintiffs that those funds would be used for any specific purpose. The purpose of this "availability cushion" was to try to ensure that Borrowers had adequate liquidity to operate their business after giving effect to the acquisition. As is the normal course in transactions of this type, the funds were readily available to Borrowers for use in their business on the day after closing. FCC fulfilled all of its obligations to lend money to Borrowers pursuant to the Loan Agreement.

Another condition precedent to FCC providing financing for the purchase of Royal American required Plaintiffs and Borrowers to execute a Subordination Agreement attached hereto as Exhibit 2. (Ex. 2 at 2; Ex. 3 at 13, ln. 1.) In the Subordination Agreement, Plaintiffs agreed, *inter alia*,: (1) to subordinate amounts owed by Borrowers to Plaintiffs to the debt owed by Borrowers to FCC (Ex. 2 § 2.1); (2) not to exercise any remedies against Borrowers until Borrowers' debt to FCC has been fully satisfied (Ex. 2 § 2.3(a)); (3) not to seek a receiver with respect to any Borrower until at least 91 days after Borrowers' debt to FCC has been fully satisfied (Ex. 2 § 2.3(b)); (4) that none of Plaintiffs would have any claim against FCC for action taken with respect to any Borrower *or its assets* (Ex. 2 § 2.6(b)); and (5) that Plaintiffs waive any right to seek marshalling of assets.[2] (Ex. 2 § 2.7(b)).

The Subordination Agreement additionally contains an exculpatory provision under which Plaintiffs expressly waived any claims which they would have against FCC and agreed not to hold FCC liable for any action taken with regard to the collateral and the enforcement of the provisions of the Loan Agreement. Specifically the waiver precludes actions by Plaintiffs relating to "the creation, perfection or continuation of Liens on the Collateral", "the foreclosure upon, sale, release, or depreciation of, or failure to realize upon, any of the Collateral", "the

[2] During the October 16, 2006 hearing on Plaintiffs' Motion for Preliminary Injunction, Plaintiffs' counsel admitted that bringing this action might constitute a breach of the Subordination Agreement. (Ex. 3 at 16, ln. 12-14).

collection of any claim for all or any part of the Senior Creditor Indebtedness [debt of Borrowers to FCC] from any account debtor, guarantor, or any other party", and "any other action with respect to enforcement of the [loan documents among Borrowers and FCC] or the valuation, use, protection, or disposition of the Collateral . . ." (Ex. 2 § 2.6.)

The Subordination Agreement contains an integration clause reciting that the Subordination Agreement was "the entire agreement and understanding of the parties hereto regarding the subject matter hereof." (Ex. 2 § 3.8.) Finally, the Subordination Agreement contains a choice of law provision which states that the laws of the state of Georgia govern interpretation of the Subordination Agreement and the determination of rights and liabilities thereunder. (Ex. 2 § 3.7.)

In the Amended Complaint, Plaintiffs allege that as part of the overall agreement, FCC, along with the other defendants, "represented to the parties that it would provide Royal American with a minimum of $500,000 in working capital for the purposes of paying equipment leases, purchasing raw materials, and other day-to-day expenses necessary to continue the operations of the business." (Am. Compl. ¶ 28.) Indeed, most of Plaintiffs' claims against FCC rest upon this single assertion. Plaintiffs attached as Exhibit B to their Amended Complaint an unsigned, preliminary draft of the Borrowing Base Certificate, which they attempt to twist into a representation by FCC to Plaintiffs that FCC would provide financing to Borrowers. (*Id*.) As explained above, however, FCC made no such representation to Plaintiffs. It is also important to note that FCC fulfilled its obligations to make loans to Borrowers.[3]

According to the Amended Complaint, Plaintiffs allege that the Defendants (somehow including FCC), "took control" of Royal American, and shortly thereafter, production stopped, layoffs occurred, debts went unpaid, and "at the behest of First Capital" the other defendants hired a liquidation consultant.[4] (Am. Compl. ¶ 44.) Plaintiffs also allege upon information and belief that the defendants, FCC, and a liquidation consultant entered into "some sort of receivership or liquidation-type scenario . . . and began liquidating the inventory and assets of Royal American in a manner not in accordance with the ordinary course of business." (*Id*. at ¶ 54-55.) As explained in more detail below, neither one of these allegations have any merit. All

[3] The $500,000 was available to Borrowers after the transaction closed. FCC had no control over how these funds were used by Borrowers in their business.

[4] Plaintiffs' counsel acknowledged during the Preliminary Injunction hearing that FCC had nothing to do with hiring or recommending the so-called liquidation consultant, yet the allegations were restated in their Amended Complaint filed after the hearing. (Ex. 3 at 35, lns. 22-25.)

actions taken by FCC were specifically provided by law and remedy in the Loan and Security Agreement.

III. ARGUMENT

A. Dismissal of This Entire Lawsuit is Proper Because the Allegations in Plaintiffs' Amended Complaint Fail to Support a Single Claim Against FCC.

