EXHIBIT 1

CHANCE WORLD TRADING E.C., Kingdom of Bahrain, Plaintiff, v. HERITAGE BANK OF COMMERCE, a California corporation, Does 1 through 10, inclusive, Defendant.

No. C-03-05474 RMW, [Re Docket No. 15, 19, 21]

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SAN JOSE DIVISION

2004 U.S. Dist. LEXIS 21451

October 15, 2004, Decided
October 18, 2004, Filed

SUBSEQUENT HISTORY: Summary judgment granted by *Chance World Trading v. Heritage Bank of Commerce, 2005 U.S. Dist. LEXIS 30996 (N.D. Cal., Nov. 4, 2005)*

DISPOSITION: Defendant's motion to dismiss granted in part and denied in part.

COUNSEL: [*1] For Chance World Trading E.C., Kingdom of Bahrain, Plaintiff: Alan L. Martini, Sheuerman Martini & Tabari, San Jose, CA; David Sheuerman, Sheuerman, Martini & Tabari, San Jose, CA.

For Heritage Bank of Commerce, a California corporation, Defendant: Breck E. Milde, Terra Law LLP, San Jose, CA; Perry J. Woodward, Terra Law LLP, San Jose, CA.

For Rani Yadav-Ranjan, Cross-defendant: Anthony F. Ventura, Miller Morton Caillat & Nevis, LLP, San Jose, CA.

For Poonam Sawhney, Cross-defendant: Alan L. Martini, Sheuerman Martini & Tabari, San Jose, CA.

For Construction Navigator Inc, Cross-defendant: Anthony F. Ventura, Miller Morton Caillat & Nevis, LLP, San Jose, CA.

JUDGES: RONALD M. WHYTE, United States District Judge.

OPINION BY: RONALD M. WHYTE

OPINION

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS MOTION TO DISMISS THE FIRST AMENDED COMPLAINT FOR FAILURE TO STATE A CLAIM (*FRCP 12(b)(6)*)

Defendant Heritage Bank of Commerce's motion to dismiss plaintiff Chance World Trading's First Amended Complaint for failure to state a claim, pursuant to *Fed. R. Civ. P. 12(b)(6)*, was heard on May 28, 2004. For the reasons set forth below, the court denies motion to the extent that it seeks [*2] to dismiss the aiding and abetting claim and grants it as to all other claims.

I. BACKGROUND

Plaintiff, Chance World Trading, agreed to invest $ 200,000 in Construction Navigator, Inc. ("Construction Navigator"). The investment agreement was memorialized in a term sheet. Construction Navigator opened a checking account at defendant's bank. Plaintiff's owner and principal is Rajeev Sawhney. The president of Construction Navigator is Rani Yadav-Ranjan. The Construction Navigator bank account designated three signers on the account, Rani Yadav-Ranjan, Rajeev Sawhney, and Poonam Sawhney, Rajeev's wife. The terms of the account required two signatures to authorize any check over ten thousand dollars. On or about October 1, 2002, plaintiff wired its initial investment of $ 200,000 to the Construction Navigator account at defendant's bank.

Under the terms of the investment agreement, Construction Navigator was to use plaintiffs investment only to pay for certain technical testing of the Construction Navigator product. However, Construction Navigator's president misappropriated these funds by using them to pay his personal salary, office rent, and other general corporate expenses [*3] not related to technical testing. None of the checks withdrawing these funds for these expenditures contained the required number of signatures.

To accomplish the misappropriation of the invested funds, Rani Yadav-Ranjan opened a second Construction Navigator account at defendant's bank. To do so, she presented the bank with a "Corporate Resolution to Open a Bank Account" signed by "President/Secretary Rani Yadav-Ranjan." This resolution purportedly permitted the opening of another account which, unlike the first account, required that checks could be authorized by the signature of Rani Yadav-Ranjan alone. The corporate resolution presented was not signed by the Constructive Navigator Board of Directors [1] and did not comply, for that reason, with defendant's internal policies. Subsequently, Rani Yadav-Ranjan was able to transfer funds from the original Construction Navigator account to the second account without the authorization of Rajeev or Poonam Sawhney.

> 1 Pursuant to the investment agreement, together Rajeev and Poonam Sawhney comprised 50% of the Construction Navigator Board.

[*4] On or about January 19, 2003, plaintiff sent the Controller for Construction Navigator and defendant an email advising that the $ 200,000 it had invested was being misappropriated and to cease all activities in that account (with the account number designated). The email was signed by Rajeev Sawhney. Plaintiff alleges that defendant ignored this email and continued to honor checks that were made without proper corporate authority and without the signatures required by the signature card agreement between Construction Navigator, Inc., and the bank. Eventually, the entire $ 200,000 was misappropriated, allegedly to the detriment of Construction Navigator and plaintiff, its only investor. Plaintiffs complaint seeks relief from defendant for its conduct which allegedly allowed this misappropriation to occur.

The court granted defendant's motion to dismiss the original complaint because plaintiff had not adequately pled the existence of a contractual, statutory, or tort duty owed by defendant to plaintiff. (March 2, 2004 Order). In that order, the court granted plaintiff twenty days leave to amend the complaint. (Id.). Subsequently, plaintiff filed a First Amended Complaint adding (1) [*5] an allegation that the term sheet created a trust; and (2) a new cause of action for aiding and abetting the fraudulent breach of a fiduciary duty.

II. ANALYSIS

1. Unauthorized Signatures

In the original complaint, plaintiff alleged it "invested $ 200,000 in the Construction Navigator account for purposes of funding a term sheet' under which [plaintiff] was investing in [Construction Navigator], in exchange for equity in [Construction Navigator]." (Compl. P 12; see Plaintiffs Opposition to Dismiss Complaint wherein plaintiff repeatedly refers to the $ 200,000 as an "investment"). The first amended complaint now alleges:

> Pursuant to [the] Term Sheet, [plaintiff] agreed to advance the sum of $ 200,000 . . ., in trust, to the Construction Navigator bank account.
>
> * * * *
>
> [Plaintiff] remained the equitable owner and beneficiary of the Construction Navigator trust account and retained control and ownership of the account by the requirement that either Rajeev Sawhney or Poonam Sawhney sign any check written on the account over $ 10,000.

(First Amended Complaint ("FAC") PP 11, 14).

The five elements required to create an express trust [*6] are: (1) a competent trustor, (2) the manifestation of an intention to create a trust, (3) trust property, (4) a trust purpose, and (5) a beneficiary. *Keitel v. Heubel, 103 Cal. App. 4th 324, 337, 126 Cal. Rptr. 2d 763 (2002)*; see *RESTATEMENT (SECOND) OF TRUSTS § 2*. The term sheet contains no express language creating a trust. However, no particular words are necessary to create a trust, instead an express trust may arise from a manifestation of the intent to create a trust. See *Marsh v. Home Fed. Savings & Loan Assn., 66 Cal. App. 3d 674, 682, 136 Cal. Rptr. 180 (1977)*.

In *First Citizens Fed. Savings & Loan Assn. v. Worthen Bank & Trust Co., 919 F.2d 510, 513-514 (9th Cir. 1990)*, the court held a contractual agreement did not create a trust relationship despite the agreement's use of the word "trust." The Ninth Circuit explained that in the context of agreements between sophisticated parties a fiduciary relationship should not be inferred absent unequivocal contractual language. The court observed that the provisions of the agreement were more indicative of a typical business relationship among equally sophisticated entities dealing at arm's length than of a fiduciary [*7] relationship. Id.

After reviewing the term sheet, the court finds no clear manifestation that either party intended to create a trust. In addition, plaintiff has failed to cite to any specific terms in the term sheet which it believes manifests such an intent As in *First Citizen*, the term sheet appears to create an ordinary business relationship between two sophisticated parties. The term sheet does not manifest an intent to create a trust.

In the First Amended Complaint, plaintiff attempts to allege that defendant owed a contractual duty to plaintiff by claiming that plaintiff was the intended beneficiary of Construction Navigator's account with defendant's bank. Plaintiffs theory of why it was the intended beneficiary of the account agreement is set forth by the allegation that the term sheet created a trust wherein plaintiff was the beneficiary and the $ 200,000 was the trust res. Because plaintiff has failed to adequately plead the existence of a trust, its intended beneficiary argument fails. [2] Furthermore, since plaintiff has failed to sufficiently plead the existence of a duty owed by defendant to plaintiff, the claim for negligence must also be dismissed.

2 Plaintiff has also failed to adequately plead that it was a third party beneficiary of the Construction Navigator account agreement with defendant's bank, because a plaintiff seeking to enforce a contract as third party beneficiary must plead that the contract was made expressly for its benefit and must set forth the terms of the contract that clearly show that plaintiff was a beneficiary. See *California Emergency Physicians Med. Group v. PacifiCare of California, 111 Cal. App. 4th 1127, 1138, 4 Cal. Rptr. 3d 583 (2003)* ("Third party beneficiary status is a matter of contract interpretation. For that reason, the contract must be set out in the pleadings." (internal citations omitted)).

[*8] 2. Aiding and Abetting

Plaintiff brings a claim against defendant for aiding and abetting Rani Yadav-Ranjan's fraudulent scheme to misappropriate the money deposited in defendant's bank. To properly state a claim for aiding and abetting the tortious breach of a duty, plaintiff must plead defendant (1) had knowledge that another's conduct constitutes a breach of a duty, and (2) substantially assisted or encouraged that breach. See *Neilson v. Union Bank of California, 290 F. Supp. 2d 1101, 1133 (C.D. Cal. 2003)* (citing *Fiol v. Doellstedt, 50 Cal. App. 4th 1318, 1325, 58 Cal. Rptr. 2d 308 (1996)*); *RESTATEMENT (SECOND) TORTS § 876*.

Defendant points to several cases noting that aiding and abetting is similar to civil conspiracy. Liability under a civil conspiracy requires the co-conspirator have an independent duty to the plaintiff. See *Applied Equip. Corp. v. Litton Saudi Arabia Ltd., 7 Cal. 4th 503, 514, 28 Cal. Rptr. 2d 475, 869 P.2d 454 (1994)* (tort recovery for civil conspiracy is only allowed against a party who already owes the duty, under substantive tort law, that was violated). Defendant argues that an independent duty between plaintiff and defendant should also be required in [*9] aiding and abetting claims. This argument was raised and rejected by the court in *Neilson, 290 F. Supp. 2d at 1133*. After a thorough review of California case law, the Neilson court found two major distinctions between aiding and abetting and civil conspiracy which explain why an independent duty requirement is not an element of aiding and abetting. First, conspirators are held jointly liable for the tort committed, whereas aiders and abettors are not held liable as joint tortfeasors for the underlying tort. *Id. at 1135* (in a civil conspiracy, "because liability is premised on the commission of a single tort, it is logical that all conspirators must be legally capable of committing the wrong). Second, in aiding and abetting, the defendant's conduct must be a substantial factor in causing the harm, while conspiracy requires no proof that the conspirator did anything that actually caused the harm. Id. The reasoning of *Neilson* is persuasive. Consequently, the court does not find a claim for aiding and abetting requires defendant owe an independent duty to plaintiff.

The underlying tort plaintiff alleges is Rani Yadav-Ranjan's fraudulent misappropriation [*10] of plaintiffs $ 200,000 investment from the Construction Navigator account. Plaintiff sufficiently pleads the first element of aiding and abetting by alleging:

> Heritage Bank *knew* that Rani Yadav-Ranjan was in fact engaged in actions amounting to fraud and breach of her fiduciary duty to plaintiff.
>
> * * * *
>
> Heritage Bank participated in Rani Yadav-Ranjan's scheme with *knowledge* of the wrongdoing by failing to follow its typical banking procedures and allowing Rani Yadav-Ranjan to fraudulently withdraw the money.

(FAC PP 35, 39) (emphasis added).

The second element of aiding and abetting, substantial assistance, "requires the plaintiff to allege that the actions of the aider/abettor proximately cause the harm on which the primary liability is predicated." *Neilson, 290 F. Supp. 2d at 1135* (quoting in citation *Cromer Finance Ltd, v. Berger, 137 F. Supp. 2d 452, 470 (S.D.N.Y. 2001))*. In other words, the assistance must have been "a substantial factor in causing the harm suffered." Id. Plaintiff has adequately pleaded that defendant "substantially assisted Rani Yadav-Ranjan in her commission of the above alleged frauds [*11] and breach of fiduciary duty." (FAC P 37). But for defendant's alleged failure to require checks drawn on the Construction Navigator account to contain the necessary signatures designated on the signature card, Rani Yadav-Ranjan would not have been able to withdraw the funds plaintiff invested. The misappropriation of these funds is the direct and natural consequence of defendant's failure to maintain the security precaution put in place by the signature card agreement. Therefore, by knowingly allowing Rani Yadav-Ranjan alone to withdraw the funds, defendant substantially contributed to the harm suffered by plaintiff. As a result, plaintiff has properly pled a claim against defendant for aiding and abetting a fraudulent scheme.

III. ORDER

For the foregoing reasons, the court denies defendant's motion to dismiss as to the aiding and abetting claim and grants the motion as to the remaining claims. Plaintiff is granted twenty days leave, calculated from the date of this order, to make a final attempt to amend and add additional claims.

DATED: October 15, 2004

RONALD M. WHYTE

United States District Judge

CITY OF NORTH MYRTLE BEACH; Plaintiff, v. HOTELS.COM L.P.; HOTWIRE INC.; TRIP NETWORK INC. D/B/A CHEAPTICKETS.COM; TRAVELPORT INC. F/K/A CENDANT TRAVEL DISTRIBUTION SERVICES GROUP INC.; EXPEDIA INC.; INTERNETWORK PUBLISHING CORP D/B/A LODGING.COM; LOWESTFARE.COM INCORPORATED; MAUPINTOUR HOLDING LLC; ORBITZ LLC; PRICELINE.COM INCORPORATED; SITE59.COM LLC; TRAVELOCITY.COM LP; TRAVELWEB LLC; TRAVELNOW.COM INC.; DEFENDANTS.

Civil Action No.: 4:06-CV-3063-RBH

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF SOUTH CAROLINA, FLORENCE DIVISION

2007 U.S. Dist. LEXIS 85886

September 30, 2007, Decided
September 30, 2007, Filed

COUNSEL: [*1] For North Myrtle Beach South Carolina, City of, Plaintiff: Edward A Berman, LEAD ATTORNEY, Edward A Berman Law Office, Chicago, IL; Howard B Stravitz, LEAD ATTORNEY, Howard B Stravitz Law Office, Columbia, SC; Walter Ronald Bonds, LEAD ATTORNEY, Attorneys for Medical Help, Charleston, SC.

For Hotels.com LP, Hotwire Inc, Expedia Inc, Lowestfare.com Incorporated, Maupintour Holding LLC, Priceline.com Incorporated, Travelweb LLC, Defendants: Bradish Johnson Waring, LEAD ATTORNEY, Thomas S Tisdale, Jr, LEAD ATTORNEY, Nexsen Pruet Jacobs Pollard and Robinson, Charleston, SC.

For Trip Network Inc, doing business as Cheaptickets.com, Travelport Inc, formerly known as Cendant Travel Distribution Services Group Inc, Internetwork Publishing Corp, doing business as Lodging.com, Orbitz LLC, Defendants: Bradish Johnson Waring, LEAD ATTORNEY, Thomas S Tisdale, Jr, LEAD ATTORNEY, Nexsen Pruet Jacobs Pollard and Robinson, Charleston, SC; Elizabeth B Herrington, LEAD ATTORNEY, Paul E Chronis, LEAD ATTORNEY, Purvi G Patel, LEAD ATTORNEY, McDermott Will and Emery, Chicago, IL.

For Site59.com LLC, Travelocity.com LP, Defendants: Bradish Johnson Waring, LEAD ATTORNEY, Thomas S Tisdale, Jr, LEAD ATTORNEY, [*2] Nexsen Pruet Jacobs Pollard and Robinson, Charleston, SC; Brian Scott Stagner, LEAD ATTORNEY, Jason Chad Nash, LEAD ATTORNEY, Kelly Hart and Hallman, Fort Worth, TX.

JUDGES: R. Bryan Harwell, United States District Judge.

OPINION BY: R. Bryan Harwell

OPINION

ORDER

Pending before the court are Defendants' [Docket Entry ## 12 and 14] motions to dismiss Plaintiff's Complaint. A hearing was held before the undersigned on September 12, 2007.

Procedural History and Factual Background

This case was originally filed in the Circuit Court of Common Pleas for the Fifteenth Judicial Circuit in Horry County, South Carolina. On October 27, 2006, Defendants removed the case to this court on the basis of diversity jurisdiction, *28 U.S.C. § 1332*. Defendants filed motions to dismiss on December 1 and 13, 2006, arguing that the Complaint failed to state a claim upon which relief could be granted under *Rule 12(b)(6) of the Federal Rules of Civil Procedure*.

The Complaint includes the following allegations relevant to the pending motions to dismiss:

> Pursuant to the City's hospitality fee ordinance, a one (1) percent fee is imposed on the gross proceeds derived from the rental of any "accommodation" within the City. Sec. 7-120 - Sec. 7-155, [*3] City of North Myrtle Beach, S.C. Code of Ordinances. . . .
>
> All persons renting hotel rooms in the City are required to pay the City's 1% tax, in addition to the gross price of the hotel room. The tax . . . shall be collected by the provider or seller of the service, services, or items. Sec. 7-130. . . .
>
> In addition, there is a one-half (1/2) percent local accommodations tax imposed on every person within the boundaries of the City of North Myrtle Beach that is engaged in the business of furnishing accommodations to transients for consideration. Sec. 10-5, City of North Myrtle Beach, S.C. Code of Ordinances . . .
>
> Defendants are online sellers and/or resellers of hotel rooms to the general public. Defendants have rented rooms in North Myrtle Beach to consumers and have collected hospitality fees and accommodations taxes, but have failed to pay the full amount of taxes due and owing to the City on these transactions.
>
> Specifically, defendants contract with hotels operating within North Myrtle Beach for rooms at negotiated discounted room rates. Defendants then mark up the prices on their inventory of rooms and sell the rooms at a higher price to the consumers who occupy the rooms. Defendants [*4] charge and collect the hospitality fees and accommodations taxes from occupants at the time of the sale based on the marked up room rates, but only remit amounts based on the lower, negotiated room rates to the hotel who then remits the lower tax amounts to the City. Defendants keep the difference between the amount charged to the public and the amount remitted to the hotels. . . .
>
> Defendants as "provider or seller" of the hotel rooms and/or agents for the "provider or seller" of the hotel rooms were required to collect the full hospitality and accommodations taxes from the consumers of the rooms and pay them to the City. . . .
>
> Defendants have either failed to collect, or collected and failed to remit, to the City the tax amounts due and owing to the City pursuant to the [Hospitality Fee] Ordinance. . .
>
> Defendants have either failed to collect, or collected and failed to remit to the City the tax amounts due and owing to the City pursuant to the [Local Accommodations Tax] Ordinance.

[Complaint, Docket Entry # 1-2].

The City's Complaint contains the following causes of action: 1) Violation of Hospitality Fee Ordinance; 2) Violation of Local Accommodations Tax Ordinance; 3) Conversion; 4) [*5] Imposition of Constructive Trust; and 5) Accounting. The City's causes of action for conversion, constructive trust, and accounting are premised on the City's allegation that the Defendants are in wrongful possession of taxes and fees owed to the City.

Defendants contend the Complaint should be dismissed because they are not subject to the North Myrtle Beach Hospitality Fee and Accommodations Tax

Ordinances because only local persons that furnish hotel rooms are required to collect and remit the South Carolina taxes. Defendants also argue that the City's causes of action for conversion, constructive trust, and accounting are "tag along" claims that must be dismissed if the City's statutory claims are dismissed. The City submits that because the Defendants are "providers or sellers" of the hotel rooms, the Defendants are required to pay the hospitality fees and accommodations taxes based on the "gross price" charged by the Defendants to the consumers.

Discussion

I. *Rule 12(b)(6)* Standard

A motion to dismiss under the federal rules challenges the sufficiency of the complaint for failure to state a claim upon which relief may be granted. *FED. R. CIV. P. 12(b)(6)*. *Rule "8(a)(2)* requires only [*6] 'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the . . . claim is and the grounds upon which it rests.'" *Bell Atlantic Corp. v. Twombly, 127 S. Ct. 1955, 1964, 167 L. Ed. 2d 929 (2007)* (citing *Conley v. Gibson, 355 U.S. 41, 47, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957))*. "While a complaint attacked by a *Rule 12(b)(6)* motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to provide the grounds of his entitle[ment] to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Twombly, 127 S. Ct. at 1964-65* (internal citations and quotations omitted). In ruling on a motion to dismiss, the court "accepts as true the facts alleged in the complaint [and] views them in the light most favorable to the plaintiff. . . ." *Ostrzenski v. Seigel, 177 F.3d 245, 251 (4th Cir. 1999)*. Furthermore, the purpose of a motion to dismiss is simply to test the sufficiency of the complaint because it *"does not resolve contests surrounding the facts, the merits of a claim or the applicability of defenses;"* and, in testing the sufficiency of the complaint, the court must [*7] draw all reasonable inferences from those facts in favor of the plaintiff. *Edwards v. City of Goldsboro, 178 F.3d 231, 243-244 (4th Cir. 1999)* (emphasis added).

II. Violation of Hospitality Fee Ordinance

Count one of the Complaint alleges a violation of the City's Hospitality Fee Ordinance. The Hospitality Fee Ordinance provides that:

> A uniform fee equal to one (1) percent is hereby imposed on a [sic] gross proceeds derived from . . . [t]he rental or charges for any rooms (excluding meeting and conference rooms), campground spaces, lodgings, or sleeping accommodations furnished to transients by any hotel, inn, tourist court, tourist camp, motel, campground, residence, or any place in which rooms, lodgings, or sleeping accommodations are furnished to transients for consideration.

Hospitality Fee Ordinance, Sec. 7-125, City of North Myrtle Beach, S.C. Code of Ordinances. The City alleges that the Defendants have either failed to collect, or collected and failed to remit, tax amounts due and owing to the City pursuant to the Ordinance. [Complaint, at P 39, Docket Entry # 1-2].

The City's Hospitality Fee Ordinance expressly imposes a 1% hospitality fee on the "gross proceeds derived from . [*8] . . the rental or charges for any rooms . . .furnished to transients by any hotel . . .or any place in which rooms . . . are furnished to transients for a consideration." Section 130 of the Hospitality Fee Ordinance states that the hospitality fee "shall be collected by the provider or seller of the service."

The first rule of statutory interpretation is to determine the intent of the legislature. *Jones v. State Farm Mut. Auto. Ins. Co., 364 S.C. 222, 612 S.E.2d 719, 723 (S.C. Ct. App. 2005)*. "All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute." *Jones, 612 S.E.2d at 723*. The court should look to the plain language of the statute to ascertain legislative intent. *State v. Landis, 362 S.C. 97, 606 S.E.2d 503, 505 (S.C. Ct. App. 2004)*. "Words must be given their plain and ordinary meaning without resorting to subtle or forced construction which limits or expands the statute's operation." *Landis, 606 S.E.2d at 505*. "If a statute's language is unambiguous and clear, there is no need to employ the rules of statutory construction [*9] and this Court has no right to look for or impose another meaning." *Jones, 612 S.E.2d at 723.*

The plain language of the Hospitality Fee Ordinance reveals an intent by the City to impose a 1% hospitality fee on the gross proceeds received by the provider or seller of hotel rooms located within the City. This hospitality fee must be collected by the provider or seller of the hotel rooms. The City's Complaint alleges that the Defendants are *providers* or *sellers* of hotel rooms. The Complaint also alleges that the Defendants rent hotel rooms in the City of North Myrtle Beach. Although the City's allegations may ultimately be disproved, at the motion to dismiss stage, the court is required to accept the City's allegations as true. Based on the City's allegations and the plain meaning of the hospitality fee ordinance, the City's Complaint states a claim upon which relief can be granted. Therefore, the Defendants' motions to dismiss are denied as to count one of the City's Complaint.

III. Violation of Local Accommodations Tax Ordinance

The Local Accommodations Tax Ordinance states that "[a] local accommodations tax of one-half (1/2) percent is created and is imposed on every person within the [*10] boundaries of the City of North Myrtle Beach that is engaged in the business of furnishing accommodations to transients for consideration." Local Accommodations Tax Ordinance, Sec. 10-5, City of North Myrtle Beach, S.C. Code of Ordinances. Again, the City alleges that the Defendants have either failed to collect, or collected and failed to remit, tax amounts due and owing to the City pursuant to the Ordinance. [Complaint, at P 44, Docket Entry # 1-2].

The South Carolina Code defines "local accommodations tax" as "a tax on the gross proceeds derived from the rental or charges for accommodations furnished to transients as provided in *Section 12-36-920(A)* and which is imposed on every person engaged or continuing within the jurisdiction of the imposing local governmental body in the business of furnishing accommodations to transients for consideration." *S.C. Code Ann. § 6-1-510(1).*

It is clear from the plain language of the City's ordinance and the codified definition of "local accommodations tax" that the City intended to impose a tax of .5 % on the gross proceeds received by the provider or seller of hotel rooms located within the City. Based on the City's allegations that the Defendants [*11] are providers or sellers of hotel rooms and rent hotel rooms within the City of North Myrtle Beach, count two of the Complaint states a claim upon which relief can be granted.

Defendants argue that the City's local accommodations tax should not be applied to them because they are not persons within the boundaries of the City. However, reading the definition of "local accommodations tax" together with the City's ordinance reveals an intent that the language "within the boundaries of the City" was meant to refer to the location of the accommodations, rather than the location of the person providing or selling the accommodations.

IV. State law causes of Action

The City's state law causes of action include conversion, constructive trust, and accounting. Because the Defendants' grounds for dismissing these causes of action appear dependent upon the court dismissing counts one and two and the court has denied Defendants' motions as to counts one and two, Defendants' motions as to the City's common law causes of action are also denied. The City has properly pled facts sufficient to support these common law claims under *Rule 12(b)(6).*

Conclusion

For the reasons stated above, the Defendants' [Docket [*12] Entry ## 12 and 14] motions to dismiss Plaintiff's Complaint are **DENIED.**

IT IS SO ORDERED.

Florence, S.C.

September 30, 2007

s/ R. Bryan Harwell

R. Bryan Harwell

United States District Judge

DONALD DEAN COOK, Petitioner-Appellant, v. ROSIE B. GARCIA, Warden, Centinela State Prison; ATTORNEY GENERAL, STATE OF CALIFORNIA, Respondents-Appellees.

No. 96-55285

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

1997 U.S. App. LEXIS 5980

March 24, 1997 **, Submitted

** The panel unanimously finds this case suitable for decision without oral argument. Fed. R. App. P. 34(a); 9th Cir. R. 34-4.

March 27, 1997, FILED

NOTICE: [*1] RULES OF THE NINTH CIRCUIT COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THIS CIRCUIT.

SUBSEQUENT HISTORY: Reported in Table Case Format at: *110 F.3d 67, 1997 U.S. App. LEXIS 10968.*

PRIOR HISTORY: Appeal from the United States District Court for the Southern District of California. D.C. No. CV-94-01206-JSR. John S. Rhoades, District Judge, Presiding.

DISPOSITION: AFFIRMED.

JUDGES: Before: SNEED, FARRIS, AND THOMAS, Circuit Judges.

OPINION

MEMORANDUM *

* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by *9th Cir. R. 36-3.*

Donald D. Cook appeals the district court's denial of his habeas corpus petition challenging his state court conviction for grand theft on *Supremacy Clause* grounds. We have jurisdiction under *28 U.S.C. § 2253.* We affirm.

I.

Cook owned and operated San Diego Realty Exchange, Inc. ("SDRE"), a company which purported to serve as an independent third party principal for tax-deferred exchanges of like-kind property under *section 1031 of the Internal Revenue* [*2] *Code.* SDRE entered "Exchange Agreements" with taxpayers under which SDRE agreed to facilitate tax-deferred transactions for a fee. Specifically, SDRE agreed to take title to property a taxpayer wished to transfer (the "downleg" property), convey that property to a buyer, purchase a new property identified by the taxpayer (the "upleg" property), and convey the upleg property to the taxpayer. In 1988, Cook began diverting the downleg proceeds to himself and his other business entities, leaving SDRE without sufficient funds to close the upleg portions of the transactions. In 1990, SDRE was placed in bankruptcy.

Cook was charged with grand theft of money and personal property. The jury was instructed on two theories of grand theft: embezzlement and false pretenses. The jury convicted Cook by general verdict.

On appeal, Cook argued that his conviction for grand theft from the taxpayers could not stand under an embezzlement theory because the taxpayers had no interest in the downleg sales proceeds at the time the proceeds were diverted. The California Court of Appeal disagreed, concluding that although SDRE held legal title to the downleg proceeds, the taxpayers retained beneficial interests [*3] which Cook misappropriated for his own use. The California Supreme Court denied review.

Cook petitioned for federal habeas relief, arguing that the California Court of Appeal's conclusion that the taxpayers retained beneficial interests in the downleg proceeds contravened federal tax law and thus violated the *Supremacy Clause of the Constitution*, and that the California Court of Appeal misconstrued the Exchange Agreements. The district court rejected Cook's arguments and denied the petition. This appeal followed.

II.

We review the district court's decision to deny a petition for habeas relief de novo. *Calderon v. Prunty, 59 F.3d 1005, 1008 (9th Cir. 1995).* [1]

1 Because Cook's petition was filed before April 24, 1996, the 1996 amendments to *28 U.S.C. § 2254* do not apply. *Jeffries v. Wood, 103 F.3d 827 (9th Cir. 1996).*

III.

State law is preempted by and must yield to federal law where the state law "stands as obstacle to the accomplishment and execution of the full purposes and objectives of Congress." [*4] *Gade v. National Solid Wastes Management Ass'n, 505 U.S. 88, 98, 120 L. Ed. 2d 73, 112 S. Ct. 2374 (1992).* Cook argues that the California Court of Appeal's determination that the taxpayers held a beneficial interest in the downleg proceeds is preempted by *section 1031*, which, according to Cook, prohibits taxpayers from maintaining any such interest in downleg proceeds during the course of a like-kind exchange. We reject the argument.

A taxpayer need not abandon all equitable interest in the proceeds from downleg property for a transaction to qualify as a non-taxable event under *section 1031.* So long as the taxpayer's control over the proceeds during the interim period is subject to substantial limitations or restrictions, the taxpayer is not in constructive receipt of the proceeds, and the transaction qualifies as an non-taxable exchange rather than a taxable sale. *See Treas. Reg. § 1.451-2(a)*("income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions"); *Garcia v. Commissioner of Internal Revenue, 80 T.C. 491, 499-500 (1983)*(applying general rule of constructive receipt from Treas. Reg. *§ 1.451-2(a)* [*5] to *section 1031* exchange); *Swaim v. United States, 651 F.2d 1066, 1070-71 (5th Cir. 1981)*("The receipt of money which is unfettered or unrestrained signifies a sale of the property."); *see also* Treas. Reg. § 1.1031(k)-(1)(f)(2)(affecting exchanges occurring after June 10, 1991)(taxpayer not in constructive receipt of downleg proceeds "if taxpayer's control of its receipt is subject to substantial limitations or restrictions").

Cook's citation to *In re San Diego Realty Exchange, Inc. (Taxel v. Vaca), 132 Bankr. 424 (S.D. Cal. 1991)*, is unavailing. According to Cook, the *Taxel* court held that Cook's victims held no beneficial interest in the downleg sales proceeds because retention of such an interest was contrary to federal law. The *Taxel* court, however, made no such holding.

In *Taxel*, SDRE's bankruptcy trustee sought to avoid an upleg transfer made by SDRE to Michael Vaca within ninety days of the filing of the company's petition in bankruptcy. *Id. at 426.* Vaca argued that the transfer was not voidable under *11 U.S.C. § 547(b)* because the upleg property was not the "property of the debtor" for *section 547* purposes. Although SDRE did momentarily hold legal [*6] title to the upleg property, Vaca argued, it held that title in resulting trust for the benefit of Vaca. *Id. at 428.*

The court rejected Vaca's argument because SDRE had purchased Vaca's upleg property with funds from a commingled bank account containing the downleg proceeds from numerous transactions. *Id.* The court concluded that any resulting trust in the upleg property thus arose "for the benefit of all SDRE clients who contributed to the commingled fund." *Id. at 428.* Vaca, like the other contributors to the commingled fund, consequently "assumed the position of an unsecured creditor of SDRE." *Id. at 430.* Because Vaca did not demonstrate that only his funds were used to purchase the upleg property, the upleg property was "property of the debtor" for *section 547* purposes, and the transfer was voidable. *Id. at 429-30.*

Contrary to Cook's arguments, the bankruptcy court held that one SDRE client failed to establish that particular upleg property was purchased with the proceeds from the sale of his downleg property. It did not hold that SDRE's clients did not, let alone could not, hold beneficial interests in the proceeds from the sales of their downleg properties.

[*7] Cook's reliance on *Reed v. CIR, 723 F.2d 138 (1st Cir. 1983)*, is equally unavailing. The *Reed* court merely suggested that a taxpayer may be in constructive receipt of escrowed funds from which he receives investment income during the escrow period because in such a situation, the taxpayer has received a complete and present interest the equivalent of cash. A taxpayer does not enjoy a complete and present interest the equivalent of cash in funds in which he holds nothing more than an equitable interest. A taxpayer is thus not in constructive receipt of such funds under Reed's "economic benefit" analysis.

Section 1031 does not prohibit taxpayers from retaining a beneficial interest in downleg sales proceeds during the course of a qualifying like-kind exchange. The California Court of Appeal's conclusion that Cook's victims maintained equitable interests in their downleg proceeds does not conflict with, and is thus not preempted by, federal law.

IV.

Cook also argues that the California Court of Appeal misconstrued the Exchange Agreements in concluding that the taxpayers held a beneficial interest in the downleg proceeds. This claim is not cognizable in a *section 2254* proceeding. [*8] *Estelle v. Mcguire, 502 U.S. 62, 67-68, 116 L. Ed. 2d 385, 112 S. Ct. 475 (1991)*("It is not the province of a federal habeas court to reexamine state court determinations on state law questions.").

AFFIRMED.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

IN RE:	LANDAMERICA FINANCIAL GROUP, INC., et al., Debtors.	Case No. 08-35994-KRH Chapter 11 Jointly Administered

FRONTIER PEPPER'S FERRY, LLC,

Plaintiff,

v. Adv. Pro. No. 08-03148

LANDAMERICA 1031 EXCHANGE SERVICES, INC.,

Defendant.

HOWARD FINKELSTEIN,

Plaintiff,

v. Adv. Pro. No. 08-03171

LANDAMERICA 1031 EXCHANGE SERVICES, INC.,

Defendant.

MATTHEW B. LUXENBERG, TRUSTEE OF THE MATTHEW B. LUXENBERG REVOCABLE FAMILY TRUST,

Plaintiff,

v. Adv. Pro. No. 09-03023

LANDAMERICA 1031 EXCHANGE SERVICES, INC.,

Defendant.

MEMORANDUM OPINION

Before the Court are the cross-motions for partial summary judgment of the plaintiffs Frontier Pepper's Ferry, LLC ("Frontier"), Howard Finkelstein ("Finkelstein"), and Matthew B. Luxenberg, Trustee of the Matthew B. Luxenberg Revocable Family Trust ("Luxenberg" and together with Frontier and Finkelstein the "Plaintiffs"), on the one hand, and of the defendant, LandAmerica 1031 Exchange Services, Inc. ("LES" or "Debtor"), and the Intervenors, The Official Committee of Unsecured Creditors of LandAmerica Financial Group, Inc. (the "LFG Committee") and The Official Committee of Unsecured Creditors of LandAmerica 1031 Exchange Services, Inc. (the "LES Committee" and together with the LFG Committee the "Committees"), on the other hand.

