

STATE OF NORTH CAROLINA
GUILFORD COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
22 CVS 8287

ALAN W. (“A”) CONE, JR. and LOUIS
 (“BILLY”) CONE individually and
derivatively on behalf of BLUE GEM,
INC.,

Plaintiffs,

v.

BLUE GEM, INC.; STEPHEN B.
CONE; and ELAINE BULLUCK,

Defendants.

**ORDER AND OPINION ON
DEFENDANTS’ MOTIONS FOR
EXPENSES**

1. **THIS MATTER** is before the Court on two motions for payment of expenses filed by Defendants, (the “Motions”), (ECF Nos. 58, 61).¹

2. Defendants Stephen B. Cone (“Steve”) and Elaine Bulluck (“Bunny”) seek recovery of reasonable expenses, including attorneys’ fees, from Plaintiffs pursuant to N.C.G.S. § 55-7-46(2) and (3). Alternatively, Steve and Bunny seek court-ordered indemnification pursuant to N.C.G.S. § 55-8-54.

¹ Plaintiffs filed a single, consolidated brief in support of their own motion to dismiss their derivative claim and in opposition to Defendants’ Motions. (Pls.’ Reply Supp. Mot. Dismiss and Resp. Opp. Defs.’ Motions for Costs, ECF No. 63.) They then filed a Motion for Leave to File Surreply Brief in opposition to the Defendants’ reply briefs. (Pls.’ Mot. Leave File Surreply Br., ECF No. 66.) Defendants responded by filing briefs opposing Plaintiffs’ surreply. (Blue Gem’s Mem. Resp. Pls.’ Mot Leave File Surreply Br., ECF No. 72; Cone and Bulluck’s Resp. Opp. Pls.’ Mot. Leave File Surreply Br., ECF No. 73.) In its discretion, the Court **GRANTS** Plaintiffs’ Motion for Leave to File Surreply and has considered Plaintiffs’ Surreply, which was submitted as Exhibit A to their motion (ECF No. 66.1), in making the determinations herein.

3. Similarly, Defendant Blue Gem, Inc. (“Blue Gem”) seeks to recover from Plaintiffs its reasonable expenses, including attorneys’ fees, pursuant to N.C.G.S. § 55-7-46(2) and (3). Blue Gem also seeks an order taxing Plaintiffs, jointly and severally, with any amount it is required to indemnify Steve and Bunny.

4. Having considered the Motions, the related briefing, and other appropriate matters of record, the Court hereby **GRANTS in part and DENIES in part** Steve and Bunny’s motion, **DENIES** Blue Gem’s motion, and taxes Steve and Bunny’s reasonable expenses, including attorney’s fees, incurred in defending against the derivative claim against Plaintiffs.²

Brooks, Pierce, McLendon, Humphrey & Leonard LLP, by Clinton Shepperd Morse and Amanda Hawkins, for Plaintiffs Alan W. (“A”) Cone, Jr. and Louis (“Billy”) Cone.

Block, Crouch, Keeter, Behm & Sayed, by Christopher K. Behm, for Defendant Blue Gem, Inc.

Ward and Smith, P.A., by Jenna F. Butler and Joseph Anthony Schouten, for Defendants Stephen B. Cone and Elaine Bulluck.

Earp, Judge.

I. BACKGROUND

5. Plaintiffs, shareholders in Blue Gem, a closely-held corporation, initiated this action on 25 October 2022 with the filing of their Complaint, (ECF No. 3.) After designation to the Business Court, Plaintiffs filed an Amended Complaint on 12 December 2022, asserting a direct claim against Blue Gem for

² The Court determines, in its discretion, that oral argument will not aid in its decision and issues this ruling without a hearing pursuant to BCR 7.4.

judicial dissolution and a derivative claim against Steve and Bunny for breach of fiduciary duty, (ECF No. 11).

6. Each Defendant moved to dismiss the Amended Complaint. (Blue Gem's Mot. Dismiss First Am. Compl. for Jud. Dissol., ECF No. 20; Stephen B. Cone's and Elaine Bulluck's Corrected Mot. Dismiss, ECF No. 22). The Court held a hearing on those motions on 11 April 2023. (Not. of Hr'g, ECF No. 50.)

7. On 9 August 2023, following an unsuccessful mediation but prior to the Court's ruling on Defendants' Motions to Dismiss, Plaintiffs filed their own motion in which they sought a voluntary dismissal without prejudice of their case in its entirety, including their derivative claim for breach of fiduciary duty. (Mot. Dismiss Without Prejudice ["Pls.' Mot. to Dismiss"], ECF No. 55.)³ Pursuant to N.C.G.S. § 55-7-45, the Court's approval was required to effect a dismissal of the derivative claim.