A motion to dismiss pursuant to N.C. Civ. P. Rule 12(b)(6) is designed to test the legal sufficiency of the complaint. *Sutton v. Duke*, 277 N.C. 94, 102-03, 176 S.E.2d 161, 165-66 (1970). A complaint should be dismissed for insufficiency where it appears from the face of the complaint that the plaintiff has not made allegations that would support a claim for which relief may be granted. *Stanback v. Stanback*, 297 N.C. 181, 185, 254 S.E.2d 661, 615 (1979). In deciding the instant motion, it is appropriate for the Court to consider the contracts that underlie the dispute and are specifically referred to in the complaint, and it may do so without converting the motion into one for summary judgment. *See Coley v. N.C. Nat'l Bank*, 41 N.C. App. 121, 126, 254 S.E.2d 217, 220 (1979) (holding that the trial court's consideration of a contract which was the subject of the action and referred to in the complaint did not convert the motion to dismiss into one for summary judgment); *Oberlin Capital, LP v. Slavin*, 147 N.C. App. 52, 554 S.E.2d 840 (2001). The following agreements are relevant to Plaintiffs' claims and were attached to the Amended Complaint: (1) the Purchase Agreement, (2) a Subordinated Promissory Note by Royal American in favor of Webb (the "Subordinated Note"), and (3) an Amended and Restated Limited Liability Company Agreement with respect to Royal American (the "LLC Agreement"). Additionally, the Loan Agreement and the Subordination Agreement underlie several of Plaintiffs' claims and referenced repeatedly in the Amended Complaint and were put into evidence on Plaintiffs' Motion for Preliminary Injunction. (Am. Compl. ¶¶ 30, 40, 97-98, 191.) All of these documents may be considered by the Court in resolving this motion to dismiss without converting the motion into one for summary judgment under Rule 56. *See Coley*, 41 N.C. App. at 126.

Furthermore, as explained in more detail below, all of Plaintiffs' claims against FCC are not supported by the facts alleged by Plaintiffs. Nonetheless, even if the Court were to find that any issue existed, the claims fail due to Plaintiffs' express waiver of such claims in the Subordination Agreement. Each of Plaintiffs' claims fail individually in that the facts alleged in

the pleadings and documents incorporated therein fail to support the claims alleged. Therefore, all claims against FCC should be dismissed as a matter of law.

a. *Plaintiffs Expressly Waived the Claims They Have Asserted Against FCC Through an Exculpatory Clause in the Subordination Agreement, Thus Plaintiffs Cannot Recover On Any Theory in the Complaint.*

As described above, the only written agreement entered into among Plaintiffs and FCC was the Subordination Agreement. The Subordination Agreement contained an exculpatory provision whereby Plaintiffs agreed not to hold FCC liable for any action taken (or not taken) under the Loan Agreement. (Ex. 2 § 2.6.) The Subordination Agreement contains a choice of law provision under which the parties consented to the application of Georgia law. (Ex. 2 § 3.7.) The North Carolina Supreme Court has directed that "where parties to a contract have agreed that a given jurisdiction's substantive law shall govern the interpretation of the contract, such a contractual provision will be given effect." *Tanglewood Land Co. v. Byrd*, 299 N.C. 260, 262, 261 S.E.2d 655, 656 (1980); *see also Bueltel v. Lumber Mut. Ins. Co.*, 134 N.C. App. 626, 631, 518 S.E.2d 205, 209 (1999).

The exculpatory provision in the Subordination Agreement is valid and fully enforceable under Georgia law. *See Monroe v. Martin*, 137 Ga. 262, 73 S.E. 341 (1911) (holding that a promissory note stipulating that the maker was never to be sued on the note had the effect of relieving the maker "of all liability on the note."). The Georgia Court of Appeals has consistently enforced exculpatory provisions, so long as they are not in contravention of public policy. *See, e.g., Orkin Extermination Co., Inc. v. Stevens*, 130 Ga. App. 363, 369, 203 S.E.2d 587, 593 (1973); *West Side Loan Office v. Eletro-Protective*, 167 Ga. App. 520, 520, 306 S.E.2d 686, 687 (1983); *Piedmont Arbors Condo. Assoc., Inc. v. BPI Constr. Co.*, 197 Ga. App. 141, 142-42, 397 S.E.2d 611, 612 (1990). Courts should "exercise extreme caution in declaring a contract void as against public policy, and should do so only when the case is free from doubt and an injury to the public interest clearly appears." *Piedmont Arbors*, 197 Ga. App. at 141-42, 397 S.E.2d at 612. The mere fact that an exculpatory provision would eliminate most or all of a plaintiff's claims and have the effect of waiving numerous and substantial rights is not sufficient to support a finding that the contract violates public policy. *See id.*

The exculpatory provision here does not contravene public policy. The circumstances here involve a straight-forward, arm's length financing arrangement in which Plaintiffs agreed to

subordinate their rights to receive payments from Royal American, Wall and Royal Acquisition to the rights of FCC, as well as to not hold FCC liable for exercising its rights to the collateral upon an event of default. This was done in exchange for FCC's agreement to finance the transaction. Neither the Georgia courts nor the Georgia legislature has articulated a public policy that would invalidate the Subordination Agreement, perhaps because finding such an agreement unenforceable would cause turmoil in the financing industry by substantially increasing the liability exposure of lenders and potentially deterring lending and commercial development.