The question presented by the cross motions for partial summary judgment is whether certain exchange funds and other consideration delivered to LES on behalf of the Plaintiffs for the purpose of facilitating three like-kind exchange transactions under § 1031 of the Internal Revenue Code constitute property of the bankruptcy estate of LES where the exchange funds were deposited into a commingled operating account of the Debtor. On April 15, 2008, the Court issued a Memorandum Opinion in *Millard v. LandAmerica 1031 Exchange Services, Inc.*[1] wherein the Court addressed many of the same legal issues that are presented in these motions. The primary factor that distinguishes *Millard* from the motions at bar is that the exchange funds in *Millard* were deposited into segregated accounts whereas the exchange funds that are the subject of these motions were deposited into the commingled operating account of the Debtor. For many of the same reasons as previously enunciated in *Millard*, the Court answers the question presented by the cross-motions in these cases in the affirmative. The exchange funds

[1] Adv. Pro. No. 08-03147-KRH.

are not held by the Debtor subject to an express trust or a resulting trust and cannot be excluded from property of the bankruptcy estate for that reason.

This case is one of over 100 adversary proceedings that have been brought, so far, by former customers of LES in connection with its chapter 11 bankruptcy case. Each of these former customers asserts that money and other consideration deposited with LES to facilitate like-kind exchanges under § 1031 of the Internal Revenue Code was held in trust for its benefit and should be returned to it. As of November 26, 2008, the date that LES filed its bankruptcy petition (the "Petition Date"), LES had approximately 450 uncompleted exchange transactions. Each of these uncompleted exchange transactions was governed by a separate exchange agreement executed by LES and its former customer.

LES identified two primary types of exchange agreements that it had utilized in the course of its operations: (a) agreements that included language contemplating that the applicable exchange funds would be placed into an account or sub-account associated with the relevant customer's name (the "Segregated Account Agreements"); and (b) agreements that did not include this "segregation" language (the "Commingled Account Agreements"). Approximately 50 of the uncompleted exchange transactions involved Segregated Account Agreements while the remaining approximately 400 of the uncompleted exchange transactions involved Commingled Account Agreements.

The Court entered a protocol order on January 16, 2009, wherein the Court stayed the litigation in all but five of the over 100 adversary proceedings (the "Protocol Order"). Five lead cases were selected to proceed on an expedited basis because they presented legal and factual issues that were common to certain of the other adversary proceedings. Two of the select cases were representative of customers who had Segregated Account Agreements: customers with escrow account agreements and customers with segregated exchange agreements. The *Millard* case, in which the Court issued its April 15, 2008, Memorandum Opinion, was representative of customers who had segregated exchange agreements. In *Millard*, the Court held that the exchange funds held by LES in segregated accounts were property of its bankruptcy estate.

The three lead cases now before the Court are representative of customers who had Commingled Account Agreements: those with type A agreements, those with type B agreements, and customers with hybrid type B agreements whereunder both cash and non-cash proceeds were transferred to LES. As defined by the parties, Commingled Type A Cases generally involve the wire transfer of exchange funds to an LES account at SunTrust Bank; Commingled Type B Cases generally involve the deposit by LES of exchange funds into an LES account at SunTrust Bank.[2] Other than the inclusion of non-cash proceeds, the hybrid agreements are otherwise Type B agreements. Finkelstein's and Frontier's cases are representative of the "Commingled Type B" cases and Luxenberg's case is representative of the "Commingled Type A" cases.

By Order entered February 10, 2009, the Court divided the litigation involving the five lead cases into phases and limited the scope of the first phase to tracing of exchange funds, contractual interpretation of the exchange agreements, the existence of an express trust and the existence of a resulting trust. Specifically, the Court declined to consider at this stage of the litigation whether the exchange agreements are, or should be, the subject of a constructive trust. Hearing was conducted on the cross-motions for partial summary judgment on April 16, 2009, at which counsel for the parties presented argument. Pursuant to the terms of the Court's Protocol Order, all of the parties to the stayed adversary proceedings were permitted to file amicus briefs advocating their respective positions.

[2] *See* Joint Motion of Debtor and LES Committee for Order Establishing Scheduling Protocol, ¶ 8.

This Memorandum Opinion sets forth the Court's findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.[3] The Court has subject matter jurisdiction of this adversary proceeding pursuant to 28 U.S.C. §§ 157(a) and 334 and the General Order of Reference from the United States District Court for the Eastern District of Virginia dated August 15, 1984. This is a core proceeding under 28 U.S.C. §§ 157(b)(2)(A), (M) and (O), in which final orders or judgments may be entered by a bankruptcy judge. Venue is appropriate in this Court pursuant to 28 U.S.C. § 1409(a).

Issues Presented

Plaintiffs contend that they are entitled to partial summary judgment because their exchange funds were held by LES in trust for their benefit, and, therefore, the exchange funds should be turned over to them outside of the bankruptcy pro rata distribution system. LES and the Committees counter that all three Plaintiffs entered into agreements with LES to facilitate like-kind exchange transactions under Section 1031 of the Internal Revenue Code. All three deposited money or other consideration (the "Exchange Funds") with LES which was in all respects treated as property of LES. LES and the Committees point out that under the terms and provisions of the exchange agreements, the Plaintiffs each disclaimed all "right, title and interest" in and to the Exchange Funds and provided LES with exclusive rights of "dominion, control and use" of the Exchange Funds. LES and the Committees assert that the Plaintiffs vested full authority over the Exchange Funds with LES; and, in so doing, transferred clearly more than bare legal title to the Exchange Funds. LES promised to pay a defined rate of interest on the Exchange Funds and to repay the Exchange Funds at some future point in accordance with the contractual terms. LES and the Committees therefore argue that the Exchange Agreements

[3] Findings of fact shall be construed as conclusions of law and conclusions of law shall be construed as findings of fact when appropriate. *See* Fed. R. Bankr. P. 7052.

created nothing more than a debtor-creditor relationship; and, as unsecured creditors of LES, Plaintiffs are not entitled to any recovery beyond that which the Bankruptcy Court grants to similarly-situated creditors in due course.

Undisputed Facts

Plaintiff Luxenberg is a physician residing in California. He is the trustee of the Matthew B. Luxenberg Revocable Family Trust, a trust created under California law. Plaintiff Frontier is a Virginia limited liability company with its principal place of business in Richmond, Virginia. Plaintiff Finkelstein is an individual residing in Garden City, New York

Defendant Debtor LES is a wholly owned subsidiary of LandAmerica Financial Group, Inc. ("LFG"). On November 24, 2008, LES ceased doing business as a qualified intermediary for like-kind exchanges, and on November 26, 2008, it filed, along with LFG, a petition for relief under Chapter 11 of the United States Bankruptcy Code in this Court. The LES Committee and the LFG Committee are both statutory committees appointed in the respective bankruptcy cases of LES and LFG. The Committees were each granted leave to intervene in this action.

Prior to the Petition Date, LES was a qualified intermediary for like-kind exchanges consummated by taxpayers pursuant to § 1031 of the Internal Revenue Code, 26 U.S.C. § 1031 ("1031 Exchange"). A 1031 Exchange allows a taxpayer to defer the payment of tax that otherwise would be due upon the realization of a gain on the disposition of business or investment property. *Id.* In the typical transaction, an exchanger such as one of the Plaintiffs assigns its rights as seller under a purchase agreement for the disposition of business or investment property (the "Relinquished Property") to a qualified intermediary such as LES. The purchaser of the Relinquished Property transfers the net sales proceeds directly to the qualified intermediary.

The exchanger must identify like-kind replacement property (the "Replacement Property") within 45 days. The exchanger has 180 days to close on the Replacement Property. *See id.* The qualified intermediary purchases the Replacement Property and then transfers the Replacement Property to the exchanger. In the event that the Replacement Property is not identified or closed within the specified time periods, then the qualified intermediary pays an amount equal to the net sales proceeds to the exchanger. This series of transactions is governed by a written exchange agreement executed by the exchanger and the qualified intermediary.

In connection with its business as qualified intermediary for like-kind exchanges, LES maintained a general, multipurpose checking account at SunTrust Bank, Inc. ("SunTrust") since 1992. This checking account was titled in LES' own name, bearing an account number with the last four digits "3318." LES used this account as its general operating account. The SunTrust account received cash from various sources including cash (i) in the form of certain customers' exchange funds, (ii) in the form of service fees charged to customers, (iii) in the form of interest, and (iv) in the form of returns on LES' investments. LES disbursed funds from the SunTrust account to pay its expenses, to pay dividends to LFG, to make investments in other investment vehicles, and to purchase replacement property for customers who had not insisted that their exchange funds be deposited in segregated accounts.

LES used funds in the SunTrust account to invest in a variety of short-term investments, including money market mutual funds, short-term bonds, certificates of deposit, floating rate notes, and auction rate securities.[4] The auction rate securities were held in a brokerage

[4] In the ordinary course of its business, LES invested certain of the exchange funds that it had received from its former customers and which it had deposited into its Commingled Account. Some of the invested exchange funds received by LES are now held in the form of illiquid auction rate securities as a result of the unprecedented recent and rapid economic decline. As a consequence, LES does not have the ability from a liquidity standpoint to fund all of the exchanges it is contractually obligated to complete within the time parameters that § 1031 of the Internal Revenue Code requires as it had committed. To permit one group of exchangers to recover their exchange funds

investment account at SmithBarney and SunTrust Robinson Humphrey. Each evening, the aggregate cash balance in the SunTrust account was swept out into an LES overnight investment account and then returned to the SunTrust account the following morning. The SunTrust account is referred to as the commingled account of LES (the "Commingled Account").

Plaintiffs Frontier, Finkelstein, and Luxenberg executed separate Exchange Agreements with LES (the "Exchange Agreements")[5]. The Exchange Agreements were identical as to certain key provisions regarding LES's control and use of the funds transferred to LES by Plaintiffs. The Exchange Agreements uniformly provide that Plaintiffs assigned to LES their rights as sellers under purchase agreements for three Relinquished Properties. The net consideration from the sale of Plaintiffs' Relinquished Properties was initially deposited into the Debtor's Commingled Account.[6] From the moment the Plaintiffs authorized LES to receive the proceeds of their Relinquished Property sales, LES commingled those funds and treated them as its own.

Section 2 of each of the Exchange Agreements provides in pertinent part:

> (c) LES shall have sole and exclusive possession, dominion, control and use of all Exchange Funds, including interest, if any, earned on the Exchange Funds. . . . Taxpayer shall have no right, title, or interest in or to the Exchange Funds or any earnings thereon and Taxpayer shall have no right, power, or option to demand, call for, receive, pledge, borrow or otherwise obtain the benefits of any of the Exchange Funds. . . .

under a trust theory necessarily impacts all of the other exchangers adversely, whether similarly situated or otherwise.

[5] The Luxenberg Exchange Agreement was executed on November 14, 2008. The Finkelstein Exchange Agreement was executed on July 21, 2008. The Frontier Exchange Agreement was executed on September 22, 2008.

[6] On November 20, 2008, $1,430,813.96 of net proceeds from the sale of the Relinquished Property that Luxenberg had assigned to LES was wired into the Commingled Account. On September 22, 2008, $1,189,830.50 of net proceeds from the sale of the Relinquished Property that Frontier had assigned to LES was wired into the Commingled Account. On July 21, 2008, $1,482,316 of net proceeds from the sale of the Relinquished Property that Finkelstein had assigned to LES was wired into the Commingled Account. As additional consideration for the sale of the Relinquished Property that Finkelstein had assigned to LES, a note secured by a mortgage on property located at 36-40 West 13th Street, New York, New York, in the amount of $2.1 million was made out and delivered to LES.

The Exchange Agreements differ with respect to Section 3. Luxenberg's Exchange Agreement provides that "Taxpayer will receive interest on the Exchange Funds at . . . [accrual of interest at a certain rate] from the first business day following *LES' receipt of funds via wire transfer to the LES account in Richmond, Virginia, that it maintains at SunTrust Bank for the purpose of collecting taxpayers' exchange funds,* or from three business days after receipt in Richmond, Virginia, if sent by check . . . ." (emphasis added).[7] In contrast, the Exchange Agreements executed by Frontier and Finkelstein provide that *"LES will deposit the Exchange Funds in an account maintained at SunTrust Bank in Richmond, Virginia,* and guarantees Taxpayer will receive interest on the Exchange Funds at . . . [accrual of interest at a certain rate] from the first business day following receipt of funds via wire transfer at Richmond, Virginia, or from three business days after receipt in Richmond, Virginia, if sent by check . . . ." (emphasis added).[8]

Section 4 of each of the Exchange Agreements sets forth the procedures for Plaintiffs to identify their Replacement Properties. Section 5 of each of the Exchange Agreements sets forth the terms under which LES will acquire the Replacement Properties and transfer them to Plaintiffs. Section 6 of each of the Exchange Agreements makes clear that the sole purpose of the Exchange Agreements is to facilitate the exchange of the Relinquished Properties for the Replacement Properties. Section 6(c) of each of the Exchange Agreements limits the duties and obligations of LES. That section provides:

> LES shall only be obligated to act as an intermediary in accordance with the terms and conditions of this Exchange Agreement and shall not be bound by any other contract or agreement, whether or not LES has knowledge of any such contract or agreement or of its terms or conditions. LES has undertaken to perform only such

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[7] *See* Luxenberg Exchange Agreement at § 3(a). The use of the plural possessive "taxpayers'" suggests that the funds of multiple customers are being deposited into the same SunTrust account.

[8] *See* Frontier and Finkelstein Exchange Agreements at § 3(a).

> duties as are expressly set forth herein, and no additional duties or obligations shall be implied hereunder or by operation of law or otherwise.

Disclaimer

Each of the Exchange Agreements contains an integration (or merger) clause in section 11 providing that "[t]his Exchange Agreement contains the entire understanding between and among the parties hereto."

Standard for Entry of Summary Judgment

Rule 56 of the Federal Rules of Civil Procedure, made applicable to these proceedings by Rule 7056 of the Federal Rules of Bankruptcy Procedure, provides that summary judgment should be granted "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); *Celotex Corp. v. Catrett,* 477 U.S. 317, 327 (1986). In determining whether this showing has been made, the court must assess the evidence in the light most favorable to the party opposing the motion. *See, e.g., Charbonnages de France v. Smith*, 597 F.2d 406, 414 (4th Cir. 1979).

The United States Supreme Court has made clear that summary judgment is not a disfavored procedural shortcut, but rather an integral part of the Federal Rules, which are designed "to secure the just, speedy and inexpensive determination of every action." *Celotex Corp. v. Catrett,* 477 U.S. at 32 (quoting Fed. R. Civ. P. 1); *see also Thompson Everett, Inc. v. Nat'l Cable Adver., L.P.*, 57 F.3d 1317, 1322–23 (4th Cir. 1995); *Sibley v. Lutheran Hosp. of Md., Inc.,* 871 F.2d 479, 483 n.9 (4th Cir. 1989); *Schultz v. Wills (In re Wills),* 126 B.R. 489, 494 (Bankr. E.D. Va. 1991).

A party moving for summary judgment bears the initial burden of demonstrating that there is no genuine issue of material fact. *See Celotex Corp. v. Catrett,* 477 U.S. at 322. Summary judgment is appropriate only where there are no "disputes over facts that might affect the outcome of the suit;" disputes over mere peripheral or irrelevant facts are not sufficient. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

If the moving party demonstrates that there is no genuine issue of material fact, the burden shifts to the nonmoving party to produce evidence to demonstrate that there is indeed a genuine issue for trial. Fed. R. Civ. P. 56(e)(2) ("When a motion for summary judgment is properly made and supported, an opposing party may not rely merely on allegations or denials in its own pleading; rather, its response must—by affidavits or as otherwise provided in this rule—set out specific facts showing a genuine issue for trial. If the opposing party does not so respond, summary judgment should, if appropriate, be entered against that party."); *see also Celotex Corp. v. Catrett,* 477 U.S. at 325; *RGI, Inc. v. Unified Indus., Inc.*, 963 F.2d 658 (4th Cir. 1992).

The parties all assert that summary judgment is appropriate in this case because there is no dispute as to any material fact regarding the subject transactions. Resolution of the matters in dispute involves the interpretation of three substantially similar contracts, none of which is ambiguous.[9] Furthermore, as all of the parties have filed motions for summary judgment, no party can be heard to complain that it will be deprived of a right to trial if summary judgment is entered.

Discussion

Section 541 of the Bankruptcy Code provides for the creation of a bankruptcy estate upon the filing of a bankruptcy petition.[10] Property included within that estate is defined very broadly

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[9] It is important to determine whether the contracts are ambiguous, since "[i]f a court properly determines that the contract is unambiguous on the dispositive issue, it may then properly interpret the contract as a matter of law and grant summary judgment because no interpretive facts are in genuine issue." *Washington Metro. Area Transit Auth. v. Potomac Inv. Props., Inc.*, 476 F.3d 231, 235 (4th Cir. 2007).

[10] Section 541 of the Bankruptcy Code provides in pertinent part:

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
>
> > (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

to include every interest that a debtor has in property as of the commencement of the bankruptcy case, wherever located and by whomever held. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204-05 (1983) ("The House and Senate Reports on the Bankruptcy Code indicate that § 541(a)(1)'s scope is broad."); *Grochal v. Ocean Tech. Servs. Corp. (In re Baltimore Marine Indus.)*, 476 F.3d 238, 240 (4th Cir. 2007) ("Section 541 of the Bankruptcy Code governs the composition of the bankruptcy estate and provides a broad definition of 'property of the estate.'").

In line with the broad definition of "property of the estate," money held in a bank account in the name of a debtor is presumed to be property of the bankruptcy estate. *See, e.g., In re Amdura Corp.*, 75 F.3d 1447, 1451 (10th Cir. 1996) ("We presume that deposits in a bank to the credit of a bankruptcy debtor belong to the entity in whose name the account is established."); *Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A.* (*In re U.S.A. Diversified Prods., Inc.*), 100 F.3d 53, 55 (7th Cir. 1996) ("Property of the debtor is defined to include all legal or equitable interests of the debtor . . . and obviously that includes the interest that a depositor has in the money in his account, more precisely the money owed him by the bank by virtue of the account.") (internal quotations omitted); *Asurion Ins. Servs., Inc. v. Amp'd Mobile, Inc.* (*In re Amp'd Mobile, Inc.*), 377 B.R. 478, 483 (Bankr. D. Del. 2007) ("Property held by a debtor is presumed to be property of the estate."); *Sousa v. Bank of Newport*, 170 B.R. 492, 494 (D.R.I. 1994) (the bankruptcy estate "includes funds held in a checking or savings account"); *Stratton v. Equitable Bank*, N.A., 104 B.R. 713, 726 (D. Md. 1989) (funds deposited in an account owned and controlled by the debtor become the debtor's property).[11]

[11] *See* 5 Collier on Bankruptcy ¶ 541.09 (Alan N. Resnick & Henry J. Sommer, eds., 15th ed. Rev. 2008) ("deposits in the debtor's bank account become property of the estate under § 541(a)(1)").

In this case, the facts mandate a presumption that the Exchange Funds are the property of the LES bankruptcy estate. The Exchange Funds were derived from the proceeds of the sale of the Relinquished Properties that Plaintiffs had assigned to LES. The Exchange Funds were transferred from the third party purchasers of these Relinquished Properties directly into the Commingled Bank Account of LES by the closing agents. The transferred funds remained in that Commingled Bank Account through the Petition Date. Plaintiffs never had any ability to withdraw the funds. The Commingled Bank Account was and remains under the complete control of LES. Only LES had the ability to disburse or withdraw the funds. As LES maintained the Exchange Funds in its general operating account in its name and under its control and as LES had the right to use the funds to pay its own expenses, the money is presumably property of the LES bankruptcy estate. *Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. (In re USA Diversified Products, Inc.)*, 100 F.3d at 55 (estate property "includes the interest that a depositor has in the money in its account"); *Elsaesser v. Gale (In re Salt Lake City R.V., Inc.)*, No. 95-03264-7, 1999 WL 33486709, at *4 (Bankr. D. Idaho, March 17, 1999) ("[m]oney in a bank account under the debtor's control presumptively constitutes property of the debtor's estate. . . ."); *In re Amdura Corp.*, 75 F.3d at 1451 (10th Cir. 1996) (holding that the funds in the debtor's bank account were the property of the estate, where the debtor held the account exclusively in its own name, earned interest on the account, and had the right to use the funds to pay its own expenses and those of its subsidiaries, without any consideration of which subsidiaries had contributed funds to the account).

To rebut this presumption that the funds are property of the bankruptcy estate of LES, Plaintiffs must show that they retained some right to the funds. Any such right to the funds must

demand it today at any time.

be established as an interest in property recognized under state law.[12] *Butner v. United States*, 440 U.S. 48, 55 (1979). Plaintiffs contend that LES was temporarily holding the Exchange Funds on their behalf solely for the purpose of facilitating the exchange of the Relinquished Properties for the Replacement Properties. Plaintiffs maintain that they never parted with their equitable interest in the ownership of the Exchange Funds[13] and that LES was holding the Exchange Funds in trust for Plaintiffs' benefit. Therefore, they assert, although the Exchange Funds may have been commingled in the general operating account of LES, the funds did not become property of the LES bankruptcy estate. 11 U.S.C. § 541(d).[14]

Whether property in the possession of the Debtor is held in trust for Plaintiffs is a question of state law. *Butner*, 440 U.S. at 55. While federal law creates the bankruptcy estate, state law defines the scope and existence of the debtor's interest in property. *Raleigh v. Ill. Dept. of Revenue*, 530 U.S. 15, 20 (2000) ("The 'basic federal rule' in bankruptcy is that state law governs the substance of claims, Congress having 'generally left the determination of property rights in the assets of the bankrupt's estate to state law.'") (quoting *Butner,* 440 U.S. at 57). LES and Plaintiffs

[12] One of Plaintiffs' alternative arguments is that LES was acting as a mere conduit for the Exchange Funds; and, as such, the funds are excluded from the LES bankruptcy estate pursuant to § 541(d) of the Bankruptcy Code as a matter of federal common law. In support, Plaintiffs cite *City of Springfield, Mass. v. Ostrander (In re LAN Tamers),* 329 F.3d 204 (1st Cir. 2003); *T&B Scottdale Contractors, Inc. v. United* States, 866 F.2d 1372 (11th Cir. 1989). In those cases cited by Plaintiffs in support of this position, the funds originated from a Federal program and were earmarked for a specific statutory purpose. That is not the case here where the Exchange Funds represent the net proceeds of third party purchasers' acquisitions of Relinquished Properties.

[13] Legal title to property and the equitable interest in property are separate property interests. *See, e.g., In re Halabi,* 184 F.3d 1335, 1337 (11th Cir. 1999). Virginia law recognizes the beneficiary as "equitable owner of the trust property." *Broaddus v. Gresham,* 181 Va. 725, 26 S.E.2d 33, 36 (1943) (quoting 1 Scott on Trusts § 12.1, at 86 (1939)).

[14] Section 541(d) of the Bankruptcy Code creates a limitation on the otherwise broad definition of property of the estate. That section provides in pertinent part that:

> "property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate under sub-section (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold."

11 U.S.C. § 541(d).

agreed that the Exchange Agreements would be governed by Virginia law.[15] That contractual choice of law provision is determinative of the law to be applied in this case. *See Holmes Envtl., Inc. v. SunTrust Banks, Inc. (In re Holmes Envtl., Inc.)*, 287 B.R. 363, 374 (Bankr. E.D. Va. 2002) (*citing Tate v. Hain*, 180 Va. 402, 410, 25 S.E.2d 321, 324 (1943)).

Under the terms of the Court's February 10, 2009, order, the question to be resolved at this stage of the litigation is whether the Exchange Funds are excluded from property of LES' bankruptcy estate because of the existence of either an express trust or a resulting trust.[16] The Court will look to the law of the Commonwealth of Virginia in analyzing these two issues. Plaintiffs bear the burden of proving the existence of a trust. *See Page v. Page*, 132 Va. 63, 110 S.E. 370, 372 (1922) (party seeking to establish a trust has the burden of proving its existence); *Chiasson v. J. Louis Matherne & Assocs. (In re Oxford Mgmt., Inc.)*, 4 F.3d 1329, 1335 (5th Cir. 1993) ("When the property of an estate is alleged to be held in trust, the burden of establishing the trust's existence rests with the claimants.").

Under Virginia law, an express trust is created only where there is "an affirmative intention to create it." *Peal v. Luther*, 199 Va. 35, 37, 97 S.E.2d 668, 669 (1957); *Leonard v. Counts*, 221 Va. 582, 588, 272 S.E.2d 190, 194 (1980) (an express trust is "based on the declared intention of the trustor."). The affirmative intention to create a trust may be established by "either express language to that effect or circumstances which show with reasonable certainty that a trust

[15] Section 11 of the Exchange Agreements provides that "[t]his Exchange Agreement shall be governed by and construed in accordance with the applicable laws of the Commonwealth of Virginia without regard to the conflict of laws provisions thereof. . . ."

STRUCTIVE TRUST

[16] The Court does not have under consideration at this phase of the litigation whether the imposition of a constructive trust is appropriate. A constructive trust "arise[s] by operation of law, independently of the intention of the parties . . . ." *Crestar Bank v. Williams*, 250 Va. 198, 204, 462 S.E.2d 333, 335 (1995) (citation omitted). Such trusts "occur not only where the property has been acquired by a fraud or improper means, but also where it has been fairly and properly acquired, but it is contrary to the principles of equity that it should be retained . . . ." *Leonard v. Counts*, 221 Va. 582, 589, 272 S.E.2d 190, 195 (1980) (citation omitted). Many of the arguments advanced by the Plaintiffs go to this issue.

was intended to be created." *Woods v. Stull*, 182 Va. 888, 902, 30 S.E.2d 675, 682 (1944); *Rivera v. Nedrich*, 259 Va. 1, 6, 529 S.E.2d 310, 312 (1999).

There is no express language in the Exchange Agreements that creates a trust. The words "trust," "trustee," or "beneficiary" do not appear anywhere in the Exchange Agreements. Given the omission of any language normally associated with the creation of a trust, Plaintiffs must demonstrate with "reasonable certainty" circumstances that show the parties to the Exchange Agreements nevertheless intended to create a trust. *Woods v. Stull*, 182 Va. at 902, 30 S.E.2d at 682.

The Court thus turns to an examination of whether Plaintiffs have demonstrated the parties' intent to create a trust despite the absence of express language to do so. Although formal or technical words are not necessary to create a trust, the fact that the Exchange Agreements make no mention of a "trust" is significant in determining whether a trust was intended. *See In re Estate of Vallery*, 883 P.2d 24, 27 (Colo. App. 1993). Here, not only is there an absence of any language that the parties intended to create a trust, but there is language in the Exchange Agreements that actually evidences an intent *not* to do so. Plaintiffs, in the Exchange Agreements, conveyed exclusive possession, dominion,[17] control and use of the Exchange Funds to LES. They also disclaimed any right, title or interest in and to the Exchange Funds. The conveyances, combined with the disclaimers, are inconsistent with the establishment of a trust. Under a trustee-beneficiary relationship, the trustee holds legal title to the trust property and the beneficiary holds an equitable interest in the trust property. *Kubota Tractor Corp. v. Strack*, Case No. 4:06cv145, 2007 WL 517492, at *4 (E.D. Va. Feb. 6, 2007) (citing *Broaddus v. Gresham*, 181 Va. 725, 731, 26 S.E.2d 33, 35 (1943)) (reversed on other grounds, *Kubota*

[17] "Dominion" has been defined by one court as "perfect control in right of ownership, and indicates that it was the intention to make the instrument as effectual as a conveyance as it was possible for the parties to make it." *Baker v. Westcott*, 11 S.W. 157, 159 (Tex. 1889).

Tractor Corp. v. Strack (*In re Strack*), 524 F.3d 493 (4th Cir. 2008)). However, Plaintiffs relinquished *any and all* interests in the property, including the equitable interest that a beneficiary of a trust would retain in trust property. Plaintiffs expressly disclaimed the "equitable" interest that they now ask this Court to find that they otherwise somehow retained.

fiduciary intent

Not used

Further evidence that the parties did not intend the Exchange Agreements to create a trust can be found in the parties' agreement to limit the duties of LES to those expressly contained in the Exchange Agreements. A trust necessarily requires the establishment of fiduciary duties. *See Restatement (3d) of Trusts § 2* (2003) (stating that a trust is a fiduciary relationship with respect to property); *In re NOVA Real Estate Inv. Trust*, 23 B.R. 62, 66 (Bankr. E.D. Va. 1982) ("A trust involves a duty of the fiduciary to deal with particular property for the benefit of another.").[18] Fiduciary duties create a special relationship of trust and good faith that goes beyond the duties set forth in an ordinary contract between commercial parties. *See Balbir Brar Ass'n v. Consol. Tracking Servs. Corp.*, At Law No. 137795, 1996 WL 1065615 at *5 (Va. Cir. Ct. October 1, 1996) (distinguishing between contract duties and fiduciary duties).

The parties to the Exchange Agreements acknowledged that LES was not undertaking any duties not expressly set forth in the Exchange Agreements (i. e. the contract duties) including any implied duties or any duties imposed by operation of law. This limitation on the scope of LES' duties eliminates any argument that LES had a duty to act as a fiduciary for Plaintiffs. *Metric Constructors, Inc. v. Bank of Tokyo-Mitsubishi, Ltd.*, Case No. 99-2330, 2000 WL 1288317, at *4 (4th Cir. Sept. 13, 2000) (holding that no fiduciary duties existed where the plaintiff "expressly consented (in the Consent Agreement) to the [defendants'] disclaimer of any

[18] A trustee has a fiduciary obligation to act for the benefit of the trust beneficiary. *See Continental Cas. Co. v. Powell*, 83 F.2d 652, 654 (4th Cir. 1936) ("There is a fiduciary relation between trustee and beneficiary; there is not a fiduciary relation between debtor and creditor.") (internal citations omitted); *Caldwell v. Hanes* (*In re Hanes*), 214 B.R. 786, 812 (Bankr. E.D. Va. 1997) ("The trustee . . . is a fiduciary of the trust beneficiaries.") (internal citations omitted).

fiduciary relationship toward it"). The Exchange Agreements provide that LES was acting in the narrow capacity of an exchange facilitator. The parties agreed that LES assumed no duties not expressly set forth in the Exchange Agreements, including fiduciary duties, and none can be implied or imposed by operation of law. LES merely had the contractual duty to effect the exchanges. The unambiguous language of the Exchange Agreements makes clear that LES and Plaintiffs intended their relationships to be relationships of contract obligor and obligee.

'Annot disclaim

The Exchange Agreements were integrated contracts. *See Robinette v. Robinette*, 4 Va. App. 123, 354 S.E.2d 808, 810 (1987); *see also Lysk v. Criswell (In re Criswell)*, 52 B.R. 184, 197 (Bankr. E.D. Va. 1985) (holding that an integrated agreement containing a merger clause precluded parties from claiming any reliance on "terms, conditions, statements, warranties, or representations not contained [in the integrated agreement]"). Plaintiffs therefore cannot utilize extrinsic evidence to modify or alter the contracts' plain statements (i) that Plaintiffs had no interest, including any equitable interest, in or to the Exchange Funds and (ii) that LES owed to Plaintiffs no duty, including any fiduciary duty, not expressly set forth in the Exchange Agreements. *Robinette v. Robinette*, 4 Va. App. at 128, 354 S.E.2d at 810 (holding that a party cannot introduce parol evidence to show the existence of a trust if it would defeat or contradict the terms of an express agreement). The objective language of the Exchange Agreements precludes consideration of any subjective belief that the parties may have had regarding the relationship between them. *Boone v. U.S. Attorney*, Case No. 7:06VA00006, 2006 WL 1075010, at *3 (W.D. Va. Apr. 21, 2006) ("Boone may have had a subjective intent to the contrary, but it is the objective manifestation of intent, as shown by the words used in the agreement, that governs.").

Plaintiffs maintain that they intended for the Exchange Funds to be held in escrow by LES and that their funds were to be used only for the acquisition of the replacement properties.

They argue that the Fourth Circuit has held that an escrow arrangement is a specialized type of express trust under Virginia law. *Old Republic Nat'l Title Ins. Co. v. Tyler (In re Dameron)*, 155 F.3d 718, 722 (4th Cir. 1998). Plaintiffs point to various provisions of their Exchange Agreements such as (i) section 6(b) wherein LES acknowledges that it entered into the agreement solely to facilitate the tax deferred exchanges, (ii) section 2(a) wherein LES agreed to hold and apply the Exchange Funds in accordance with the terms of the agreement, (iii) section 2(b) wherein LES stated that it would use the Exchange Funds to purchase the replacement properties, (iv) section 3(a) wherein LES unconditionally guaranteed the return and availability of the Exchange Funds, and (v) section 1(c) wherein LES promised to return the funds if closing on the Replacement Properties did not occur within the stated time period. Like the title company in *Dameron*, Plaintiffs argue, LES was serving as an escrow agent holding and disbursing the funds under certain specified contingencies.

The term "escrow" (like the word "trust") is notably absent from the parties' Exchange Agreements. In *Dameron*, the Forth Circuit found the parties' real estate closing instructions exhibited an intention to create a trust. Those instructions stated that "[y]ou may not cash, deposit, or disburse our funds until you have fully complied with all instructions." 155 F.3d at 721 n.2. The Exchange Agreements did not similarly restrict LES' use of the funds. Rather, LES was vested with all legally-cognizable indicia of ownership. LES was given sole and exclusive possession, dominion, control and use of the Exchange Funds. LES bore the risk of any bad investments it made and was free to use the funds to operate its business activities without any limitations whatsoever. Go to Vegas

yes it did

"The Exchange Funds"

The Restatement of Trusts provides that if the parties to an agreement intend that the person receiving money will have the unrestricted use of it, being liable to pay a similar amount back to the payor, with or without interest a debt is created. Restatement (Third) of

Trusts § 5(k). *See also Altura P'ship v. Breninc., Inc. (In re B.I. Fin. Servs. Group, Inc.)*, 854 F.2d 351, 354 (9th Cir. 1988). ("[l]ack of control by the payor over treatment of its money is an indication of the establishment of a debtor-creditor, not trust, relationship."); *In re Morales Travel Agency*, 667 F.2d 1069, 1071 (1st Cir. 1981) (holding that there was a debtor-creditor relationship, rather than a trustee-beneficiary relationship, where the payor did not require the debtor to keep its proceeds separate ~~from debtor's own funds and where there was no specific~~ restriction placed upon the debtor's use of the payor's proceeds).

As the Exchange Funds were held in the commingled operating account of LES and as LES maintained both control over those funds and had the unrestricted right to use those funds as it saw fit, the funds cannot be said to have been held in escrow. *Dameron,* 155 F.3d 718, is simply inapplicable to this case and, under the facts presented here, cannot form the predicate for finding an express trust.

Further confirmation of this point can be found in the agreement of LES to pay interest to the Plaintiffs on the Exchange Funds at a fixed rate. Again the Restatement of Trusts provides that

A loan unsecured at 2%

> "[i]f there is an understanding between the parties that the person to whom funds are transferred is to pay 'interest' thereon (at a fixed or current rate, and not merely such interest or other earnings as the funds, being invested, may earn), it becomes close to certain that the relationship is a debt rather than a trust. Interest is normally paid for the 'use of funds.' Accordingly, recipients of funds who pay interest are, in the absence of a definite understanding to the contrary, borrowers who are entitled to use the funds for their own purposes."