8. On 13 October 2023, the Court entered an Order and Opinion dismissing the Plaintiffs' derivative claim for breach of fiduciary duty with prejudice, acknowledging Plaintiffs' voluntary dismissal of the dissolution claim without prejudice, and taxing Plaintiffs with the costs of the action pursuant to Rule 41(d) of

³ Accompanying Plaintiffs' Motion to Dismiss was an unsworn letter to the Court from Plaintiffs. (Pls.' Mot. to Dismiss, Ex. A ["Pls.' Letter"], ECF No. 55.1.) In the letter, Plaintiffs represented to the Court, among other things, that when filing this action, they were "unaware that the precedents set in family law were so thoroughly irrelevant to a case brought to trial in business court" and that "a precedent set in a family courtroom is not relevant to a precedent set in a business courtroom." They asserted that because the Business Court is "guided by Business Court precedence [sic]" this Court is "incapable of dealing with [their claims]." (Pls.' Letter pp. 1-2.) They also stated that they had decided to dismiss the case because of its financial impact and emotional toll. (Pls.' Letter pp. 1-2.) Because the letter was unsworn, however, the Court does not consider it with respect to the Motions.

the North Carolina Rules of Civil Procedure. (Order and Opinion on Mots. Dismiss, ECF No. 71.)

9. Following dismissal of the action, each Defendant seeks to recover expenses, including attorneys' fees.

III. FINDINGS OF FACT⁴

10. Plaintiffs (Alan "A" Cone and Louis "Billy" Cone) and the individual Defendants (Elaine "Bunny" Bulluck and Stephen B. "Steve" Cone) are siblings who inherited stock in their father's company, Blue Gem, Inc. ("Blue Gem" or the "Company").⁵

11. Steve owns 29.748 percent of the voting stock of Blue Gem and serves as a director of the Company, as well as its President. Bunny owns 23.146 percent of the voting stock of Blue Gem and serves as a director of the Company. Together, Steve and Bunny own a majority interest in Blue Gem.

12. A Cone and Billy each own 23.146 percent of the voting stock of Blue Gem. Billy is also a director.

13. A Cone and Billy complain that, because Blue Gem is organized as a C corporation, its income is taxed both at the corporate level and again at the

⁴ To the extent the Court's findings of fact are more properly considered conclusions of law or vice versa, the finding or conclusion may be properly reclassified. *N.C. State Bar v. Key*, 189 N.C. App. 80, 88 (2008) ("[C]lassification of an item within [an] order is not determinative, and, when necessary, the appellate court can reclassify an item before applying the appropriate standard of review.").

⁵ The Court's findings are derived from facts that are alleged in the Amended Complaint and not contested by Defendants in their Motions to Dismiss.

shareholder level when paid out as dividends. Because they disagree with Steve and Bunny on the best course to reduce this tax burden, they want to redeem their shares at what they consider to be “fair value.” To them, fair value does not involve minority or illiquidity discounts.

14. Alternatively, A Cone and Billy have proposed that Blue Gem spin off some of its assets to a new entity to be owned by them.

15. Steve and Bunny disagree with A Cone and Billy’s proposals and have voted against them.

16. The parties initially took steps toward converting Blue Gem from a C to an S Corporation, but A Cone and Billy have now made it clear that they will not agree to such a conversion because they have concluded that they no longer wish to be in business with Steve and Bunny.

17. After Steve and Bunny did not agree to Plaintiffs’ proposals either to sell their interests without discounts or for a “tax-free spin-off,” A Cone and Billy filed this action asserting a derivative claim against Steve and Bunny for breach of fiduciary duty, as well as a claim against Blue Gem for judicial dissolution.

II. CONCLUSIONS OF LAW

18. Pursuant to N.C.G.S. § 55-7-46, upon the termination of a derivative proceeding, a court may:

(2) Order the plaintiff to pay any defendant’s reasonable expenses, including attorneys’ fees, incurred in defending the proceeding if it finds that the proceeding was commenced or maintained without reasonable cause or for an improper purpose; or

(3) Order a party to pay an opposing party's reasonable expenses, including attorneys' fees, incurred as a result of the filing of a pleading, motion, or other paper, if the court, after reasonable inquiry, finds that the pleading, motion, or other paper was not well grounded in fact or was not warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it was interposed for an improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

N.C.G.S. § 55-7-46(2), (3).