The exculpatory provision is clear, prominent, and unambiguous, as required by Georgia law. *See Grace v. Golden*, 206 Ga. App. 416, 425 S.E.2d 363 (1993). The provision clearly states that FCC shall have no "liability or duty of any kind, nature or origin . . . except as set forth in this Agreement" (Ex. 2 § 2.6(a)) and that each plaintiff "hereby waives and releases any claim which [it] may not or hereafter have against [FCC] arising out of any and all actions which [FCC], in good faith, takes or omits to take with respect to any Borrower, any Collateral or any [FCC loan document] . . . ." (Ex. 2 § 2.6(b).) Additionally the clause contains a waiver of any claims that Plaintiffs may otherwise have against FCC in connection with FCC's "foreclosure upon, sale, release, or depreciation of, or failure to realize upon, any of the Collateral."[5] (*Id.*) As a valid and enforceable exculpatory provision, Section 2.6 of the Subordination Agreement precludes Plaintiffs from proceeding with their claims alleged in the Amended Complaint, and therefore, dismissal is appropriate.

b. *The Averments Relating To The Specific Causes Of Action Asserted Against First Capital Are Insufficient to Sustain the Claims, And Therefore, Dismissal Is Proper.*

1. *Breach of Contract*

In their original complaint, Plaintiffs asserted that Defendants breached the Purchase Agreement, the Lease, the Subordinated Note, and the LLC Agreement (as defined by the complaint in Exhibits A, C-E attached thereto). As described in more detail below, FCC was not a party to any of the aforementioned agreements and, therefore, is not subject to liability for any

[5] Plaintiffs' counsel acknowledged the Subordination Agreement's affect on Plaintiffs' rights in the Preliminary Injunction hearing. (Ex. 3 at 32, ln. 12; *Id.* at 33, lns 4-7.)

alleged breach of those agreements.[6] Plaintiffs, however, amended the original complaint to include a cause of action for breach of contract against FCC, alleging that "First Capital breached its financial contract and subordination agreement with Defendants and Plaintiffs by failing to provide the $500,000 in working capital to or for the benefit of Royal American, unfairly and fraudulently liquidating, controlling, and converting the assets of Royal American, Royal Acquisition, and Wall and tortiously interfering with contracts between Plaintffs and the other defendants." (Am. Compl., ¶¶ 97-99.)

In a breach of contract case, interpretation of the applicable contract is purely a question of law. *See Harris v. Ray Johnson Constr. Co.*, 139 N.C. App. 827, 829, 534 S.E.2d 653, 654 (2000); OCGA § 13-2-1 ("The construction of a contract is a question of law for the court."). As discussed above, Plaintiffs' breach of contract claim, as it pertains to FCC, should be dismissed because Plaintiffs released any claims which might arise against FCC.

The only agreement underlying Plaintiffs' breach of contract claim to which both Plaintiffs and FCC are parties is the Subordination Agreement, which Plaintiffs allege FCC breached (1) by failing to ensure that $500,000 in working capital was infused into Royal American and (2) by liquidating Royal American's assets under the Loan Agreement. There is no factual basis for this assertion. There exists no agreement by FCC to provide working capital for any particular use by Royal American. The Subordination Agreement does not contain language prohibiting FCC from exercising its remedies against Borrowers under the Loan Agreement. To the contrary, pursuant to the Subordination Agreement, Plaintiffs expressly agreed not to interfere with FCC's right to recover on the collateral pursuant to the Loan Agreement and further provided that FCC has no "duty or liability of any kind, nature or origin" to Plaintiffs except as provided for under the Subordination Agreement. (Ex. 2 § 2.6.) Moreover, as discussed above, FCC fulfilled all of its obligations to lend money to Borrowers. Due to the express waiver of liability under the exculpatory provisions and the lack of a contractual term creating any of the alleged obligations, Plaintiffs have failed to allege the breach of any provision sufficient to withstand scrutiny under 12(b)(6).

[6] Defendants do not believe that Plaintiffs causes of action for breach of contract based on these agreements are directed at FCC, but in the event that they are determined to be, FCC asserts that because it was not a party to these agreements, it cannot be in breach them.

