STATE OF NORTH CAROLINA

COUNTY OF LINCOLN

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
15 CVS 1391

DENVER GLOBAL PRODUCTS, INC.,

Plaintiff,

v.

JEANNE HENDRIX,

Defendant,

and

ROGER LEON and KEITH PIERCY,

Defendants and Counterclaim/Third-Party Plaintiffs,

v.

CHONGQING RATO POWER CO., LTD.; CHONGQING RATO POWER MANUFACTURING CO., LTD.; CHONGQING RATO TECHNOLOGY CO., LTD.; ZHU LIEDONG; LARRY QIAN WANG; JIN XIANG; MICHAEL PARKINS; GODWIN LENG; and RATO NORTH AMERICA, INC.,

Third-Party Defendants.

ORDER DENYING DEFENDANTS' MOTION TO DISMISS, DISQUALIFY, AND REPLACE COUNSEL AND DENYING PLAINTIFF'S MOTION FOR PRELIMINARY INJUNCTION

1. Defendants Roger Leon and Keith Piercy have moved to dismiss this action and to disqualify counsel for Plaintiff Denver Global Products, Inc. ("Denver Global"). (Defs.' Mem. Supp. Mot. Dismiss, Disqualify and Replace Counsel and Stay Litigation ("Mot. Dismiss") 1–2.) Claiming to be the "rightful owners" and officers of Denver

Global, Leon and Piercy argue that they have not "authorized" a lawsuit against themselves. (Defs.' Mem. Supp. Mot. Dismiss 2.) They contend that certain third-party defendants have instead "perpetrated a fraud on the court" by causing Denver Global to file this action—and that the Court should exercise its inherent authority to dismiss this case for that reason. (Defs.' Mem. Supp. Mot. Dismiss 7.)

2. Denver Global argues in opposition that it is a wholly owned subsidiary of Chongqing Rato Power Manufacturing Co. ("Rato Manufacturing") and that Leon and Piercy resigned as officers of the company in 2013. (Pl.'s Mem. Opp'n Mot. Dismiss 2 & n.1, 6.) Denver Global has also filed a cross-motion for a preliminary injunction to prohibit Leon and Piercy from holding themselves out as the company's owners and officers. (*See* Pl.'s Mot. Prelim. Inj. 1–2.)

3. Having considered the motions, the briefs supporting and opposing the motions, and the parties' oral arguments, the Court **DENIES** Leon and Piercy's motion to dismiss. The Court also **DENIES** without prejudice Denver Global's motion for a preliminary injunction.

I.

BACKGROUND

4. Formed in October 2010, Denver Global is a North Carolina corporation that manufactures and sells multi-purpose vehicles. (*See* Compl. ¶¶ 17–18; Countercl. ¶¶ 33–34.) According to the Complaint, Denver Global is a wholly owned subsidiary of Rato Manufacturing, a Chinese company that manufactures general-purpose engines for a variety of outdoor equipment. (*See* Compl. ¶¶ 17, 19.) In this action,

filed December 30, 2015, Denver Global alleges that former officers Leon, Piercy, and Jeanne Hendrix embezzled the company's funds and fraudulently transferred over $1.6 million to relatives, friends, and business partners. (*See* Compl. ¶¶ 1, 13, 21, 22.)

5. Leon and Piercy answered on February 29, 2016, and denied any wrongdoing. They also filed counterclaims and claims against a number of third-party defendants, including Rato Manufacturing and its parent, Chongqing Rato Power Co., Ltd. ("Rato Power"). Among other things, Leon and Piercy allege that the third-party defendants fraudulently induced them to "transfer" their "ownership interests" in Denver Global. (Countercl. ¶ 115.)

6. It is undisputed that Leon and Piercy were among the original owners of Denver Global. (*See* Third Leon Aff. ¶ 4; Zhu Aff. ¶ 9.) In 2011, they and the other owners sold Denver Global, transferring half the company's stock to JRT Metals, Inc. and the other half to Davis Sales Group LLC. (*See* Countercl. ¶¶ 35, 38, 47.) Leon and Piercy are officers and shareholders of JRT Metals, which they formed to hold their interests in Denver Global. (*See* Third Leon Aff. ¶ 5.)