LOAN

Restatement (Third) of Trusts § 5(k) cmt. k; *see also Weststeyn Dairy 2 v. Eades Commodities Co.*, 280 F. Supp. 2d 1044, 1076-1077 (E.D. Cal. 2003) (agreement to pay fixed rate of interest is "more indicative of a debt than a trust"). LES bore all the risk associated with ownership of the funds. The parties' arrangement resembles that of a bank account, not an escrow account.

regulated

Plaintiffs also have the burden of proving their ability to trace the property alleged to be held in trust. *See Dameron,* 155 F.3d at 723 ("[A] party claiming entitlement to a trust must be able to trace its assets into the fund or property that is the subject of the trust."); *Hatoff v. Lemons & Assocs., Inc. (In re Lemons & Assocs., Inc.),* 67 B.R. 198, 213 (Bankr. D. Nev. 1986) ("A party who wishes to exempt trust property from the estate must not only prove the existence of the trust relationship, but must also specifically identify the trust property in either its original or substituted form."). The tracing of trust property is governed by federal law. *See In re Dameron,* 155 F.3d at 723. Plaintiffs cannot possibly satisfy the tracing requirement. The net proceeds realized from the sale of Plaintiffs' relinquished properties were commingled in the general operating account of LES along with the proceeds from other exchange transactions and along with LES's own funds and investments. The commingled funds were disbursed to pay for exchanges of other exchange customers and to fund LES's operations. Nor is the lowest intermediate balance test available to resolve this issue, as it was in *Dameron.* The operating account of LES was swept daily. Once the account went to zero, tracing became impossible as a matter of law. "[E]ven assuming the existence of a trust relationship, a creditor cannot sufficiently identify or trace the trust res through a commingled fund where the fund is too small to satisfy the claims of similarly situated parties." *In re Lemons & Assocs.,* 67 B.R. at 213.

Finally, the intention of the parties not to create an express trust can be gleaned from their decision to use the qualified intermediary option from among the four safe harbor options available within the Treasury Regulations. Qualified intermediaries are not the only means for effectuating like-kind exchange transactions under § 1031. Treasury Regulation § 1.1031(k)-1(g), which addresses the delivery of funds to third-parties in connection with a 1031 Exchange, provides, in pertinent part, as follows:

> Safe harbors - - (1) In general. Paragraphs (g)(2) through (g)(5) of this section set forth four safe harbors the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for purposes of section 1031 and this section. . . .
> (2) Security or guarantee arrangements.
> . . . .
> (3) Qualified escrow accounts and qualified trusts
> . . . .
> (4) Qualified Intermediaries
> . . . .
> (5) Interest and Growth Factors

Treas. Reg. § 1.1031(k)-1(g). These safe harbors are not mutually exclusive. *See* 26 Treas. Reg. § 1.1031(k)-1(g)(1) ("More than one safe harbor can be used in the same deferred exchange, but the terms and conditions of each must be separately satisfied."). Plaintiffs and LES had the option to utilize a "qualified escrow" or to establish a "qualified trust" pursuant to subsection (g)(3) of the Treasury Regulation. The qualified trust option requires a written trust agreement. 26 C.F.R. § 1.1031(k)-1(g)(iii)(B). Instead of using either of these available options, the parties chose the "qualified intermediary" safe harbor. The Exchange Agreements specifically state that: "LES and Taxpayer acknowledge and agree that this Exchange Agreement is intended to satisfy the safe harbor provisions of Section 1.1031(k)-1(g)(4) of the Regulations." Exchange Agreement at ¶6(a). The parties did not in addition separately satisfy the terms and conditions of the Treasury Regulations for the creation of either a qualified escrow or a qualified trust. As the LES Committee points out in its brief, the parties' decision to eschew the escrow and trust provisions of the tax code in favor of a different safe harbor evidences that there was no intention to create a trust relationship. The Court thus finds that no express trust was created in any of the three 1031 Exchange transactions at issue.

The holdings in the two cases that previously have considered whether commingled funds of 1031 exchange customers held in the name and accounts of a debtor are property of the bankruptcy estate are entirely consistent with the Court's holding here. The Bankruptcy

Court for the District of Minnesota has held that exchange funds received by a qualified intermediary in connection with a 1031 exchange were property of the debtor's estate. *Manty v. Miller & Holmes, Inc. (In re Nation-Wide Exch. Servs., Inc.),* 291 B.R. 131, 143 (Bankr. D. Minn. 2003). This determination was based on a number of factors, all of which are present in this case:

> The initial commingling of [taxpayer's] funds with those of the Debtor's other clients was not expressly forbidden by the terms of the [Exchange] Agreement. Nowhere does either Agreement specify that the Debtor was to hold the proceeds in a segregated form or account. In point of fact, Term 8 gave the Debtor a discretionary power to choose the form in which it was to hold and invest the proceeds . . . . The lack of specific client instructions to segregate proceeds, and the Debtor's exercise of substantial control over the funds under contractual warrant, mean that the funds became Debtor's property upon receipt . . . .

Id. (internal quotations omitted).

Similarly, the Bankruptcy Court for the Southern District of California has held that where a qualified intermediary commingled the proceeds it received from its various 1031 exchange customers, deposited those proceeds into general bank accounts held in the debtor's name, and further commingled those proceeds with income from transaction fees that it charged clients for performing as a qualified intermediary, the funds were property of the debtor's estate. *Taxel v. Vaca (In re San Diego Realty Exch., Inc.),* 132 B.R. 424, 429 (Bankr. S.D. Cal. 1991).

As the Court has found that the parties to the Exchange Agreements did not intend to create an express trust, Plaintiffs are not now entitled to the imposition of a resulting trust. In Virginia, a resulting trust is "an indirect trust that arises from the parties' intent or from the nature of the transaction and does not require an express declaration of trust." *1924 Leonard Rd., L.L.C. v. Roekel,* 272 Va. 543, 552, 636 S.E.2d 378, 383 (2006) (citing *Tiller v. Owen,* 243 Va. 176, 180, 413 S.E.2d 51, 53 (1992); *Salyer v. Salyer,* 216 Va. 521, 525, 219 S.E.2d 889, 893

(1975)). The party seeking to establish such a trust must do so by clear and convincing evidence. *Id.* (citing *Leonard v. Counts,* 221 Va. 582, 589, 272 S.E.2d 190, 195 (1980)).

"For a resulting trust to arise, the alleged beneficiary must pay for the property, or assume payment of all or part of the purchase money before or at the time of purchase, and have legal title conveyed to another without any mention of a trust in the conveyance." *1924 Leonard Rd.,* 272 Va. at 552, 636 S.E.2d at 383 (citing *Morris v. Morris,* 248 Va. 590, 593, 449 S.E.2d 816, 818 (1994)). *See also Tiller*, 243 Va. at 180, 413 S.E.2d at 53; *Leonard,* 221 Va. at 588, 572 S.E.2d at 194 (1980). In *Morris,* the Supreme Court of Virginia quoted its prior opinion in *Kellow v. Bumgardner,* 196 Va. 247, 83 S.E.2d 391 (1954):

> The existence of a resulting trust thus depends upon an equitable presumption of intention, based upon the natural precept that one who advances the purchase money for real property is entitled to its benefits. Therefore, after it has been shown that payment of all or a part of the purchase price for property has been paid by one person and title thereto has been placed in the name of another, the factor which will determine whether the title is to be impressed with a trust in favor of the payor is the intention of the party providing the purchase money. If no evidence of intention is available, then the presumed intention will stand; *but if there is evidence that the person who provided the money had some intention other than to secure the benefits for himself, the presumed intention fails and no resulting trust will be recognized.*

Morris, 248 Va. at 593, 449 S.E.2d at 818 (quoting *Kellow,* 196 Va. at 255, 83 S.E.2d at 396) (emphasis added).

In this case the parties entered into fully integrated Exchange Agreements that evidenced an intention not to create a trust. The Court need not divine the intent of the parties from the surrounding circumstances. The parties' intentions are readily discernible from the Exchange Agreements themselves. These were complex, fully-documented, commercial transactions. The parties represented to each other that they were separately represented by counsel and had the advice of other financial professionals.[19] If the parties had wanted to create a trust or if they had wanted to create an escrow, they certainly were capable of doing so. They did not. A resulting trust cannot be imposed in the face of Exchange Agreements that demonstrate clearly a contrary intent. The Court thus finds that no resulting trust was created in any of the three 1031 Exchange transactions at issue. This result obtains without regard to the considerable hurdle that Plaintiffs would otherwise have to overcome that a resulting trust must be established through clear and convincing evidence.

Finally, the Court's holding that the Exchange Funds are not excluded from property of the bankruptcy estate because they are not the subject of an express or resulting trust does not lead to an inequitable result. Rather, it furthers one of the primary policies of bankruptcy law – equitable distribution among similarly situated creditors. Impressing the Debtor's funds with the claims of 450 different trusts would, in the end, serve no constructive purpose.[20] Each adversary proceeding would have to be litigated to conclusion in order to sort out the proper entitlement of the different trusts to the funds. The scope and complexity of such litigation threatens to consume the entire estate. It would most certainly severely diminish the amount available for distribution to the exchange customers. It will also take years to finally resolve all the cases. The bankruptcy process is designed to address and resolve this very kind of collective action problem. The similarly situated commingled exchangers should be given equal treatment in a prioritized and ratable distribution of estate assets. This can be best accomplished through the plan confirmation process. While it may not be the perfect remedy,

[19] For example, Section 11 of the Exchange Agreements provides that: "Each party hereto and their legal counsel have reviewed this Exchange Agreement and have had an opportunity to revise (or request revision of) this Exchange Agreement and, therefore, any usual rules of construction requiring that ambiguities are to be resolved against a particular party shall not be applicable in the construction and interpretation of this Exchange Agreement."

[20] The court notes that it has yet to address the claims that the Exchange Funds should be impressed with a constructive trust.

it does offer the most inexpensive and expeditious method for distributing these funds on a ratable basis to those who deserve to receive them.

Conclusion

The Exchange Funds are not excluded from property of the estate pursuant to 11 U.S.C. § 541(d) because of the existence of an express trust or as a result of the imposition of a resulting trust. The plain, unambiguous language of the Exchange Agreements clearly establishes that it was not the intent of LES or Plaintiffs to create an express trust. As the Exchange Agreements were integrated contracts, Plaintiffs cannot use parol evidence to prove the existence of an express trust. Given the parties' clear intent in the Exchange Agreements not to create an express trust, it is inappropriate for the Court to impose a resulting trust upon them. This is especially true in this case in which the parties have represented that they relied upon the advice of their own legal and financial professionals, and in which the parties have included a merger clause in their agreement. Therefore, the Court will deny Plaintiffs' motion for partial summary judgment and grant partial summary judgment in favor of the Debtor and the Committees against Plaintiffs. Separate orders shall issue.

ENTERED: May 7 2009

/s/ Kevin R. Huennekens
UNITED STATES BANKRUPTCY JUDGE

Entered on Docket: 5-7-2009

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
	:	
MEDICOR LTD, *et al.*,[1]	:	Case No. 07-10877 (MFW) Jointly Administered
Debtors.	:	
	:	Re: Docket No. ____

ORDER APPROVING STIPULATION OF CONSENT TO GRANTING THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF THE DEBTORS DERIVATIVE STANDING TO ASSERT CLAIMS AND CAUSES OF ACTION AGAINST CERTAIN ENTITIES BY AND BETWEEN THE DEBTORS AND THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF THE DEBTORS

Upon consideration of the *Stipulation Of Consent To Granting The Official Committee Of Unsecured Creditors Of The Debtors Derivative Standing To Assert Claims And Causes Of Action Against Certain Entities By And Between The Debtors And The Official Committee Of Unsecured Creditors Of The Debtors* (the "Stipulation")[2] attached hereto as **Exhibit A**; and upon consideration of the Certification of Counsel submitting the Stipulation to this Court for approval; and sufficient notice of the Stipulation having been provided and no further notice being necessary; and after due deliberation; and sufficient cause appearing therefore,

IT IS HEREBY ORDERED THAT:

1. The Stipulation and all of its terms are hereby approved.

2. The Committee is hereby granted derivative standing to commence, prosecute, compromise, and release, on behalf of the Debtors and the Debtors' estates, the Subject Claims.

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[1] The Debtors are the following entities: MediCor, Ltd., a Delaware corporation; International Integrated Incorporated, a British Virgin Islands corporation; International Integrated USA Incorporated, a British Virgin Islands corporation; MediCor Management, Inc., a Delaware corporation; MediCor Development Company, a Delaware corporation; MediCor Aesthetics, a Nevada corporation; III Acquisition Corporation, a Delaware corporation; Intellectual Property International, Inc., a Delaware corporation.

[2] Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Stipulation.

3. This Court retains jurisdiction to interpret, implement and enforce the provisions of this Order and the Stipulation.

Dated: May 6, 2009

The Honorable Mary F. Walrath
United States Bankruptcy Judge

Exhibit A

The Stipulation

LexisNexis

LEXSEE 2008 U.S. DIST. LEXIS 92449

HELENA CHEMICAL COMPANY, as servicing agent for Helena Funding Corporation and Helena Services Corporation, Plaintiff, v. BILLY W. HUGGINS, and HUGGINS FARM SERVICE, INC., Defendants.

Civil Action No.: 4:06-cv-2583-RBH

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF SOUTH CAROLINA, FLORENCE DIVISION

2008 U.S. Dist. LEXIS 92449

November 13, 2008, Decided
November 13, 2008, Filed

SUBSEQUENT HISTORY: Motion granted by, Motion denied by *Helena Chem. Co. v. Billy W. Huggins & Huggins Farm Serv., 2008 U.S. Dist. LEXIS 105399 (D.S.C., Dec. 31, 2008)*

PRIOR HISTORY: *Helena Chem. Co. v. Huggins, 2007 U.S. Dist. LEXIS 41986 (D.S.C., June 8, 2007)*

COUNSEL: [*1] For Helena Chemical Company, as servicing agent for Helena Funding Corporation agent of Helena Funding Corporation, Helena Services Corporation, Plaintiffs: Amy LB Hill, Robert E Tyson, Jr, Thornwell Forrest Sowell, III, LEAD ATTORNEYS, Sowell Gray Stepp and Laffitte, Columbia, SC.

For Billy W Huggins, Huggins Farm Service Inc, Defendants: Danny V Butler, Henrietta U Golding, LEAD ATTORNEYS, McNair Law Firm, Myrtle Beach, SC.

For JR Battle & Company Inc, Respondent: Michael Warner Battle, LEAD ATTORNEY, Battle and Vaught, Conway, SC.

For Huggins Farm Service Inc, Billy W Huggins, Counter Claimants: Danny V Butler, Henrietta U Golding, LEAD ATTORNEYS, McNair Law Firm, Myrtle Beach, SC.

For Helena Services Corporation, Helena Chemical Company, as servicing agent for Helena Funding Corporation, Counter Defendants: Amy LB Hill, Robert E Tyson, Jr, Thornwell Forrest Sowell, III, LEAD ATTORNEYS, Sowell Gray Stepp and Laffitte, Columbia, SC.

JUDGES: R. Bryan Harwell, United States District Judge.

OPINION BY: R. Bryan Harwell

OPINION

ORDER

Pending before the court are: 1) Defendants' [Docket Entry # 84] motion for partial summary judgment; and 2) Plaintiff's [Docket Entry # 87] motion for partial summary judgment. A hearing [*2] was held on the motions for partial summary judgment on October 16, 2008. For the reasons stated below, the court denies Defendants' motion for partial summary judgment and grants in part and denies in part Plaintiff's motion for partial summary judgment.

Background

This case arises out of the business relationship between Plaintiff, Helena Chemical Company, as servicing agent for Helena Funding Corporation and Helena Services Corporation, ("Helena"), and Defendants Billy W. Huggins and Huggins Farm Service, Inc. (collectively referred to as "Huggins").

Helena sells farm and agricultural chemicals to suppliers for retail sales to farmers and the agricultural industry. Huggins Farm Service is in the business of supplying agricultural chemicals to farms in Marion and Horry Counties in South Carolina and is owned by Defendant Billy W. Huggins.

From 1993 until 2006, Huggins Farm Service promoted and sold agricultural products distributed by Helena pursuant to a Consignment and Commissioned Sales Agreement ("Sales Agreement"). The Sales Agreement provided that Helena would provide inventory to Huggins Farm Service on a consignment basis, whereby the title to the inventory would remain in Helena's [*3] name until such inventory was sold to the customer.

Huggins Farm Service and Billy Huggins signed a Promissory Note dated June 7, 2005, made payable to Helena in the amount of $ 450,000 with an interest rate of 10.5%. The Promissory Note allowed Huggins Farm Service to borrow from a line of credit in the amount of $ 450,000 to repay outstanding accounts receivable due to Helena at an interest rate of 10.5%.

Although the parties dispute who initiated the discussions, sometime in 2005 the parties began discussing the purchase of Huggins Farm Service by Helena. Billy Huggins' price to Helena for Huggins Farm Service was $ 750,000. After Helena decided not to purchase Huggins Farm Service, the business relationship between Helena and Huggins deteriorated and this lawsuit ensued.

Helena alleges that Huggins Farm Service has defaulted on the amounts owed under the Sales Agreement and Promissory Note. Helena further alleges that Billy Huggins is also individually liable for the amount owed pursuant to the Promissory Note. Helena claims the amounts due by Huggins Farm Service and Huggins, as of the filing of the complaint, are $ 686,054.52, plus costs and attorneys fees, with interest accruing [*4] on a daily basis.

Helena has brought causes of action for: 1) Breach of the Guaranty; 2) Breach of Contract; 3) Unjust Enrichment; 4) Breach of Security Agreement; 5) Conversion; 6) Violation of Statute of Elizabeth; and 7) Attorney's Fees. Huggins Farm Service and Billy Huggins have moved for summary judgment as to Helena's claims for Unjust Enrichment, Conversion, and Violation of Statute of Elizabeth. At the hearing, Helena withdrew its claim under the Statute of Elizabeth. *See* [Docket Entry # 148].

Huggins alleges that Helena misrepresented its intent to purchase Huggins Farm Service in order to induce Huggins to disclose confidential financial information regarding his business as well as information relating to a lease agreement entered into by Carolyn Doyle d/b/a Pee Dee Farm Company, as tenant, for the lease of a gas station, convenience store, and warehouse located in Galivant's Ferry, South Carolina.

Huggins utilized the warehouse portion of the property leased by Carolyn Doyle in the operation of Huggins Farm Service. In November 2005, the landlord allegedly notified Doyle that the lease would be terminated and that Doyle and Huggins had to vacate the premises by December 31, [*5] 2005 because Helena was going to lease the property beginning January 1, 2006. [1]

1 Counsel for Helena represented at the hearing that Helena never leased the property. [Transcript, at 8, Docket Entry # 150].

Huggins also alleges that in reliance on Helena's representations, he rejected an offer from another buyer willing to purchase his business for $ 750,000. Huggins further alleges that, as a result of Doyle's eviction, his business suffered tremendously and he was forced to sell various business equipment and assets to recoup losses and take advantage of buyers willing to purchase the equipment and assets.

Huggins Farm Service and Billy Huggins brought counterclaims against Helena for: 1) Breach of Contract; 2) Breach of Contract Accompanied by Fraud; 3) Negligence; 4) Negligent Misrepresentation; 5) Civil Conspiracy; 6) Violation of South Carolina Unfair Trade Practices Act; 6) Fraud; 8) Violation of Covenant of Good Faith and Fair Dealing; and 9) Interference with Prospective Contract. Helena has moved for summary judgment as to Huggins' claims for Breach of Contract Accompanied by Fraud, Negligence, Negligent Misrepresentation, Civil Conspiracy, Violation of South

Carolina Unfair [*6] Trade Practices Act, Fraud, and Interference with Prospective Contract. At the hearing, Huggins withdrew its negligence claim. *See* [Docket Entry # 148].

Summary Judgment Standard

Summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Fed. R. Civ. P. 56(c)*. Once the moving party makes the showing, however, the opposing party must respond to the motion with "specific facts showing there is a genuine issue for trial." *Fed. R. Civ. P. 56(e)*. The party moving for summary judgment has the burden of showing the absence of a genuine issue of material fact, and the court must view the evidence before it and the inferences to be drawn therefrom in the light most favorable to the nonmoving party. *United States v. Diebold, Inc., 369 U.S. 654, 655, 82 S. Ct. 993, 8 L. Ed. 2d 176 (1962)*.

Summary judgment is appropriate when a party, after adequate time for discovery, "fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party [*7] will bear the burden of proof at trial." *Celotex Corp. v. Catrett, 477 U.S. 317, 322, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)*. Failure of proof of an essential element of the case "necessarily renders all other facts immaterial." *Celotex Corp., 477 U.S. at 323*.

A party "cannot create a genuine issue of material fact through mere speculation or the building of one inference upon another." *Beale v. Hardy, 769 F.2d 213, 214 (4th Cir. 1985)*. Therefore, "[m]ere unsupported speculation . . . is not enough to defeat a summary judgment motion." *Ennis v. National Ass'n of Bus. & Educ. Radio, Inc., 53 F.3d 55, 62 (4th Cir. 1995)*.

Discussion

I. Huggins' Motion for Partial Summary Judgment

A. Unjust Enrichment

Helena's unjust enrichment claim is based upon the allegation that Huggins received inventory from Helena in 2005 with a value of approximately $ 9,972.19 and failed to repay Helena for the value of that inventory. Accordingly, Helena alleges that Huggins was unjustly enriched in the amount of $ 9,972.19.

Huggins argues that Helena's unjust enrichment claim fails because Helena has an adequate remedy at law and therefore is not entitled to equitable relief. Huggins argues that the inventory at issue was subject to a Security Agreement [*8] executed in favor of Helena. Therefore, Huggins argues, Helena has an adequate statutory remedy to recover the amount of the alleged unjust enrichment under South Carolina's Uniform Commercial Code, *S.C. Code Ann. §§ 36-1-101 et seq.*

South Carolina Code Ann. § 36-1-103 states that "[u]nless displaced by the particular provisions of [the UCC], the principles of law and equity . . . shall supplement its provisions." Displacement occurs when the UCC comprehensively addresses an issue. *Hitachi Elec. Devices (USA), Inc. v. Platinum Techs., Inc., 366 S.C. 163, 621 S.E.2d 38, 41 (S.C. 2005)* (holding that buyer cannot pursue common law remedies for seller's alleged breach of warranty). For example, *Article 2* comprehensively addresses a buyer's remedies for breach of warranty.

However, as to the remedies available to a secured party under *Article 9 of the UCC*, South Carolina courts have held that pre-UCC remedies remain available to a secured party in the event of the debtor's default. In *Nat'l Bank of South Carolina v. Daniels*, the South Carolina Court of Appeals stated:

> *Section 36-9-501* of the Uniform Commercial Code established the rights of a secured party in the collateral after the debtor's default. . [*9] . *Section 36-9-501(1)* creates no substantive cause of action in favor of the secured party. Rather, the secured party must look to state law to determine "available judicial procedures" other than foreclosing or securing a judgment against the debtor. *Pre-Code remedies are still available to the secured party.*

283 S.C. 438, 322 S.E.2d 689, 691 (S.C. Ct. App. 1984) (emphasis added). "The remedies given the creditor by the Uniform Commercial Code upon a debtor's default do not exclude non-Code remedies." *68A Am. Jur. 2d*

Secured Transactions § 531 (2008). Aside from referring to the general proposition that where there is an adequate remedy at law, equitable relief is not appropriate, Huggins has offered no authority to support the proposition that a secured party is precluded from seeking equitable remedies against a debtor in default.

Additionally, at the hearing, counsel for Helena indicated that the claim for unjust enrichment was separate and distinct from the claims for breach of security agreement and breach of contract. The claim for unjust enrichment involves inventory received by Huggins d/b/a Pee Dee Farms Company. The claims for breach of the security agreement and breach of contract involve [*10] Huggins and Huggins Farm Service, Inc. Contrary to Huggins' assertions, the record does not appear to contain a security agreement that covers inventory received by Huggins d/b/a Pee Dee Farms Company. [2]

2 This statement is not intended to be a conclusive interpretation of the scope of the security agreement attached as Exhibit D to the Amended Complaint. *See* [Security Agreement, Docket Entry # 62-5].

Because the UCC did not displace the pre-Code remedies available to a secured party in the event of a debtor's default and the inventory at issue does not appear to be covered by any Security Agreement in the record, Huggins' motion for summary judgment is denied as to Helena's claim for unjust enrichment.

B. Conversion

Helena's conversion claim is based upon the allegation that Huggins sold or otherwise disposed of collateral under a Security Agreement. Huggins argues that summary judgment should be granted as to Helena's conversion claim because Helena has failed to set forth any evidence that Helena either had title to, or right to possession of, the equipment that was allegedly sold.

The wrongful detention of another's personal property may give rise to an action for conversion. *Owens v. Andrews Bank & Trust Co., 265 S.C. 490, 220 S.E.2d 116, 119 (S.C. 1975).* [*11] To prevail in a conversion action, the plaintiff must prove either title to or a right to possession of the personal property at the time of the conversion. *Causey v. Blanton, 281 S.C. 163, 314 S.E.2d 346, 348 (S.C. Ct. App. 1984).*

When a debtor defaults under a security agreement, the secured party has the right to take possession of the collateral. *Daniels, 322 S.E.2d at 692.* Helena submitted the affidavit of Charles O'Neal, which states that Huggins allegedly sold collateral, a spreader truck, to Marvin Johnson. Upon Huggins' alleged default under the Security Agreement, Helena was arguably entitled to take possession of the spreader truck. Taking the evidence in the light most favorable to Helena, it is a disputed issue of material fact as to whether Helena had the right to take possession of the spreader truck at the time of the alleged conversion. Summary judgment is therefore denied as to Helena's conversion claim.

II. Helena's Motion for Partial Summary Judgment

A. Breach of Contract Accompanied By A Fraudulent Act

Huggins' breach of contract accompanied by a fraudulent act claim is based on an alleged breach of the Sales Agreement by Helena. Huggins claims that Helena breached the Sales Agreement [*12] by failing to pay proper commissions and improperly charging Huggins for Helena products.

In order to recover for breach of contract accompanied by a fraudulent act, the plaintiff must establish: 1) a breach of contract; 2) fraudulent intent relating to the breaching of the contract and not merely to its making; and 3) that the breach was accompanied by a fraudulent act. *Minter v. GOCT, Inc., 322 S.C. 525, 473 S.E.2d 67, 70 (S.C. Ct. App. 1996).* "Breach of contract accompanied by a fraudulent act is not simply a combination of a claim for breach of contract and a claim for fraud." *Ball v. Canadian American Exp. Co., Inc., 314 S.C. 272, 442 S.E.2d 620, 622 (S.C. Ct. App. 1994).* Unlike a fraud claim, which goes to the *making* of the contract, a claim for breach of contract accompanied by a fraudulent act "requires proof of fraudulent intent relating to the *breaching* of the contract not merely to its making." *Ball, 442 S.E.2d at 623* (emphasis added). Fraudulent intent is normally proved by circumstances surrounding the breach. *Floyd v. Country Squire Mobile Homes, Inc., 287 S.C. 51, 336 S.E.2d 502, 503-4 (S.C. Ct. App. 1985).* The fraudulent act that must accompany the breach is defined as "any act characterized by dishonesty in [*13] fact or unfair dealing." *RoTec Servs., Inc. v. Encompass Servs., Inc., 359 S.C. 467, 597 S.E.2d 881, 883 (S.C. Ct. App. 2004).* The fraudulent act may be prior to, contemporaneous with, or subsequent to the breach, but it must be connected with the breach itself and may not be too remote in time or character. *Floyd, 336 S.E.2d at 504.*

Helena argues that summary judgment should be granted because Huggins has failed to put forward any evidence of a fraudulent act independent of the breach itself.

Huggins alleges a number of alleged fraudulent acts which accompany the claimed breach. Although the court questions whether many of the alleged fraudulent acts are sufficiently connected with the breach itself, the court finds Huggins' allegation that Helena intentionally withheld the results of an in-house audit concerning Huggins' account with Helena to be sufficiently connected to the breach and not too remote in time or character.

At the hearing, Huggins argued that account information had previously been made available to them, but when Huggins raised the issue of improper invoicing and unpaid commissions, Helena suddenly refused to disclose the information. Helena responded that withholding the audit information [*14] cannot be a fraudulent act because there was no duty to disclose the audit information in the first place. However, an argument could be made that the duty to disclose pertinent account information was voluntarily undertaken by Helena based on its prior actions and course of dealing with Huggins.

Additionally, irrespective of Helena's duty to disclose argument, the fraudulent act that must accompany the breach is broadly defined as any act characterized by dishonesty in fact or unfair dealing so long as the act is sufficiently connected with the breach itself. *See Rotec Servs., Inc., 597 S.E.2d at 883*; *Floyd, 336 S.E.2d at 504.* The circumstances under which the audit information was allegedly withheld, coupled with the previous disclosure of account information, creates an inference that the act of withholding the audit information constituted dishonesty in fact or unfair dealing. Taking the evidence in the light most favorable to Huggins, a reasonable juror could conclude that withholding the audit information was a fraudulent act and that such fraudulent act accompanied the breach of the Sales Agreement. Therefore, Helena's motion for partial summary judgment is denied as to Huggins' [*15] claim for breach of contract accompanied by a fraudulent act.

B. Fraud and Negligent Misrepresentation

Huggins alleges that Helena committed fraud when it misrepresented its intention to purchase Huggins Farm Service and lease two warehouses. Similarly, in its negligent misrepresentation claim, Huggins claims that Helena negligently misrepresented its intent to purchase Huggins Farm Service and lease two warehouses. Helena argues that Huggins' fraud and negligent misrepresentation claims should be dismissed because the agreement to purchase Huggins Farm Service and lease two warehouses was unenforceable under the statute of frauds and evidence of a mere broken promise is not sufficient to prove fraud or negligent misrepresentation. Finally, Helena argues that Huggins had no right to rely on any alleged statement regarding the purchase of the business and lease of the warehouses because the parties were business associates engaged in arms length negotiations.

In order to prove fraud, the following elements must be shown by clear and convincing evidence: (1) a representation; (2) its falsity; (3) its materiality; (4) either knowledge of its falsity or a reckless disregard of its truth or [*16] falsity; (5) intent that the representation be acted upon; (6) the hearer's ignorance of its falsity; (7) the hearer's reliance on its truth; (8) the hearer's right to rely thereon; and (9) the hearer's consequent and proximate injury. *Ardis v. Cox, 314 S.C. 512, 431 S.E.2d 267, 269 (S.C. Ct. App. 1993).* In order to recover for negligent misrepresentation, a plaintiff must prove: 1) a false representation made by the defendant to the plaintiff; 2) a pecuniary interest by the defendant in making the statement; 3) a duty of care owed by the defendant to see that truthful information was communicated to the plaintiff; 4) the defendant breached the duty by failing to exercise due care; 5) the plaintiff justifiably relied on the representation; and 6) the plaintiff suffered a pecuniary loss as a direct and proximate result of reliance on the representation. *Sauner v. Public Serv. Auth. of South Carolina, 354 S.C. 397, 581 S.E.2d 161, 166 (S.C. 2003).*

Huggins' fraud and negligent misrepresentation claims fail primarily for two reasons. First, Huggins had no right to rely on the alleged representation that Helena intended to purchase Huggins Farm Service and lease two warehouses. Huggins argues that there was justifiable [*17] or reasonable reliance on the alleged representation because a confidential or fiduciary relationship existed between Helena and Huggins arising from the 13 year supplier-retailer business relationship between them.

"Where there is no confidential or fiduciary relationship, and an arm's length transaction between mature, educated people is involved, there is no right to rely." *Florentine Corp., Inc. v. PEDA I, Inc., 287 S.C. 382, 339 S.E.2d 112, 114 (S.C. 1985)*; *Poco-Grande Invs. v. C&S Family Credit, Inc., 301 S.C. 323, 391 S.E.2d 735 (S.C. Ct. App. 1990)*. Under South Carolina law, "[a] confidential or fiduciary relationship exists when one imposes a special confidence in another, so that the latter, in equity and good conscience, is bound to act in good faith and with due regard to the interest of the one imposing the confidence." *Brown v. Pearson, 326 S.C. 409, 483 S.E.2d 477, 484 (S.C. Ct. App. 1997)*. "A fiduciary relationship cannot be established by the unilateral action of one party. The other party must have actually accepted or induced the confidence placed in him." *Steele v. Victory Sav. Bank, 295 S.C. 290, 368 S.E.2d 91, 94 (S.C. Ct. App. 1988)*. "Although whether a fiduciary relationship has been breached can be a question for [*18] the jury, the question of whether one should be imposed between two classes of people is a question for the court." *Hendricks v. Clemson University, 353 S.C. 449, 578 S.E.2d 711, 715 (S.C. 2003)*.

The court concludes that no confidential or fiduciary relationship existed between the parties in this case. Helena and Huggins are two separate business entities who were engaged in an arms length transaction. Although the past supplier-retailer business relationship lasted for approximately 13 years, there is simply no basis for finding a confidential or fiduciary relationship between the parties regarding the sale or purchase of a business. Nothing in the record suggests that Helena actually accepted or induced a special confidence. *See Brown, 483 S.E.2d at 484*. Furthermore, the court has found no South Carolina case finding a confidential or fiduciary relationship under the circumstances of this case. As a federal court sitting in diversity, it is not this court's function to expand South Carolina common law as to what creates a fiduciary relationship.

Because there is no confidential or fiduciary relationship, and the discussions concerning the purchase of Huggins Farm Service and the lease of two warehouses [*19] were conducted at arms length by mature, educated people, the court finds that Huggins had no right to rely on Helena's alleged representation that it would purchase Huggins Farm Service and lease two warehouses.

Second, Huggins' fraud and misrepresentation claims are due to be dismissed because, at best, Huggins' evidence consists of a mere broken or unfulfilled promise to purchase Huggins Farm Service and lease two warehouses. Fraud must relate to a present or pre-existing fact, and cannot ordinarily be predicated on unfulfilled promises or statements as to future events. *Woodward v. Todd, 270 S.C. 82, 240 S.E.2d 641, 643 (S.C. 1978)*. A mere unfulfilled promise to do an act in the future cannot support an action for fraud. *Foxfire Village, Inc. v. Black & Veatch, Inc., 304 S.C. 366, 404 S.E.2d 912, 917 (S.C. Ct. App. 1991)*. Likewise, "[e]vidence of a mere broken promise is not sufficient to prove negligent misrepresentation." *Sauner, 581 S.E.2d at 166*. To be actionable as a misrepresentation, the representation must relate to a present or pre-existing fact and be false when made. *Koontz v. Thomas, 333 S.C. 702, 511 S.E.2d 407, 413 (S.C. Ct. App. 1999)*. Representations based on statements as to future events or unfulfilled [*20] promises are not usually actionable. *Sauner, 581 S.E.2d at 167*. Helena's alleged promise or representation that they intended to purchase Huggins Farm Service and lease two warehouses is nothing more than a promise to do something in the future. The court notes that Huggins has not brought a cause of action for breach of contract regarding the alleged agreement by Helena to purchase Huggins Farm Service and lease two warehouses.

Helena also asserts that the statute of frauds bars the claims because the leasing of the two warehouses was unenforceable under both *S.C. Code Ann. § 32-3-10* and *§ 27-35-20*. Huggins argues that the purchase of "goodwill" of the business and "business assets" have nothing to do with the statute of frauds and the statute is inapplicable to them. Additionally, Helena raised for the first time at the hearing the U.C.C. statute of frauds codified at *S.C. Code Ann. § 36-2-201*, which provides that a contract for the sale of "goods" for the price of $ 500 or more is unenforceable unless reduced to writing.