Plaintiffs also mention breach of a "financial contract" without identifying the actual contract.[7] The cause of action should be dismissed as it relates to the "financial contract" due to this fundamental omission alone; however, in the event that the claim survives this challenge, there are other grounds for dismissal. First, Plaintiffs were not parties to any other agreement, including "financial contract[s]" with FCC other than the Subordination Agreement. Second, with respect to the allegations relating to the $500,000 "working capital" commitment, Plaintiffs cannot and have not pointed to a single contract provision that creates this obligation on the part of FCC in the way Plaintiffs have characterized it. In the Amended Complaint, Plaintiffs rely heavily on the preliminary, unsigned version of the Borrowing Base Certificate attached thereto. However, as indicated previously, the Loan Agreement merely required that "Borrowers have at least $500,000 of unused borrowing availability" under the Loan Agreement after giving affect to the loans used to finance the acquisition, which is standard in the commercial finance industry. The Borrowing Base Certificate is simply a certification by Borrowers to FCC as to Borrowers' compliance with the lending formula detailed in the Loan Agreement. No plaintiff was a party to either the Loan Agreement or the Borrowing Base Certificate. Thus, Plaintiffs' claims with respect to FCC's alleged breach fail for two fundamental reasons: (1) FCC did not have any contract with Plaintiffs that creates any obligation on the part of FCC toward Plaintiffs, and (2) in any event, FCC fulfilled all of its contractual obligations to lend money to Borrowers.

Finally, although not clear whether this count is directed at FCC, it appears that Plaintiffs' assert that FCC breached the implied duty of good faith and fair dealing. Plaintiffs allege that FCC entered into the Subordination Agreement with Plaintiffs "with no good faith intention of fulfilling [its] obligations." While it is a basic principle of contract law that contracting parties are required to act in good faith, *Weyerhaeuser Co. v. Godwin Bldg. Supply Co.*, 40 N.C. App. 743, 253 S.E.2d 625 (1979), a party does not breach its implied duty of good faith and fair dealing by doing precisely that which is expressly permitted by the contract. *See Sara Lee Corp. v. Quality Manuf., Inc.*, 201 F. Supp. 2d 608, 616 (2002); *Dull v. Mutual of Omaha Ins. Co.*, 85 N.C. App. 310, 354 S.E.2d 752 (1987) (no breach for termination of agency agreements when agreements were expressly terminable at will). The Subordination Agreement specifically recognizes FCC's right under the Loan Agreement to recover the collateral in the event of default, and Plaintiffs' allegations point to no restriction in the Subordination

[7] Plaintiffs may have been referring to the Loan Agreement, but it is not clear.

Agreement on those rights. For these reasons and those stated above, Plaintiffs' breach of contract claim against FCC should be dismissed.

2. Fraudulent Transfers

To the extent it is asserted against FCC, Plaintiffs have failed to state a claim for fraudulent conveyance. Under the Uniform Fraudulent Transfers Act, N.C.G.S. § 39-23.1 *et seq*., transfers made or obligations incurred by a *debtor* of the party asserting the claim may constitute a fraudulent transfer if the transfer was made or obligation incurred "(1) with the intent to hinder, delay, or defraud any creditor of the debtor; or (2) [w]ithout receiving a reasonably equivalent value in exchange . . . ." N.C.G.S. § 39-23.4(a); *see also* N.C.G.S. § 39-25.5 (fraudulent transfers as to present creditors). FCC is not a debtor of any of Plaintiffs nor is it one of the "debtors" named in Plaintiffs' fraudulent transfer claim. (Am. Compl. ¶ 107.) Furthermore, Plaintiffs have not alleged, nor could they allege, the presence of any of the factors listed in N.C.G.S. § 39-23.4(b) for determining whether FCC possessed the "intent" to hinder, delay, or defraud Plaintiffs. *See Mascaro v. Moutaineer Land Group, L.L.C.*, 2006 NCBC 18 (2006) (failure to plead state of mind for claim under N.C.G.S. § 39-23.4(a)(1) "reveals on its face, the absence of facts sufficient to make a good claim."). Therefore, to the extent the claim may be construed as being asserted against FCC, Plaintiffs' claim for fraudulent transfer should be dismissed.

3. Fraud

To make out a prima facie claim for fraud, a plaintiff must allege each of the following essential elements:

> (a) that defendant made a representation relating to some material past or existing fact; (b) that the representation was false; (c) that when he made it defendant knew it was false or made it recklessly without any knowledge of its truth and as a positive assertion; (d) that the defendant made the false representation with the intention that it should be acted on by the plaintiff; (e) that the plaintiff reasonably relied upon the representation and acted upon it; and (f) that the plaintiff suffered injury.

Maurer v. Slick-Edit, Inc., 2006 NCBC 1, ¶ 50 (N.C. Super. Feb. 3, 2006) (quoting *Bolick v. Townsend Co*., 94 N.C. App. 650, 652, 381 S.E.2d 175, 176 (1989)). The complaint must set forth the circumstances constituting the fraud "with particularity". N.C. R. Civ. Pro. 9. "[I]n

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." *Terry v. Terry*, 302 N.C. 77, 85, 273 S.E.2d 674, 678 (1981). Moreover, the plaintiff "must identify the particular individuals who dealt with him when he alleges that he was defrauded by a group or association of persons." *Coley*, 41 N.C. App. at 125.

