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IN THE UNITED STATES DISTRICT COURT

DISTRICT OF UTAH, NORTHERN DIVISION

PASKENTA ENTERPRISES CORPORATION, a federally chartered corporation, Plaintiff, v. ALAN COTTLE, an individual; and KNEE CENTERS MANAGEMENT, LLC, a Utah limited liability company, Defendants.	**DEFENDANTS' REPLY MEMORANDUM IN SUPPORT OF MOTION TO DISMISS** Case No. 1:17-CV-00033-JNP-BCW Judge Jill N. Parrish Magistrate Judge Brooke C. Wells

Pursuant to Federal Rule of Civil Procedure 12(b)(6) and DUCivR 7-1, Defendants Alan Cottle ("**Cottle**") and Knee Centers Management, LLC ("**Knee Centers**") (collectively, "**Defendants**") hereby submit this *Reply Memorandum in Support of their Motion to Dismiss* ("**Motion**") the claims asserted against them in the Complaint filed by Plaintiff Paskenta Enterprises Corporation ("**PEC**" or "**Plaintiff**").

INTRODUCTION

As set forth in Defendants' motion, PEC's Complaint should be dismissed for three reasons. *First*, PEC's claims are barred by the Funds Settlement Agreement. *Second*, PEC failed to allege facts supporting essential elements of its claims. *Third*, PEC's negligent misrepresentation claim is barred by the economic loss doctrine.

PEC's Opposition to Defendants' Motion to Dismiss ("**Opposition**") highlights a number of fatal flaws underlying its claims in this case. Indeed, PEC cannot rightly counter any of these arguments in opposing the Motion. Mr. Cottle invested his life savings in Knee Centers. He chose PEC as his business partner because the Paskenta Band of Nomlaki Indians (the "**Tribe**") understood the challenges of this business in light of the Tribe's experience with its own medical clinics. After years of working with the Crosbys in trying to build the business for Defendants and PEC, the rug was pulled out from under Mr. Cottle. Mr. Cottle was informed that an intra-Tribe squabble occurred and that Mr. Crosby was no longer PEC's president. Moreover, PEC's "new leadership" unilaterally caused Knee Centers' bank to freeze the Company's operating account and actually move the funds from that account.

Lawyers were retained on behalf of both parties. To appease the "new leadership" of Knee Centers' minority shareholder (PEC), Mr. Cottle allowed PEC to send a lawyer and accountant to inspect Knee Centers' books and records. Without access to the operating account to run its business, Defendants were desperate. A settlement agreement was executed. After crucial delays, Knee Centers was finally allowed access to its account, but was told it would not be receiving the additional funds ($1 million) that PEC previously committed and that were necessary to run the business.

Without the promised funds, and after taking out a second mortgage on Cottle's home to cash flow the business, Knee Centers eventually failed—in no small part due to PEC's wrongful

failure to timely provide access to the deposited funds and its refusal to provide the additional $1 million previously committed by PEC. Now, in what can be best described as a cruel and sad irony, PEC claims that *Defendants* wrongfully caused it damages by committing fraud, being negligent, and breaching fiduciary duties.[1] PEC's Complaint should be dismissed.

ARGUMENT

I. THE FUNDS SETTLEMENT AGREEMENT BARS ALL OF PEC'S CLAIMS.

A. PEC Cannot Avoid the Relevant Provisions of the Agreement.

Despite PEC's arguments to the contrary, the Funds Settlement Agreement is applicable and bars its claims entirely. PEC points to paragraph 10 of the Funds Settlement Agreement and argues that this release applies only to "its right to assert claims against Defendants premised on the lack of authority of John and Ines Crosby to invest in Emere in the first place." PEC's Opp. at 6. This argument is irrelevant and unpersuasive because Defendants are not relying on paragraph 10, and paragraph 10 is inapplicable here.

Rather, PEC's claims are barred by paragraph 14, which PEC altogether fails to address. Paragraph 14 states that the "Agreement constitutes the full and entire agreement and understanding between the Parties as to the matters described or set forth herein. No party is relying upon any statement or representation not specified in this Agreement as an inducement or basis for entering into this Agreement." Accordingly, PEC agreed that it was not relying on any additional statements in connection with the disbursement of the funds, including those statements it alleges based on the May Letter. The bottom line is that PEC has not stated claims for relief outside the scope of the Funds Settlement Agreement. Therefore, PEC's Complaint should be dismissed in its entirety.