Huggins testified in his deposition as follows:

> Q. What was the deal?
>
> A. That they was buying my Huggins Farm Service and leasing Dixon's Tobacco Warehouse and Galivant's [*21] Ferry Store - - Farms Warehouse for $ 750,000. And in leasing those facilities he wanted

> me to guarantee him five years at Dixon's warehouse, and I did.

[Deposition of Billy Huggins, at pg. 64, Docket Entry # 90-2]. In another portion of Huggins' deposition, he stated:

> [T]hey were going to buy Huggins Farm Service and my equipment, my assets, pay me goodwill for the three point some millions dollars worth of business; they would hire all of my employees, and now I was informed by Johnny Skipper and David Duvall at Galivant's Ferry, Pee Dee Stores that they had leased those properties at Galivant's Ferry to Helena Chemical Company.

[Deposition of Billy Huggins, at pg. 62-63, Docket Entry # 90-2].

The leasing of the two warehouses is clearly covered by the statute of frauds. However, it is unclear whether the lease of the two warehouses was severable from the agreement to purchase Huggins Farm Service. It is also unclear whether the "business assets" and "equipment" mentioned in the deposition testimony falls within the definition of "goods" as contemplated by *§ 36-2-201*.

Neither party has briefed the severability issue nor the questions regarding the applicability of *§ 36-2-201* to the facts [*22] of this case. While the court has not been provided with any authority regarding the severability issue, the general rule is that if a contract is not severable, and part of it is within the statute of frauds, the contract is unenforceable as a whole and no action can be maintained to enforce a part which would not have been affected by the statute of frauds if it had been separate and distinct from the other part. *See 73 Am. Jur. 2d Statute of Frauds § 435*. On the other hand, when an agreement is divisible, if some portions are not covered by the statute of frauds, those portions are enforceable. *See id.* Additionally, Helena argues that Huggins cannot circumvent the operation of the statute of frauds by bring an action in tort, when the tort action is based primarily on an unenforceable contract. *See McDabco, Inc. v. Chet Adams Co., 548 F. Supp. 456, 458 (D.S.C. 1982).*

Regardless, the court need not reach these issues on the statute of frauds because the claims of fraud and negligent misrepresentation cannot proceed for the reasons stated earlier.

D. Civil Conspiracy

Huggins alleges that representatives of Helena conspired with each other and third parties for the purpose of injuring [*23] Huggins. Huggins alleges that, as a result of the civil conspiracy, it has suffered special damages, including lost revenue and profits, loss of goodwill of Huggins' business, lost employees, lost customers, and lost opportunity to sell Huggins Farm Service.

A civil conspiracy is a combination of two or more persons joining for the purpose of injuring and causing special damage to the plaintiff. *Lawson v. S.C. Dept. of Corrections, 340 S.C. 346, 532 S.E.2d 259, 261 (S.C. 2000).* A civil conspiracy consists of three elements: (1) a combination of two or more persons, (2) for the purpose of injuring the plaintiff, (3) which causes him special damage. *Vaught v. Waites, 300 S.C. 201, 387 S.E.2d 91 (S.C. Ct. App. 1989).* A conspiracy is actionable only if overt acts pursuant to the common design proximately cause damage to the party bringing the action. *Future Group, II v. Nationsbank, 324 S.C. 89, 478 S.E.2d 45, 51 (S.C. 1996)*; *Todd v. S.C. Farm Bureau Mut. Ins. Co., 276 S.C. 284, 278 S.E.2d 607 (S.C. 1981).* The difference between civil and criminal conspiracy is that in criminal conspiracy the agreement is the gravamen of the offense, whereas in civil actions, the gravamen of the tort is the damage resulting to plaintiff from an overt act done [*24] pursuant to a common design. *Vaught v. Waites, 300 S.C. 201, 387 S.E.2d 91, 95 (S.C. Ct. App. 1989).*

The lawyers submitted additional authority on the civil conspiracy claim after the hearing. During the hearing, the court referenced the elements of civil conspiracy noting that there must be a combination of two or more persons for the purpose of injuring the plaintiff, in addition to the requirement of special damage. The court questioned Huggins' counsel regarding what evidence in the record existed to show that other alleged conspirators, besides Helena, possessed an improper motive, purpose or intent to injure Huggins. Notably, no co-conspirators have been named parties in this lawsuit.

Counsel for Huggins indicated that Messrs. Johnson, Duvall, and Skipper conspired with Helena to injure Huggins. Huggins' counsel cited the following as evidence of improper motive, intent or purpose to injure:

1) deposition testimony of Charles O'Neal that Skipper and Duvall had made the statement that Huggins was a "crook;" 2) Helena's refusal to renew its Sales and Consignment Agreement with Huggins after 13 years without a justifiable explanation; 3) the timing of the termination of the Sales and Consignment [*25] Agreement within a day of receiving notification that Doyle and Huggins could no longer rent the Galivant's Ferry warehouse; 4) alleged secret meetings between Helena and the co-conspirators regarding leasing the warehouse.

Allegation of an unlawful act is not required to state a cause of action for civil conspiracy, although a civil conspiracy may be furthered by an unlawful act. *Swinton Creek Nursery v. Edisto Farm Credit, ACA, 326 S.C. 426, 483 S.E.2d 789, 795 (S.C. Ct. App. 1997), aff'd in part, rev'd in part 334 S.C. 469, 514 S.E.2d 126 (S.C. 1999).* An action for civil conspiracy may exist even though the defendant committed no unlawful act and no unlawful means were used. *Lamotte v. Punch Line of Columbia, Inc., 296 S.C. 66, 370 S.E.2d 711, 713 (S.C. 1988).* Thus, lawful acts may become actionable as a civil conspiracy when the "object is to ruin or damage the business of another." *LaMotte, 370 S.E.2d at 713.* "Conspiracy may be inferred from the very nature of the acts done, the relationship of the parties, the interests of the alleged conspirators and other circumstances." *Island Car Wash, Inc. v. Norris, 292 S.C. 595, 358 S.E.2d 150, 153 (S.C. Ct. App. 1987).* "Because civil conspiracy is 'by its very nature covert and clandestine,' [*26] it is usually not provable by direct evidence." *Moore v. Weinberg, 373 S.C. 209, 644 S.E.2d 740, 750 (S.C. Ct. App. 2007).*

While it can be argued that Huggins' evidence of improper motive or purpose as to the alleged co-conspirators is weak, the court believes that at this stage it is sufficient to survive summary judgment. Taking the evidence in the light most favorable to Huggins, summary judgment is denied as to Huggins' claim for civil conspiracy.

E. South Carolina Unfair Trade Practices Act

Huggins alleges in its counterclaim that Helena's actions violated the South Carolina Unfair Trade Practices Act ("SCUTPA"). To recover under SCUTPA, the plaintiff must establish: 1) the defendant engaged in an unfair or deceptive act in the conduct of trade or commerce; 2) the unfair or deceptive act affected public interest; and 3) the plaintiff suffered monetary or property loss as a result of the defendant's unfair or deceptive acts. *Wright v. Craft, 372 S.C. 1, 640 S.E.2d 486, 498 (S.C. Ct. App. 2006).* A showing of adverse public impact is required. The Act is not available to redress a private wrong where the public interest is not affected. An impact on the public interest may be shown if the acts or practices have [*27] the potential for repetition. *Crary v. Djebelli, 329 S.C. 385, 496 S.E.2d 21, 23 (S.C. 1998).* A mere breach of contract does not constitute a violation of SCUTPA. *Key Company, Inc. v. Fameco Distributors, Inc., 292 S.C. 524, 357 S.E.2d 476 (S.C. Ct. App. 1987).*

Helena argues that Huggins' SCUTPA claim is premised upon the alleged breach of contract. Helena argues that because a mere breach of contract does not constitute a violation of SCUTPA, Huggins SCUTPA claim should be dismissed. Additionally, Helena argues that Huggins has failed to establish an unfair or deceptive act or practice that has an adverse impact on the public interest.

Huggins responds that the counterclaim contains allegations of negligent and fraudulent misrepresentation and conspiracy and therefore clearly establishes more than a mere breach of contract. Huggins refers to the following alleged unfair or deceptive acts: 1) improperly charging products to agents and customers who had not purchased such products; 2) refusing to provide confirmation and documentation that the improper charges had been corrected; 3) making certain representations to its agents and customers while secretly acting in controvert to such representations; 4) and scheming [*28] with other persons for the purpose of injuring another.

Helena's motion for summary judgment is due to be granted because Huggins has failed to establish that any alleged unfair or deceptive act adversely affects the public interest. To be actionable under the UTPA, an unfair or deceptive act or practice must have an impact upon the public interest. *S.C.Code Ann. § 39-5-10(b).* "An impact on the public interest may be shown if the acts or practices have the potential for repetition." *Wright, 640 S.E.2d at 501.* "The potential for repetition may be demonstrated in either of two ways: (1) by showing the same kind of actions occurred in the past, thus making it likely they will continue to occur absent deterrence; or (2) by showing the company's procedures create a potential for repetition of the unfair and deceptive acts." *Id. at 502.* At the hearing, Huggins' counsel conceded that there was no evidence that Helena had committed similar acts against other agents/retailers like Huggins. [Transcript, at 62, Docket Entry # 150]. An alleged unfair practice that affects only the parties to the transaction is insufficient under the Act. In spite of Huggins' general and conclusory allegations of [*29] possible repetition of the alleged unfair or deceptive acts, any impact on the public interest is simply too speculative to survive summary judgment.

G. Intentional Interference with Prospective Contract

Huggins' intentional interference with prospective contract is premised upon the allegation that Helena intentionally interfered with Huggins' potential contract with a third party to purchase Huggins Farm Service for $ 750,000.

The elements of a claim for intentional interference with prospective contractual relations are (1) the intentional interference with the plaintiffs potential contractual relations, (2) for an improper purpose or by improper methods, and (3) causing injury to the plaintiff. *Brown v. Stewart, 348 S.C. 33, 557 S.E.2d 676, 688 (S.C. Ct. App. 2001)*; *Love v. Gamble, 316 S.C. 203, 448 S.E.2d 876, 882 (S.C. Ct. App. 1994)*. Generally, there can be no finding of intentional interference with prospective contractual relations if there is no evidence to suggest any purpose or motive by the defendant other than the proper pursuit of its own contractual rights with a third party. *Southern Contracting, Inc. v. H.C. Brown Constr. Co., 317 S.C. 95, 450 S.E.2d 602, 606 (S.C. Ct. App. 1994)*. "The plaintiff must actually [*30] demonstrate, at the outset, that he had a truly prospective (or potential) contract with a third party." *United Educ. Distribs., LLC v. Educational Testing Serv., 350 S.C. 7, 564 S.E.2d 324, 329 (S.C. Ct. App. 2002)*. "The agreement must be a close certainty; thus, a mere offer to sell, for example, does not, by itself, give rise to sufficient legal rights to support a claim of intentional interference with a business relationship." *United Educ. Distribs., 564 S.E.2d at 330*. Likewise, a speculative contract or the mere hope of a contract is insufficient to support a claim. *Id.*

Helena argues that summary judgment should be granted because Huggins cannot demonstrate that it had a prospective contract to sell Huggins Farm Service with a third party. Carolina Eastern Company was the third-party which Huggins alleges made an offer to purchase Huggins Farm Service. However, Helena submitted the affidavit of Jerry Hewitt, an employee of Carolina Eastern, which stated that although he had general talks with Huggins about the possibility of purchasing Huggins Farm Service, no offer was ever made to Huggins because the price was too high. Additionally, Helena argues that there is no evidence of any improper [*31] purpose or motive.

Huggins responds that there is a genuine issue of material fact as to whether a potential contract existed between Carolina Eastern and Huggins. Specifically, Huggins argues that there is evidence which indicates that various representatives of Carolina Eastern had approached Huggins on a number of occasions seeking to purchase his business. However, Huggins' evidence does not establish a prospective contractual relationship. At best, the evidence establishes an offer to purchase, which does not, by itself, give rise to sufficient legal rights to support a claim of intentional interference with prospective contractual relations. *See United Educ. Distribs., 564 S.E.2d at 330*. The prospective agreement must be a close certainty. *Id.* Huggins' alleged prospective contractual relationship with Carolina Eastern is too speculative support a claim. Accordingly, Helena's motion for summary judgment is granted as to Huggins' claim for intentional interference with prospective contract.

Conclusion

For the reasons stated above, Huggins' [Docket Entry # 84] motion for partial summary judgment is **DENIED,** and Helena's [Docket Entry # 87] motion for partial summary judgment is **GRANTED** [*32] **in part and DENIED in part.** Specifically, with regard to Huggins' motion for partial summary judgment, summary judgment is denied as to Helena's claims for unjust enrichment and conversion. With regard to Helena's motion for partial summary judgment, summary judgment is denied as to Huggins' claims for breach of contract accompanied by a fraudulent act and civil conspiracy and granted as to Huggins' claims for fraud, negligent misrepresentation, violation of unfair trade practices act, and intentional interference with contractual relations.

IT IS SO ORDERED.

Florence, SC

November 13, 2008

/s/ R. Bryan Harwell

R. Bryan Harwell

United States District Judge

METRIC CONSTRUCTORS, INCORPORATED, Plaintiff-Appellant, and J.A. JONES, INCORPORATED, Plaintiff, v. THE BANK OF TOKYO-MITSUBISHI, LIMITED, NEW YORK BRANCH; BARCLAYS BANK PLC, NEW YORK BRANCH; BAYERISCHE VEREINSBANK, AG, NEW YORK BRANCH; DAI-ICHI KANGYO BANK, LIMITED, NEW YORK BRANCH; MEES PIERSON NV, NEW YORK AGENCY; CREDIT LOCAL DE FRANCE; BANK OF TOKYO-MITSUBISHI TRUST COMPANY, Defendants-Appellees. METRIC CONSTRUCTORS, INCORPORATED, Plaintiff-Appellee, and J.A. JONES, INCORPORATED, Plaintiff, v. THE BANK OF TOKYO-MITSUBISHI, LIMITED, NEW YORK BRANCH; BARCLAYS BANK PLC, NEW YORK BRANCH, BAYERISCHE VEREINSBANK, AG, NEW YORK BRANCH; DAI-ICHI KANGYO BANK, LIMITED, NEW YORK BRANCH; MEES PIERSON NV, NEW YORK AGENCY; CREDIT LOCAL DE FRANCE; BANK OF TOKYO-MITSUBISHI TRUST COMPANY, Defendants-Appellants.

No. 99-2330, No. 99-2379

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

2000 U.S. App. LEXIS 23185

June 8, 2000, Argued
September 13, 2000, Decided

NOTICE: [*1] RULES OF THE FOURTH CIRCUIT COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THIS CIRCUIT.

SUBSEQUENT HISTORY: Reported in Table Case Format at: *2000 U.S. App. LEXIS 30899.*

PRIOR HISTORY: Appeals from the United States District Court for the Eastern District of North Carolina, at Raleigh. W. Earl Britt, Senior District Judge. (CA-97-369-5-BR).

DISPOSITION: AFFIRMED IN PART, VACATED IN PART, AND REMANDED.

COUNSEL: ARGUED: Douglas Leo Patin, SPRIGGS & HOLLINGSWORTH, Washington, D.C., for Appellant. Thomas Joseph Hall, CHADBOURNE & PARKE, L.L.P., New York, New York, for Appellees.

ON BRIEF: Jeffrey R. Gans, SPRIGGS & HOLLINGSWORTH, Washington, D.C.; James P. McLoughlin, Gregory J. Murphy, MOORE & VAN ALLEN, Charlotte, North Carolina, for Appellant.

Brian A. Miller, CHADBOURNE & PARKE, L.L.P., New York, New York; L. Neal Ellis, Jr., Albert Diaz, HUNTON & WILLIAMS, Raleigh, North Carolina, for Appellees.

JUDGES: Before MURNAGHAN, * WILLIAMS, and MICHAEL, Circuit Judges.

* Judge Murnaghan heard oral argument in this case but died prior to the time the decision was filed. The decision is filed by a quorum of the panel. 28 U.S.C. § 46(d).

OPINION

PER CURIAM:

Plaintiff-appellant, Metric [*2] Constructors, Inc. (Metric), a construction company, sued certain banks (collectively, the "Banks"), including defendant-appellees The Bank of Tokyo-Mitsubishi, Ltd. and Bank of Tokyo-Mitsubishi Trust Company (together, the "Bank of Tokyo"), after the Banks stopped funding the construction of facilities that would convert garbage to energy (the "Project") in North Carolina. Metric claims that the Banks allowed it to continue working when they knew the Project was in jeopardy. After the Project failed, Metric sued the Banks to recover payment for some of its construction work, and the Banks counterclaimed. The district court granted summary judgment to the Banks on Metric's claims and to Metric on the Banks' counterclaims. We affirm, except for the award of summary judgment to the Banks on Metric's claim for unjust enrichment. We vacate the summary judgment on that claim and remand for further proceedings.

I.

In May 1995 Metric and Carolina Energy Limited Partnership (CELP) entered into an $ 86 million Turnkey Design and Construction Agreement (Construction Agreement) under which Metric was to build the Project for CELP at two sites in North Carolina. * The Construction Agreement provided [*3] for payment to Metric under the following procedures. Each month Metric submitted to CELP an application for payment for work performed during the previous month. The application included a detailed description of the work done on the Project, measured according to "work milestones." Metric also had to make a number of certifications on each application, including a statement that the work was performed in accordance with the Construction Agreement. Lien waivers from Metric and its subcontractors were also required to insure the effective release of all mechanic and materialmen's liens for the month for which payment was due. The application had to be reviewed by an independent engineer for compliance with the terms of the Construction Agreement. CELP and the engineer had fifteen days to review an application for payment. If both approved, CELP had ten days to pay Metric.

* CELP is not a party in this case.

CELP arranged financing for the Project several months after it entered into the Construction Agreement [*4] with Metric. On July 1, 1995, the Lenoir County Authority and CELP entered into a loan agreement whereby the Authority agreed to lend CELP the proceeds of an $ 86 million tax exempt bond sale. In addition, CELP itself issued $ 6.5 million in resource recovery bonds. Finally, CELP's limited partners provided certain equity funding for the Project.

In a Credit and Reimbursement Agreement (Credit Agreement) between CELP and the Banks, the Banks issued letters of credit as security for the repayment of the bonds in the event CELP defaulted. The Credit Agreement also designated one of the Banks, the Bank of Tokyo, to act as "Account Agent," a role which, among other things, gave the Bank of Tokyo responsibility for disbursing the funds for Project construction to CELP. The Credit Agreement set out a detailed application process that governed the Banks' disbursement of monies to CELP. Any disbursement to CELP was subject to seventeen conditions, including a certification by an independent engineer that the Project would meet its debt service ratio, that no material adverse changes had occurred since the last payment to CELP, and that lien waivers had been executed by Metric and its subcontractors. [*5] Last, the Credit Agreement provided that the Bank of Tokyo did not assume obligations to third parties:

> Account Agent . . . does not assume and shall not be deemed to have assumed any obligation towards or relationship of trust with, or any fiduciary relationship with, or for Borrower, Agent, any of the other Secured Parties or any other party to any Project Document or Bond Document.

Along with the Credit Agreement, the Banks and CELP entered into an Assignment and Security Agreement (Security Agreement). Under the Security Agreement CELP conveyed to the Banks a first priority security interest in Project documents, Project accounts, and equipment. The Security Agreement provided that the Banks (including the Bank of Tokyo, as Agent) assumed no implied duties or obligations to third parties:

> Agent undertakes to perform or to observe only such of its agreements and

> obligations as are specifically set forth in this Security Agreement or any other Credit Instrument, and no implied agreements, covenants or obligations with respect to Debtor, any Affiliate of Debtor or any other party to any of the Assigned Agreements shall be read into this Security Agreement against [*6] Agent or any of the Secured Parties [i.e., the Banks].

The Banks were not parties to the Construction Agreement between Metric and CELP, and Metric was not a party to the Credit Agreement between CELP and the Banks.

In a separate agreement with CELP, Metric executed a Consent to Assignment of Agreement (Consent Agreement) in which Metric consented to CELP's assignment of a security interest to the Banks. Again, the Consent Agreement provided that the Banks undertook no fiduciary or other obligations with respect to Metric.

Metric began construction of the Project in January of 1996. Metric's first fifteen pay applications were approved without major problems. Serious concerns, however, arose over an October 1996 application. This application's lien waiver indicated that there were a number of exceptions. However, the exceptions were not attached to the application as required by the Construction Agreement. CELP approved the October 1996 payment application despite this deficiency, but the Banks balked. The Banks asked CELP to obtain assurances from Metric that there were no exceptions to the lien waiver. After several days, Metric sent the Banks a copy of the lien waiver that [*7] stated there were no exceptions to be listed. The Banks then transferred payment to Metric's account. Some three days later, however, Metric prepared an attachment that listed certain exceptions to the lien waiver and sent it to the Banks.

Later in October 1996 the Banks "became increasingly alarmed about the economic viability of the Project." Much of this concern came from construction delays and expenditures that were over budget. In late November 1996 a lawyer for the Bank of Tokyo, Nicholas R. Battista, determined that the debt service coverage ratio had not been met. In addition, Battista determined that several of the other seventeen conditions required for payment of Metric under the Credit Agreement had not been met, including the absence of defaults and the absence of material adverse changes. On November 22 Battista conveyed his concerns to CELP. Without notifying Metric of these problems, CELP and the Banks entered into extensive discussions (or negotiations) in late November and early December 1996 aimed at keeping the Project afloat. To this end, Battista arranged for the Banks to place funds in CELP's Project accounts so that obligations could be paid immediately, if [*8] negotiations proved successful. The negotiations fell through, however. Within a few days, CELP admitted that the Project could not meet the required debt service coverage ratio. Further, CELP essentially conceded that under the current financial structuring the Project would not be able to pay all of its debts.

Metric was without knowledge of these negotiations, and it continued to work through November and the first part of December 1996. On December 13, 1996, CELP notified Metric that the Banks were suspending funding. Metric stopped construction work immediately, and it was not paid for the work performed in November and the first half of December of 1996. Metric claims it is owed over $ 16 million for this work.

In May 1997 Metric sued the Banks in federal court. By the time it filed an amended complaint, Metric was seeking damages for conversion, breach of contract, tortious interference with contract, unfair and deceptive trade practices, breach of fiduciary duty and civil conspiracy to breach fiduciary duty, unjust enrichment, constructive trust, and equitable lien. The Banks asserted four counterclaims arising out of Metric's October 1996 application for payment: fraud, [*9] negligent misrepresentation, unfair and deceptive trade practices, and conversion. The district court dismissed Metric's claims for tortious interference with contract and breach of contract. The balance of Metric's claims were rejected on summary judgment, as were the Banks' counterclaims. The district court's summary judgment order was based on its adoption of the magistrate judge's memorandum and recommendation. The magistrate judge concluded that Metric's unfair trade practice and breach of fiduciary duty claims failed under the express language of the Project agreements. In addition, the magistrate judge concluded that Metric did not have an unjust enrichment claim because the Banks suffered net losses on the Project. Finally, the magistrate judge concluded that the Banks' counterclaims should be dismissed on several grounds, one of which was that the Banks suffered no injury from Metric's tangled handling of the October 1996 application. Metric appeals the summary judgment on three of its claims, those asserting unfair and deceptive trade practices, breach of fiduciary duty, and unjust enrichment. The Banks cross-appeal the rejection of their counterclaims, except the one for [*10] fraud.

II.

A.

Metric argues that the district court erred in dismissing its unfair trade practice and breach of fiduciary duty claims. We disagree. Both of these claims run up against the plain language of the agreements relating to the Project's construction and financing. These agreements expressly laid out the duties the parties owed to one another. Metric was aware, at least through the Consent Agreement, that the Banks disclaimed any fiduciary obligations to Metric. Moreover, Metric was not a party to the agreements governing the financing of the Project, and those agreements did not impose any duty on the Banks with respect to Metric.

As for Metric's unfair trade practice claim, the magistrate judge concluded that the Banks' failure to inform Metric at the earliest moment the Project was in trouble was not an unfair or deceptive trade practice because "nothing would have required the Banks to provide [payment] assurances [to Metric] in that Metric had no contractual rights against the Banks." The magistrate judge added, "in light of the fact that these are sophisticated parties who were involved in what appears to this court to have been an arm's-length business transaction [*11] in all respects, the court . . . fails to see how the Banks in any way misled Metric . . . or how the Banks' actions rose to the level of unfair or deceptive conduct." Under North Carolina's Unfair and Deceptive Trade Practices Act, *N.C. Gen. Stat. § 75-1.1*, a plaintiff must show (1) an unfair or deceptive act or practice or an unfair method of competition (2) in or affecting commerce (3) that proximately caused actual injury to the plaintiff. *See Spartan Leasing, Inc. v. Pollard, 101 N.C. App. 450, 400 S.E.2d 476, 482 (N.C. App. 1991)*. Metric alleges that the Banks' behavior satisfied the first element in several ways: (1) the Banks put CELP in default in order to use funds designated for Metric as a bargaining chip in the restructuring negotiations with CELP, (2) the Banks processed the November payment application in a deceptive manner, (3) industry standards imposed a duty on the Banks to warn Metric of the Project's potential failure, and (4) the Banks' promise on an earlier project to keep Metric informed created a duty to keep Metric informed on the current Project. We agree with the magistrate judge that these allegations, when measured against the express terms of the Project [*12] financing agreements, do not give rise to unfair or deceptive practices under the North Carolina statute. The agreements make clear that the Banks disclaimed any duty to Metric. Moreover, Metric was not a party to the Credit Agreement between CELP and the Banks, and that is the agreement that governed the disbursement of funds for Project construction to CELP. As the magistrate judge correctly concluded, "the Banks were exercising their rights under their agreements with CELP when they suspended funding for the Project."

We turn to Metric's fiduciary duty claim. Under North Carolina law a fiduciary relationship exists when "there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence." *Abbitt v. Gregory, 201 N.C. 577, 160 S.E. 896, 906 (N.C. 1931). See also Curl v. Key, 311 N.C. 259, 316 S.E.2d 272, 275 (N.C. 1984)*; *Frizzell Constr. Co. v. First Citizens Bank & Trust Co., 759 F. Supp. 286, 290 (E.D.N.C. 1991), aff'd, 972 F.2d 339 (4th Cir. 1992)*. The magistrate judge concluded that Metric failed [*13] to "set forth . . . evidence of the existence of a fiduciary relationship." Metric expressly consented (in the Consent Agreement) to the Banks' disclaimer of any fiduciary relationship toward it. Moreover, as the magistrate noted, Metric has not proffered any evidence of the existence of a fiduciary relationship between it and the Banks.

We conclude that the district court properly entered summary judgment dismissing Metric's unfair trade practice and breach of fiduciary duty claims.

B.

Metric's final argument is that the district court erred in granting summary judgment to the Banks on Metric's unjust enrichment claim. Earlier in the case the district court ruled that Metric's unjust enrichment claim survived the Banks' motion to dismiss under *Fed. R. Civ. P. 12(b)(6)*. In its December 5, 1997, order the district court said that the claim "could have merit" if Metric "among other factors . . . can show that the Banks' security has been fulfilled or even exceeded by reason of the value of the incomplete project." When the summary judgment motions were referred to the magistrate judge, that judge read the district court's statement to mean the following: unless the Banks enjoyed a [*14] net gain on the Project, Metric could not have been unjustly enriched. Because the Banks suffered net losses of over $ 27 million, the magistrate judge said that he "felt compelled by the District Court's December 5, 1997 Order to find that[Metric's] unjust enrichment claim is without merit." The magistrate judge went on to say: "this court is not suggesting that a claim for unjust enrichment is never viable in a net loss context. Rather, under the particular facts of this case, and in light of . . . language in the District Court's [earlier] Order, this court finds that the Banks have not been unjustly enriched." Because the magistrate judge did not cite any "particular facts" other than those relating to the Banks' losses, we must conclude that he recommended the rejection of Metric's unjust enrichment claim solely because Metric could not show that the Banks had a net gain. Based on the magistrate judge's recommendation, the district court granted summary judgment to the Banks on Metric's unjust enrichment claim.

To establish a claim for unjust enrichment under North Carolina law, a plaintiff must show that (1) it conferred a benefit on the defendant, (2) the benefit was not [*15] conferred officiously or gratuitously, (3) the benefit is measurable, and (4) the defendant consciously accepted the benefit. *See Booe v. Shadrick, 322 N.C. 567, 369 S.E.2d 554, 556 (N.C. 1988)*. Obviously missing from this list is the ground upon which the district court appeared to rest its award of summary judgment--that the defendant must also enjoy a net gain in the underlying transaction. As the magistrate judge recognized, no North Carolina court has concluded that a net gain by the defendant is a necessary element of a claim for unjust enrichment. In light of this, it is not for us to add the showing of a net gain as a requirement. We therefore conclude that the district court erred in granting summary judgment to the Banks on Metric's claim for unjust enrichment solely on the ground that the Banks suffered a net loss on the Project. The summary judgment on the unjust enrichment claim is vacated, and the case is remanded for further proceedings on this claim, including further proceedings on summary judgment, if that is appropriate. In reaching this decision, we offer no opinion as to the applicability or merits of an unjust enrichment claim in the circumstances [*16] of this case.

III.

The Banks cross-appeal the award of summary judgment to Metric on their counterclaims for negligent misrepresentation, unfair and deceptive trade practices, and conversion. Those counterclaims assert wrongdoing by Metric in its preparation and submission of the October 1996 application for payment. As the magistrate judge noted, each of these claims requires the Banks to show that they suffered damage at the hands of Metric or that their property was taken by Metric. *See Forbes v. Par Ten Group, Inc., 99 N.C. App. 587, 394 S.E.2d 643, 648 (N.C. App. 1990)* (negligent misrepresentation); *Spartan Leasing , 400 S.E.2d at 482* (unfair and deceptive trade practices); *United States v. Whedbee, 964 F.2d 330, 333 (4th Cir. 1992)* (conversion). The Banks proffered no evidence that they were damaged by any irregularities in Metric's October 1996 pay application or that Metric converted their property. The summary judgment dismissing the Banks' counterclaims was therefore proper.

IV.

The district court's order awarding summary judgment to the Banks on Metric's claims is affirmed except for the unjust enrichment claim. The [*17] summary judgment on Metric's claim against the Banks for unjust enrichment is vacated, and the case is remanded for further proceedings on that claim only. The district court's order awarding summary judgment to Metric on the Banks' counterclaims is affirmed.

AFFIRMED IN PART, VACATED IN PART, AND REMANDED

LEXSEE 2009 BANKR. LEXIS 940

IN RE: LANDAMERICA FINANCIAL GROUP, INC., et al., Debtors. MILLARD REFRIGERATED SERVICES, INC., Plaintiff, v. LANDAMERICA 1031 EXCHANGE SERVICES, INC., Defendant.

Case No. 08-35994-KRH, Chapter 11, Jointly Administered, APN 08-03147-KRH

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF VIRGINIA, RICHMOND DIVISION

2009 Bankr. LEXIS 940*; *51 Bankr. Ct. Dec. 148

April 15, 2009, Decided
April 15, 2009, Filed; April 15, 2009, Entered

COUNSEL: [*1] For LandAmerica Financial Group, Inc., et al, Glen Allen, VA, Debtor: Brian E. O' Connor, Jamie M. Ketten, Jordana Linder, Marc Abrams, Paul Vincent Shalhoub, Rachel Strickland, Willkie Farr & Gallagher LLP, New York, NY; Dion W. Hayes, John H. Maddock III, Joseph S. Sheerin, Richard Francis Blair, McGuire Woods LLP, Richmond, VA; James P. Ryan, Nossaman LLP/O'Connor & Hannan, Washington, DC; William H. Schwarzschild, III, Williams Mullen, Richmond, VA.

For W. Clarkson McDow, Jr., Office of the U. S. Trustee, Richmond, VA, U.S. Trustee: Robert B. Van Arsdale, Office of the U. S. Trustee, Richmond, VA.

For The Official Commitee of Unsecured Creditors, Creditor Committee: Bruce H. Matson, Christian K. Vogel, LeClair Ryan, A Professional Corporation, Richmond, VA; Christopher L. Perkins, LeClair Ryan, Richmond, VA; Jeffrey S. Sabin, Bingham McCutchen LLP, New York, NY; Martha E. Hulley, LeClair Ryan, Alexandria, VA.

For Official Committee of Unsecured Creditors of LandAmerica 1031 Exchange Services, Inc., Akin Gump Strauss Hauer & Feld LLP, Dallas, TX, Creditor Committee: Lynn L. Tavenner, Paula S. Beran, Tavenner & Beran, PLC, Richmond, VA; Mary Angela House, Akin Gump Strauss Hauer & Feld, [*2] LLP, Washington, DC.

JUDGES: Kevin R. Huennekens, UNITED STATES BANKRUPTCY JUDGE.

OPINION BY: Kevin R. Huennekens

OPINION

MEMORANDUM OPINION

Before the Court are the cross-motions for partial summary judgment of Plaintiff Millard Refrigerated Services, Inc. ("Millard"), and of Interveners The Official Committee of Unsecured Creditors of LandAmerica Financial Group, Inc. (the "LFG Committee") and The Official Committee of Unsecured Creditors of LandAmerica 1031 Exchange Services, Inc. (the "LES Committee;" together with the LFG Committee, the "Committees"). The question presented by the cross motions is whether certain exchange funds deposited into a bank account of Defendant LandAmerica 1031 Exchange Services, Inc. ("LES" or the "Debtor") for the purpose of facilitating three like-kind exchange transactions constitute property of the bankruptcy estate of LES. [1] For the reasons set forth below, the Court answers this question in the affirmative.

1 LES has joined in the cross motions filed by

the Committees.

This case is one of over 85 adversary proceedings that have been brought, so far, by former customers of LES in connection with its Chapter 11 bankruptcy case. Each of these former customers asserts that money deposited [*3] into the bank accounts of LES to facilitate like-kind exchanges was held in trust for its benefit and should be returned to it. As of the Petition Date, the Debtor had approximately 450 uncompleted exchange transactions. Each of these uncompleted exchange transactions was governed by a separate exchange agreement executed by LES and its former customer.

The Debtor identified two primary types of exchange agreements that LES utilized in the course of its operations: (a) agreements that included language contemplating that the applicable exchange funds would be placed into an account or sub-account associated with the relevant customer's name (the "Segregated Account Agreements"); and (b) agreements that did not include this "segregation" language (the "Commingled Account Agreements"). Approximately 50 of the uncompleted exchange transactions involved Segregated Account Agreements while the remaining approximately 400 of the uncompleted exchange transactions involved Commingled Account Agreements.

The Court entered a protocol order on January 16, 2009, wherein the Court stayed the litigation in all but five of the over 85 adversary proceedings (the "Protocol Order"). Each of the five select [*4] cases, which were allowed to proceed on an expedited basis, presented legal and factual issues that were common to certain of the other adversary proceedings. Three of the select cases were representative of customers who had Commingled Account Agreements: those with type A agreements, those with type B agreements, and customers with hybrid agreements under which both cash and non-cash proceeds were transferred to LES. [2] Two of the select cases were representative of customers who had Segregated Account Agreements: customers with escrow account agreements and customers with segregated exchange agreements. The Millard adversary proceeding currently before the Court is the adversary proceeding selected to be the representative case for customers with segregated exchange agreements.