Plaintiffs' fraud allegations fall woefully short of the pleading requirements for actual fraud. The Amended Complaint conclusorily asserts that "the Defendants, including First Capital" "made false representations of fact to, and concealed material facts from Plaintiffs." (Am. Compl. ¶ 134.) Plaintiffs however fail to state the specific representation, when or how the representation was made, to whom it was made, how they relied on it, and how they were damaged. All of these are essential elements to a claim for fraud.

Furthermore, the documents that Plaintiffs use in support of their claim of fraud fail to show that FCC intended to defraud the Plaintiffs as they do not reflect a representation made to Plaintiffs by FCC. The loan transaction was between FCC and Borrowers, and as noted herein and shown by the documents attached to the Amended Complaint, FCC fulfilled all of its financial obligations to Borrowers, including without limitation making the $500,000 opening availability available to Borrowers following the closing of the acquisition of Royal American.

Plaintiffs also have failed to adequately plead reasonable reliance. Plaintiffs freely entered into the Subordination Agreement and agreed not to interfere with FCC's rights with regard to the collateral under the Loan Agreement. (Ex. A §§ 2.3 & 2.6.) In the case of parties standing in a non-fiduciary relationship, such as exists between a creditor and a guarantor, the "person signing a written instrument is under a duty to read it and ordinarily is charged with knowledge of its contents." *Spartan Leasing*, 101 N.C. App. at 455, 400 S.E.2d at 479 (quoting *Mills v. Lynch*, 259 N.C. 359, 130 S.E.2d 541 (1963)). Plaintiffs and FCC were not in a fiduciary relationship at the time the Subordination Agreement was executed, nor do Plaintiffs allege that any such relationship existed.

For the reasons expressed above, Plaintiffs' fraud claim fails to adequately plead both the misrepresentation and the reasonable reliance elements and should be dismissed to the extent that it is alleged against FCC.

4. Negligent Misrepresentation

In *Oberlin Capital LP v. Slavin*, the North Carolina Court of Appeals recognized that the tort of negligent misrepresentation "occurs when a party justifiably relies to his detriment on information prepared without reasonable care *by one who owed the relying party a duty of care*." 147 N.C. App. 52, 58, 554 S.E.2d 840, 846 (2001) (emphasis added); *see also Hudson-Cole Development Corp. v. Beemer*, 132 N.C. App. 341, 346, 511 S.E.2d 309, 313 (1999). This Court also recognized that a claim of negligent misrepresentation requires the existence of "a duty of care arising from the parties' working relationship." *Oberlin Capital LP v. Slavin*, 2000 NCBC 6, ¶ 27 (N.C. Super. Apr. 28, 2000) (quoting *Davidson and Jones, Inc. v. New Hanover County*, 41 N.C. App. 661, 255 S.E.2d 580 (1979)). In negligent misrepresentation cases, a duty is defined as "an obligation, recognized by the law, requiring the person to conform to a certain standard of conduct, for the protection of others against unreasonable risks." *Id.*

No such relationship or duty exists or has ever existed among FCC and Plaintiffs. The extent of FCC's relationship with Plaintiffs is the Subordination Agreement under which Plaintiffs agreed to subordinate their claims against Borrowers to those of FCC, which was the "entire understanding and agreement of the parties." Furthermore, as stated above, FCC was not a party to any of the agreements under which Plaintiffs' claim to have suffered injury, nor do Plaintiffs allege that FCC owed any duty to Plaintiffs in the drafting and execution of those agreements. FCC's role in the transaction was as the lender to the purchasers—a role which does not give rise to an affirmative duty for the benefit of the sellers. *See First Nat'l Bank v. Theos*, 794 P.2d 1055, 1066 (Colo. Ct. App. 1990) (relationship between borrower and lender does not give rise to fiduciary duty as a matter of course). Plaintiffs' negligent misrepresentation claim, insofar as it has been asserted against FCC, should therefore be dismissed.

5. Unfair Trade Practices

To state a claim of relief for unfair and deceptive trade practices, a "plaintiff must show (1) an unfair and deceptive act by defendant, (2) in or effecting commerce, (3) which proximately caused actual injury to plaintiff." *Wilson v. Blue Ridge Electric Membership Corp.*, 157 N.C. App. 355, 357, 578 S.E.2d 692, 694 (2003). Whether a practice is unfair and deceptive

is a question of law. *See Gray v. N.C. Ins. Underwriting Assoc*., 132 N.C. App. 63, 510 S.E.2d 396 (1999).

Most of the discernable claims against FCC arise out of FCC's role as financier for the transaction among Plaintiffs and Borrowers. FCC's remedial actions with respect to the assets of Borrowers flow directly from the terms and rights established under the Loan Agreement and merely represent the customary and proper post-default actions of a commercial lender. *See Oberlin Capital, LP v. Slavin*, 147 N.C. App. 52, 62, 554 S.E.2d 840, 848 (2001) (transaction involving lending institution in capital raising function not "in or affecting commerce"). FCC's conduct in exercising its rights pursuant to the Loan Agreement and as expressly recognized by the Subordination Agreement do not constitute unfair or deceptive acts and therefore cannot support a claim under N.C. Gen. Stat. § 75-1.1.