[1] There are no facts supporting PEC's claims. But, in the event that this case proceeds, Mr. Cottle and Knee Centers will be asserting counterclaims against PEC for its wrongful actions that resulted in the failure of the business, Mr. Cottle's devastating personal financial losses, and all other damages suffered by Defendants because of PEC.

B. The Funds Settlement Agreement Applies to PEC's Precise Claims.

Although PEC takes no issue with holding onto the perceived benefits of the Funds Settlement Agreement, it argues that the provisions it does not necessarily like, such as the provision that "[n]o party is relying upon any statement or representation not specified in this Agreement as an inducement or basis for entering into this Agreement," should not be enforced against it. While it is true that a contract clause limiting liability may not be applied in a fraud action, this is simply not the case here. The Funds Settlement Agreement was negotiated between the parties' respective counsel and specifically outlines the actions, terms, and conditions associated with unfreezing the account and restoring the funds to Defendants, including a provision stating that PEC was no longer required to contribute the additional $1 million provided for in the Addendum. *See* Funds Settlement Agreement. PEC cannot assert that the Funds Settlement Agreement was obtained by fraud under these circumstances.

Importantly, as discussed more fully below, PEC has altogether failed to allege facts supporting fraud as a matter of law. In particular, PEC has failed to allege facts demonstrating the statements were false, or that PEC relied on the statements. *See Robinson v. Tripco Inv. Inc.*, 2000 UT App 200, ¶ 19, 21 P.3d 219 (citation omitted) stating that "[o]ne of the elements of fraud that a plaintiff must prove is that he or she, acting reasonably and in ignorance of the statement's falsity, did in fact rely upon the misrepresentations." *Id.* Accordingly, PEC cannot avoid the impact and controlling nature of the Funds Settlement Agreement based on Defendants' alleged fraud.

Furthermore, because PEC has failed to properly plead fraud, it cannot plead a proper claim for negligent misrepresentation as the Funds Settlement Agreement expressly provides that PEC was not relying on any representations in entering the agreement other than what was contained in the agreement. Thus, the Funds Settlement Agreement bars all of PEC's claims.

II. THE REPRESENTATIONS IN THE MAY LETTER DO NOT SUPPORT PEC'S CLAIMS AS A MATTER OF LAW.

A careful review of the actual representations contained in the May Letter (a true and correct copy of which is attached hereto as Exhibit A) reveals that **none** of Defendants' four statements allegedly relied on by PEC support its claims as a matter of law. Significantly, PEC fails to allege facts demonstrating that these representations were actually false. PEC fails to allege facts demonstrating its reliance on these statements. PEC's actions after receiving the May Letter—inspecting the books and records of Defendants' business and refusing to pay $1 million that it previously promised to pay and that was necessary to transition to the new business model—demonstrate that PEC did not rely on the representations in the May Letter as a matter of law.

Moreover, PEC's claims fail on the additional ground that the May Letter, at an absolute minimum, triggered PEC's duty to investigate any question or concern related to the representations. Thus, the representations PEC attempts to rely on in the May Letter do not and cannot support any of PEC's claims as a matter of law.

A. Statement Concerning the New Business Model's Future Clinics and Estimated Future Valuation.

First, PEC points to Defendants' statement about the clinics and estimated valuation. PEC presents the statement as follows: "Emere would grow to 40-50 clinics over a 48 month period with an estimated $400-$500 million valuation." Compl. ¶¶ 77, 85, 93, 99. This sentence is not contained in the May Letter. The actual sentence in the May Letter addressing this issue is as follows: "All of our professional (medical and executive) talent has signed up to take this new company to 40-50 clinics over a 48 month period with an estimated $400MM-500MM valuation." May Letter at 1. This statement does not support PEC's claims for numerous reasons.

1. PEC presents no facts demonstrating this statement was false.

Initially, PEC misquotes the actual representation in the May Letter and then relies on this misquotation in arguing that it was false. What Defendants actually stated was that "all of our professional (medical and executive) talent has signed up to take this new company to 40-50 clinics over a 48 month period with an estimated $400MM-500MM valuation." May Letter at 1. Defendants did not state that the company *would* have 40-50 clinics or *would* be worth over $400 million. These forecasts under the new business model were what those involved with the company were working toward for the future. PEC has not and cannot provide facts demonstrating that this statement was false.