2 As defined by the parties, Commingled Type A Cases generally involve the wire transfer of exchange funds to a general LES account at SunTrust Bank; Commingled Type B Cases generally involve the deposit by LES of exchange funds into a LES account at SunTrust Bank. (Joint Motion of Debtor and LES Committee for Order Establishing Scheduling Protocol, P 8.) Another distinction between Type A and Type B Cases can [*5] be found in Section 3(a) of the respective Exchange Agreements. The Type A agreements state that interest will be computed from the first business day following LES' receipt of funds in the account "it maintains at SunTrust Bank for the purpose of collecting taxpayers' exchange funds." The use of the plural possessive "taxpayers'" suggests that the funds of multiple customers are being deposited into the same SunTrust account. The Type B agreements state that interest will be computed after receipt "in an account maintained at SunTrust Bank" without reference to other "taxpayers." The hybrid agreements are otherwise Type B agreements.

By Order entered February 10, 2009, the Court divided the litigation involving the five select cases into phases and limited the scope of the first phase to tracing of exchange funds, contractual interpretation of the exchange agreements, the existence of an express trust and the existence of a resulting trust. In the Millard adversary proceeding, the case presently before the Court, hearing was conducted on the cross motions for partial summary judgment on April 7, 2009, at which counsel for Millard, counsel for the LFG Committee, counsel for the LES [*6] Committee, and counsel for the Debtor all presented argument. Pursuant to the terms of the Court's Protocol Order, all of the parties to the stayed adversary proceedings were permitted to file amicus briefs advocating their respective positions in this case.

This Memorandum Opinion sets forth the Court's findings of fact and conclusions of law pursuant to *Rule 7052 of the Federal Rules of Bankruptcy Procedure.* [3] The Court has subject matter jurisdiction over this adversary proceeding pursuant to *28 U.S.C. §§ 157(a)* and *1334* and the General Order of Reference from the United States District Court for the Eastern District of Virginia dated August 15, 1984. This is a core proceeding under *28 U.S.C. §§ 157(b)(2)(A), (M)* and *(O)*, in which final orders or judgments may be entered by a bankruptcy judge. Venue is appropriate in this Court pursuant to *28 U.S.C. § 1409(a)*.

3 Findings of fact shall be construed as conclusions of law and conclusions of law shall be construed as findings of fact when appropriate. *See Fed. R. Bankr. P. 7052.*

Issues Presented

Millard contends that it is entitled to partial summary judgment with respect to Count I (Declaratory Relief) and Count II (Injunctive Relief) of [*7] its Complaint against LES because its exchange funds were held in three segregated sub-accounts of LES established and maintained for the benefit of Millard. Millard contends that the exchange funds held in the segregated accounts are held in trust and, therefore, are not property of the Debtor pursuant to *11 U.S.C. § 541(d)*. Thus, it argues that the exchange funds should be turned over to Millard in their entirety, outside of the bankruptcy pro rata distribution system.

The Committees and the Debtor counter that the exchange funds were held by LES pursuant to the terms of exchange agreements executed by Millard and LES. The three exchange agreements at issue here, they argue, set forth the complete agreement and understanding of the parties plainly and unambiguously. The Committees point out that under the terms and provisions of the exchange agreements, Millard disclaimed all "right, title and interest" in and to the exchange funds and provided LES with exclusive rights of "dominion, control and use" with respect to the exchange funds. From this they argue that it was the clear intention of the parties not to create a trust arrangement. The Committees and the Debtor assert that Millard [*8] vested LES with full authority over the exchange funds and, in so doing, Millard transferred clearly more than bare legal title to the exchange funds. They conclude that the contractual relationship established between Millard and LES was not one of trustee and beneficiary; rather, they assert that the relationship was, and continues to be, one of debtor and creditor. Thus, they argue that while the Debtor may be contractually obligated to perform the exchange transactions on Millard's behalf, its failure to do so would render it liable only for the breach of its contract and under no other theory of liability. They argue that Millard should receive the same pro rata treatment as all of the other former exchange customers of LES. [4]

4 In the ordinary course of its business, LES invested certain of the exchange funds it received from its former customers. Some of the invested exchange funds received by LES are now held in the form of illiquid auction rate securities as a result of the unprecedented, rapid economic decline experienced in the latter part of 2008 that left the credit markets frozen. As a consequence, LES does not have the ability from a liquidity standpoint to fund all of [*9] the exchanges it is contractually obligated to complete within the time parameters that *§ 1031 of the Internal Revenue Code* requires. To permit one group of exchangers to recover their exchange funds under a trust theory necessarily reduces the amount of liquid funds available for distribution to other exchange creditors and impacts all of the other exchange creditors adversely, whether similarly situated or otherwise.

Undisputed Facts

The material facts are not in dispute. Millard is a Georgia corporation engaged in the refrigerated warehouse and distribution business. It maintains 35 locations throughout the country. LES is a wholly owned subsidiary of LandAmerica Financial Group, Inc. ("LFG"). On November 24, 2008, LES ceased doing business as a qualified intermediary for like-kind exchanges. On November 26, 2008 (the "Petition Date"), LES filed, along with LFG, a petition for relief under Chapter 11 of the United States Bankruptcy Code in this Court. The LES Committee and the LFG Committee both are statutory committees appointed in the respective bankruptcy cases of LES and LFG. The Committees were each granted leave to intervene in this action. [5]

5 *See* the January 6, 2009, Order granting [*10] the LES Committee's Motion to Intervene and the January 16, 2009, Notice of Intervention filed by the LFG Committee.

Prior to the Petition Date, LES was a qualified intermediary for like-kind exchanges consummated by taxpayers pursuant to *§ 1031 of the Internal Revenue Code, 26 U.S.C. § 1031* ("1031 Exchange"). A *1031* Exchange allows a taxpayer to defer the payment of tax that otherwise would be due upon the realization of a gain on the disposition of business or investment property. *Id.* In the typical transaction, an exchanger such as Millard assigns its rights as seller under a purchase agreement for the disposition of business or investment property to a qualified intermediary such as LES. The purchaser of the relinquished property transfers the net sales proceeds directly to the qualified intermediary.

Under *§ 1031*, the exchanger must identify like-kind replacement property within 45 days. The exchanger has 180 days to close on the replacement property. *Id.* The qualified intermediary purchases the replacement property and then transfers the replacement property to the exchanger. In the event that the replacement property is not identified or the closing is not completed within the [*11] specified time periods, then the qualified intermediary pays an amount equal to the net sales proceeds it realized from the sale of the relinquished property to the exchanger. This series of transactions is governed by a written exchange agreement executed by the exchanger and the qualified intermediary. [6]

6 The treasury regulations governing 1031 Exchanges make clear that the taxpayer must abrogate all control over the exchange funds until the exchange is completed. "If the taxpayer actually or constructively receives money or property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property." *Treas. Reg. § 1.1031(k)-1(f)*. However, the abrogation of control required by the treasury regulations does not require the taxpayer to relinquish all right, title and interest to the exchange funds as the parties to these Exchange Agreements (as hereinafter defined) contracted for Millard to do. *See DeGroot v. Exchanged Titles, Inc. (In re Exchanged Titles, Inc.), 159 B.R. 303, 306 (Bankr. C.D. Cal. March 27, 1993)* [*12] ("for the purpose of the exchange . . . there was no need for [the accommodator] to acquire 'real' interest in the . . . property . . . to make the exchange qualify under the statute. . . .'") (citation omitted); *Cook v. Garcia, No. 96-55285, 1997 U.S. App. LEXIS 5980, 1997 WL 143827, at *1 (9th Cir. 1997)* ("A taxpayer need not abandon all equitable interests in the proceeds . . . for a transaction to qualify as a non-taxable event under *section 1031*."). This negates Millard's argument that the disclaimers contained in Section 2 of the Exchange Agreements were included only because the treasury regulations required them to be included.

Beginning in 1992, LES maintained a general, multipurpose checking account at SunTrust Bank, Inc. ("SunTrust"). This checking account was titled in LES' own name, bearing an account number with the last four digits "3318." LES used this account as its general operating account. The SunTrust account received cash (i) in the form of certain customers' exchange funds, (ii) in the form of service fees charged to customers, (iii) in the form of interest, and (iv) in the form of returns on LES' investment of the cash it received. LES disbursed funds from the SunTrust account to pay its [*13] expenses, to pay dividends to LFG, to make investments in other investment vehicles, and to purchase replacement property for customers who had not insisted that their exchange funds be deposited in segregated accounts.

LES used funds in the SunTrust account to invest in a variety of short-term investments, including money market mutual funds, short-term bonds, certificates of deposit, floating rate notes, and auction rate securities. [7] The auction rate securities were held in a brokerage investment account at SmithBarney and SunTrust Robinson Humphrey. Each evening, the aggregate cash balance in the SunTrust account was swept out into an LES overnight investment account and then returned to the SunTrust account the following morning. The SunTrust account is referred to as the commingled account of LES (the "Commingled Account").

7 See note 4 *infra* regarding LES' investments in auction rate securities.

Treasury Regulation Section 1.468B-6, 26 C.F.R. § 1.468B-6, [8] establishes rules concerning the taxation of exchange funds held by exchange facilitators. The default rule established by the treasury regulation is that where the exchange funds exceed $ 2 million, they will be treated for tax [*14] purposes as a loan from the taxpayer to the qualified intermediary. *Treas. Reg. § 1.468B-6(c)(1)*; *Treas. Reg. § 1.7872-5(b)(16)*. There are, however, four safe harbor exceptions to this default rule. One of those safe harbors provides that if a qualified intermediary holds the exchange funds in a segregated account established under the taxpayer's name and identification number, then the qualified intermediary need not take into account items of income, deduction, and credit attributable to the exchange funds. *Treas. Reg. § 1.468B-6(c)(2)(i)-(ii)*. [9] Under this exception exchange funds held in sub-accounts are treated as separate accounts even though they may be linked to a master account. *Treas. Reg. § 1.468B-6(c)(2)(ii).*

8 All subsequent references to Treasury Regulations may be found in Title 26 of the Code of Federal Regulations in correspondingly numbered sections.

9 *Treas. Reg. § 1.468B-6(c)(2)(i)-(ii)* provides:

> (2) Exchange funds not treated as loaned to an exchange facilitator--
>
> (i) Scope.
>
> This paragraph (c)(2) applies if, in accordance with an escrow agreement, trust agreement or exchange agreement, as applicable, all the earnings attributable to a taxpayer's exchange funds are paid [*15] to the taxpayer.
>
> (ii) Earnings attributable to the taxpayer's exchange funds--
>
> (A) Separately identified account. If an exchange facilitator holds all of the taxpayer's exchange funds in a separately identified account, the earnings credited to that account are deemed to be all the earnings attributable to the taxpayer's exchange funds for purposes of paragraph (c)(2)(i) of this section. In general, a separately identified account is an account established under the taxpayer's name and taxpayer identification number with a depository institution. For purposes of paragraph (c)(2)(i) of this section, a sub-account will be treated as a separately identified account if the master account under which the sub-account is created is established with a depository institution, the depository institution identifies the sub-account by the taxpayer's name and taxpayer identification number, and the depository institution specifically credits earnings to the sub-account.

LES entered into an exchange management control account agreement with Citibank, N.A. ("Citibank") in August 2008. This management control account agreement permitted LES to open segregated client sub-accounts (the "Segregated Accounts") [*16] under one or more control accounts. Millard and LES entered into three substantially identical exchange agreements on October 21, 2008 (the "Exchange Agreements"), with LES acting as qualified intermediary. Previously, prior to 2006, Millard had successfully completed two 1031 Exchange transactions with a different qualified intermediary known as Apex Property Exchange, Inc. In connection with those earlier exchange transactions, Millard had specifically negotiated for the exchange funds to be held in segregated sub-accounts associated with Millard's name and taxpayer identification number. Consistent with those previous transactions, Millard discussed with LES the use of the Segregated Accounts for the 2008 1031 Exchange transactions; and ultimately, the parties agreed that the proceeds of the sales of Millard's Relinquished Properties would be placed in the Segregated Accounts maintained by LES at Citibank. [10]

10 *See Treas. Reg. § 1.1031(k)-1(g)(4)(i).* The language of this section says that the "determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the [*17] qualified intermediary is not the agent of the taxpayer." This suggests that the intent of the Internal Revenue Service is to treat the funds as NOT those of the taxpayer.

Pursuant to the three Exchange Agreements dated October 21, 2008, Millard assigned to LES its rights as seller under purchase agreements for three separate properties (the "Relinquished Properties"). The net sale proceeds from the sale of Millard's Relinquished Properties (the "Exchange Funds") were transferred by the closing agents directly to the LES master account at Citibank. The Exchange Funds were then moved from the master account into the separate sub-accounts, i.e. the Segregated Accounts, associated with Millard's name and Millard's taxpayer identification number. The Exchange Funds were never held in the Commingled Account. The Segregated Accounts were in the name of and were controlled by LES. Only LES had the ability to direct the disbursement or withdrawal of the Exchange Funds. LES was the only signatory on the Segregated Accounts. Only LES had direct control of movement within or between the master account and the sub-accounts. The parties agreed in the Exchange Agreements that LES could earn interest [*18] or other fees on the Exchange Funds through its maintenance of the master account and the Segregated Accounts.

Section 2 of each of the Exchange Agreements provides in pertinent part:

> (c) Subject to the investment protocol described in Paragraph 3 below, LES shall have sole and exclusive possession, dominion, control and use of all Exchange Funds, including interest, if any, earned on the Exchange Funds. . . . This agreement i) expressly limits the Taxpayer's [11] rights to receive, pledge, borrow or otherwise obtain the benefits of money or other property held by the qualified intermediary. . . . Taxpayer shall have no right, title, or interest in or to the Exchange Funds or any earnings thereon and Taxpayer shall have no right, power, or option to demand, call for, receive, pledge, borrow or otherwise obtain the benefits of any of the Exchange Funds. . . .

Section 3 of each of the Exchange Agreements (to which Section 2 was expressly subject) requires LES to place the Exchange Funds in Segregated Accounts. It further provides that all earnings on the Exchange Funds were payable to Millard. [12] Section 3 does not restrict the ability of LES to pledge, encumber, borrow, or otherwise receive [*19] the benefits of the Exchange Funds placed in the Segregated Accounts. Section 4 of each of the Exchange Agreements sets forth the procedures for Millard to identify the Replacement Property. Section 5 of each of the Exchange Agreements sets forth the terms under which LES will acquire the Replacement Property and transfer it to Millard. Section 6 of each of the Exchange Agreements makes clear that the sole purpose of the Exchange Agreements is to facilitate Millard's exchange of the Relinquished Properties for the Replacement Properties. Section 6(c) of each of the Exchange Agreements expressly limits the duties and obligations of LES. That section provides:

> LES shall only be obligated to act as an intermediary in accordance with the terms and conditions of this Exchange Agreement and shall not be bound by any other contract or agreement, whether or not LES has knowledge of any such contract or agreement or of its terms or conditions. LES has undertaken to perform only such duties as are expressly set forth herein, and no additional duties or obligations shall be implied hereunder or by operation of law or otherwise.

Each of the Exchange Agreements contains an integration (or merger) [*20] clause in Section 11 providing that "[t]his Exchange Agreement contains the entire understanding between and among the parties hereto."

11 Under the terms of the Exchange Agreements, Millard is defined as "Taxpayer."

12 Millard argues that the use of an apostrophe "s" in the phrase "Taxpayer's Exchange Funds," as that phrase is used in Section 3 of the Exchange Agreements, connotes that the funds in the Segregated Accounts belong to Millard, the taxpayer. But this forced interpretation of Section 3 proves too much. If the Court were to adopt this interpretation, then more than just the beneficial interest in the Exchange Funds would remain with the taxpayer and the transaction would not pass IRS regulatory scrutiny for a 1031 Exchange. This forced interpretation would also require the Court to ignore completely the unambiguous language in Section 2 that LES shall have sole and exclusive possession, dominion, control and use of the Exchange Funds and that Millard shall have no right, title, or interest in or to the Exchange Funds. If the alternate interpretation that Millard now advances was truly what the parties intended, there were better ways to evidence that intent than through the [*21] use of an apostrophe "s" in an isolated phrase contained in Section 3 of the parties' Exchange Agreement.

Standard for Entry of Summary Judgment

Rule 56 of the Federal Rules of Civil Procedure, made applicable to these proceedings by *Rule 7056 of the Federal Rules of Bankruptcy Procedure*, provides that summary judgment should be granted "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." *Fed. R. Civ. P. 56(c)*; *Celotex Corp. v. Catrett, 477 U.S. 317, 327, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)*. In determining whether this showing has been made, the court must assess the evidence in the light most favorable to the party opposing the motion. *See, e.g., Charbonnages de France v. Smith, 597 F.2d 406, 414 (4th Cir. 1979)*.

The United States Supreme Court has made clear that summary judgment is not a disfavored procedural shortcut, but rather an integral part of the Federal Rules, which are designed "to secure the just, speedy and inexpensive determination of every action." *Celotex Corp. v. Catrett, 477 U.S. at 327*. (quoting *Fed. R. Civ. P. 1*); *see also Thompson Everett, Inc. v. Nat'l Cable Adver., L.P., 57 F.3d 1317, 1322-23 (4th Cir. 1995)*; [*22] *Sibley v. Lutheran Hosp. of Md., Inc., 871 F.2d 479, 483 n.9 (4th Cir. 1989)*; *Schultz v. Wills (In re Wills), 126 B.R. 489, 494 (Bankr. E.D. Va. 1991)*.

A party moving for summary judgment bears the initial burden of demonstrating that there is no genuine issue of material fact. *See Celotex Corp. v. Catrett, 477 U.S. at 322*. Summary judgment is appropriate only where there are no "disputes over facts that might affect the outcome of the suit;" disputes over mere peripheral or irrelevant facts are not sufficient. *Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)*.

If the moving party demonstrates that there is no genuine issue of material fact, the burden shifts to the nonmoving party to produce evidence to demonstrate that there is indeed a genuine issue for trial. *Fed. R. Civ. P. 56(e)(2)* ("When a motion for summary judgment is properly made and supported, an opposing party may not rely merely on allegations or denials in its own pleading; rather, its response must--by affidavits or as otherwise provided in this rule--set out specific facts showing a genuine issue for trial. If the opposing party does not so respond, summary judgment should, if appropriate, be entered against [*23] that party."); *see also Celotex Corp. v. Catrett, 477 U.S. at 325*; *RGI, Inc. v. Unified Indus., Inc., 963 F.2d 658 (4th Cir. 1992)*.

The parties all assert that summary judgment is appropriate in this case because there is no dispute as to any material fact regarding the subject transactions. Resolution of the matters in dispute involves the interpretation of three substantially similar contracts, none of which is ambiguous. [13] Furthermore, as all of the parties have filed motions for summary judgment, no party can be heard to complain that it will be deprived of a right to trial if summary judgment is entered.

> 13 It is important to determine whether the contracts are ambiguous, since "[i]f a court properly determines that the contract is unambiguous on the dispositive issue, it may then properly interpret the contract as a matter of law and grant summary judgment because no interpretive facts are in genuine issue." *Washington Metro. Area Transit Auth. v. Potomac Inv. Props., Inc., 476 F.3d 231, 235 (4th Cir. 2007)*.

Discussion

Section 541 of the Bankruptcy Code provides for the creation of a bankruptcy estate upon the filing of a bankruptcy petition. [14] Property included within that estate [*24] is defined very broadly to include every interest that a debtor has in property as of the commencement of the bankruptcy case, wherever located and by whomever held. *United States v. Whiting Pools, Inc., 462 U.S. 198, 204-05, 103 S. Ct. 2309, 76 L. Ed. 2d 515 (1983)* ("The House and Senate Reports on the Bankruptcy Code indicate that *§ 541(a)(1)*'s scope is broad."); *Grochal v. Ocean Tech. Servs. Corp. (In re Baltimore Marine Indus.), 476 F.3d 238, 240 (4th Cir. 2007)* ("*Section 541 of the Bankruptcy Code* governs the composition of the bankruptcy estate and provides a broad definition of 'property of the estate.'").

> 14 *Section 541 of the Bankruptcy Code* provides in pertinent part:
>
> > (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
> >
> > > (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or

equitable interests of the debtor in property as of the commencement of the case.

In line with the broad definition of "property of the estate," money held in a bank account in the name of a debtor is presumed to be property of the bankruptcy estate. *See, e.g., In re Amdura Corp., 75 F.3d 1447, 1451 (10th Cir. 1996)* [*25] ("We presume that deposits in a bank to the credit of a bankruptcy debtor belong to the entity in whose name the account is established."); *Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. (In re U.S.A. Diversified Prods., Inc.), 100 F.3d 53, 55 (7th Cir. 1996)* ("Property of the debtor is defined to include all legal or equitable interests of the debtor . . . and obviously that includes the interest that a depositor has in the money in his account, more precisely the money owed him by the bank by virtue of the account.") (internal quotations omitted); *Asurion Ins. Servs., Inc. v. Amp'd Mobile, Inc. (In re Amp'd Mobile, Inc.), 377 B.R. 478, 483 (Bankr. D. Del. 2007)* ("Property held by a debtor is presumed to be property of the estate."); *Sousa v. Bank of Newport, 170 B.R. 492, 494 (D.R.I. 1994)* (the bankruptcy estate "includes funds held in a checking or savings account"); *Stratton v. Equitable Bank, N.A., 104 B.R. 713, 726 (D. Md. 1989)* (funds deposited in an account owned and controlled by the debtor become the debtor's property). [15]

15 *See Collier on Bankruptcy P 541.09* (Alan N. Resnick & Henry J. Sommer, eds., 15th ed. Rev. 2008) ("deposits in the debtor's bank account [*26] become property of the estate under *§ 541(a)(1)*").

In this case, the facts mandate a presumption that the Exchange Funds are the property of the LES bankruptcy estate. The Exchange Funds were derived from the proceeds of the sale of the Relinquished Properties that Millard had assigned to LES. The Exchange Funds were transferred from the third party purchasers of these Relinquished Properties directly into the bank account of LES by the closing agents. The transferred funds remained in the bank accounts of LES through the Petition Date. Millard never had any ability to withdraw the funds. The accounts were under the complete control of LES. Only LES had the ability to disburse or withdraw the funds. As LES maintained the exchange funds in bank accounts in its name and under its control, the money is presumably property of the LES bankruptcy estate. *Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. (In re USA Diversified Products, Inc.), 100 F.3d 53, 55 (7th Cir. 1996)* (estate property "includes the interest that a depositor has in the money in its account"); *Elsaesser v. Gale (In re Salt Lake City R.V., Inc.),* No. 95-03264-7, 1999 WL 33486709, at *4 (Bankr. D. Idaho, March 17, 1999) [*27] ("[m]oney in a bank account under the debtor's control presumptively constitutes property of the debtor's estate. . . .").

To rebut this presumption that the funds are property of the bankruptcy estate of LES, Millard must show that it retained some right to the funds. Any such right to the funds must be established as an interest in property recognized under state law. [16] *Butner v. United States, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979).* Millard contends that LES was temporarily holding the Exchange Funds on its behalf solely for the purpose of facilitating the exchange of the Relinquished Properties for the Replacement Properties. Millard maintains that it never parted with its equitable interest in the ownership of the Exchange Funds [17] and that LES was holding the Exchange Funds in trust for Millard's benefit. Therefore, it asserts, although the Exchange Funds may have been held in the bank accounts of LES, they did not become property of the LES bankruptcy estate. *11 U.S.C. § 541(d).* [18] Millard points to the fact that under the Exchange Agreements LES was required to place the Exchange Funds in segregated sub-accounts associated with Millard's name and taxpayer identification number. [19] Millard [*28] also points to the fact that nothing in the Exchange Agreements imposes on LES any risk of loss commonly associated with ownership. These facts, together with the fact that Millard retained the benefits of accrued interest, are strong indicia, Millard argues, that it never parted with its equitable ownership interest in the Exchange Funds. Millard concludes, therefore, that LES holds the funds in trust for its benefit.

16 One of Millard's alternative arguments is that LES was acting as a mere conduit for its Exchange Funds; and, as such, the funds are excluded from the LES bankruptcy estate pursuant to *§ 541(d) of the Bankruptcy Code* as a matter of federal common law. In support, it cites

City of Springfield, Mass. v. Ostrander (In re LAN Tamers), 329 F.3d 204 (1st Cir. 2003); *T&B Scottdale Contractors, Inc. v. United States, 866 F.2d 1372 (11th Cir. 1989)*. In those cases cited by Millard in support of this position, the funds originated from a Federal program and were earmarked for a specific statutory purpose. That is not the case here where the Exchange Funds represent the net proceeds of third party purchasers' acquisitions of Relinquished Properties.

17 Legal title to property and [*29] the equitable interest in property are separate property interests. *See, e.g., In re Halabi, 184 F.3d 1335, 1337 (11th Cir. 1999)*.

18 *Section 541(d) of the Bankruptcy Code* creates a limitation on the otherwise broad definition of property of the estate. That section provides in pertinent part that:

> "property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate under sub-section (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold."

19 Nothing in the Exchange Agreements, however, prohibited LES from investing the Exchange Funds that were placed into the Segregated Accounts (indeed LES was indemnified in the event it chose not to do so), from transferring the Exchange Funds out of the Segregated Accounts, from encumbering or pledging the Segregated Accounts for its own use, or from otherwise obtaining the benefits of the Exchange Funds. In fact, the funds in the Segregated Accounts were entirely and completely vulnerable to attachment and levy by third party creditors [*30] of LES.

Whether property in the possession of the Debtor is held in trust for Millard is a question of state law. *Butner, 440 U.S. at 55*. While federal law creates the bankruptcy estate, state law defines the scope and existence of the debtor's interest in property. *Raleigh v. Ill. Dept. of Revenue, 530 U.S. 15, 20, 120 S. Ct. 1951, 147 L. Ed. 2d 13 (2000)* ("The 'basic federal rule' in bankruptcy is that state law governs the substance of claims, Congress having 'generally left the determination of property rights in the assets of the bankrupt's estate to state law.'") (quoting *Butner 440 U.S. at 57*). LES and Millard agreed that the Exchange Agreements would be governed by Virginia law. [20] That contractual choice of law provision is determinative of the law to be applied in this case. *See Holmes Envtl., Inc. v. SunTrust Banks, Inc. (In re Holmes Envtl., Inc.), 287 B.R. 363, 374 (Bankr. E.D. Va. 2002) (citing Tate v. Hain, 181 Va. 402, 410, 25 S.E.2d 321, 324 (Va. 1943))*.

20 Section 11 of the Exchange Agreements provides that "[t]his Exchange Agreement shall be governed by and construed in accordance with the applicable laws of the Commonwealth of Virginia without regard to the conflict of laws provisions thereof . . . [*31] ."

Under the terms of the Court's February 10, 2009, order, the question to be resolved at this stage of the litigation is whether the Exchange Funds are excluded from property of LES' bankruptcy estate because of the existence of either an express trust or a resulting trust. The Court will look to the law of the Commonwealth of Virginia for its analysis of these two issues. Millard bears the burden of proving the existence of a trust. *See Page v. Page, 132 Va. 63, 110 S.E. 370, 372 (1922)* (party seeking to establish a trust has the burden of proving its existence); *Chiasson v. J. Louis Matherne & Assocs. (In re Oxford Mgmt., Inc.), 4 F.3d 1329, 1335 (5th Cir. 1993)* ("When the property of an estate is alleged to be held in trust, the burden of establishing the trust's existence rests with the claimants.").

Under Virginia law, an express trust is created only where there is "an affirmative intention to create it." *Peal v. Luther, 199 Va. 35, 37, 97 S.E.2d 668, 669 (1957)*; *Leonard v. Counts, 221 Va. 582, 588, 272 S.E.2d 190, 194 (1980)* (an express trust is "based on the declared intention of the trustor."). The affirmative intention to create a trust may be established by "either express [*32] language to that effect or circumstances which show with reasonable certainty that a trust was intended to be created." *Woods v. Stull, 182 Va. 888, 902, 30 S.E.2d 675, 682 (1944)*; *Rivera v. Nedrich, 259 Va. 1, 6, 529*

S.E.2d 310, 312 (1999).

There is no express language in the Exchange Agreements that creates a trust. The words "trust," "trustee," or "beneficiary" do not appear anywhere in the Exchange Agreements. Given the omission of any language normally associated with the creation of a trust, Millard must demonstrate with "reasonable certainty" circumstances that show both parties to the Exchange Agreement nevertheless intended to create a trust. *Woods v. Stull, 182 Va. at 902, 30 S.E.2d at 682.*

The Court thus turns to an examination of whether Millard has demonstrated the parties' intent to create a trust despite the absence of express language to do so. Although formal or technical words are not necessary to create a trust, the fact that the Exchange Agreements make no mention of a "trust" is significant in determining whether a trust was intended. *See In re Estate of Vallery, 883 P.2d 24, 27 (Colo. App. 1993).* Here, not only is there an absence of any language that the parties [*33] intended to create a trust, but there is language in the Exchange Agreements that actually evidences an intent *not* to do so. Millard, in the Exchange Agreements, conveyed exclusive possession, dominion, [21] control and use of the Exchange Funds to LES. It also disclaimed any right, title or interest in and to the Exchange Funds. That conveyance combined with that disclaimer is inconsistent with the establishment of a trust. Under a trustee-beneficiary relationship, the trustee holds legal title in the trust property and the beneficiary holds an equitable interest in the trust property. *Kubota Tractor Corp. v. Strack, Case No. 4:06cv145, 2007 U.S. Dist. LEXIS 9803, 2007 WL 517492, at *4 (E.D. Va. Feb. 6, 2007)* (citing *Broaddus v. Gresham, 181 Va. 725, 731, 26 S.E.2d 33, 35 (1943))* (reversed on other grounds, *Kubota Tractor Corp. v. Strack (In re Strack), 524 F.3d 493 (4th Cir. 2008)*. However, Millard relinquished *any and all* interests in the property, including the equitable interest that a beneficiary of a trust would retain in trust property. Millard expressly disclaimed the equitable interest that it now asks this Court to find that it otherwise somehow retained.

21 "Dominion" has been defined by one court as "perfect [*34] control in right of ownership, and indicates that it was the intention to make the instrument as effectual as a conveyance as it was possible for the parties to make it." *Baker v. Westcott, 73 Tex. 129, 11 S.W. 157, 159 (Tex. 1889).*

Further evidence that the parties did not intend the Exchange Agreements to create a trust can be found in the parties' agreement to limit the duties of LES to those expressly contained in the Exchange Agreements. A trust necessarily requires the establishment of fiduciary duties. *See Restatement (3d) of Trusts § 2* (2003) (stating that a trust is a fiduciary relationship with respect to property); *In re NOVA Real Estate Inv. Trust, 23 B.R. 62, 66 (Bankr. E.D. Va. 1982)* ("A trust involves a duty of the fiduciary to deal with particular property for the benefit of another."). [22] Fiduciary duties create a special relationship of trust and good faith that goes beyond the duties set forth in an ordinary contract between commercial parties. *See Balbir Brar Ass'n v. Consol. Tracking Servs. Corp.,* At Law No. 137795, 1996 WL 1065615 at *5 (Va. Cir. Ct. October 1, 1996) (distinguishing between contract duties and fiduciary duties).

22 A trustee has a fiduciary obligation to act [*35] for the benefit of the trust beneficiary. *See Continental Cas. Co. v. Powell, 83 F.2d 652, 654 (4th Cir. 1936)* ("There is a fiduciary relation between trustee and beneficiary; there is not a fiduciary relation between debtor and creditor.") (internal citations omitted); *Caldwell v. Hanes (In re Hanes), 214 B.R. 786, 812 (Bankr. E.D. Va. 1997)* ("The trustee . . . is a fiduciary of the trust beneficiaries.") (internal citations omitted).

The parties to the Exchange Agreements acknowledged that LES was not undertaking any duties not expressly set forth in the Exchange Agreements (i. e. the contract duties) including any implied duties or any duties imposed by operation of law. This limitation on the scope of LES' duties eliminates any argument that LES had a duty to act as a fiduciary for Millard. *Metric Constructors, Inc. v. Bank of Tokyo-Mitsubishi, Ltd., Case No. 99-2330, 2000 U.S. App. LEXIS 23185, 2000 WL 1288317, at *4 (4th Cir. Sept. 13, 2000)* (holding that no fiduciary duties existed where the plaintiff "expressly consented (in the Consent Agreement) to the [defendants'] disclaimer of any fiduciary relationship toward it"). The Exchange Agreements provide that LES was acting in the narrow capacity as an exchange [*36] facilitator. The parties agreed that LES assumed no duties not expressly set forth in the Exchange Agreements including fiduciary duties and none can be implied or imposed by operation of law. LES merely had the contractual duty to effect the exchanges. The unambiguous language of the Exchange Agreements makes clear that the parties intended their relationship to be one of contract obligor and obligee.

The Exchange Agreements were integrated contracts. *See Robinette v. Robinette, 4 Va. App. 123, 354 S.E.2d 808, 810, 3 Va. Law Rep. 2151 (1987)*; *see also Lysk v. Criswell (In re Criswell), 52 B.R. 184, 197 (Bankr. E.D. Va. 1985)* (holding that an integrated agreement containing a merger clause precluded parties from claiming any reliance on "terms, conditions, statements, warranties, or representations not contained [in the integrated agreement]"). Millard cannot utilize extrinsic evidence to modify or alter the contracts' plain statements (i) that Millard had no interest, including any equitable interest, in or to the Exchange Funds and (ii) that LES owed to Millard no duty, including any fiduciary duty, not expressly set forth in the Exchange Agreements. *Robinette v. Robinette, 4 Va. App. at 128, 354 S.E.2d at 810* [*37] (holding that a party cannot introduce parol evidence to show the existence of a trust if it would defeat or contradict the terms of an express agreement). The objective language of the Exchange Agreements precludes consideration of any subjective belief that the parties may have had regarding the relationship between them. *Boone v. U.S. Attorney, Case No. 7:06VA00006, 2006 U.S. Dist. LEXIS 22161, 2006 WL 1075010, at *3 (W.D. Va. Apr. 21, 2006)* ("Boone may have had a subjective intent to the contrary, but it is the objective manifestation of intent, as shown by the words used in the agreement, that governs."). [23]

> 23 Millard argues that post-contractual conduct is competent to alter or contradict the express terms of an integrated contract. However, the cases cited by Millard apply to subsequent parol *agreements* between the parties--not just the parties' conduct. *See Piedmont Mt. Airy Guano Co. v. Buchanan, 146 Va. 617, 131 S.E.793 (1926)*; *Centex Constr. v. Acstar Ins. Co., 448 F.Supp.2d 697, 712 (E.D. Va., 2006)*. No post-execution agreements between LES and Millard have been alleged in this case. Furthermore, whether a trust was created is to be determined at the time of the transfer of the property.

Millard argues [*38] that the intent of the parties to create a trust can be gleaned from the requirement set forth in the Exchange Agreements that the Exchange Funds were required to be held in segregated sub-accounts, but this argument fails. The requirement of Segregated Accounts may provide evidence on the traceability of the funds, but that alone does not create a trust.

> In order to establish such a right as trust beneficiary, a claimant must make two showings: first the claimant must prove the existence and legal source of a trust relationship; second, the claimant must identify the trust fund or property and, where the trust fund has been commingled with general property of the bankrupt, sufficiently trace the property or funds--the res.