Further, to the extent that Plaintiffs' allegations against FCC arise solely out of an alleged breach of contract, it is well-settled that "[a] mere breach of contract, even if it is intentional, is not sufficiently unfair or deceptive to sustain an action under N.C. Gen. Stat. § 75-1.1." *Gray v. N.C. Ins. Underwriting Assoc*., 132 N.C. 63, 510 S.E.2d 396 (1999). The allegations of the complaint fail to properly alleged a cause of action for unfair and deceptive trade practices.

6. Tortious Interference with Contract

Plaintiffs assert a claim for tortious interference with contract or in the alternative for breach of contract. In their Amended Complaint, Plaintiffs assert that the liquidation of Royal American, Royal Acquisition, and Wall by FCC constitutes a tortious interference with a contract, i.e., the Purchase Agreement and LLC Agreement. (Am. Compl. ¶¶ 178-184.)

The elements necessary to establish a claim of tortious interference with a 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." *Filmar Racing, Inc. v. Stewart*, 141 N.C. App. 668, 674, 541 S.E.2d 733, 738 (2001) (citing *Embree Construction Group v. Rafcor, Inc.*, 330 N.C. 487, 498 (1992)). With respect to the fourth element, absence of justification, actions that are taken for legitimate business purposes are justified. *See Peoples Security Life Ins., Co. v. Hooks*, 322 N.C. 216, 221, 367 S.E.2d 647, 650 (1988) (citations

omitted); *Privette v. University of North Carolina*, 96 N.C. App. 124, 134, 385 S.E.2d 185, 191 (1989) ("The interference is 'without justification' if the defendants' motives for procuring termination of the employment contract were 'not reasonably related to the protection of a legitimate business interest' of the defendant."). North Carolina Torts (2d ed.) states that a party's financial interest and a bona fide legally protected interest are considered legitimate business purposes and are thus justified. *See* North Carolina Torts (2d Ed.) § 25.40, at 642.

A complaint alleging tortious interference with a contract "must admit of no motive for interference other than malice." *Filmar Racing,* 141 N.C. App. at 674, 541 S.E.2d at 738 (dismissing claim because the complaint described co-pending litigation involving circumstances suggesting that defendants had a legitimate business purpose and a "motive for interference other than malice."). *See also Area Landscaping, L.L.C. v. Glaxo-Wellcome, Inc.*, 160 N.C. App. 520, 523-24, 586 S.E.2d 507, 510-11 (2003) (holding summary judgment proper when evidence indicated that the defendant's bid for landscaping project was for a legitimate business purpose of seeking and obtaining business rather than malice).

As with *Filmar*, Plaintiffs' Amended Complaint contains factual allegations which reveal a legitimate business purpose for the alleged interference associated with the alleged liquidation of Royal American's assets. FCC financed the acquisition of Royal American via loans to Borrowers. (Am. Compl. ¶¶ 28-30.) Plaintiffs allege that after control of Royal American changed hands, FCC initiated the process of liquidation of Royal American and Wall. (Am. Compl. ¶¶ 44, 54.) Finally, Plaintiffs allude to the Subordination Agreement entered between FCC and Plaintiffs, as well as financing contracts. (*Id*. at ¶¶ 30, 40, 97.) These allegations, collectively and/or individually, strongly suggest the legitimate business purpose of FCC's remedial actions with respect to its collateral following Borrowers' defaults under the Loan Agreement. Because motives other than malice (i.e. FCC's desire to have its loans repaid from the proceeds of its collateral) are apparent from the Amended Complaint, this cause of action must be dismissed. *Filmar Racing,* 141 N.C. App. at 674, 541 S.E.2d at 738.

7. Conspiracy/Facilitating Fraud

Plaintiffs' conspiracy claims fail as a matter of law because there is no such cause of action under North Carolina law. North Carolina appellate courts have expressly declined to recognize a separate cause of action for civil conspiracy. *See Dalton v. Camp,* 138 N.C. App.

201, 213, 531 S.E.2d 258, 266 (2000) ("[t]here is no cause of action for conspiracy per se"); *Dickens v. Puryear*, 302 N.C. 437, 456, 276 S.E.2d 325, 337 (1981); *Henderson v. LeBauer*, 101 N.C. App. 255, 260-61, 399 S.E.2d 142, 145 (1991). Therefore, to the extent Plaintiffs' conspiracy claim is asserted as a separate cause of action, it should be dismissed.