7. It is also undisputed that JRT Metals and Davis Sales Group agreed to sell Denver Global to Rato Power in December 2011, as set forth in a document titled "Stock Purchase, Merger, and Employment Agreement" ("2011 Agreement"). (*See* Countercl. Ex. A; Third Leon Aff. ¶ 6.) According to the terms of the 2011 Agreement, JRT Metals and Davis Sales Group agreed to transfer all of Denver Global's stock to Rato Power in return for 10% of Rato Power's stock. (Countercl. ¶ 49.) Leon and

Piercy acknowledge that JRT Metals and Davis Sales Group did, in fact, "transfer all of the corporate stock of" Denver Global. (Countercl. ¶ 49; *see also* Answer ¶¶ 21–22; Countercl. ¶¶ 67, 115, 118.)

8. According to Denver Global, the parties later "entered into a novation of" the 2011 Agreement to comply with Chinese law. (Pl.'s Mem. Opp'n Mot. Dismiss 2 n.1; *see also* Zhu Aff. ¶¶ 13–14.) Denver Global points to three "substitute" agreements, all dated November 28, 2012 ("2012 Agreements"). (*See* Pl.'s Mem. Opp'n Mot. Dismiss 5 & n.5; Zhu Aff. ¶¶ 16–17.) It contends that the 2012 Agreements restructured the transaction: Rato Manufacturing purchased Denver Global, and in return, Leon personally received 10% of Rato Manufacturing's stock. (*See* Pl.'s Mem. Opp'n Mot. Dismiss 9.)

9. Leon and Piercy argue that the 2011 Agreement remains operative because Leon's "signature on" the 2012 Agreements "was fraudulently coerced." (Defs.' Reply to Mot. Dismiss 4.) Nevertheless, consistent with the intent to sell Denver Global and the actual transfer of its stock, it does not appear that Leon or Piercy claimed any ownership interest in the company after December 2011. They continued as officers until April 2013, at which point they either resigned (according to Denver Global) or were terminated (according to Leon and Piercy). (*See* Compl. ¶ 51; Answer ¶ 51; Countercl. ¶ 91.)

10. In October 2016, more than ten months after the complaint was filed, Leon and Piercy began holding themselves out as the owners and officers of Denver Global and purporting to take actions on the company's behalf. On October 7, Leon filed an

amended annual report for 2015 with the North Carolina Secretary of State, identifying Leon as Denver Global's "President" and Piercy as its "Treasurer." (Mot. Dismiss Ex. D.) Leon and Piercy also retained a law firm, Kennedy & Wulfhorst, P.A., ostensibly to represent Denver Global. On October 13, attorneys from Kennedy & Wulfhorst demanded that Robinson, Bradshaw & Hinson, P.A.—Denver Global's current counsel—"cease immediately all activities holding yourselves out to represent Denver Global." (Mot. Dismiss Ex. E.)

11. A few days later, claiming to be the "true owners and officers" of Denver Global, Leon and Piercy moved to dismiss the case. (Defs.' Mem. Supp. Mot. Dismiss 7.) Denver Global opposed and also moved for a preliminary injunction to prohibit Leon and Piercy from holding themselves out as owners and officers of the company. The motions are ripe for resolution.

II.

LEON AND PIERCY'S MOTION TO DISMISS AND DISQUALIFY

12. Leon and Piercy claim to be the "rightful owners" of Denver Global and argue that Rato Power "has perpetrated a fraud on the court" by knowingly causing Denver Global to initiate this lawsuit without authority to do so. (Defs.' Mem. Supp. Mot. Dismiss 7.) On that basis, Leon and Piercy contend that the Court should exercise its inherent authority to dismiss this action. The Court disagrees and denies the motion.

13. Dismissal is "the most severe sanction available to the court in a civil case." *Wilder v. Wilder*, 146 N.C. App. 574, 576, 553 S.E.2d 425, 427 (2001). For that reason,

the Court's inherent power to dismiss an action "must be exercised with the greatest restraint and caution, and then only to the extent necessary." *United States v. Shaffer Equip. Co.*, 11 F.3d 450, 461 (4th Cir. 1993).

14. Caution is warranted here. As Denver Global correctly observes, Leon and Piercy's claim to be the company's true owners is at odds with the fact that "they have acted for years as if they no longer had any interest in the company." (Pl.'s Reply Supp. Mot. Prelim. Inj. 4.) Leon and Piercy have not argued that they or JRT Metals currently possess any of Denver Global's stock; they admit that JRT Metals transferred its entire stake in the company; and they do not dispute that they left Denver Global in 2013. There is no evidence that Leon or Piercy took any actions between April 2013 and the filing of the complaint in December 2015 that would be consonant with ownership of the company.