2. Even if Defendants had represented that the company *would* grow as hoped, such a statement still fails to state a claim.

Opinions about future values or future events *are not* statements of presently existing fact. *Palmer v. U.S. West Communications, Inc.*, 36 Fed. Appx. 646, 647 (10th Cir. 2002) ("As a general rule, actionable fraud cannot consist of unfulfilled predictions or erroneous conjectures as to future events. Merely expressing an opinion in the nature of a prophecy as to the happening of a future event is not actionable."). The policy underlying these cases is clear: courts are not going to hold an individual liable for fraud or negligent misrepresentation should the individual provide forecasts or estimates of future events—like how many clinics were forecasted to be opened or the future estimated value of the business—that turn out to be wrong.

PEC, however, attempts to argue that this statement about future anticipated clinics and future estimated valuation can support its claims for fraud and negligent misrepresentation because Defendants somehow knew that these projections were false. This argument fails because PEC has provided the Court with no facts demonstrating that Mr. Cottle knew that the new business model was false and that there was no possible way that the business could reach those projections. In fact, the May Letter provides facts demonstrating that Mr. Cottle believed

and was invested in his company so much so that he put at least $1 million of his own personal money into the business venture. *See* May Letter at 1. Defendants were simply making statements about what they hoped would happen in the future with the company (as opposed to simply referencing the projections under the new business model), and such statements cannot support PEC's claims as a matter of law. *See, e.g.*, *Layton Constr. Co., Inc. v. Wrapid Specialty, Inc.*, 2015 WL 7312896, at *11 (D. Utah Nov. 19, 2015) (dismissing negligent misrepresentation claim because a "statement of future event cannot form the basis for a negligent misrepresentation claim").

3. PEC did not reasonably rely on this representation.

Even if Defendants' representation on the issue of future clinics and future estimated appraisal was a presently existing fact and was false (which it was neither), PEC's claims based on this representation still fail as a matter of law because PEC did not reasonably rely on this representation.

First, Defendants explained in the May Letter that the original business model provided for $25,000 monthly profit based on projections. May Letter at 5. Yet, PEC was fully aware that it had already invested $5 million that Defendants had gone through "in just over a year, with little to show for it." Compl. ¶ 27. In other words, Defendants explained that the original business model—the business model that was in place when Defendants went through $6 million "with little to show for it," provided for $25,000 monthly profit based on projections, yet PEC now alleges that it "reasonably relied" on the representation concerning the "new business model." Because the statements concern business models and future projections, PEC could not reasonably rely on the notion that the company absolutely would reach these projections.

Second, PEC could not have reasonably relied on this statement because it was based on a business model that required $3 million of additional capital before it could even be

implemented. May Letter at 5. The business's need for this $3 million of additional capital was clearly addressed by the parties and was the basis for the Addendum. *See id.*; Compl. ¶ 32 ("In November 2013, Defendants presented their new business plan to the Crosbys, and represented that another $3 million was needed from [PEC]."). PEC obviously knew about the need and role of the $3 million. *See id.* However, one week after the May Letter, the parties entered into the Funds Settlement Agreement, wherein PEC expressly stated that it would not have any duty or obligation to provide the final $1 million that was addressed in the Addendum. *See* Funds Settlement Agreement ¶ 8. In other words, PEC knew that Defendants were getting only $2 million of the $3 million required to transition to the new business model. *See id.* Accordingly, PEC could not have reasonably relied on this statement concerning the projections under the new business model when it knew (and was responsible for the fact) that the Defendants were still short at least 30% of the funds necessary to *even transition* to the new business model.[2] PEC could not have reasonably relied on the representations concerning the estimated valuation and clinics under the new business model when it knew that Defendants did not have the funds to even transition to the new business model. *See* May Letter at 5; Addendum.