On the other hand, Plaintiffs may have asserted a conspiracy claim in order to associate the various defendants in this action with each other and to seek the admission of evidence of one defendant against the others. *Jones v. City of Greensboro*, 51 N.C. App. 571, 583, 277 S.E.2d 562, 571 (1981) ("the charge of conspiracy itself does nothing more than associate defendants together and perhaps liberalize the rules of evidence to the extent that under proper circumstances the acts and conduct of the one defendant might be admissible against all."), *overruled on other grounds by Fowler v. Valencourt*, 334 N.C. 345, 435 S.E.2d 530 (1993). In order to do so, however, a plaintiff must allege the following: (1) an agreement between two or more persons to do an unlawful act or a lawful act in an unlawful manner causing damages to the claimant; and (2) the commission of an "overt act" by at least one of the conspirators in furtherance of the conspiracy. *Dalton*, 138 N.C. at 213, 531 S.E.2d at 266-67; *Dickens*, 302 N.C. at 456, 276 S.E.2d at 337. A complaint stating a claim for civil conspiracy must state facts supporting an inference that an agreement was made between the parties and *stipulate specific tortious or unlawful acts agreed upon and committed* pursuant to the conspiracy. *See Kirby v. Reynolds*, 193 S.E. 412 (N.C. 1937) (emphasis added). "In civil conspiracy, recovery must be on the basis of sufficiently alleged wrongful overt acts." *Shope v. Boyer*, 268 N.C. 401, 405, 150 S.E.2d 771, 773-74 (1966) (dismissing complaint because it failed "to allege any overt, tortious, or unlawful act which any defendant committed in furtherance of the conspiracy").

The elements of a cause of action for facilitation of fraud are substantially similar. The elements of facilitating fraud are: (1) that the defendants agreed to defraud the plaintiff; (2) that the defendants committed an overt tortuous act in furtherance of the agreement; and (3) that the plaintiff suffered damages from that act. *Neugent v. Beroth Oil Co.*, 149 N.C. App. 38, 560 S.E.2d 829 (2002).

Plaintiffs' conspiracy/facilitating fraud claim does not allege that FCC was party to any conspiracy with the other defendants. To the extent Plaintiffs have alleged a conspiracy claim against FCC, it fails because the Amended Complaint does not properly plead any specific tortious or unlawful acts committed in furtherance of any agreement between the parties. First,

as discussed above, none of Plaintiffs tort-based claims (fraud, negligent misrepresentation, breach of fiduciary duty, tortious interference with contract) adequately allege that FCC engaged in any tortious activity. Second, the Amended Complaint does not allege any tortious or unlawful acts by FCC that do not already purport to serve as the basis for Plaintiffs' substantive claims for relief. A plaintiff cannot allege the same tortious or unlawful acts committed in furtherance of the conspiracy that serve as the basis for his other claims for relief. *See Jones v. City of Greensboro*, 51 N.C. App. 571, 583-83, 277 S.E.2d 562, 571 (1981) ("Plaintiff cannot . . . use the same alleged acts to form both the basis of a claim for conspiracy to commit certain torts and the basis of claims for those torts."). Therefore, Plaintiffs conspiracy/facilitating fraud claims should be dismissed for failure to state a claim for which relief may be granted.

8. Punitive Damages

N.C. Gen. Stat. 1D-1 *et seq*. permits an award of punitive damages to punish a defendant for misconduct of an aggravated, extreme, outrageous, or malicious character. *See Rhyne v. K-Mart Corp.*, 149 N.C. App. 672, 562 S.E.2d 82 (2002). Punitive damages are given in addition to compensatory damages due to the wanton, reckless, malicious, or oppressive character of the injurious acts. *See Watson v. Dixon*, 352 N.C. 343, 532 S.E.2d 175 (2000). However, an award is appropriate only if the claimant proves that the defendant is liable for compensatory damages in addition to the presence of aggravating factors. *See Murray v. Allstate Ins. Co.*, 51 N.C. App. 10, 275 S.E.2d 195 (1981). Granting Defendants' motion to dismiss Plaintiffs' causes of action will remove the requisite liability for compensatory damages upon which an award of punitive damages must be based.

9. Marshalling of the Assets

Plaintiffs request that the Court invoke the doctrine of Marshalling of the Assets to protect their interest as alleged junior creditors of Royal American. Plaintiffs seek this relief despite the fact that FCC's actions to liquidate the general assets of Royal American to collect the debt that it is owed were authorized by this Court by Order dated October 17, 2006.[8] More

[8] This Court noted that Plaintiffs willingly executed a Subordination Agreement with FCC that precludes any action against FCC for exercising its rights over the assets of Royal American until FCC collects in full on Royal American's debt to FCC.

notably, Plaintiffs invoke the doctrine despite expressly waiving their right to seek marshalling in the Subordination Agreement. (Ex. 2 § 2.7(b).) This alone is sufficient basis for dismissal.

The doctrine of Marshalling of the Assets is an equitable doctrine that applies when a common debtor holds separate funds and one creditor has a lien on both funds, while the other creditor has a lien on only one fund. *See Dixieland Realty Co. v. Wysor*, 272 N.C. 172, 181, 158 S.E.2d 7, 14 (1967) (there must be two separate funds at the time the equitable relief is sought). Plaintiffs have not alleged such a scenario here. Further, the doctrine cannot be invoked against a superior creditor, nor does the doctrine apply if the holder of the superior lien would be forced to expose himself to the possibility of costly litigation or suspend his immediate right to proceed against the fund subject to the lien. *See Stokes v. Stokes*, 206 N.C. 108, 110, 173 S.E. 18, 19 (1934); *Dixieland Realty Co.*, 272 N.C. at 181, 158 S.E.2d at 14.