Conn. Gen. Life Ins. Co. v. Universal Ins. Co., 838 F.2d 612, 618 (1st Cir. 1988). See also Ellis v. Ellis, 310 B.R. 762, 764 (Bankr. W.D. Okla. 2004) (holding that agreement to segregate and not commingle proceeds from the sale of borrower's collateral cannot create a trust in lender's favor under "fiduciary capacity" exception to discharge under *§ 523(a)(4)*); *Barclay's Amer./Bus. Credit, Inc. v. Long (In re Long), 44 B.R. 300, 305 (Bankr. D. Minn. 1983)* (holding [*39] that "existence of a collateral account, into which proceeds from receivables were to be deposited in order to segregate the money" did not "create a fiduciary relationship where the substance of the relationship between the parties was that of creditor/debtor"); *cf. Kubota Tractor Corp. v. Strack (In re Strack), 524 F.3d 493 (4th Cir. 2008)* (holding that proceeds from the sale of collateral were held in trust where the agreement between the parties created an express trust in the sales proceeds). [24] The fact that the Exchange Funds were required to be placed in segregated sub-accounts provides only half of the equation. Segregation alone is insufficient to prove the parties' affirmative intention to create an express trust. [25]

> 24 Millard argues that *Strack* stands for the proposition that a segregation provision in an agreement demonstrates with reasonable certainty the intent to establish an express trust. However, the plain language of the agreement in *Strack* required the debtor to "hold the same in trust." *In re Strack, 524 F.3d, at 495-96.*

> 25 The requirement for segregated accounts in

the Exchange Agreements reflects the desire of the parties to satisfy one of the safe harbors offered [*40] by the Treasury Regulations in order to obtain favorable tax treatment. It does not, without more, evidence an intention to establish an express trust. *Treasury Regulation section 1.468B-6* requires that any exchange funds exceeding $ 2 million must be maintained by a qualified intermediary in a separately identified account with all earnings on the account going to the exchanger or in a commingled account with earnings on the account disbursed pro rata to the commingled exchangers. See *Treas. Reg. § 1.468B-6 (2008).* Failure to do so results in treatment of the exchange funds as a loan to the qualified intermediary for tax purposes. *See id.* The Exchange Agreements' Segregated Accounts were set up as required in the Treasury Regulations, thus contradicting Millard's argument that the Segregated Accounts were indicative necessarily of an intention to create a trust relationship.

Finally, the intention of the parties not to create an express trust can be gleaned from their decision to use the qualified intermediary option from among the four safe harbor options available within the Treasury Regulations. Qualified intermediaries are not the only means for effectuating like-kind exchange [*41] transactions under *§ 1031. Treasury Regulation § 1.1031(k)-1(g)*, which addresses the delivery of funds to third-parties in connection with a 1031 Exchange, provides, in pertinent part, as follows:

> Safe harbors - - (1) In general. Paragraphs (g)(2) through (g)(5) of this section set forth four safe harbors the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for purposes of *section 1031* and this section. . . .
>
> (2) Security or guarantee arrangements.
>
> . . . .
>
> (3) Qualified escrow accounts and qualified trusts
>
> . . . .
>
> (4) Qualified Intermediaries
>
> . . . .
>
> (5) Interest and Growth Factors

Treas. Reg. § 1.1031(k)-1(g). These safe harbors are not mutually exclusive. *See* 26 *Treas. Reg. § 1.1031(k)-1(g)(1)* ("More than one safe harbor can be used in the same deferred exchange, but the terms and conditions of each must be separately satisfied."). Millard and LES had the option to utilize a "qualified escrow" or to establish a "qualified trust" pursuant to *subsection (g)(3)* of the Treasury Regulation. The qualified trust option requires a written trust agreement. *26 C.F.R. § 1.1031(k)-1(g)(3)(iii)(B)*. Instead of using either of [*42] these available options, the parties chose the "qualified intermediary" safe harbor. The Exchange Agreements specifically state that: "LES and Taxpayer acknowledge and agree that this Exchange Agreement is intended to satisfy the safe harbor provisions of *Section 1.1031(k)-1(g)(4)* of the Regulations." Exchange Agreement at P6(a). The parties did not in addition separately satisfy the terms and conditions of the Treasury Regulations for the creation of either a qualified escrow or a qualified trust. As the LES Committee points out in its brief, the parties' decision to eschew the escrow and trust provisions of the tax code in favor of a different safe harbor evidences that there was no intention to create a trust relationship. The Court thus finds that no express trust was created in any of the three 1031 Exchange transactions at issue.

As the Court has found that the parties to the Exchange Agreements did not intend to create an express trust, Millard is not now entitled to the imposition of a resulting trust. In Virginia a resulting trust is "an [*43] indirect trust that arises from the parties' intent or from the nature of the transaction and does not require an express declaration of trust." *1924 Leonard Rd., L.L.C. v. Roekel, 272 Va. 543, 552, 636 S.E.2d 378, 383 (2006)* (citing *Tiller v. Owen, 243 Va. 176, 180, 413 S.E.2d 51, 53, 8 Va. Law Rep. 1883 (1992)*; *Salyer v. Salyer, 216 Va. 521, 525, 219 S.E.2d 889, 893 (1975))*. The party seeking to establish such a trust must do so by clear and convincing evidence. *Id.* (citing *Leonard v. Counts, 221 Va. 582, 589, 272 S.E.2d 190, 195 (1980))*.

"For a resulting trust to arise, the alleged beneficiary must pay for the property, or assume payment of all or part of the purchase money before or at the time of purchase, and have legal title conveyed to another without any mention of a trust in the conveyance." *1924 Leonard Rd., 272 Va. at 552, 636 S.E.2d at 383* (citing *Morris v. Morris, 248 Va. 590, 593, 449 S.E.2d 816, 818 (1994)). See also Tiller, 243 Va. at 180, 413 S.E.2d at 53*; *Leonard, 221 Va. at 588, 272 S.E.2d at 194 (1980)*. In *Morris,* the Supreme Court of Virginia quoted its prior opinion in *Kellow v. Bumgardner, 196 Va. 247, 83 S.E.2d 391 (1954)*:

> The existence of a resulting trust thus depends upon an equitable [*44] presumption of intention, based upon the natural precept that one who advances the purchase money for real property is entitled to its benefits. Therefore, after it has been shown that payment of all or a part of the purchase price for property has been paid by one person and title thereto has been placed in the name of another, the factor which will determine whether the title is to be impressed with a trust in favor of the payor is the intention of the party providing the purchase money. If no evidence of intention is available, then the presumed intention will stand; *but if there is evidence that the person who provided the money had some intention other than to secure the benefits for himself, the presumed intention fails and no resulting trust will be recognized.*

Morris, 248 Va. at 593, 449 S.E.2d at 818 (quoting *Kellow, 196 Va. at 255, 83 S.E.2d at 396*) (emphasis added).

Millard argues that a trust was found to exist in each of the few reported cases that dealt with like-kind exchange transactions utilizing segregated accounts. [26] In those cases, the courts were compelled to discern the intent of the parties from the circumstances surrounding their conduct, and the courts imposed [*45] resulting trusts. [27] In none of those cases was it found, however, that the parties had entered into a fully integrated agreement that evidenced an intention not to create a trust. In this case, the parties' intentions are readily discernible from the Exchange Agreements themselves. The Court need not divine the intent of the parties from the surrounding circumstances. Millard and LES were each experienced, sophisticated parties to complex documented commercial transactions. They were separately represented by capable counsel and experienced financial professionals. [28] If the parties had wanted to create a trust, they certainly were capable of doing so. They did not. A resulting trust cannot be imposed in the face of Exchange Agreements that demonstrate clearly a contrary intent. The Court thus finds that no resulting trust was created in any of the three 1031 Exchange transactions at issue. This result obtains without regard to the considerable hurdle that Millard would otherwise have to overcome that a resulting trust must be established through clear and convincing evidence.

26 *See Taxel v. Surnow (In re San Diego Realty Exchange, Inc.), No. 92-56526, 1994 U.S. App. LEXIS 10317, 1994 WL 161646 (9th Cir. May 2, 1994)*; [*46] *Siegel v. Boston (In re Sale Guaranty Corp.), 220 B.R. 660 (9th Cir. BAP 1998)*.

27 In *Cook v. 1031 Exch. Corp., 29 Va. Cir. 302, 1992 WL 885015 (Va. Cir. Ct. 1992)*, another case upon which Millard relies, the court found that the parties stipulated that the funds were held in trust.

28 Consistent therewith, Section 11 of the Exchange Agreements provides that: "Each party hereto and their legal counsel have reviewed this Exchange Agreement and have had an opportunity to revise (or request revision of) this Exchange Agreement and, therefore, any usual rules of construction requiring that ambiguities are to be resolved against a particular party shall not be applicable in the construction and interpretation of this Exchange Agreement."

Conclusion

The Exchange Funds are not excluded from property of the estate pursuant to *11 U.S.C. § 541(d)* because of the existence of an express trust or as a result of the imposition of a resulting trust. The plain, unambiguous language of the Exchange Agreements clearly establishes that it was not the intent of LES or Millard to create an express trust. As the Exchange Agreements were integrated contracts, Millard cannot use parol evidence to prove [*47] the existence of an express trust. Given the parties' clear intent in the Exchange Agreements not to create an express trust, it is inappropriate for the court to impose a resulting trust upon them. This is especially the case where the parties are sophisticated, as they are here, and where the parties have included a merger clause in their agreement. Therefore, the Court will deny Millard's motion for partial summary judgment and grant partial summary judgment in favor of the Committees against Millard. The Court will dismiss Millard's requested relief for declaratory judgment and injunctive relief as set forth in Counts I and II of its Complaint. A separate order shall issue.

ENTERED: April 15 2009

/s/ Kevin R. Huennekens

UNITED STATES BANKRUPTCY JUDGE

Entered on Docket: 4-15-2009

1 of 1 DOCUMENT

NIGERIAN NATIONAL PETROLEUM CORPORATION, Plaintiff, -against- CITIBANK, N.A., CITIBANK, FEDERAL SAVINGS BANK; CITICORP BANKING CORPORATION; CITICORP; CITIBANK (NEW YORK STATE); and JOHN DOES INC. 1 TO 100, Defendants.

98 Civ. 4960 (MBM)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

1999 U.S. Dist. LEXIS 11599

July 29, 1999, Decided
July 30, 1999, Filed

DISPOSITION: [*1] Citibank's motion to dismiss granted, and plaintiff's amended complaint dismissed with respect to Citibank.

COUNSEL: ROBERT D. OWEN, ESQ., HENRY G. BURNETT, ESQ., Owen & Davis, New York, NY, for Plaintiff.

MARK G. HANCHET, ESQ., NOELLE M. KURTIN, ESQ., Zeichner Ellman & Krause, New York, NY, for Defendants.

JUDGES: Michael B. Mukasey, U.S. District Judge.

OPINION BY: Michael B. Mukasey

OPINION

OPINION AND ORDER

MICHAEL B. MUKASEY, U.S.D.J.,

Nigerian National Petroleum Corporation ("NNPC"), a Nigerian corporation that sells crude oil on behalf of the Nigerian government (Compl. P 6), [1] sues Citibank, N.A.; Citibank, Federal Savings Bank; Citicorp Banking Corp.; Citicorp; Citibank (New York State) (collectively, "Citibank"); and John Does, 1 to 100, seeking to recover approximately $ 15.1 million that it lost as a result of fraud by a third-party named Alberto Vadra, who used Citibank accounts. Citibank moves to dismiss plaintiff's amended complaint pursuant to *Fed. R. Civ. P. 12(b)(6)* for failure to state a claim. For the reasons stated below, Citibank's motion is granted, and the amended complaint is dismissed with respect to Citibank.

1 "Compl." refers to the amended complaint dated September 14, 1998.

[*2] I.

The following relevant facts are assumed to be true for the purposes of this motion. In 1993, Alberto Vadra, a United States citizen who was born in Argentina, formed two corporations under the laws of Nevada, one called Ministry of Petroleum Resources ("MPR"), the other National Petroleum Resources ("National Petroleum"). (Compl. PP 15, 19) Vadra registered both corporations using his home address in Las Vegas, Nevada, and, at least as to MPR, named as directors two persons with addresses in Lagos, Nigeria. (*Id.* PP 15, 18-19) In subsequent filings, however, Vadra replaced these directors with directors from Miami, Florida, and changed his own address to one in Miami. (*Id.* PP 16-18)

In August 1993, Vadra opened three bank accounts at Citibank: (1) account number 71118209, in the name of MPR (the "First MPR Account"); (2) account number 71118233, in the name of National Petroleum (the "National Petroleum Account"); and (3) account number 3200106121, also in the name of MPR (the "Second MPR Account"). (*Id.* PP 21, 23-24) In July 1994, Vadra opened an additional Citibank account in the name of MPR, numbered 46816814 (the "Third MPR Account"). (*Id.* P 25) For nine months, [*3] there was minimal activity in the three Citibank accounts opened in 1993. (*Id.* P 26) However, in June 1994, Vadra induced Bank Indosuez, banker for one of NNPC's customers, to wire transfer $ 15,144,307.75 intended for NNPC to the First MPR Account instead (the "First Fraudulent Transfer"). (*Id.* PP 27, 35) [2] Although the documents submitted to Citibank to verify the transfer were allegedly "riddled with inconsistencies and other badges of fraud," such as typographical errors and incomplete addresses (*id.* PP 31-34), on June 28, 1994, Citibank "swiftly processed" the transfer. (*Id.* P 28)

2 The amended complaint is ambiguous with respect to whether the money was diverted from NNPC's account at the Central Bank of Nigeria or from the Nigerian government's account at the Federal Reserve Bank in New York. (*Compare id.* P 27, *with id.* P 35) This ambiguity is immaterial for present purposes.

The amended complaint is ambiguous also with respect to the precise amount that was diverted from NNPC. (*Compare* Compl. P 37 ($ 15,144,325.25), *with id.* P 51 ($ 15,144,309), *and id.* at p. 24 ($ 15,144,307.75)) I have accepted the figure in NNPC's prayer for relief, although the precise figure is immaterial for present purposes.

[*4] The next day, Vadra faxed a letter, on letterhead from an entity called Transportes Aereos Internacionales S.R.L. ("TAI"), to Donna Harrington, an employee of Citibank in New York City. (*Id.* P 39) The letter, which provided the same address for TAI as Vadra earlier had provided Citibank for MPR, instructed Harrington in typescript to wire transfer the following sums from the First MPR Account: (1) $ 1 million to Key Biscayne Bank; (2) $ 3 million to Bank of America; and (3) $ 11 million to a Citibank account in Vadra's name, numbered 3100170206 ("Vadra's Personal Account"). (*Id.* P 39) In handwriting, the first and third amounts were changed to $ 2 million and $ 5 million, respectively. (*Id.*)

On the same day, Vadra faxed Harrington another letter -- this one on letterhead of an entity called Alneva Enterprises Inc., albeit at the same address as TAI -- providing an address for MPR, National Petroleum and an entity called National Maritime Authority ("NMA"). (*Id.* P 40) That address, in Miami, Florida, was Vadra's home address, and above each listing "c/o Alberto Vadra" was written by hand. (*Id.*)

On July 1, 1994, presumably pursuant to Vadra's instructions, Citibank [*5] wire transferred the following amounts from the First MPR Account: (1) $ 2 million to an account at Towerbank in the name of NMA; (2) approximately $ 3 million to an account at Bank of America in the name of NMA; (3) $ 5 million to the Third MPR Account; and (4) $ 5 million to Vadra's Personal Account. (*Id.* P 41) [3] In turn, on July 6, 1994, $ 5 million was wire transferred from Vadra's Personal Account to two banks in Lagos, Nigeria (*id.* P 43); on July 7, 1994, $ 4 million was wire transferred from the Third MPR Account to the Second MPR Account (*id.* P 48); and between July 11 and 15, 1994, that money was transferred again from the Second MPR Account to four other accounts, including $ 600,000 to Vadra's Personal Account and $ 1.9 million to an account in MPR's name at Barnett Bank of South Florida. (*Id.* P 50)

3 The discrepancies between Citibank's transfers on July 1, 1994 and Vadra's instructions on June 29, 1994, are unexplained in the amended complaint.

In the meantime, on July 6, 1994 also, [*6] Towerbank returned to Citibank the $ 2 million that had been wire transferred to NMA's account on July 1, 1994, apparently because NMA had not informed Towerbank that it was expecting to receive a large transfer, as required by the bank's rules. (*Id.* P 45) However, Citibank did not redeposit the $ 2 million into the First MPR Account from which it had been transferred. (*Id.* P 47) Instead, on July 11, 1994, Thomas A. Gallo, Assistant Vice President of Citibank, ordered the money deposited into the National Petroleum Account. (*Id.*) Later the same day, Gallo ordered the money transferred again to Vadra's Personal Account. (*Id.*)

On July 12, 1994, only days after the First Fraudulent Transfer, Vadra effected a second fraudulent transfer at NNPC's expense, diverting $ 15,543,710 intended for the Nigerian government's account at the Federal Reserve Bank in New York to the First MPR Account (the "Second Fraudulent Transfer"). (*Id.* P 52)

However, this time, the fraudulent transfer did not escape NNPC's or the transferring bank's notice. Thus, on July 19 and 20, 1994, respectively, NNPC and the transferring bank notified Gallo, the Assistant Vice President of Citibank, about [*7] the fraud. (*Id.* PP 53-55) On July 27, 1994, having traced some of the Second Fraudulent Transfer to the Third MPR Account, where it had been re-transferred, Citibank remitted $ 15,543,710 to NNPC's account at the Federal Reserve Bank. (*Id.* P 56)

Notwithstanding discovery of the Second Fraudulent Transfer, however, Citibank did not freeze the First MPR Account. Instead, on July 29, 1994, the bank permitted transfer to the First MPR Account of approximately $ 1 million from the Third MPR Account. (*Id.* P 60) On the same day, Citibank permitted another $ 1.1 million to be withdrawn from the Third MPR Account, money which was deposited in an account bearing NMA's name at Bank of America. (*Id.*)

Whether, or to what extent, Citibank investigated the First MPR Account after these events is not apparent. (*Id.* P 58) According to the amended complaint, Citibank "failed to conduct any further inquiry into the [First MPR Account], or if it did conduct an inquiry, recklessly failed to take notice that $ 15.1 million had been received just two weeks earlier." (*Id.*) Whatever Citibank's knowledge, however, NNPC did not learn of the First Fraudulent Transfer until May 1995, [*8] when it finally discovered that the $ 15,144,307.75 due from Bank Indosuez was never received. (*Id.* P 61-62) NNPC "immediately advised Gallo at Citibank . . . by letter dated June 1, 1995 of the newly discovered fraud, and demanded repayment." (*Id.* P 63) Nevertheless, "neither Gallo nor anyone else at Citibank . . . ever replied to NNPC's letter or repaid the $ 15.1 million in fraudulently transferred funds." (*Id.* P 64)

Moreover, according to the complaint, Citibank "stonewalled and otherwise impeded subsequent attempts by NNPC to investigate the [First Fraudulent Transfer]." (*Id.; see id.* P 5) Specifically, Citibank refused to release signature cards and photographs of the holders of the First MPR Account, refused to disclose the names or numbers of the accounts to which the First Fraudulent Transfer had been disbursed and refused to disclose the name of the "operator" of the First MPR Account. (*Id.* P 65) After receiving pressure from the U.S. Department of Justice, Citibank did finally release "some relevant documentation." (*Id.* P 66) Allegedly, however, "even this production was plainly inadequate." (*Id.*) According to the complaint, "it was only in [*9] May 1998 that NNPC received certain documents revealing Citibank's role in . . . permitting Vadra to perpetrate his fraudulent activities." (*Id.*)

On July 10, 1998, NNPC commenced this action. NNPC's amended complaint states five claims: (1) that Citibank was "negligent in permitting and/or failing to prevent the fraud perpetrated by Vadra" (*id.* P 70); (2) that Citibank "acted in a commercially unreasonable manner," in violation of the New York Uniform Commercial Code ("NYUCC") (*id.* P 72); (3) that Citibank "negligently and/or recklessly failed to disclose and therefore concealed Vadra's fraudulent and criminal activities" (*id.* P 74); (4) that Citibank "aided and abetted Vadra in the fraud" (*id.* P 76); and (5) that Citibank "acted in commercial bad faith." (*Id.* P 78) NNPC seeks "an amount not to exceed the sum of $ 15,144,307.75 plus interest from June 1994, compensatory and punitive damages in an amount to be determined, and such other and further relief as the Court deems proper." (*Id.* at p. 24)

II.

On a motion to dismiss for failure to state a claim pursuant to *Fed. R. Civ. P. 12(b)(6)*, the court should dismiss the complaint if it appears "'beyond doubt [*10] that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" *Northrop v. Hoffman of Simsbury, Inc., 134 F.3d 41, 44 (2d Cir. 1997)* (quoting *Conley v. Gibson, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957))*. It is not the court's function to weigh the evidence that might be presented at trial; instead, the court must merely determine whether the complaint itself is legally sufficient. *See Goldman v. Belden, 754 F.2d 1059, 1067 (2d Cir. 1985)*. In doing so, the court must accept the material facts alleged in the complaint as true, and draw all reasonable inferences in favor of the plaintiff. *See Gant v. Wallingford Bd. of Educ., 69 F.3d 669, 673 (2d Cir. 1995)*. The issue before the court on a *Rule 12(b)(6)* motion "is not whether a plaintiff is likely to prevail ultimately, 'but whether the claimant is entitled to offer evidence to support the claims. Indeed it may appear on the face of the pleading that a recovery is very remote and unlikely but that is not the test.'" *Id.* (quoting *Weisman v. LeLandais, 532 F.2d 308, 311 (2d Cir. 1976)* (per curiam)).

[*11] III.

Citibank argues that NNPC's first, second, third and fifth claims are time barred. Because the relevant issues vary to some extent depending on the particular claim, I will consider each claim more or less individually.

Under New York law, which applies in this diversity case, NNPC's first and third claims -- for negligence and/or recklessness -- are governed by a three-year statute of limitations. *See* N.Y. C.P.L.R. ("CPLR") *§ 214(4)* (McKinney 1990). Because the First Fraudulent Transfer occurred in June 1994, and NNPC did not commence this action until July 10, 1998, it would appear that these claims are barred.

Read liberally, NNPC's memorandum of law makes two arguments to the contrary, neither of which has merit. First, NNPC contends that although the First Fraudulent Transfer occurred in June 1994, its claims against Citibank did not accrue until May 1998, when it finally "received certain documents revealing Citibank's role." (Compl. P 67) However, under New York law, the statute of limitations for negligence and/or recklessness "begins to run when the injury first occurs." *Iacobelli Constr., Inc. v. County of Monroe, 32 F.3d 19, 27 (2d Cir. 1994)*; [*12] *see Triangle Underwriters, Inc. v. Honeywell, Inc., 604 F.2d 737, 744 (2d Cir. 1979)* ("A cause of action accrues when acts or omissions constituting negligence produce injury."); *Snyder v. Town Insulation, Inc., 81 N.Y.2d 429, 432-33, 599 N.Y.S.2d 515, 516-17, 615 N.E.2d 999 (1993)* ("Accrual occurs when the claim becomes enforceable, i.e., when all elements of the tort can be truthfully alleged in a complaint."). Indeed, "'the statutory period of limitations begins to run from the time when liability for wrong has arisen *even though the injured party may be ignorant of the existence of the wrong or injury.'*" *Evans v. Visual Tech. Inc., 953 F. Supp. 453, 456 (N.D.N.Y. 1997)* (emphasis added) (quoting *Schmidt v. Merchants Despatch Transp. Co., 270 N.Y. 287, 300, 200 N.E. 824 (1936)*); *see Kronos, Inc. v. AVX Corp., 81 N.Y.2d 90, 94, 595 N.Y.S.2d 931, 934, 612 N.E.2d 289 (1993)* (stating that the date of injury, "rather than the wrongful act of defendant or discovery of the injury by plaintiff, is the relevant date for marking accrual"). Thus, even accepting as true NNPC's assertion that it remained ignorant [*13] of Citibank's alleged complicity until 1998 -- an assertion that is hard to believe in light of the fact that NNPC wrote to Citibank as early as June 1, 1995 demanding repayment of the money (Compl. P 63) -- its argument fails.

Second, NNPC contends that the statute of limitations should be equitably tolled because "Citibank itself stymied NNPC's investigation of its role in the fraud for almost four years." (Pl. Mem. in Opp'n at 18) Under New York law, a defendant "may be estopped to plead the Statute of Limitations where [the] plaintiff was induced by fraud, misrepresentations or deception to refrain from filing a timely action." *Simcuski v. Saeli, 44 N.Y.2d 442, 448-49, 406 N.Y.S.2d 259, 262, 377 N.E.2d 713 (1978)*; *see also Farkas v. Farkas, 168 F.3d 638, 642 (2d Cir. 1999)*. 4 However, unless the defendant and the plaintiff were in a fiduciary relationship -- which Citibank and NNPC were not -- the doctrine of equitable estoppel does not apply without "actual misrepresentation" by the defendant. *Gleason v. Spota, 194 A.D.2d 764, 765, 599 N.Y.S.2d 297, 299* (2d Dep't 1993) (citing cases); *see General Stencils, Inc. v. Chiappa, 18 N.Y.2d 125, 128, 272 N.Y.S.2d 337, 340, 219 N.E.2d 169 (1966)* [*14] (noting that courts may bar assertion of a statute of limitations defense when the defendant's "affirmative wrongdoing" produced the plaintiff's delay). In the present case, NNPC alleges no such misrepresentation.

4 Strictly speaking, NNPC invokes the federal doctrine of equitable tolling. However, equitable tolling applies only to federal claims. *See, e.g., Department of Econ. Dev. v. Arthur Andersen & Co., 747 F. Supp. 922, 943 (S.D.N.Y. 1990)*. Equitable estoppel is the comparable doctrine under New York law.

Further, equitable estoppel does not apply when a plaintiff "possessed 'timely knowledge' sufficient to place him or her under a duty to make inquiry and ascertain all the relevant facts prior to expiration of the applicable Statute of Limitations." *Gleason, 194 A.D.2d at 765, 599 N.Y.S.2d at 298* (internal quotation marks and citation omitted). Here, whatever knowledge NNPC had on June 1, 1995 -- when it wrote to Citibank demanding repayment of the lost money (Compl. [*15] P 63) -- was more than sufficient to place it under such a duty. Accordingly, Citibank is not estopped to raise its statute of limitations defense. NNPC's first and third claims therefore are barred.

IV.

The principal dispute with respect to NNPC's second claim -- for violation of the NYUCC -- pertains to the relevant limitations period. Article 4A of the NYUCC, which governs wire transfers, *see* NYUCC § 4-A-102, off. cmt. (McKinney 1991), does not provide an express statute of limitations. Citibank argues, therefore, that the claim is governed by *CPLR § 214(2)*, which establishes a three-year limitations period for an action "to recover upon a liability . . . created or imposed by statute." NNPC counters that its claim has a common law antecedent and, thus, is not one "created or imposed by statute." *See, e.g., Aetna Life & Cas. Co. v. Nelson, 67 N.Y.2d 169, 174, 501 N.Y.S.2d 313, 315, 492 N.E.2d 386 (1986)* ("[*CPLR § 214(2)*] only governs liabilities which would not exist but for a statute. It does not apply to liabilities existing at common law which have been recognized or implemented by statute. Thus, if the [statute imposing liability] merely codifies [*16] or implements an existing liability, the three-year statute would be inapplicable." (citations omitted)). Instead, NNPC contends, the claim is governed by *CPLR § 213(1)*, which provides a six-year statute of limitations for any action "for which no limitation is specifically prescribed by law." Following the Second Circuit's recent decision in *Banca Commerciale Italiana v. Northern Trust International Banking Corp., 160 F.3d 90 (2d Cir. 1998)*, I agree with Citibank.

In *Banca Commerciale*, the plaintiff sued for return of funds involved in a wire transfer under NYUCC § 4-A-211(6), which provides in relevant part that if a receiving bank, "after accepting a payment order, agrees to cancellation or amendment of the order by the sender . . . , the sender . . . is liable to the bank for any loss and expenses . . . incurred by the bank as a result." *See Banca Commerciale, 160 F.3d at 93*. As here, the defendant argued that the claim was "created or imposed by statute," and therefore governed by the three-year statute of limitations in *CPLR § 214(2)*; the plaintiff contended that its claim had a common law antecedent and, thus, was governed by the six-year [*17] limitations period in *CPLR § 213(1). See id. at 93-94.*

The Second Circuit agreed with the defendant, concluding that imposition of liability under § 4-A-211(6) "does not require any showing of the elements required to establish common law fraud or unjust enrichment." *Id. at 94*. More significant for present purposes, the Court stated further:

> It is widely recognized that Article 4-A was enacted to correct the perceived inadequacy of "'attempting to define rights and obligations in funds transfers by general principles [of common law] or by analogy to rights and obligations in negotiable instruments law or the law of check collection.'" *Banque Worms* [v. *BankAmerica Int'l, 77 N.Y.2d 362, 369, 568 N.Y.S.2d 541, 545, 570 N.E.2d 189 (1991)* (quoting N.Y.U.C.C. § 4-A-102, cmt.)] . . . . The Official Comment to Article 4-A states that the drafters made "a deliberate decision . . . to write on a clean slate and to treat a funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised by this method of payment." N.Y.U.C.C. § 4-A-102, cmt. *This lends powerful support* [*18] *to the application of CPLR § 214(2) to claims brought under Article 4-A.*
>
> Finally, any lingering doubts we might have about imposing a three-year statute of limitations are removed by the New York Court of Appeals' observation in *Banque Worms* that "establishing *finality* in electronic fund wire transactions was considered a singularly important policy goal" to be served by Article 4- A. 77 N.Y.2d at 372, 568 N.Y.S.2d [at 547] (emphasis added). This goal is better served by requiring claimants to assert their claims concerning electronic funds transfers within a limitations period of three years rather than six years.

160 F.3d at 95 (emphasis added).

Although NNPC fails to identify the NYUCC provision on which its second claim is based, that provision plainly is not § 4-A-211(6). [5] Nevertheless, NNPC has not identified any particular common law antecedent to its claim. Further, the Second Circuit's reasoning in *Banca Commerciale* was not limited to § 4-A-211(6). To the contrary, the Court declared broadly that *CPLR § 214(2)* should be applied to all "claims brought under Article 4A." Accordingly, the three-year statute of limitations from *CPLR §* [*19] *214(2)* applies, and NNPC's second claim is barred for the same reasons that its first and third claims were barred.

5 NNPC's second claim states in full: "The defendants acted in a commercially unreasonable manner, in violation of the N.Y.U.C.C. and their duty to provide commercially reasonable security, in permitting and/or failing to prevent the fraud perpetrated by Vadra on NNPC." (Compl. P 72) NYUCC § 4-A-202, pertaining to "authorized and verified payment orders," utilizes the phrase "commercially reasonable method of providing security," although it is otherwise not apparent that NNPC's third claim is based on that provision.

V.

The parties disagree also about the statute of limitations applicable to NNPC's fifth claim, for commercial bad faith. Citibank argues that, in its "essence," the claim is for negligence, so the three-year limitations period from *CPLR § 214* applies. NNPC contends that the claim is "based upon fraud," *CPLR § 213(2)*, which would make the limitations period six years. Although [*20] New York courts have not addressed which limitations period applies to claims of commercial bad faith, either way NNPC's claim fails.

Under New York law, a claim for commercial bad faith "requires allegations of a scheme or acts of wrongdoing, together with allegations of the bank's actual knowledge of the scheme or wrongdoing that amounts to bad faith or allegations of complicity by bank principals in alleged confederation with the wrongdoers." *Peck v. Chase Manhattan Bank, N.A., 190 A.D.2d 547, 548-49, 593 N.Y.S.2d 509, 510-11* (1st Dep't 1993) (citing *Prudential-Bache Sec., Inc. v. Citibank, N.A., 73 N.Y.2d 263, 275-77, 539 N.Y.S.2d 699, 705-07, 536 N.E.2d 1118 (1989)*; *accord Williams v. Bank Leumi Trust Co., 1998 U.S. Dist. LEXIS 10636*, No. 96 Civ. 6695(LMM), 1998 WL 397887, at *9 (S.D.N.Y. July 15, 1998). Therefore, a bank is liable for commercial bad faith only where it "acts dishonestly -- where it has actual knowledge of facts and circumstances that amount to bad faith, thus itself becoming a participant in a fraudulent scheme." *Prudential-Bache, 73 N.Y.2d at 275, 539 N.Y.S.2d at 706.* Allegations charging a bank with a "lapse of wary [*21] vigilance," with "disregard of suspicious circumstances which might have well induced a prudent banker to investigate," even with "gross negligence," are insufficient to state a claim. *Getty Petroleum Corp. v. American Express Travel Related Servs. Co., 90 N.Y.2d 322, 331, 660 N.Y.S.2d 689, 694-95, 683 N.E.2d 311 (1997)*; *accord Prudential-Bache, 73 N.Y.2d at 276, 539 N.Y.S.2d at 706-07*; *Retail Shoe Health Comm'n v. Manufacturers Hanover Trust Co., 160 A.D.2d 47, 51, 558 N.Y.S.2d 949, 952* (1st Dep't 1990); *Calisch Assocs., Inc. v. Manufacturers Hanover Trust Co., 151 A.D.2d 446, 448, 542 N.Y.S.2d 644, 646* (1st Dep't 1989).

A commercial bad faith claim is subject to the requirement of *Fed. R. Civ. P. 9(b)* that the circumstances of an alleged fraud be alleged with particularity. *See Williams*, 1998 WL 397887, at *9. However, *Rule 9(b)* allows knowledge to be averred generally. Nevertheless, the Second Circuit has cautioned that this relaxation of the rule's specificity requirement "must not be mistaken for license to base claims of fraud on speculation and conclusory allegations." *Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1128 (2d Cir. 1994)* [*22] (internal quotation marks and citations omitted). Thus, a plaintiff is required "to allege facts that give rise to a strong inference of fraudulent intent." *Id.; accord Powers v. British Vita, P.L.C., 57 F.3d 176, 184 (2d Cir. 1995)* (stating that a plaintiff must "provide some minimal factual basis for conclusory allegations of scienter that give rise to a strong inference of fraudulent intent" (internal quotation marks and citation omitted)). This may be accomplished in either of two ways. First, the plaintiff may allege a motive for committing fraud and a clear opportunity for doing so. *See Powers, 57 F.3d at 184*; *Shields, 25 F.3d at 1128.* Second, "where motive is not apparent," the plaintiff may "identify[] circumstances indicating conscious behavior by the defendant, though the strength of the circumstantial allegations must be correspondingly greater." *Powers, 57 F.3d at 184* (quoting *Beck v. Manufacturers Hanover Trust Co., 820 F.2d 46, 50 (2d Cir. 1987)*, *overruled in part on other grounds, United States v. Indelicato, 865 F.2d 1370, 1383-84 (2d Cir. 1989)* (en banc) (citations [*23] omitted)).

In the present case, NNPC does not allege that Citibank had any motive to assist Vadra in perpetrating fraud. Instead, NNPC argues that the circumstances indicate "conscious behavior" by Citibank. Thus, for example, NNPC alleges that Citibank knowingly or recklessly disregarded several "badges of fraud," including irregularities in the opening of Vadra's accounts and in the documents he submitted to verify the wire transfers; that the assistant bank manager who approved Vadra's application for the First MPR Account in New

York had lived on the same street in Miami as one of Vadra's companies, and returned to that address after opening the account; and that the rejection by Towerbank of the $ 2 million wire transfer "alerted, or ought to have alerted, Citibank to the probability of fraud." (*Id. P 46*) However, none of these allegations, or any other allegation in NNPC's amended complaint, gives rise to an inference, let alone a "strong inference," that Citibank actually knew of, and participated in, Vadra's fraud. *See Retail Shoe Health Comm'n, 160 A.D.2d at 51, 558 N.Y.S.2d at 951* (stating that a claim for commercial bad faith can survive a motion to [*24] dismiss "only if the plaintiff has alleged facts inculpating the principals of the bank as *actual participants* in unlawful activity" (emphasis added)). In fact, NNPC's amended complaint leads inexorably to the exact opposite conclusion: that Citibank knew nothing about Vadra's fraud. (*See, e.g.*, Compl. P 58 ("Citibank NA *failed to conduct any further inquiry* into the [First MPR Account], or if it did conduct an inquiry, recklessly *failed to take notice* that $ 15.1 million had been received just two weeks earlier . . . ." (emphasis added)).