15. Indeed, Leon and Piercy offer no coherent legal theory to support their sudden reassertion of ownership rights. In their opening brief, Leon and Piercy characterized the 2011 Agreement as a merger and argued that "Rato Power retained counsel on behalf of [Denver Global] with the full knowledge that it never performed the acts necessary to consummate the merger between" the two companies. (Defs.' Mem. Supp. Mot. Dismiss 7.) After Denver Global pointed out that it had retained its corporate existence and was not merged into another entity, Leon and Piercy swiftly abandoned the argument.

16. The remaining arguments—set forth mainly in the reply—fare no better. Leon and Piercy contend, first, that the 2011 Agreement was an invalid share

exchange,[1] rather than an invalid merger. (Defs.' Reply to Mot. Dismiss 10 (citing N.C. Gen. Stat. § 55-11-05).) Second, they argue that Rato Power did not uphold its end of the bargain and "never paid" for Denver Global by transferring 10% of Rato Power stock to JRT Metals. (Defs.' Reply to Mot. Dismiss 8.)

17. There is a glaring problem: neither argument supports Leon and Piercy's claim to *present* ownership of Denver Global. Rather, the essence of both arguments is that Rato Power or an affiliate actually, but improperly, obtained Denver Global's stock. Leon and Piercy may believe that entitles them (or perhaps JRT Metals) to relief, but they cite no law for the proposition that they have assumed ownership by operation of law. *See, e.g.*, *Shidler v. All Am. Life & Fin. Corp.*, 775 F.2d 917, 920, 924 (8th Cir. 1985) (invalid merger may give cause of action for damages to shareholders); *Hardin v. KCS Int'l, Inc.*, 199 N.C. App. 687, 705, 682 S.E.2d 726, 739 (2009) (breach of contract gives cause of action for damages and, in certain circumstances, rescission).

18. Leon and Piercy recognized as much in their opening brief, stating that Rato Power's failure to transfer its stock to JRT Metals was a "breach" of the 2011 Agreement and "the subject of separate litigation." (Defs.' Mem. Supp. Mot. Dismiss

[1] A share exchange is "a transaction by which a corporation becomes the owner of all the outstanding shares of one or more classes of another corporation by an exchange that is compulsory on all owners of the acquired shares." *Ehrenhaus v. Baker*, 216 N.C. App. 59, 85 717 S.E.2d 9, 26 (2011) (quoting N.C. Gen. Stat. § 55-11-02 commentary); *see also* Russell M. Robinson, II, *Robinson on North Carolina Corporation Law* § 24.03, at 24-6 to -8 (7th ed. 2016). Although the Court denies the motion for other reasons, it bears noting that the 2011 Agreement likely does not meet this definition. The evidence of record appears to show that the 2011 Agreement was a voluntary stock purchase directly from JRT Metals and Davis Sales Group, which are parties to the agreement.

2.) That echoes their counterclaims, which request damages or rescission of the 2011 Agreement on the ground that Rato Power or Rato Manufacturing obtained Denver Global by fraud. (Countercl. ¶ 164.)

19. Simply put, to the extent that Leon and Piercy are entitled to damages or rescission, they are obliged to plead and prove their claims. The parties dispute, for example, whether the 2011 Agreement or the 2012 Agreements are the operative contracts. (Pl.'s Mem. Opp'n Mot. Dismiss 4–5; Defs.' Reply Mot. Dismiss 3–4.) Those disputes should be resolved in the ordinary course of litigation, not through a motion for sanctions.

20. Nor can Leon and Piercy short-circuit the litigation by calling the alleged wrongdoing a fraud on the court. Often cited as a reason to set aside a judgment under Rule 60(b) of the North Carolina and Federal Rules of Civil Procedure, a fraud on the court occurs "where it can be demonstrated, clearly and convincingly, that a party has sentiently set in motion some unconscionable scheme calculated to interfere with the judicial system's ability impartially to adjudicate a matter by improperly influencing the trier or unfairly hampering the presentation of the opposing party's claim or defense." *Spears v. Betsy Johnson Mem'l Hosp.*, 210 N.C. App. 716, 722, 708 S.E.2d 315, 320 (2011) (quoting *Aoude v. Mobil Oil Corp.*, 892 F.2d 1115, 1118 (1st Cir. 1989)).

21. There is no such evidence here. The parties' briefing concerns only disputed pre-litigation events that occurred years before the complaint was filed, none of which reflects interference *with the judicial system*. Any associated allegations of fraud,

even if true, do not amount to a fraud on the court. *See Gleason v. Jandrucko*, 860 F.2d 556, 559 (2d Cir. 1988) (contrasting fraud on a party with fraud on the court).

22. Accordingly, the Court denies the motion to dismiss. For the same reasons, the Court denies Leon and Piercy's alternative request to disqualify Denver Global's counsel or to stay the action.