19. With respect to Section 55-7-46(2), “[a]n improper purpose is ‘any purpose other than one to vindicate rights . . . or to put claims of right to a proper test.’” *Ekren v. K&E Real Estate Invs., LLC*, 2014 NCBC LEXIS 57, at *14 (N.C. Super. Ct. Nov. 10, 2014) (quoting *Coventry Woods Neighborhood Ass’n v. City of Charlotte*, 213 N.C. App. 236, 241 (2011)). The Court assesses Plaintiffs’ objective behavior in view of the totality of the circumstances when determining whether an improper purpose exists. *Id.*

20. A derivative suit is filed for an improper purpose if it is “instituted more with a view to obtaining a settlement favorable to the plaintiff and his attorney than to righting a wrong to the corporation.” An Official Comment to the statute refers to such an action as a “strike suit.” N.C.G.S. § 55-7-40, Official Comment.⁶

21. As for Section 55-7-46(3), a well-respected treatise states that “the grounds for an order of payment . . . are the same as the basis for the payment of expenses under Rule 11 of the Rules of Civil Procedure and apply to any document

⁶ Although Official Comments are not binding because they have not been enacted into law, “they were included with the printing of the statute and are, therefore, relevant in construing the intent of the statute.” *Miller v. First Bank*, 206 N.C. App. 166, 171 (2010).

filed at any time in the action.” Russell M. Robinson, II, *Robinson on North Carolina Corporation Law* § 17.10.

22. However, there is a subtle distinction. Rule 11 sanctions may be based on factual insufficiency, legal insufficiency, *or* improper purpose, whereas Section 55-7-46(3) requires factual or legal sufficiency *and* improper purpose. *Cf. Ekren*, 2014 NCBC LEXIS 57, at *12 (“in contrast to Rule 11, [under § 57D-8-05(3)] the Court must find that Defendant . . . filed the document for an ‘improper purpose’ *in addition* to finding that same document ‘was not well grounded in fact or was not warranted by existing law’ ”) (citing N.C.G.S. § 57D-8-05(3)). However, “whether or not a pleading has a foundation in fact or is well grounded in law will often influence the determination of the signer’s purpose.” *Coventry Woods Neighborhood Ass’n*, 213 N.C. App. at 242 (quoting *In re Kunstler*, 914 F.2d 505, 518 (4th Cir. 1990)).

23. Defendants contend they are entitled to reasonable expenses, including attorneys’ fees, pursuant to N.C.G.S. § 55-7-46(2) because Plaintiffs’ action is an impermissible “strike suit” filed for an improper purpose. They argue that the action was commenced and maintained, not to remedy a wrong to Blue Gem, but “to coerce [Steve and Bunny] into a buyout of Plaintiffs’ shares at an unwarranted premium.” (Mem. Supp. Defs.’ Stephen B. Cone’s and Elaine Bulluck’s Mot. Payment of Expenses [“Steve and Bunny’s Br. Supp.”] 12-13, 16, ECF No. 59; Def. Blue Gem’s Mem. Supp. Mot. for Recovery of Reasonable Expenses, Including Attys’ Fees (N.C. Gen. Stat. §§ 55-7-46(1) and (2)) [“Blue Gem’s Br. Supp.”] 10, ECF No. 62.)

24. Defendants also argue that Plaintiffs brought their derivative claim without reasonable cause. While the case law interpreting this phrase is scant, in *Sutton v. Sutton*, this Court concluded that where plaintiff lacked standing and the complaint was “on its face . . . seriously deficient and subject to dismissal on several grounds,” plaintiff had commenced and maintained the action “without reasonable cause.” *Sutton v. Sutton*, 2011 NCBC LEXIS 44, at **6-7 (N.C. Super. Ct. Nov. 22, 2011); cf. *McMillan v. Ryan Jackson Props., LLC*, 232 N.C. App. 35, 41 (2014) (construing “without reasonable cause” in N.C.G.S. § 55A-7-40 to mean there is “no ‘reasonable belief’ in a ‘sound chance’ that the claim could be sustained.”) (citation omitted).