To be sure, NNPC might be correct in contending that there were several red flags that should have alerted Citibank to Vadra's fraud or at least prompted it to investigate, and that Citibank acted negligently in allowing Vadra to make additional wire transfers even after the Second Fraudulent Transfer was uncovered. However, allegations that a bank "disregarded . . . suspicious circumstances which might have well induced a prudent banker to investigate" do not suffice to state a claim for commercial bad faith. *Getty Petroleum, 90 N.Y.2d at 331, 660 N.Y.S.2d at 694-95*. Citibank's actions may well have been "lamentable, [*25] . . . even grossly negligent." *Id. at 332, 660 N.Y.S.2d at 695*. But the amended complaint falls short of alleging that Citibank "had actual knowledge of [the] wrongdoing or was somehow a participant in [the] fraudulent scheme." *Id.* Thus, NNPC's commercial bad faith claim fails.

VI.

NNPC's final claim -- technically, its fourth -- is for aiding and abetting Vadra's fraud. To state a claim for aiding and abetting under New York law, a plaintiff must allege: (1) the existence of an underlying fraud; (2) "knowledge" of this fraud on the part of the aider and abettor; and (3) "substantial assistance" by the aider and abettor in achievement of the fraud. *See Oei v. Citibank, N.A., 957 F. Supp. 492, 520 (S.D.N.Y. 1997)* (citing *Morin v. Trupin, 711 F. Supp. 97, 112 (S.D.N.Y. 1989))*; *cf. Kolbeck v. Lit America, Inc., 939 F. Supp. 240, 245-47 (S.D.N.Y. 1996)* (discussing the elements, under New York law, of aiding and abetting a breach of fiduciary duty), *aff'd without opinion, 152 F.3d 918 (2d Cir. 1998)*. Thus, as with a claim for commercial bad faith, liability for aiding and abetting "require[s] [*26] actual knowledge of the primary wrong" by the defendant. *Williams*, 1998 WL 397887, at *8; *accord Kolbeck, 939 F. Supp. at 246*; *cf. Wight v. BankAmerica Corp., 1999 U.S. Dist. LEXIS 5087*, No. 98 CIV. 2010(RPP), 1999 WL 199021, at *7 (S.D.N.Y. Apr. 8, 1999) (noting that the elements of commercial bad faith and aiding and abetting are "similar"). Accordingly, for the reasons stated in the previous section, NNPC's aiding and abetting claim fails.

Further, even if Citibank had known of Vadra's fraud, NNPC's aiding and abetting claim would still fail because Citibank did not provide "substantial assistance" in the achievement of the fraud, within the meaning of aiding and abetting jurisprudence. A defendant provides substantial assistance only if it "affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables [the fraud] to proceed." *Diduck v. Kaszycki & Sons Contractors, Inc., 974 F.2d 270, 284 (2d Cir. 1992)*; *see Kolbeck, 939 F. Supp. at 247*. The mere fact that participants in a fraudulent scheme "use accounts at [a bank] to perpetrate it, without more, does not rise to the level of substantial [*27] assistance necessary to state a claim for aiding and abetting liability." *Williams v. Bank Leumi Trust Co., 1997 U.S. Dist. LEXIS 7538*, *14, No. 96 CIV. 6695(LMM), 1997 WL 289865, at *5 (S.D.N.Y. May 30, 1997) (citing *DePinto v. Ashley Scott, Inc., 222 A.D.2d 288, 290, 635 N.Y.S.2d 215, 217* (1st Dep't 1995)).

* * *

For the reasons stated above, Citibank's motion to dismiss is granted, and plaintiff's amended complaint is dismissed with respect to Citibank.

SO ORDERED:

%

Dated: New York, New York

July 29, 1999

KLAUS RENNER, Plaintiff -against- CHASE MANHATTAN BANK, MICHELINO MORELLI, TOWNSEND FINANCIAL SERVICES CORP., TOWNSEND INVESTMENT FUND, LLC, GERALD TOWNSEND, and RABON WOLFORD, Defendants.

98 Civ. 926 (CSH)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

1999 U.S. Dist. LEXIS 978*; *Fed. Sec. L. Rep. (CCH) P90,438

February 2, 1999, Decided
February 3, 1999, Filed

DISPOSITION: [*1] Complaint dismissed against defendant Chase Manhattan Bank in its entirety. Leave to amend denied as to plaintiff's other claims against Chase.

COUNSEL: For KLAUS RENNER, plaintiff: John B. Harris, Paul Schectman, Stillman & Friedman, P.C., New York, NY.

For TOWNSEND FINANCIAL SERVICES CORP., TOWNSEND INVESTMENT FUND, LLC, GERALD TOWNSEND, defendants: Richard J. DeMarco, Jr., Reed, Smith, Shaw & McClay, L.L.P., New York, NY.

JUDGES: CHARLES S. HAIGHT, JR., U. S. S. D. J.

OPINION BY: CHARLES S. HAIGHT, JR.

OPINION

MEMORANDUM OPINION AND ORDER

HAIGHT, Senior District Judge:

Plaintiff Klaus Renner, according to the allegations of his complaint, is a citizen and resident of Switzerland, an engineer, and the inventor of a snow-removing device. Renner alleges that during the course of his efforts to fund the manufacture and sale of that device, the defendants defrauded him out of $ 3 million. As against all or certain defendants, his complaint alleges claims under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), *18 U.S.C. §§ 1961 et seq.*; claims under Section 17(a) of the Securities Exchange Act of 1933, *15 U.S.C. § 77q(a)*, *Section 10(b)* of the Securities Exchange [*2] Act of 1934, *15 U.S.C. § 78j(b)* and *Rule 10b-5*, *17 C.F.R. § 240.10b-5* promulgated thereunder; and common law claims for fraud, negligence, breach of contract, breach of fiduciary duty, and breach of the covenant of good faith. Subject matter jurisdiction in this Court does not depend upon the viability of plaintiff's federal claims, since it appears that complete diversity of citizenship exists between the parties.

The first two named defendants are the Chase Manhattan Bank ("Chase") and Michelino Morelli, identified in the complaint at P 8 as at the relevant times "a senior vice-president of Chase and the manager of its Mount Vernon, New York office." [1] Chase now moves for an order dismissing the complaint as to it [2] pursuant to *Rule 12(b)(6), Fed. R. Civ. P.*, for failure to state a claim upon which relief may be granted; and to dismiss the fraud-based claims pursuant to *Rule 9(b)* for failure to plead fraud with the requisite particularity.

1 P 16 of the complaint refers to "Chase's Mount

Vernon *branch*," a word that appears to be the more accurate term in banking parlance.

2 The Chase Legal Department, counsel of record in the case, does not represent Morelli.

[*3] I. *Background*

Plaintiff alleges the following facts. [3] In or about December 1994, an international confidence man named Dr. Gustav Susse, not a party to this action, opened an account at Chase through Morelli on behalf of Hampstead Trust Ltd., an entity he controlled with defendant Rabon Wolford. Wolford, Morelli, and Susse all were members of a sham New York "Order" of a group called the "Knights of Malta," which purported to enjoy close connections with the Vatican and to perform "good deeds" around the world, but which actually served as a front for complicated fraudulent transactions. As a result of its concern with certain questionable practices, Chase closed Hampstead's account within months after it was opened. Through the assistance of Morelli, Susse then arranged to transact business at Chase through an entity called PTI and through defendant Townsend Financial, which also had set up its accounts at Chase's Mount Vernon branch. [4] This arrangement permitted Susse and Hampstead to continue their schemes. In or around November 1995, Hampstead swindled a "Belgian group" out of $ 5 million, promising to fund a purported $ 25 million documentary letter of credit through [*4] Chase, but instead diverting the funds to Wolford, the Knights of Malta, Susse's brother, and Townsend.

3 For the purposes of Chase's *Rule 12(b)(6)* motion, I must take "the well-pleaded factual allegations in the complaint as true." *Papasan v. Allain, 478 U.S. 265, 283, 92 L. Ed. 2d 209, 106 S. Ct. 2932 (1986)*. The requirement does not apply to allegations that are incomprehensibly vague or entirely conclusory. See additional cases cited *infra*.

4 The complaint at times refers to this account as the "Townsend Financial" account (referring to defendant Townsend Financial Services Corp.) and at other times as the "Townsend Fund" account (referring to defendant Townsend Investment Fund, LLC). Similarly, the complaint also refers at times just to "Townsend," leaving it unclear whether plaintiff means to refer to Townsend Financial, the Townsend Fund, or individual defendant Gerald Townsend. Accordingly, for the purpose of clarity, I will simply use "Townsend" to refer to any and all of the Townsend defendants.

[*5] In early February 1996, Renner was introduced to Hampstead as a result of his efforts to raise the necessary funds to manufacture and sell his snow-removing invention. Specifically, Hampstead, through Susse and another non-party director, Alexander Penly, represented to Renner that Hampstead engaged in transactions in "medium term bank debentures" with leading banks. Susse and Penly assured him that Hampstead would invest the money Renner needed to manufacture his invention by using its connections with these major banks to engage in trades of these debentures, guaranteeing an annual return rate of 120%. They advised Renner that Hampstead had purchased Townsend, which they said was its own securities house in the United States. They did not inform him that Townsend only had been established on January 22, 1996, presumably to facilitate the diversion of customer funds.

Penly and Susse stressed to Renner that the funds which he invested would be kept in a sub-account at Chase, and that Hampstead had worked with Morelli for several years on transactions with other investors. He was advised that his funds were secure because no money would leave the Chase account unless a bank note or [*6] treasury bill of higher value was substituted as collateral. They further emphasized Hampstead's and Morelli's connections with the Knights of Malta and their investment of millions of dollars of Vatican money in humanitarian projects.

On February 8, 1996, Renner signed a contract with Hampstead in which he agreed to invest $ 3 million with it, which funds were then transferred to Morelli's attention at Chase and specifically designated for the promised Renner subaccount to Townsend's account.

On or about February 12 and 13, 1996, before the Renner money even had arrived at Chase, Morelli and Townsend specifically discussed that Renner was a client of Hampstead; that Hampstead intended to use Renner's money for a purpose not permitted under Renner's agreement with Hampstead; that Renner believed that his money was to be held in a sub-account and that he expected a custody receipt confirmation from Chase; that the defendants wished to deal only with Morelli; that Morelli's personal involvement was important to defendants; and that Chase, Morelli, and Townsend "could be held accountable" in the event of a problem.

On or about February 13, 1996, Chase received Renner's money and issued [*7] two Wire Transfer Advances to Townsend, confirming receipt. Morelli confirmed on Chase letterhead that Renner's money had been credited to the Townsend account and that the funds "were received from Swiss Bank Corp., New York via Fed by Order of Klaus Renner." Plaintiff does not state how, where, or to whom Morelli sent this confirmation. On or about February 20, 1996, with Morelli silently on the line, two Chase officers told Townsend by telephone that they were concerned about Townsend's proposed transaction with investor money and asked to see authorization for its use of investor funds. Three days later, Townsend wrote directly to Morelli instructing him to wire almost all of Renner's money to Susse's common-law wife in Monaco, which instruction Chase duly followed. Shortly thereafter, upon Townsend's request, Chase wired the balance of the money to Penly's Geneva bank account. Thus, although questions had been raised at Chase as to the Hampstead and Townsend entities, the funds were transferred and Renner was told neither of the activity in the accounts nor of Chase's concerns.

On or about April 9, 1996, Morelli wrote to Townsend to advise it that Chase would be closing the account [*8] as a result of its concerns with Townsend's practices. Susse then informed plaintiff that the Townsend account had been closed; he also falsely told him that the Securities and Exchange Commission had frozen the Townsend funds, but that he intended to continue with the investment program. Having heard nothing further, plaintiff wrote to Susse on June 27, 1996, with a copy to Morelli, confirming Susse's repeated promise to return his investment and questioning why it could not be returned immediately. Plaintiff's agents also contacted Morelli by telephone, but he disclaimed any knowledge of Renner's funds.

Over a year and a half after plaintiff failed to obtain the return of his money, he brought the present action.

Renner's complaint alleges eleven claims for relief, as follows:

Claim 1 (against all defendants): Substantive violation of the RICO statute, *18 U.S.C. § 1962(c)*.

Claim 2 (against all defendants): RICO conspiracy, in violation of *18 U.S.C. § 1962(d)*.

Claim 3 (against all defendants): Securities fraud, in violation of the 1933 and 1934 Acts and accompanying regulations, in connection with the conspirators' promise to trade with Renner's funds in "securities," [*9] namely, the "medium term bank debentures."

Claim 4 (against all defendants): Common law fraud.

Claim 5 (against Chase only): Negligence, in respect of its failure to "safeguard" Renner's funds on deposit with Chase.

Claim 6 (against Chase only): Breach of contractual duty to "make sure that Townsend/Hampstead was using the Renner money for authorized purposes."

Claim 7 (against Chase and Morelli only): Breach of "a covenant of good faith and fair dealing inherent in every contract."

Claim 8 (against Gerald Townsend and the two Townsend corporate entities only): Breach of contract.

Claim 9 (against Townsend defendants only): Breach of the covenant of good faith and fair dealing.

Claim 10 (against Townsend defendants only): Breach of fiduciary duty.

Claim 11 (against Townsend defendants only): Negligence.

Chase's motion under *Rule 12(b)(6)* and *Rule 9(b)* challenges only the claims plaintiff asserts against Chase. No other defendant has made a motion at this time or sought to adopt that of Chase.

II. *Standard of Review*

A. *Rule 12(b)(6)*

On a motion to dismiss under *Rule 12(b)(6)*, the trial court's function "is merely to assess the [*10] legal feasibility of the complaint, not to assay the weight of the evidence which might be offered in support thereof." *Geisler v. Petrocelli, 616 F.2d 636, 639 (2d Cir. 1980)*; *see Ricciuti v. N.Y.C. Transit Authority, 941 F.2d 119, 124 (2d Cir. 1991)*. "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Scheuer* *v. Rhodes, 416 U.S. 232, 236, 40 L. Ed. 2d 90, 94 S. Ct. 1683 (1974)*. The district court should grant a *Rule 12(b)(6)* motion "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Hishon v. King & Spalding, 467 U.S. 69, 73, 81 L. Ed. 2d 59, 104 S. Ct. 2229 (1984)* (citing *Conley v. Gibson, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957))*. Except in certain circumstances, consideration of a motion to dismiss the complaint must focus on the allegations contained on the face of the complaint. *See Cortec Industries, Inc. v. Sum Holding, L.P., 949 F.2d 42, 47 (2d Cir. 1991)*; *Kramer v. Time Warner, Inc., 937 F.2d 767, 773 (2d Cir. 1991)*. On a motion to dismiss, a district court must [*11] accept plaintiff's well-pleaded factual allegations as true, *Papasan v. Allain, 478 U.S. 265, 283, 92 L. Ed. 2d 209, 106 S. Ct. 2932 (1986)*, and the allegations must be "construed favorably to the plaintiff." *LaBounty v. Adler, 933 F.2d 121, 123 (2d Cir. 1991)*.

B. *Rule 9(b)*

In addition, *Rule 9(b)* requires that in all allegations of fraud, including actions under § 10(b) and *Rule 10b-5*, the circumstances constituting the fraud must be stated with particularity. *See Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1127-28 (2d Cir. 1994)*. The pleading must be particular enough to satisfy the three goals of *Rule 9(b)*: (1) to provide a defendant with fair notice of the claims against it; (2) to protect a defendant from harm to its reputation or goodwill by unfounded allegations of fraud; and (3) to reduce the number of strike suits. *See DiVittorio v. Equidyne Extractive Indus., Inc., 822 F.2d 1242, 1247 (2d Cir. 1987)*.

"Conclusory allegations that defendant's conduct was fraudulent or deceptive are not enough." *Decker v. Massey-Ferguson, Ltd., 681 F.2d 111, 114 (2d Cir. 1982)*. A complaint alleging fraud must (1) specify the statements, oral or written, that [*12] the plaintiff contends were fraudulent, either as misrepresentations or containing fraudulent omissions; (2) identify the speaker or the writer; state where, when, and to whom the statements were made; and (3) explain why the statements were fraudulent. *Acito v. Imcera Group, Inc., 47 F.3d 47, 51 (2d Cir. 1995)*. Thus *Rule 9(b)* requires a plaintiff to identify which defendant caused each allegedly fraudulent communication to be spoken, written, wired or mailed, and to whom; when the communication was made; and how it furthered the fraudulent scheme. *McLaughlin v. Anderson, 962 F.2d 187, 191 (2d Cir. 1992)*. In cases with multiple defendants, Rule (9b) requires that the complaint allege facts specifying each defendant's contribution to the fraud. Although the rule does not require a plaintiff to allege scienter with great specificity, it does require plaintiff to plead a factual basis which gives rise to a strong inference of fraudulent intent. *Wexner v. First Manhattan Co., 902 F.2d 169, 172 (2d Cir. 1990)*. "Where pleading is permitted on information and belief, a complaint must adduce specific facts supporting a strong inference of fraud or it will not satisfy even a relaxed [*13] pleading standard." *Id. Rule 9(b)*'s particularity requirements have "even greater urgency" in civil RICO actions. *Morin v. Trupin, 778 F. Supp. 711, 716 (S.D.N.Y. 1991)*.

III. *Discussion*

A. *The RICO Claim*

The Private Securities Litigation Reform Act

In his complaint, plaintiff alleged violations both of RICO and of the securities laws. Chase, moving to dismiss the RICO claim against it, argues that plaintiff's RICO claim is barred under the recently enacted Private Securities Litigation Reform Act ("Reform Act"), Pub. L. No. 104-67, 109 Stat. 737 (1995).

The Reform Act amends the RICO statute, *18 U.S.C. § 1964(c)*, to provide that "no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of *section 1962*." The Reform Act's legislative history shows that Congress intended to eliminate securities fraud as a RICO predicate offense, along with other offenses, such as mail or wire fraud, "if such offenses are based on conduct that would have been actionable as securities fraud." Senate Report No. 104-98, 2 U.S.C.C.A.N. 679, 698 (1995). Case law interpreting the statute has established [*14] that "where allegations of mail and wire fraud derive from conduct otherwise actionable as securities fraud, no RICO claim will lie." *ABF Capital Management v. Askin Capital Management, L.P., 957 F. Supp. 1308, 1319 (S.D.N.Y. 1997)*.

Thus the preclusive effect of the Reform Act does not depend upon whether a plaintiff has specifically alleged securities fraud as a predicate act for his RICO claims. The question turns upon the defendant's conduct, as alleged in the complaint. If that conduct "would have been actionable as securities fraud," the Reform Act bars a RICO claim, even if the pleader eschews reference to the securities laws in describing the predicate acts and dresses his claim in other clothing (as the Reform Act undoubtedly will inspire RICO-minded pleaders to do). The Senate Report, cited *supra*, makes Congress's purpose plain enough:

> The Committee intends this amendment to eliminate securities fraud as a predicate act of racketeering in a civil RICO action. In addition, a plaintiff may not plead other specified offenses, such as mail or wire fraud, as predicate acts of racketeering under civil RICO if such offenses are based on conduct that would have been [*15] actionable as securities fraud.

In the case at bar, plaintiff alleges as predicate acts mail fraud, wire fraud, money laundering, and Travel Act violations, Complaint at P 56, a list he repeats in his RICO Statement at P 5a. There is no reference to securities fraud as a predicate act. Nonetheless, the pleading implicates the Reform Act, because the Third Claim for Relief, captioned "Securities Fraud," alleges that the "medium term bank debentures" the conspirators promised to trade with Renner's funds are "securities" within the 1933 and 1934 Acts. Complaint, P 66. The Townsend defendants are identified as the architects and principal actors in the fraudulent scheme, *id., PP 68, 69.* Paragraph 70 alleges: "Chase, Morelli and Wolford, knowing that such representations were false, *aided and abetted the securities fraud* by participating in inducing Renner to enter the transaction and then diverting the money to the conspirators." (emphasis added).

Implicitly acknowledging the preclusive effect of the Reform Act, and seeking to preserve his RICO claim, plaintiff argues in his opposing papers that the scheme he alleges "is not 'core' securities fraud that Congress aimed to [*16] prohibit from RICO," brief at 29, and then goes so far as to purport to "withdraw[] the securities claim in order to avoid unnecessary litigation on collateral issues," *id. at 48 n.11.*

Those defensive maneuvers will not suffice to salvage a RICO claim if Chase's alleged conduct, whatever the label affixed to it, is "actionable as securities fraud," a question whose answer depends upon the substantive law of securities fraud.

A threshold question arises as to whether "securities" are involved at all. The complaint alleges fraudulent promises to trade in "medium term bank debentures." Such instruments certainly sound like "securities," particularly given the broad definitions of that word in the 1933 Act, *15 U.S.C. § 77b(a)(1)* ("The term 'security' means any . . . debenture, . . . or, in general, any interest or instrument commonly known as a 'security'"); and the 1934 Act, *15 U.S.C. § 78c(a)(10)* (same).

However, the case is complicated by the fact that, on plaintiff's theory, the bank debentures did not exist and never had. In a criminal case, *United States v. Jones, 648 F. Supp. 225, 231-32 (S.D.N.Y. 1986)*, this Court dismissed securities fraud charges from an indictment [*17] involving a hoary "pigeon drop" scam because "no actual securities existed in this case. No genuine transactions in securities occurred or were contemplated. References to securities simply formed a part of the talker's patter," *aff'd in part, rev'd in part on other grounds, 839 F.2d 900 (2d Cir. 1988).* [5] *Cf. United States v. Schlei, 122 F.3d 944, 972-73 (11th Cir. 1997)* ("The fraud provisions are not defeated by the fact that a security purportedly traded is nonexistent or fictitious . . . A contrary result would encourage rather than curb fraud."), *cert. denied, 140 L. Ed. 2d 674, 118 S. Ct. 1523 (1998).*

5 The government did not cross-appeal from the trial court's dismissal of the securities charges in *Jones*, and so the Second Circuit had no occasion to consider the question.

But I need not pursue this question further because the application of the Reform Act turns upon whether Chase's alleged conduct is "actionable" under the securities laws; and, assuming without deciding that the case [*18] falls within those laws, Chase's conduct is not actionable under them.

As noted, the complaint asserts that Chase, Morelli, and Wolford "aided and abetted" the fraudulent acts of others. [6] That allegation is legally insufficient because secondary liability for aiding and abetting is not a valid basis for a securities fraud claim.

6 Morelli is the only Chase employee named in the complaint. Chase's vicarious liability for

Morelli's acts is considered *infra*.

The Supreme Court's decision in *Central Bank v. First Interstate Bank, 511 U.S. 164, 128 L. Ed. 2d 119, 114 S. Ct. 1439 (1994)* holds that a claim under *§ 10(b)* must allege that a defendant has personally and directly committed fraud. "The statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act . . . The proscription does not include giving aid to a person who commits a manipulative or deceptive act. We cannot amend the statute to create liability for acts that are not themselves manipulative [*19] or deceptive within the meaning of the statute." *511 U.S. at 177-78*. Under *Central Bank*, secondary liability for "aiding and abetting" no longer is a basis for a *§ 10(b)* claim. *Id. at 191* ("Because the text of *§ 10(b)* does not prohibit aiding and abetting, we hold that a private plaintiff may not maintain an aiding and abetting suit under *§ 10(b)*."). *See also Shapiro v. Cantor, 123 F.3d 717, 721 (2d Cir. 1997)* (affirming dismissal and holding that an "assertion of aiding and abetting does not support a claim under *§ 10(b)* as interpreted by the *Central Bank* Court"); *In re JWP Inc. Sec. Litigation, 928 F. Supp. 1239, 1255-56 (S.D.N.Y. 1996)* (dismissing misrepresentation claim against audit committee defendants where those defendants did not actually make the alleged misrepresentations).

Here, plaintiff does not allege that defendants Chase, Morelli, or Wolford made any material misstatements or omissions in connection with the purchase or sale of any securities; rather, plaintiff alleges that they merely "aided or abetted" the Townsend defendants and Susse in carrying out the securities fraud. *Central Bank* instructs us that Chase, Morelli, and Wolford may [*20] not be held liable for such secondary actions. Accordingly, plaintiff's claim under the securities laws would fail in any event as against these defendants.

Because plaintiff's claim would not have been "actionable" against Chase under the securities law, the mere fact that plaintiff baselessly asserted it in his complaint would not bar a RICO claim against under the Reform Act. However, plaintiff's RICO claim fails on other grounds.

Pattern of Continuous Activity

To state a claim under RICO, a plaintiff must allege (1) a violation of the RICO statute, *18 U.S.C. § 1962*; (2) an injury to business or property; and (3) that the injury was caused by the violation of *§ 1962*. *Pinnacle Consultants, Ltd. v. Leucadia Nat'l Corp., 101 F.3d 900, 903-04 (2d Cir. 1996)*. *Section 1962* prohibits: a) the use of income "derived... from a pattern of racketeering activity" to acquire an interest in, establish, or operate an enterprise engaged in or whose activities affect interstate commerce; b) the acquisition of any interest in or control of such an enterprise "through a pattern of racketeering activity"; c) the conduct or participation in the conduct of such an enterprise's affairs "through [*21] a pattern of racketeering activity"; and (d) conspiring to do any of the above. *18 U.S.C. § 1962*; *see also GICC Capital Corp. v. Technology Finance Group, Inc., 67 F.3d 463, 465 (2d Cir. 1995), cert. denied, 518 U.S. 1017, 135 L. Ed. 2d 1067, 116 S. Ct. 2547 (1996)*. The existence of a "pattern of racketeering activity" is therefore a requirement under any prong of *§ 1962*. *See GICC Capital Corp., 67 F.3d at 465*. [7] To establish such a pattern, "a plaintiff must plead at least two predicate acts, show that the acts are related and that they amount to, or pose a threat of, continuing criminal activity." *Id.; see also H.J. Inc. v. Northwestern Bell Telephone Co., 492 U.S. 229, 240, 106 L. Ed. 2d 195, 109 S. Ct. 2893 (1989)* ("To establish a RICO pattern it must also be shown that the predicates themselves amount to, or that they otherwise constitute a threat of, continuing racketeering activity.").

7 Plaintiff at bar alleges violations of *§§ 1962(c)* and *1962(d)*.

In *H.J. Inc.*, the Supreme Court [*22] parsed out the two components of the continuity requirement: "'Continuity' is both a closed- and open-ended concept, referring either to a closed period of repeated conduct, or to past conduct that by its nature projects into the future with a threat of repetition." *492 U.S. at 241-42*. *See also GICC Capital Corp., 67 F.3d at 466* ("a plaintiff in a RICO action must allege either an 'open-ended' pattern of racketeering activity (i.e., past criminal conduct coupled with a threat of future criminal conduct) or a 'closed-ended' pattern of racketeering activity (i.e., past criminal conduct 'extending over a substantial period of time')"); *Batra v. Pace University, 1998 U.S. Dist. LEXIS 15269, 1998 WL 684621*, at *5 (S.D.N.Y. 1998). Plaintiff asserts that he has pleaded both an open-ended and a close-ended pattern of criminal activity. "Racketeering activity includes the commission of specified state-law crimes, conduct indictable under various provisions within Title 18 of the United States Code, and certain other federal offenses." *Pinnacle Consultants, 101 F.3d* *at 904* (citing *18 U.S.C. § 1961(1)*).

To determine whether a threat of "open-ended" continuity exists, a court must examine the nature of either: [*23] (1) the predicate acts alleged; or (2) the enterprise at whose behest the predicate acts were performed. *Schlaifer Nance & Co. v. Estate of Warhol, 119 F.3d 91, 97 (2d Cir. 1997)*. In this case, the moving defendants are not engaged in inherently illegal enterprises. *See Giannacopolous v. Credit Suisse, 965 F. Supp. 549, 552 (S.D.N.Y. 1997)*; *Shamis v. Ambassador Factors Corp., 1997 U.S. Dist. LEXIS 12241*, *43, 1997 WL 473577, at *13-14 (S.D.N.Y. 1997). Here, as in *Shamis*, where "all the specific acts of racketeering . . . arose out of the master agreement" between the parties, "the nature of the predicate acts and the enterprise alone do not support a finding of an 'open-ended' pattern of racketeering activity," and the Court must then "look to more general factors to determine whether the threat of continuing activity exists." *1997 U.S. Dist. LEXIS 12241*, *40 (citations omitted). However, where, as here, the alleged scheme had as its goal the fraudulent one-time inducement of one victim to part with his money, the allegations are insufficient to state a claim of open-ended continuity. *See Schlaifer Nance, 119 F.3d at 97-98* ("the allegedly fraudulent acts, although they spanned over three years, were not continuous [*24] for RICO purposes because they were acts related to a single contract and single scheme to defraud"); *China Trust Bank of New York v. Standard Chartered Bank, PLC, 981 F. Supp. 282, 287 (S.D.N.Y. 1997)* ("The Court cannot infer a threat of repeated fraud from the alleged single scheme"). There is no threat that the fraud alleged in the complaint will continue. Renner, understandably enough, is having nothing further to do with Susse and his confederates, Chase has closed the Townsend account, and Morelli and Wolford seem to have disappeared; they have not been served with process, and plaintiff's counsel noted in the Clerk's Cover Sheet that he has not been able to locate those defendants by the exercise of diligence.

In these circumstances, plaintiff cannot demonstrate RICO "open-ended" continuity.

A party demonstrates "close-ended" continuity by proving a series of related predicate acts extending over a substantial period of time. *H.J. Inc., 492 U.S. at 242.* "Predicate acts extending over a few weeks or months and threatening no future criminal conduct do not satisfy this requirement: Congress was concerned in RICO with long-term criminal conduct." *Id.*

To determine [*25] whether closed-ended continuity exists, courts consider a number of factors, including: "the length of time over which the alleged predicate acts took place, the number and variety of acts, the number of participants, the number of victims, and the presence of separate schemes." *GICC, 67 F.3d at 467* (citations omitted); *see also Skylon Corp. v. Guilford Mills, Inc., 1997 U.S. Dist. LEXIS 2104*, *15, 1997 WL 88894, at *5 (S.D.N.Y. 1997). Plaintiff has failed to allege a close-ended pattern of RICO activity under the foregoing factors.

Length of Time:

All of the racketeering acts that victimized plaintiff, as alleged in the complaint, occurred in February and March of 1996. A two-month period of time is insufficient for the purposes of the RICO statute. *See H.J., Inc., 492 U.S. at 242* ("predicate acts extending over a few weeks or months . . . do not satisfy [the continuity] requirement"). In *GICC*, the Second Circuit concluded that closed-ended continuity is not satisfied where the RICO pattern alleges a one-victim scheme to defraud over a period of less than two years. *67 F.3d at 463, 467*; *see also North American Development, Inc, v. Shahbazi, 1996 U.S. Dist. LEXIS 7784, 1996 WL 306538*, at *6 (S.D.N.Y. 1996) (collecting [*26] cases).

Number, Nature, and Variety of Predicate Acts:

Where the predicate acts alleged are not inherently unlawful acts, such as murder or obstruction of justice, courts normally require a longer span of time to satisfy the continuity requirement. *See, e.g., Skylon Corp.*, 1997 WL 88894, at *6. Accordingly, none of these factors are of any assistance to plaintiff, who alleges several predicate acts (none of them inherently unlawful) typical of a garden-variety fraud.

Number of Participants:

This factor similarly is unhelpful to plaintiff, as he does not allege a far-reaching scheme perpetrated by a host of conspirators. Instead, he implicates Chase, an officer of Chase, an officer of Hampstead, and the various Townsend defendants, who may be considered as one entity. *See R.C.M. Exec. Gallery Corp. v. Rols Capital Co., 901 F. Supp. 630, 640-41 (S.D.N.Y. 1995).*

Presence of Separate Schemes:

Courts typically dismiss RICO claims, such as the one at bar, based upon the limited nature of the scheme alleged. *See Skylon Corp.*, 1997 WL 88894, at *7 (collecting cases). A court may consider allegations of a "complex, multi-faceted conspiracy," in determining whether [*27] the complaint satisfies the continuity requirement, *GICC, 67 F.3d at 468-69*; however, where, as here, the allegedly criminal acts were "narrowly directed toward a single fraudulent end with a limited goal," the claim typically will fail. *Skylon Corp.*, 1997 WL 88894, at *7 (internal citation omitted). The simple fraud alleged here, fraudulently bilking plaintiff and diverting his money, simply does not constitute the long-term criminal conduct prohibited under RICO.

Plaintiff attempts to demonstrate that the scheme to defraud him was part of a larger venture that stretched from late 1994 until August 1996. In support of that effort, plaintiff alleges that Hampstead opened a Chase account in December 1994, which Chase closed several months later when Hampstead "presented documentary letters of credit that were fraudulent," Complaint, PP 13-15; and that, in or around November 1995, Hampstead "induced a Belgian group to provide it with $ 5 million so that Hampstead would fund a purported $ 25 million documentary letter of credit through Chase," which Hampstead then diverted to various co-conspirators, *id.*, P 17.

Plaintiff may intend by these allegations of other fraudulent [*28] acts to demonstrate either open-ended continuity (by showing the threat of ongoing fraud by the enterprise) or closed-end continuity (by enlarging the relevant period of time). But these allegations are insufficient to make either showing.

First, these other acts, to the extent that they can be understood on the basis of plaintiff's barebones allegations, are unrelated in purpose or methodology to the conduct that injured plaintiff. That is significant because "acts . . . [that] are unrelated to the predicate acts which allegedly injured plaintiff . . . cannot be considered as part of the activity to extend the scope of the pattern." *Shamis*, 1997 WL 473577 at *15 (citation and internal quotations omitted) *See Burdick v. American Express Co., 865 F.2d 527, 529 (2d Cir. 1989)* (where plaintiff employee sued defendant bank employer for termination as a result of his complaints about fraud on customers, plaintiff could not assert RICO violation because harm to defendant's customers resulting from defendant's fraudulent practices was "too remotely related" to predicate acts alleged); *Vild v. Visconsi, 956 F.2d 560, 566 (6th Cir. 1992)* (finding different types of conduct alleged [*29] to be unrelated); *Committee to Defend the United States Constitution v. Moon, 776 F. Supp. 568, 572 (D.D.C. 1991)*; *Shamis*, 1997 WL 473577 at *15.

Second, these allegations of other fraudulent acts fail entirely to comply with the pleading requirements of *Rule 9(b)*, discussed *supra*. As there noted, the law of this circuit requires that allegations of fraud specify the statements made that were false or misleading, give particulars as to the respect in which it is contended that the statements were fraudulent, and state the time and place the statements were made and the identity of the persons who made them. These pleading requirements apply with full force to the allegations in a RICO complaint intended to demonstrate continuity, *Shamis*, 1997 WL 88894, at *15; and the allegations in the case at bar are wholly insufficient to support an inference that the defendants engaged in ongoing and repeated racketeering activity over a term of years, or that they are likely to do so in the future.

For the foregoing reasons, plaintiff has failed to allege a viable RICO claim against any defendant. But there is an additional reason why the RICO claim fails as against Chase.