III.

DENVER GLOBAL'S MOTION FOR PRELIMINARY INJUNCTION

23. Denver Global has moved for a "preliminary injunction prohibiting [Leon and Piercy] from purporting to take any further actions on [Denver Global's] behalf." (Pl.'s Mem. Supp. Mot. Prelim. Inj. 11.) The Court denies the motion without prejudice.

24. A preliminary injunction is "an extraordinary measure taken by a court to preserve the status quo of the parties during litigation." *Ridge Cmty. Inv'rs, Inc. v. Berry*, 293 N.C. 688, 701 239 S.E.2d 566, 574 (1977). The moving party bears the burden to establish the "right to a preliminary injunction." *Pruitt v. Williams*, 288 N.C. 368, 372, 218 S.E.2d 348, 351 (1975). A court may issue a preliminary injunction only where the moving party has shown "a likelihood of success on the merits" and that it "is likely to sustain irreparable loss unless the injunction is issued, or if, in the opinion of the Court, issuance is necessary for the protection of [its] rights during the course of litigation." *Analog Devices, Inc. v. Michalski*, 157 N.C. App. 462, 466, 579 S.E.2d 449, 452 (2003) (quoting *Wade S. Dunbar Ins. Agency, Inc. v. Barber*, 147 N.C.

App. 463, 467, 556 S.E.2d 331, 334 (2001)); *accord A.E.P. Indus., Inc. v. McClure*, 308 N.C. 393, 401, 302 S.E.2d 754, 759–60 (1983).

25. In light of the Court's denial of Leon and Piercy's motion to dismiss and disqualify, the Court agrees that Denver Global has shown a likelihood of success. The Court concludes, however, that Denver Global has not demonstrated that it is likely to sustain irreparable loss in the absence of a preliminary injunction.

26. The evidence demonstrates, and the Court finds, that Leon and Piercy have taken two concrete steps holding themselves out as officers of Denver Global. First, Leon and Piercy filed an amended report with the Secretary of State. Second, they hired the law firm Kennedy & Wulfhorst, P.A., ostensibly to represent Denver Global and to replace Denver Global's current counsel.

27. The Court concludes that these actions do not pose a likelihood of irreparable harm. The Court has denied the motion to disqualify Robinson, Bradshaw & Hinson because Leon and Piercy are not presently the owners or officers of Denver Global and do not have the authority to retain counsel or take other actions on Denver Global's behalf. This finding resolves any dispute over which law firm represents Denver Global. In addition, at the hearing, counsel for the parties indicated that the Secretary of State was awaiting this Court's decision on the motion to dismiss. The Court expects that Leon and Piercy will notify the Secretary of State of this Court's order and take steps to withdraw or cancel the amended annual report, as appropriate.

28. Denver Global argues that an injunction is necessary to protect against "further attempts to take control of the company, purport to enter into contracts on its behalf, gain access to the company's assets, or to interfere with its customers or business partners." (Pl.'s Reply Supp. Mot. Prelim. Inj. 11.) It contends that Leon and Piercy "have refused to provide a full accounting of the actions they have purported to take since declaring themselves [Denver Global's] officers." (Pl.'s Reply Supp. Mot. Prelim. Inj. 11.)

29. At the hearing, however, Leon and Piercy's counsel represented that they had taken no further actions purporting to act on behalf of Denver Global. In addition, Denver Global has not identified any actual or imminent interference with customers, unauthorized contracts, or similar acts. Accordingly, in view of counsel's representation and the Court's ruling on the motion to dismiss and disqualify, the Court concludes that these potential harms are not sufficiently real and immediate to show irreparable harm. *See, e.g.*, *Hall v. City of Morganton*, 268 N.C. 599, 600–01, 151 S.E.2d 201, 202 (1966) ("Injunctive relief is granted only when irreparable injury is real and immediate.").

30. If Denver Global becomes aware of evidence that Leon and Piercy have taken actions inconsistent with their counsel's representation and with this order, Denver Global may renew its motion. The Court denies the motion for a preliminary injunction without prejudice.

IV.

CONCLUSION

31. For these reasons, the Court (i) **DENIES** Leon and Piercy's Motion to Dismiss, Disqualify and Replace Counsel, and to Stay the Litigation, and (ii) **DENIES** without prejudice Denver Global's Motion for Preliminary Injunction.

SO ORDERED, this the 8th day of March, 2017.

/s/ Adam M. Conrad
Adam M. Conrad
Special Superior Court Judge
for Complex Business Cases