B. The Statement Concerning the Two Clinics.

PEC next purportedly relies on the alleged representation that "[t]wo new clinics would be opening in July 2014." Compl. ¶¶ 77, 85, 93, 99. The following is from the May Letter:

> ***New Clinic, Salt Lake City, Utah*** – Opens July 7th, 2014
> We hired Dr. Cory Nelson and Dr. Curtis Nielsen to work in this first Salt Lake City clinic in anticipation of opening additional Utah clinics. We have hired or

[2] Suppose an individual needed $10,000 to transition her small business into something that a business model showed could eventually expand to be worth a million dollars. This individual and her investing partner agreed that the investor would provide the $10,000. But now suppose the investor provided only $6,700. The business eventually failed and the investor sues the owner for fraud, misrepresentation, and breach of fiduciary duties. Clearly, the investor could not have reasonably relied on statements about the business model's estimated $1 million valuation where the investor knew that the owner did not get the money necessary to even transition to the new model that provided for those projections. Such is the case here.

> are hiring a clinic administrator, X-Ray technicians, Nurse practitioners, medical assistants to have professional staff for the opening date.
>
> ***New Clinic, Boca Raton, FL*** – Opens July 14th, 2014
> Dr. Provo will work in the existing and new East Boca, FL clinics. We hired Dr. Will Felix who is in the process of moving from Connecticut back to Florida and he will help open the Boca Raton East clinic. We have hired a season clinic administrator and an experienced X-Ray technician. The East Boca clinic is currently being remodeled (at our expense) the remodel costs are $100,000 over the next 60 days. We also are purchasing medical and office equipment and supplies equal to $100,000 for this clinic. We also start our ramped up marketing campaign ($20,0000 next two months) and are retooling our web page to include the new "Walk-In" Orthopedics division.

May Letter at 6. Once again, the representations do not support PEC's claims as a matter of law.

1. PEC presents no facts demonstrating this statement was false.

In describing the new clinics in Salt Lake City and Boca Raton, Defendants explained that they had already hired various doctors and had hired or were in the process of hiring clinic administrators, technicians, and other personnel for the clinics. *See* May Letter at 6. PEC does not allege that these individuals were not hired. Most significantly, the Complaint is void of any fact demonstrating that these clinics were not opened.[3] PEC has the duty to plead facts demonstrating that this statement was false, and PEC has (unsurprisingly) failed to do so. Thus, the statements concerning the "two clinics" do not support PEC's claims as a matter of law.

2. The statement fails to support PEC's claims because it involves future events and PEC did not rely on this representation.

Defendants' statements concerning the Salt Lake City and Boca Raton clinics cannot support PEC's claims for the additional reason that they are statements about future events. As explained above, such statements cannot support the claims because they are not presently existing facts. *See, e.g., Layton Constr.*, 2015 WL 7312896, at *11 (dismissing negligent misrepresentation claim because a "statement of future event cannot form the basis for a

[3] The absence of any such fact is unsurprising because the two clinics actually *were* opened. However, because this is a Rule 12 motion, Defendants are not asking this Court to find or conclude that the clinics were in fact opened but to simply rely on the fact that PEC has failed to come forward with any fact demonstrating that they were not.

negligent misrepresentation claim"). Furthermore, there are no facts demonstrating that PEC relied on this representation. To the contrary, the facts demonstrate that PEC refused to even contribute the funds necessary to *transition* to the new business model, which model was to be incorporated in these two clinics. *See* May Letter at 4-6; Addendum; Funds Settlement Agreement ¶ 8.

C. The Statement Concerning the Schedule and Budget.

The third statement allegedly relied on by PEC is that "Emere was on track and on budget to achieve its forecasted growth." Compl. ¶¶ 77, 85, 93, 99. *See* May Letter at 6-7. The May Letter *actually* states, that "[t]he list is long of planned expenses to move the entire company to the new model during the spring and summer of this year. We are on track, we are on budget and we cannot have any stop or interference with the cash that was paid to us last year in exchange for more Paskenta ownership." *Id.* PEC again misconstrues the May Letter.

1. No facts demonstrating this statement is false.

Further, PEC provides no assertion in its Complaint demonstrating that this paragraph was false. Again, PEC's failure to provide any such facts is partially due to the reality that PEC is relying on language that was not in the May Letter. Compl. ¶¶ 77, 85, 93, 99. Defendants did not state that they were on track and on budget *to achieve its forecasted growth*. May Letter at 5-6. Indeed, the forecasted growth statements relied on by PEC were primarily on page 1 of the May Letter, and this clause is on page 5 of the May Letter. Removing "to achieve its forecasted growth" from the sentence creates a totally different representation. PEC provides no facts demonstrating that at the time of the May Letter the company was not on track and on budget.