FCC is protected by the superior equity of having entered into a contractual relationship with Plaintiffs pursuant to the Subordination Agreement, which precludes any attempt on the part of Plaintiffs to seek this relief, and FCC would not have entered into this transaction with Borrowers but for Plaintiffs entering the Subordination Agreement. Equity favors holding Plaintiffs to the terms and conditions of agreements they willingly enter and not in preventing FCC, a superior secured creditor, from rightfully and lawfully collecting on the debt owed by Borrowers. *See Stokes*, 206 N.C. at 119, 173 S.E. at 19.

Finally, granting the requested relief would result in a substantial injustice to FCC by imposing significant hardships on FCC, interfering with its rightful collection efforts, and depriving FCC of its rights under contract. *See Dixieland Realty Co.*, 272 N.C. at 181-82 (Marshalling will not be applied when it would "prejudice" or "impose hardships on the paramount creditor" or when it would "inconvenience him in the collection of his debt . . .").

10. Breach of Fiduciary Duty

Plaintiffs have not specified which defendants are the subject of their claim for breach of fiduciary duty. FCC does not owe, nor does the Amended Complaint allege that it owes, a fiduciary duty to Plaintiffs. Therefore, Plaintiffs claim for breach of fiduciary duty, to the extent it may be construed as being asserted against FCC, is insufficient as a matter of law and should be dismissed.

11. Constructive Fraud

To sufficiently plead a claim for constructive fraud the plaintiff must allege facts and circumstances to demonstrate (1) the creation of a relationship of trust and confidence that existed between the plaintiff and defendant(s) and (2) that that relationship led up to and surrounded an agreement in which the defendant took advantage of that special relationship of trust and confidence. *Barger v. McCoy Hiliard & Parks*, 346 N.C. 650, 488 S.E.2d 215 (1997); *Sidden v. Mailman*, 137 N.C. App. 669, 529 S.E.2d 266 (2000). Plaintiffs have not alleged any facts to demonstrate the creation of a relationship of trust and confidence between themselves and FCC either leading up to or at the time of the agreements here. Therefore, Plaintiffs' constructive fraud claim, to the extent it has been asserted against FCC, should be dismissed.

c. Plaintiffs, As Individual Members Of Royal American, Do Not Have Standing To Assert Many Of Their Claims.

Plaintiffs assert that they have incurred injury as a result of two alleged actions by FCC: (1) FCC's alleged misrepresentation that it would supply $500,000 in working capital; and (2) FCC's allegedly wrongful liquidation of Royal American following Borrowers' default under the Loan Agreement. They have claimed injury in two forms: (1) the loss of expected income from the promissory note and various equipment leases executed between Plaintiffs and Royal American; and (2) the devaluation of their minority interests in Royal American. To the extent they are based on the devaluation of Plaintiffs' interests in Royal American, Plaintiffs' claims should be dismissed.

The appellate courts of North Carolina have expressly held that individual shareholders do not have an individual right to recover for a wrong committed against the corporation. *See Barger v. McCoy Hilliard & Parks*, 346 N.C. 650, 659, 488 S.E.2d 215, 220 (1997) (claim by individual shareholders against third party accounting firm for negligently misrepresenting the corporation's financial condition was improper because injury was to corporation and not personal to shareholders). Similarly, Plaintiffs allege that FCC's actions caused the devaluation of their membership interests in Royal American. Plaintiffs' claims based on that injury are derivative to those of the limited liability company, and Plaintiffs failed to exhaust intra-company remedies first, a prerequisite to bringing a derivative suit under North Carolina law. *See Alford v. Shaw*, 72 N.C. App. 537, 540, 324 S.E.2d 878, 881 (1985) (shareholder must first

seek to obtain their remedy within the corporation itself). *See also, Norman v. Nash Johnson & Son's Farms, Inc.*, 140 N.C. App. 390, 411, 537 S.E.2d 248, 263 (2000) (holding that enactment of N.C. Gen. Stat. 55-7-42 effected a repeal of the futility exception). Therefore, to the extent Plaintiffs' claims are based on diminution in the value of their membership interests, they should be dismissed.

CONCLUSION

For the foregoing reasons, Defendant FCC, LLC, d/b/a FCC, respectfully requests that the Court grant its motion to dismiss Plaintiffs' claims for failure to state a claim for which relief may be granted or in the alternative Defendant's motion for judgment on the pleadings.

This, the 19th day of January, 2007.

/s/ Bradley A. Roehrenbeck
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and accurate copy of the foregoing **BRIEF IN SUPPORT OF TO DEFENDANT FCC, LLC d/b/a FIRST CAPITAL'S MOTION TO DISMISS OR IN THE ALTERNATIVE MOTION FOR JUDGMENT ON THE PLEADINGS** has been served upon counsel of record by depositing a copy thereof in the United States mail, postage prepaid and addressed as follows:

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This the 19th day of January, 2007.

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