25. In addition, Defendants contend that the derivative claim in this action was (a) not well-grounded in fact or warranted by either existing law or a good faith argument for the modification or reversal of existing law, and (b) interposed for an improper purpose. Consequently, they seek their reasonable expenses, including attorneys’ fees, for Plaintiffs’ alleged violation of Section 55-7-46(3). (Defs.’ Stephen B. Cone’s and Elaine Bulluck’s Mot. Payment of Expenses or, in the Alternative, for Indemnification [“Steve and Bunny’s Motion”] 5-6, ECF No. 58; Def. Blue Gem’s Mot. for Recovery of Reasonable Expenses, including Attys’ Fees (N.C. Gen. Stat. §§ 55-7-46(2) and (3)) [“Blue Gem’s Mot. for Expenses”] 1-2, ECF No. 61.)

26. In their Amended Complaint, Plaintiffs alleged that Steve and Bunny violated a fiduciary duty to Blue Gem by allowing it to remain a C corporation, resulting in “double taxation” of income. But the record reveals that the underlying

reason for Plaintiffs' decision to file their derivative claim is that Steve and Bunny, as directors and owners of a combined majority interest in Blue Gem, have declined to agree either (a) to redeem Plaintiffs' shares without minority and illiquidity discounts; or (b) to a "tax free" spin-off of Blue Gem assets to a new entity owned by Plaintiffs. Meanwhile, Plaintiffs themselves have rejected the option of converting Blue Gem to an S corporation as a way of resolving the tax issue because they do not want to remain in business with their siblings. The Court concludes, therefore, that Plaintiffs want to reduce taxes, but only through a mechanism that will allow them to exit the company for what they consider to be fair value.

27. The Court has addressed the insufficiency of Plaintiffs' derivative claim for breach of fiduciary duty in its earlier motion to dismiss ruling and incorporates its analysis here. *See Cone v. Blue Gem*, 2023 NCBC LEXIS 127 (N.C. Super. Ct. Oct. 13, 2023), (ECF No. 71.) In short, the Court concludes that (1) it is not a breach of fiduciary duty for Steve and Bunny to continue Blue Gem as a C corporation; (2) the facts alleged with respect to Steve and Bunny's decisions not to adopt Plaintiffs' exit proposals are insufficient to overcome the business judgment rule; and (3) the totality of the circumstances reveals that the true purpose for the breach of fiduciary duty derivative claim was to pressure Steve and Bunny into voting for a proposal that would allow Plaintiffs to exit the company while maximizing the value of their interests.

28. Accordingly, pursuant to Section 55-7-46(2), the Court, having concluded that Plaintiffs' derivative claim was brought for an improper purpose,

GRANTS in part Steve and Bunny's motion. The Court orders Plaintiffs to pay Steve and Bunny's reasonable expenses, including attorneys' fees, incurred to defend against the derivative claim for breach of fiduciary duty, the only claim stated against them. In all other respects, Steve and Bunny's motion is **DENIED**.⁷

29. As for Blue Gem's Motion, the only claim asserted against it was a direct claim for dissolution. The company itself was not a defendant in a derivative proceeding. Therefore, Blue Gem itself has no basis upon which to seek recovery of expenses pursuant to Section 55-7-46 (2) or (3).

III. CONCLUSION

30. **WHEREFORE**, the Court, in the exercise of its discretion, **ORDERS** as follows:

- a. Plaintiffs' Motion for Leave to File Surreply, (ECF No. 66.1), is **GRANTED**.
- b. Defendants Stephen B. Cone's and Elaine Bulluck's Motion for Payment of Expenses, or in the alternative, for Indemnification, (ECF No. 58), is **GRANTED in part and DENIED in part** such that Plaintiffs shall pay Steve and Bunny's reasonable expenses, including attorneys' fees, incurred to defend against the derivative claim for breach of fiduciary duty. In all other respects, the motion is **DENIED**.

⁷ Because the Court concludes that Plaintiffs should be taxed with Steve and Bunny's reasonable expenses incurred in defending against the derivative claim pursuant to N.C.G.S. § 55-7-46(2) and (3), it does not reach Bunny and Steve's alternative argument for court-ordered indemnification pursuant to N.C.G.S. § 55-8-54.

- c. Defendant Blue Gem, Inc.'s Motion for Recovery of Reasonable Expenses, Including Attorneys' Fees, (ECF No. 61), is **DENIED**.
- d. By 7 December 2023, Steve and Bunny shall file a petition with affidavits and other supporting materials sufficient to allow the Court to make findings with respect to the amount and reasonableness of the expenses assessed.
- e. By 29 December 2023, Plaintiffs may file their response to the petition.
- f. No reply will be permitted absent further order of the Court.

IT IS SO ORDERED, this 7th day of November, 2023.

/s/ Julianna Theall Earp

Julianna Theall Earp
Special Superior Court Judge
for Complex Business Cases