2. PEC did not reasonably rely on this representation.

Even if the statement were construed as PEC contends—on track and on budget to achieve forecasted growth—this statement still fails to support any claim because PEC did not

reasonably rely on it for at least the same two reasons why it could not reasonably rely on the future forecast. Specifically, PEC knew that Defendants had run through its initial $5 million investment in just over a year, with little to show for it, despite the fact that the May Letter provided for a $25,000 monthly profit. PEC cannot on the one hand criticize Defendants for their failures with respect to the original $6 million and then turn around and say it is relying on the statement that Defendants were on track and on budget to achieve the forecasted growth. Furthermore, PEC could not have reasonably relied on this statement because it knew that Defendants were getting only $2 million of the $3 million required to transition to the new business model. Accordingly, PEC could not have reasonably relied on this statement concerning being on track and on budget to achieve the forecasted growth because just one week later PEC stated that no additional funds would be provided. Thus, PEC's claim fails as a matter of law.

D. The Statement Concerning Payment to the Crosbys.

PEC's last alleged misrepresentations point to alleged unauthorized payment from Defendants to the Crosbys. Statements in the May Letter simply do not support such claims.

1. PEC presents no fact demonstrating Defendants paid the Crosbys.

Glaringly absent from the Complaint is *any* fact demonstrating that this statement was false. Again, this absence is not surprising because there *were no* payments made to the Crosbys. PEC reviewed the records of Defendants before releasing the wrongfully withheld funds, and PEC knows no payments were made to the Crosbys. Thus, this argument fails.

2. PEC did not reasonably rely as a matter of law.

PEC took actions directly demonstrating that it *did not* rely on this statement. PEC insisted that it be allowed to inspect the books and records, and then, did actually inspect those

books and records. Accordingly, PEC did not rely on this statement about payment to the Crosbys as a matter of law.

E. The May Letter Cannot Support Breach of Fiduciary Duty.

PEC's breach of fiduciary duty claims are grounded solely in the alleged misrepresentations in the May Letter. The May Letter does not, as a matter of law, contain any actionable negligent or fraudulent misrepresentations. Without any negligent or fraudulent misrepresentations, there is no breach of fiduciary duty. Accordingly, PEC's breach of fiduciary duty claim must be dismissed. Moreover, because PEC cannot establish the underlying claim for breach of fiduciary duty, the claim for aiding and abetting the alleged breach likewise fails.

III. PEC'S NEGLIGENT MISREPRESENTATION CLAIM IS BARRED BY THE ECONOMIC LOSS DOCTRINE.

PEC contends that the economic loss doctrine does not apply because: (1) there was a fiduciary relationship between the parties that created independent duties; and (2) regardless of the fiduciary relationship, the parties owed "each other duties when negotiating the agreement that are independent of those that are created by the formation of the contract itself." Opp. at 12-15. These arguments fail. Even assuming there was a fiduciary relationship between the parties, such a relationship does not remove PEC from the effects of the economic loss doctrine because any fiduciary duty that may have existed overlapped with the Funds Settlement Agreement. *See Reighard v. Yates*, 2012 UT 45, ¶ 21, 285 P.3d 1168.

PEC's second argument likewise fails. It is settled law that where, as here, two commercial parties are negotiating a deal at arm's length, the parties do not owe each other a duty "with respect to negligent misrepresentations, [but] only intentional misrepresentations." *Hafen v. Strebeck*, 338 F. Supp. 2d 1257, 1266 (D. Utah 2004). Indeed, the case relied on by PEC in support of its second argument involved a motion to dismiss a *fraudulent inducement claim*, and the court, consistent with *Hafen*, determined that the economic loss rule did not bar

the claim for fraudulent inducement. *See* Opp. at 14-15 (*citing Bigpayout, LLC v. Mantex Enterprises, LTD*, 2014 WL 5149301, *4 (D. Utah Oct. 14, 2014).

In this case, however, the economic loss doctrine *does* bar PEC's negligent misrepresentation claim. Hence, PEC's negligent misrepresentation claim should be dismissed.

CONCLUSION

For the reasons stated herein, and for the reasons stating in Defendants' opening brief, the Court should dismiss all of PEC's claims against Defendants with prejudice.

DATED this 13th day of June, 2017.

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