[*30] The only Chase employee named in the complaint is Morelli, the seemingly faithless manager of Chase's Mount Vernon branch (if plaintiff's descriptions of his conduct are accurate). This Court and other district courts in the circuit have held that "corporations may not be held vicariously liable for the actions of their employees in violation of the RICO statute where the plaintiff has not alleged any facts which portray the company as an active perpetrator of the fraud or a central figure in the criminal scheme." *Qatar National Navigation & Transportation Co., Ltd. v. Citibank, N.A., 1992 U.S. Dist. LEXIS 14784*, *19, 1992 WL 276565, at *7 (S.D.N.Y. 1992) (citations and internal quotation marks omitted); *see also Schmidt v. Fleet Bank, 1998 U.S. Dist. LEXIS 1041*, *40, 1998 WL 47827, at *12 (S.D.N.Y. 1998) ("Although the Second Circuit has not addressed the issue, district courts within this circuit have been reluctant to impose vicarious liability under RICO"; *held*, defendant Fleet Bank not liable under RICO for acts of its vice-president and branch manager, one Patnoi,

where "the complaints do not sufficiently allege that Fleet was a central figure in the criminal scheme or that it benefitted from Patnoi's alleged participation in the [*31] scheme.").

In the case at bar, plaintiff's complaint is entirely lacking in well-pleaded factual allegations that Chase (as opposed to its branch manager Morelli) was a central figure in the scheme or stood to benefit from it. On the contrary: plaintiff's allegations in P 31 of the Complaint that two unidentified Chase officers "told Townsend by phone on February 20, 1996 that they were concerned about the Townsend Fund's proposed transactions with investor money" and demanded to see an authorization "that the money in the Townsend account could be used in that way" convincingly depict Chase as an honest bank, trying to prevent, not promote, a possibly fraudulent transfer of funds by Townsend -- an effort that Morelli (silently listening to the conversation) was able to circumvent three days later. Nor is there, or could there logically be, any allegation in the complaint that Chase as an institution stood to benefit from the scheme. [8]

8 Notwithstanding the failure of the complaint to allege any benefit to Chase, plaintiff's brief asks the reader to infer it, apparently on the theory that Chase would receive "commissions and fees" from the fraudulent transaction. Brief at 40. Quite apart from the requirement that allegations of fact should appear in the pleadings, not briefs of counsel, this requested inference makes no sense, since the Renner funds, after a brief pause in the Townsend account at Chase, were dispatched to the fraudsmen in Monaco. It is fanciful to infer that Chase profited so much from this particular transaction that it was willing to become a partner in fraud to effect it.

[*32] For the foregoing reasons, the RICO claims against Chase will be dismissed. [9]

9 I have not found it necessary to discuss all of the grounds which Chase argues for dismissing the RICO claims against it.

B. *Securities Fraud*:

Plaintiff's claim for securities fraud is not viable, for the reasons previously stated, *supra*.

* * *

Plaintiff also alleges several common law claims. Because one of the bases for this Court's jurisdiction is diversity of citizenship under *28 U.S.C. § 1332*, I must address each in turn.

C. *Common Law Fraud*

The complaint alleges at P 72 that "Susse and Penly, aided and abetted by Chase, Morelli, Townsend, Townsend Financial and Townsend Fund, made knowing and intentional misrepresentations to Renner . . .".

Thus plaintiff's claim against Chase is limited to one of aiding and abetting the fraud of others. That is understandable, since the first of four elements that a plaintiff must prove by clear and convincing evidence to sustain a claim of fraud is that the defendant [*33] in question made a material false representation to the plaintiff. [10] *See Banque Arabe v. Maryland National Bank, 57 F.3d 146, 153 (2d Cir. 1995)*. The complaint contains no allegation that Morelli or anyone else at Chase made any representation to Renner which induced Renner to hand over his money to others. The only communication from anyone at Chase to plaintiff referred to in the complaint appears at P 50, where it is alleged that in a telephone conversation on June 27, 1996, between Felix Renner, plaintiff's brother, and Morelli, "Morelli disclaimed knowledge about the Renner transaction and claimed to know nothing about Townsend, Hampstead or Susse." Even if that disclaimer was false, it did not induce any action on the part of plaintiff, nor did it cause him to suffer damage; according to the complaint, his money was by that time long gone. [11]

10 The other three elements are that the defendant intended to defraud the plaintiff thereby; that the plaintiff reasonably relied upon the representation; and that the plaintiff suffered damage as the result of such reliance. *Banque Arabe, 57 F.3d at 153*. 1995).

[*34]

11 In dealing with communications between Morelli and plaintiff, I do not lose sight of the allegation in P 29 of the complaint that on or about February 15, 1996, "Morelli confirmed on Chase Mount Vernon branch letterhead that the Renner money had been credited to the Townsend Fund account and that the funds 'were received from Swiss Bank Corp., New York via Fed by Order of Klaus Renner.'" Plaintiff does not allege

that this letter was sent to him; and a careful reading of the complaint suggests that Morelli sent it to Chase's customer, Townsend, which on the same day sent a "Custody Receipt Confirmation" in quite different terms to Renner. Complaint, P 27.

I turn, then, to whether the complaint adequately alleges a claim against Chase for aiding and abetting the fraud of Susse and Penly.

To establish aiding and abetting under New York law, plaintiff must show (1) the existence of a violation by the primary wrongdoer; (2) knowledge of this violation on the part of the aider and abettor; an (3) substantial assistance by the aider and abettor in the achievement of the primary violation. *See* [*35] *Williams v. Bank Leumi Trust Co., 1997 U.S. Dist. LEXIS 7538*, *13, 1997 WL 289865, at *4 (S.D.N.Y. 1997) (collecting cases); *Moll v. U.S. Life Title Insurance Co. of New York, 710 F. Supp. 476, 479 (S.D.N.Y. 1989)* (citing elements in context of aiding and abetting fraud).

The pleading requirements of *Rule 9(b)*, previously discussed, apply to a claim for aiding and abetting fraud. *See, Williams*, 1997 WL 289865, at *5; *ABF Capital Management v. Askin Capital Management, L.P., 957 F. Supp. at 1328* ("claim of aiding and abetting fraud must meet the pleading requirements of *Rule 9(b)*"); *Frota v. Prudential Bache Securities, Inc., 639 F. Supp. 1186, 1193 (S.D.N.Y. 1986)* (applying *Rule 9(b)* to breach of fiduciary duty claims based on allegations of fraudulent conduct).

The complaint at bar fails to conform to the relevant pleading requirements in several respects.

First, the complaint fails adequately to allege knowledge on the part of Chase of the fraudulent scheme that Susse and others intended to perpetrate, and did perpetrate, upon Renner. That is so even if, assuming without deciding, the knowledge of Morelli should be imputed in law to his employer, Chase.

New York law requires that an aider and [*36] abettor have actual knowledge of the primary wrong; constructive knowledge is not sufficient. *See Kolbeck v. LIT America, Inc., 939 F. Supp. 240, 246 (S.D.N.Y. 1996)* (collecting cases); *Williams*, 1997 WL 289865, at *5 ("The only apparent basis for Bank Leumi's alleged knowledge of the check-kiting scheme was the sequence of the account transfers, and the contention that Bank Leumi was informed that the purpose of the $ 4 million check was for the purchase of LifeCo stock. At most, these facts raise the issue of constructive knowledge which is insufficient to state a claim for aiding and abetting").

Morelli, the Mt. Vernon branch manager, is the only Chase employee identified in the complaint. If there were other Chase officers or employees involved in this transaction, the complaint fails to identify or describe them, in violation of *Rule 9(b)*.

As for Morelli, only two paragraphs of the complaint contain allegations which could be read as evidencing some degree of troublesome knowledge on Morelli's part. The first of these is P 25. That paragraph alleges that on or about February 12 and 13 1996, before the Renner money had been transferred to Chase, Morelli and Townsend had [*37] a discussion about how Hampstead would use Renner's money, and how the account to which the Renner money would be paid could be structured. At the very most, these allegations raise the possibility of constructive knowledge on Morelli's part, namely, that Townsend might not be dealing with Renner in a wholly forthright manner, consistent with Renner's instructions and expectations. But the allegations fall well short of imparting to Morelli actual knowledge that, as soon as the Renner funds were received, they would be diverted to conspirators in Monaco, as the complaint alleges did occur.

Furthermore, although plaintiff does not characterize the allegations of P 25 as having been made "upon information and belief," it is difficult to see how it could be otherwise; the paragraph purports to summarize the contents of a conversation between Morelli and Townsend. This is significant, since it is well settled that "allegations made on information and belief are insufficient unless the facts are peculiarly within the knowledge of the defendants, in which case the complaint must alleges facts demonstrating the basis for the information and belief." *National Council of Young Israel v.* [*38] *Wolf, 963 F. Supp. 276, 281 (S.D.N.Y. 1997)* (citations and internal quotation marks omitted). The complaint nowhere alleges the basis for plaintiff's information and belief.

The same considerations apply to P 31 of the complaint, which alleges that on or about February 20, 1996, Morelli "listened silently on the line" to a telephone conversation between two unidentified Chase officers and Townsend. The officers told Townsend, according to these allegations, that they were concerned "about the Townsend fund's proposed transactions [unspecified] with investor money [also unspecified]" and asked to see an authorization "that the money in the Townsend account could be used in that way" (there being no further description of what "that way" referred to). Again, these allegations establish nothing more than constructive knowledge of possible concerns, rather than actual knowledge of the fraud eventually perpetrated. And, since it is equally clear that plaintiff bases this allegation "upon information and belief," it is deficient in its failure to allege facts demonstrating the basis for that information and belief.

Thus it is apparent that the complaint does not sufficiently allege [*39] the second element of the claim for aiding and abetting fraud, that of actual knowledge on the part of the alleged aider and abettor.

D. *Negligence*

Plaintiff's fifth claim alleges negligence against Chase. Plaintiff alleges that by accepting Renner's funds, Chase owed a duty to Renner in connection with the funds, which Chase negligently breached by failing to protect the funds from fraudulent diversion. Complaint, P 76-78.

To establish a claim for negligence under New York Law, "a plaintiff must show that the defendant owed the plaintiff a cognizable duty of care, that the defendant breached that duty, and that the plaintiff suffered damages as a proximate result of that breach." *King v. Crossland Savings Bank, 111 F.3d 251, 259 (2d Cir. 1997)*; *see also Stagl v. Delta Airlines, Inc., 52 F.3d 463, 467 (2d Cir. 1995)*; *Solomon v. City of New York, 66 N.Y.2d 1026, 1027, 499 N.Y.S.2d 392, 489 N.E.2d 1294 (N.Y. 1985)*.

Plaintiff's negligence claim against Chase fails because Chase did not owe plaintiff a cognizable duty of care. Whatever duty of care banks owe to their customers, *see King, 111 F.3d at 259*, Renner was not a customer of Chase. The Chase customer involved [*40] in this case was the Townsend fund, into which Chase (acting through Morelli) paid Renner's funds when they were received through Renner's Swiss Bank.

These circumstances reduce Renner to the necessity of arguing that Chase owed him a duty to prevent Chase's customer, Townsend, from defrauding Renner. But it is well settled that a bank owes no such duty to a non-customer third-party. *See Guidry v. Bank of LaPlace, 740 F. Supp. 1208 (E.D. La. 1990)* (as a matter of law, bank does not owe duty of care to non-customer defrauded by bank customer), aff'd as modified, *954 F.2d 278 (5th Cir. 1992)*; *E.F. Hutton Mortgage Corp. v. Equitable Bank, N.A., 678 F. Supp. 567 (D. Md. 1988)* (even if bank knew of or suspected customer's fraudulent scheme, it owed no duty to third-party, non-customer plaintiff and thus was not liable for negligence); *see also Century Business Credit Corp. v. North Fork Bank, 246 A.D.2d 395, 396, 668 N.Y.S.2d 18, 19* (N.Y. App. Div. 1st Dep't 1998) (holding that bank is not liable for negligence to customer's creditors, and stating that requiring a bank to monitor its customer's account would "unreasonably expand banks' orbit of duty."); *Stuart v. Tomasino,* [*41] *148 A.D.2d 370, 539 N.Y.S.2d 327* (N.Y. App. Div. 1st Dep't 1989) (no duty of care owed by mortgagee bank to mortgagors in action by mortgagors against individuals who had defrauded them, resulting in default on mortgage); *Regency House, Inc. v. Citibank, N.A., 202 A.D.2d 655, 657, 610 N.Y.S.2d 535, 536* (N.Y. App. Div. 2d Dep't 1994) (shareholders of foreclosed property failed to establish any duty owed to them by bank for negligence arising from foreclosure); *Cohen v. Standard Bank Investment Corp., Ltd.*, 1998 WL 782024, at *7 (S.D.N.Y. 1998) (no duty of care owed by bank to investor in allegedly fraudulent scheme perpetrated by bank borrower).

The cases cited by plaintiff relate only to instances in which the bank has a fiduciary duty to the plaintiff. As a general rule, a bank has no duty to monitor even a fiduciary account under New York law. *See, e.g., Home Savings of America, FSB v. Amoros, 233 A.D.2d 35, 38, 661 N.Y.S.2d 635, 637* (N.Y. App. Div. 1st Dep't. 1997) ("Ordinarily, of course, a depositary bank has no duty to monitor fiduciary accounts maintained at its branches to safeguard the funds in those accounts from fiduciary misappropriation."). However, plaintiff [*42] notes that this rule is altered where "there are facts . . . indicating misappropriation." *In re Knox, 64 N.Y.2d 434, 438, 488 N.Y.S.2d 146, 477 N.E.2d 448 (N.Y. 1985)*. Plaintiff asserts that because Chase had knowledge of Hampstead and Townsend before the Renner funds were deposited, it was negligent in its failure to question their motives and practices in connection with the Renner deposit.

In order for a bank to be liable for the diversion of fiduciary funds, plaintiff must show that the bank either itself benefitted from the transaction or that it had notice or knowledge that a diversion was intended or was in progress. *Knox, 64 N.Y.2d at 438, 488 N.Y.S.2d 146, 477 N.E.2d 448*; *see also Diller v. Schick, 1998 U.S. Dist. LEXIS 14463*, *4-*5, 1998 WL 635539, at *2 (S.D.N.Y. 1998) (citing *Home Savings of America, 661 N.Y.S.2d at 637*). The test is that "facts sufficient to cause a reasonably prudent person to suspect that trust funds are being misappropriated will trigger a duty of inquiry on the part of a depositary bank, and a bank's failure to conduct a reasonable inquiry when the obligation to do so arises will result in the bank being charged with such knowledge as inquiry would have disclosed." [*43] *Home Savings of America*, N.Y.S.2d at 637 (internal citations omitted).

In the case at bar, these principles avail plaintiff nothing. First, the Townsend Fund account with Chase was not a *fiduciary* account; accordingly, there is no reason to depart from the general rule that a bank cannot be held accountable for the ways in which its customers manage their accounts. Further, even if one assumes a fiduciary relationship, plaintiff has not pleaded facts sufficient to establish negligence. In those instances in which the New York courts have found that a bank has received adequate notice of a fraud, either the bank has accepted money from a fiduciary account in order to satisfy the fiduciary's personal debt to the bank, *see Bischoff v. Yorkville Bank, 218 N.Y. 106, 112 N.E. 759 (N.Y. 1916)*; *In re Knox, 64 N.Y.2d 434, 488 N.Y.S.2d 146, 477 N.E.2d 448*, or there is a history of overdrafts in the fiduciary account. *Home Savings of America*, N.Y.S.2d at 637. Here, there is no allegation that any payment was made to Chase; nor is there any allegation that the Townsend account ever was overdrawn. Accordingly, plaintiff has not shown that Chase had notice of an impending or [*44] ongoing misappropriation.

E. *Breach of Contract and Breach of Covenant*

I will discuss plaintiff's last two claims against Chase together.

Plaintiff's sixth claim alleges that in the circumstances alleged, "Chase assumed a contractual duty to make sure that Townsend/Hampstead was using the Renner money for authorized purposes." Complaint, P 82.

The seventh claim alleges that plaintiff was "relying on Chase's integrity in making the investment with the belief that the funds would be safeguarded," and that by receiving Renner's funds and depositing them in the Townsend Fund account, Chase (acting through Morelli) "undertook a covenant of good faith and fair dealing inherent in every contract," which Chase broke by issuing a misleading "custody receipt confirmation" and "failing to advise Renner that the funds entrusted to Chase were being looted, or even to inquire whether Renner was aware of, and had authorized, the questionable transactions Chase detected." *Id., PP 86-89.*

The sixth claim need not detain us. In order to form a contract under New York law, there must be an offer, acceptance, and consideration, and a showing of "a meeting of the minds, demonstrating the parties' [*45] mutual assent and mutual intent to be bound." *Oscar Productions, Inc. v. Zacharius, 893 F. Supp. 250, 255 (S.D.N.Y. 1995)*. The complaint at bar contains no allegation that plaintiff and Chase entered into an express contract, either written or oral; in the latter instance, the burden on a plaintiff is heavier because "a primary concern for courts in such disputes is to avoid trapping parties in surprise contractual obligations that they never intended." *Arcadian Phosphates, Inc. v. Arcadian Corp., 884 F.2d 69, 72 (2d Cir. 1989)* (citation and internal quotation marks omitted). Nor, given the principles of banking law discussed *supra*, may a contract binding Chase to plaintiff be implied.

The most that can be said for plaintiff's seventh claim against Chase is that it is an inartful effort to plead a claim for "commercial bad faith." This is a cause of action against banks, sounding more in tort than in contract, that New York law recognizes in certain special circumstances. *See Prudential-Bache Securities, Inc. v. Citibank, N.A., 73 N.Y.2d 263, 275-77, 536 N.E.2d 1118, 539 N.Y.S.2d 699 (N.Y. 1989)*; *Peck v. Chase Manhattan Bank, N.A., 190 A.D.2d 547, 593 N.Y.S.2d* [*46] *509 (N.Y. App. Div. 1st Dept. 1993)*. The plaintiff need not be a customer of the defendant bank, nor related to the bank by contract. Plaintiff need only be a foreseeable victim of a fraudulent scheme executed by lower echelon bank employees; bank liability attaches if "managerial employees of the bank knew of and thus participated in the scheme." *Prudential-Bache, 73 N.Y.2d at 277.* In that regard, allegations charging managerial employees with "merely a lapse of wary vigilance" or "even suspicious circumstances which might well have induced a prudent banker to investigate" are insufficient, *id. at 276.* Individuals more exalted in the bank hierarchy than a branch assistant manager (the fraudsman in *Prudential-Bache, see 73 N.Y.2d at 267*, and the analogue to Morelli in the case at bar) [12] must have had actual knowledge of the particular scheme and, by their silence and inaction, participated in it.

12 This parenthetical observation assumes without deciding that Morelli was a knowing participant in the fraud plaintiff charges, a circumstance which, as discussed *supra*, plaintiff has not adequately alleged.

[*47] There are no allegations sufficient to make that showing in the complaint at bar; it may be contrasted in that regard with the allegations in *Prudential-Bache*, summarized at *73 N.Y.2d at 276-77.*

It follows that plaintiff's sixth and seventh claims against Chase must also be dismissed.

All the claims against Chase being deficient for the reasons stated, the Clerk of the Court is directed to dismiss the complaint as against defendant Chase Manhattan Bank in its entirety.

Since the Court's decision as to certain claims depends in part upon the inadequacies of the pleading, plaintiff is given leave, if he is so advised and in a position to do so consistent with *Rule 11, Fed. R. Civ. P.*, to file and serve an amended complaint as to the first, second, and fourth claims against Chase, within forty-five (45) days of the date of this Opinion and Order. Leave to amend is denied as to plaintiff's other claims against Chase.

Counsel for all parties are directed to attend a status conference in Room 17C, 500 Pearl Street, at 2:00 p.m. on April 9, 1999.

It is SO ORDERED.

Dated: New York, New York

February 2, 1999

CHARLES S. HAIGHT, [*48] JR.

U. S. S. D. J.

PETER F. RYAN, PRD CORP., DALE W. RYAN, PDR HOLDINGS, INC., PDR CORP. DEFINED BENEFIT PLAN & TRUST, RYAN REALTY TRUST, LOPERENA TRUST, JAQUITH HOLDINGS, INC., PETER F. RYAN IRREVOCABLE TRUST, RESEARCH & FINANCE CORP., GLEN GUILLET, DOIT CORP., ZAYIN INVESTMENTS, LTD., BENY PRIMM, RPE MANAGEMENT, INC., DANIEL LANGER, JAY SICKLEN, MYKERINUS HOLDINGS, INC., and CHARLES SCHMIDT, Plaintiffs, - against - HUNTON & WILLIAMS, SCOTT J. MCKAY WOLAS, FRANKLIN H. STONE, CHRISTOPHER M. MASON, KATHY MCCLESKY ROBB, JERRY E. WHITSON, TARDINO & TARDINO, VICTOR J. TARDINO, JR., VICTOR J. TARDINO, SR., CRYSTAL WATERS, N.V., CRYSTAL DISTRIBUTORS, L.P., CRYSTAL DISTRIBUTORS, L.P. II, CHASE MANHATTAN BANK f/k/a CHEMICAL BANK, FLEET BANK f/k/a NATIONAL WESTMINSTER BANK, and GREGORY WOLAS, Defendants.

99-CV-5938 (JG)

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK

2000 U.S. Dist. LEXIS 13750

September 20, 2000, Decided

NOTICE: [*1] FOR ELECTRONIC PUBLICATION ONLY

DISPOSITION: Chase's motion to dismiss granted.

COUNSEL: SIGMUND S. WISSNER-GROSS, ESQ., Heller, Horowitz & Feit, P.C., New York, New York, for Plaintiffs.

ANDREW R. KOSLOFF, ESQ., The Chase Manhattan Bank Legal Department, New York, New York, for Chase Manhattan Bank, Defendant.

JUDGES: JOHN GLEESON, United States District Judge.

OPINION BY: JOHN GLEESON

OPINION

MEMORANDUM AND ORDER

JOHN GLEESON, United States District Judge:

The plaintiffs initiated this action to recover for injuries they sustained as a result of their investment in a "Ponzi" scheme operated by Scott J. McCay Wolas ("Wolas"), a partner at the New York office of Hunton & Williams ("H&W"). Defendant Chase Manhattan Bank ("Chase") has moved to dismiss the claims against it for failure to state a claim upon which relief can be granted and for failure to plead fraud with particularity pursuant to *Rules 12(b)(6)* and *Rule 9(b) of the Federal Rules of Civil Procedure*. For the following reasons, the motion is granted.

BACKGROUND

The following factual background is based on the allegations contained in the plaintiffs' complaint, which are assumed to be true for the purposes of this motion.

From 1989 [*2] to 1995, Wolas ran a "Ponzi" scheme. He induced the plaintiffs and others to invest with him by misrepresenting that their investments would be used to purchase large shipments of Scotch whiskey in Scotland for resale in the Orient. In fact, there were no such purchases; instead, Wolas used the funds to pay prior "investors" and for other unknown purposes. In 1995, Wolas absconded, and his whereabouts are still unknown. (*See* Compl. P 1.)

In 1994 Chemical Bank [1] ("Chemical") was on notice of various of "red flags" that indicated fraudulent conduct by Wolas and/or those with whom he was associated. For example, in May 1994, John Dolan, a cohort of Wolas, tried to open an account at Chemical in the name of SEV Enterprises, Inc. ("SEV"). Chemical, however, declined to open the account because Patrick J. Connor, of Chemical's in-house fraud investigative unit, suspected that SEV was probably running an "advance fee scam." (*Id.* PP 111-12.) Then, on June 29, 1994, a lawyer representing a former associate at H & W contacted Mark E. Segal, Assistant General Counsel of Chemical, and informed him that Wolas fraudulently overbilled Manufacturers Hanover Trust, Chemical's predecessor, [*3] for work done on a litigation matter. Later that year, Chemical shut down accounts maintained by Wolas and Albert H. Wolas, Inc., a family business owned by Wolas's father and brother, after a $ 950,000 check to Wolas, drawn on one of the business accounts, bounced. (*See id.* PP 113-14.)

1 Chemical Bank has since merged with Defendant Chase Manhattan Bank.

On March 16, 1995, just three months before the "Ponzi" scheme collapsed, Dolan opened a primary account in the name of SEV and Wolas opened a sub-account (to the SEV account) at a Chemical branch on Third Avenue in Manhattan. Although the sub-account was an attorney escrow account, Wolas authorized Dolan, a non-lawyer, to have signing authority over the sub-account. Wolas and/or Dolan further informed Chemical in-house counsel Manuel Gottlieb that the sub-account was an attorney escrow account and that all of the money passing through the sub-account was escrow money. (*See id.* PP 110, 115-16.)

From the accounts' inception, branch officer Kevin O'Dea [*4] suspected that they were a vehicle for fraudulent activity and immediately referred them to Chemical's in-house fraud investigative unit. On May 2, 1995, an employee of the fraud unit notified O'Dea and Gottlieb of the unit's concerns one year earlier when Dolan tried to open an account in the name of SEV, and urged that Chemical immediately shut down the primary and sub-accounts. Then, on May 5, 1995, O'Dea notified Dolan and SEV that the accounts had to be closed by June 5, 1995, one month later. [2] (*See id.* PP 115, 117-18.)

2 On May 30, 1995, a grand jury in the Southern District of Texas issued a subpoena, in part, to one of the two SEV sub-accounts. This subpoena was faxed to in-house counsel Gottlieb on June 1, 1995. (*See* Compl. P 124.)

A. *The Account Activity*

In April and May of 1995, O'Dea and his assistant signed or approved bank checks and transfers out of Wolas's sub-account and into the SEV primary account. Specifically, O'Dea effected the following transactions:

> (i) Beginning [*5] on April 27, 1995, O'Dea personally signed bank checks drawn on the Wolas sub-account;
>
> (ii) On April 25, 1995, O'Dea personally approved the internal transfer of $ 1 million of investor funds from the sub-account to the SEV primary account, and such transfer occurred on April 27, 1995; and
>
> (iii) On May 2, 1995, O'Dea's assistant approved the transfer of $ 1.6 million from the sub-account to the SEV primary account.

(*See* Compl. P 119.)

Then, on April 27, 1995, O'Dea personally approved the issuance of two Chemical checks drawn on the SEV primary account, each in the amount of $ 100,000, and certified another SEV primary account check, in the amount of $ 28,459. Several days later, O'Dea approved a May 2, 1995, certified check for $ 200,000 drawn on the SEV primary account. This check was immediately altered to indicate that it was drawn on the sub-account.

By no later than May 10, 1995, O'Dea knew that this certified check had been altered, and relied on this information in insisting that the accounts be closed. (*See id.* P 120.)

By May 2, 1995, O'Dea was also aware that $ 10 million was to be wired into another SEV sub-account at Chemical. (*See id.* P [*6] 121.) O'Dea (and/or another Chemical employee or officer) specifically approved multiple wire transfers that resulted in the theft of investor funds. For example, O'Dea approved the following transactions:

> (i) the May 2, 1995, wire transfer of $ 50,000 from the SEV primary account to Kehle & Co., Inc. in Florida;
>
> (ii) the May 4, 1995, wire transfer of $ 40,000 to a "Keeco" entity in Washington;
>
> (iii) the May 4, 1995, wire transfer of $ 50,000 for credit to Warley, Inc.;
>
> (iv) the May 4, 1995, wire transfer of $ 7,500 to Jim Roma in Washington, with "special instructions" from "F. Kelly," which O'Dea knew was false and fraudulent since the funds did not come from F. Kelly;
>
> (v) the May 12, 1995, wire transfer of $ 10,000 to "David J. Friednbach" in Oregon; and
>
> (vi) the May 12, 1995, wire transfer of $ 500,000 to "Jack Vita, Esq. Client Trust Account," with "special instructions" from "Warley, Inc.," which O'Dea knew was false and fraudulent since the funds did not come from Warley, Inc.

(*See id.* P 122.)

B. *The Relevant Plaintiffs*

1. *DOIT Corp.*

O'Dea was aware that several million dollars had been wired from the Florida Cordova [*7] Law Center ("Cordova"), in April and May 1995, to the Wolas sub-account at Chemical. However, neither O'Dea nor anyone else at Chemical contacted Cordova regarding the purpose of those transfers or alerted it of Chemical's concerns. On May 16, 1995, Plaintiff DOIT Corp. ("DOIT") deposited $ 500,000 in escrow with the Cordova, with the expectation that the funds would then be transferred to the Wolas sub-account at Chemical. DOIT was never advised that Chemical had already taken steps to shut down the sub-account. (*See id.* P 125.)

2. *Research & Finance Corp.*

In late May 1995, the Chairman of the Research & Finance Corp. ("RFIN"), who maintained personal accounts at Chemical, contacted Chemical's Private Banking Group to confirm the status of what he believed was an H & W Client Funds account before he transferred $ 500,000 out of his personal account on behalf of RFIN to that account. The Chairman was advised that the H & W Client Funds account was in good standing, but was not told, among other things, (i) that the escrow account was a sub-account of SEV; (ii) that the sub-account was Wolas's and that H & W did not maintain the firm's principal attorney escrow account at [*8] Chemical; (iii) that Chemical had notified Wolas and SEV in early May 1995 to close the primary and sub-accounts; and (iv) that Chemical believed that primary and sub- accounts were being used for fraudulent purposes. (*See id.* P 126.)

On June 29, 1995, pursuant to H & W's instructions, RFIN's accountant attempted to transfer $ 500,000 on RFIN's behalf to the Wolas sub-account at Chemical, believing it to be an escrow account maintained by H & W. As the SEV account and Wolas sub-account had already been closed at that point, the transfer did not go through. Chemical did not disclose to RFIN, however, why the Wolas sub-account had been closed. Believing it to be an administrative matter and that H & W had moved its escrow account to another bank, RFIN transferred the funds on July 13, 1995, to an account at National Westminster Bank ("Nat West"), now known as Fleet Bank, maintained by Wolas. (*See id.* P 127.)

C. *This Action*

On September 24, 1999, various investors in Wolas's "Ponzi" scheme commenced this action for damages against H & W, Wolas, and other defendants for violations of the Securities Exchange Act of 1934, the Racketeering Influenced and Corrupt Organization [*9] Act, and New York common law. Relevant to the motion before me now are the claims by DOIT and RFIC against Chase (formerly Chemical) for fraud, aiding and abetting fraud, and commercial bad faith. [3] Chase has moved to dismiss these claims for failure to state a claim upon which relief can be granted and for failure to plead fraud with particularity, pursuant to *Rules 12(b)(6)* and *Rule 9(b) of the Federal Rules of Civil Procedure.*

> 3 Although Plaintiff Glen Guillet originally asserted these claims against Chase as well, I was informed at oral argument on May 26, 2000, that Guillet's claims had been settled.

DISCUSSION

A. *The Rule 12(b)(6) Standard*

In a 12(b)(6) motion, a federal court's task in determining the sufficiency of a complaint is "necessarily a limited one." *Scheuer v. Rhodes, 416 U.S. 232, 236, 40 L. Ed. 2d 90, 94 S. Ct. 1683 (1974)*. The inquiry focuses not on whether a plaintiff might ultimately prevail on her claim, but on whether she is entitled to offer evidence in [*10] support of the allegations in the complaint. *See id.* "Indeed it may appear on the face of the pleadings that a recovery is very remote and unlikely but that is not the test." *Id. Rule 12(b)(6)* warrants a dismissal only if "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957)*; *see also Hamilton Chapter of Alpha Delta Phi, Inc. v. Hamilton College, 128 F.3d 59 (2d Cir. 1997)*. In considering a defendant's motion, the Court must accept as true all the factual allegations in the complaint and must draw all reasonable inferences in favor of the plaintiff. *See Hamilton, 128 F.3d at 59* (citing *Hospital Bldg. Co. v. Trustees of Rex Hosp., 425 U.S. 738, 740, 48 L. Ed. 2d 338, 96 S. Ct. 1848 (1976)).*

B. *Common Law Fraud*

Chase contends that RFIN's fraud or fraudulent concealment claims must be dismissed because it has failed to allege the elements of the claims and sufficient facts to give rise to a strong inference of fraudulent intent under *Rule 9(b)*. [4]

> 4 DOIT has abandoned its fraud claim against Chase. (*See* Pls.' Mem. of Law in Opp'n at 3 n.2.)

[*11]

To state a claim of common law fraud under New York law, plaintiff must establish, by clear and convincing evidence, that (i) the defendant made a material misrepresentation; (ii) with knowledge of its falsity; (iii) with the intent to defraud the plaintiff; (iv) on which the plaintiff reasonably relied; and (v) that caused damage to the plaintiff as a result. *See Schlaifer Nance & Co. v. Estate of Andy Warhol, 119 F.3d 91, 98 (2d Cir. 1997)*; *Banque Arabe et Internationale D'Investissement v. Maryland National Bank, 57 F.3d 146, 153 (2d Cir. 1995).*

1. *Proximate Cause*

RFIN alleges that Chemical made a material false misrepresentation when it represented to RFIN's Chairman that the Wolas sub-account was in good standing. It further alleges that it reasonably relied on this representation and suffered at least $ 500,000 in damages when its investment was later misappropriated by Wolas from his account at NatWest. In response, Chase contends that RFIN has failed to establish that Chemical's statement was the proximate cause of RFIN's injury. I agree.

"The absence of adequate causation is . . . fatal to a common law fraud claim under New York law. [*12] " *Bennett v. United States Trust Co., 770 F.2d 308, 316 (2d Cir. 1985)*. A plaintiff may establish proximate cause if an injury "is the natural and probable consequence of the defrauder's misrepresentation or if the defrauder ought reasonably to have foreseen that the injury was a probable consequence of his fraud.'" *Citibank, N.A. v. K-H Corp., 968 F.2d 1489, 1496 (2d Cir. 1992)* (quoting *Cumberland Oil Corp. v. Thropp, 791 F.2d 1037, 1044 (2d Cir. 1986))*. "The requisite causation is established only where the loss complained of is a direct result of the defendant's wrongful actions and independent of other causes." *Revak v. SEC Realty Corp., 18 F.3d 81, 89-90 (2d Cir. 1994)* (citing *Bennett, 770 F.2d at 316*).

In *Bennett*, the plaintiffs used the proceeds of a series of loans from the defendant bank to purchase public utility stock and then deposited the stock with the bank as collateral for the loans. *See 770 F.2d at 310.* In negotiating the loans, the bank misrepresented to the plaintiffs that the Federal Reserve's margin rules do not apply when public utility stock is deposited [*13] as collateral. The stock subsequently generated insufficient dividends to cover the interest, and its market value decreased. Thus, in addition to the plaintiffs' loss of the equity itself, they owed the bank the outstanding interest and principal in excess of the stock's depreciated value. *See id.* The district court dismissed the plaintiffs' common law fraud claim for lack of causation and the Second Circuit affirmed, concluding that the plaintiffs had only alleged "but for" causation, *i.e.*, that they would not have purchased the stock if the bank had denied the loans. *See id. at 314-16.* Noting that the plaintiffs' common law fraud and securities fraud claims were equally flawed, the court stated that there was "simply no direct or proximate relationship between the loss and the misrepresentation." *Id. at 314, 316*. The court emphasized that the plaintiffs approached the bank for a loan with the plan to purchase the public utility stock; the bank recommended neither public utility stock in general, that stock in particular, nor the investment value of any such stock. *See id. at 313-14.* Accordingly, the court concluded that [*14] the "loss at issue was caused by the [plaintiffs'] own unwise investment decisions, not by [the bank's] misrepresentation." *Id. at 314.*

RFIN's fraud claim fails for precisely the same reasons. RFIN approached Chemical with the intention of investing in Wolas's whiskey scheme. Indeed, RFIN's Chairman contacted Chemical's Private Banking Group only to confirm the status of Wolas's account at Chemical prior to directing the transfer of $ 500,000 into the account. (*See* Compl. P 126.) At that time, the Chairman was told that Wolas's account was in good standing. (*See id.*) Although RFIN insists that it would not have invested with Wolas (by depositing $ 500,000 in his account at Nat West after learning that the Chemical account was closed) if the Chemical officer had not made that representation or had told RFIN's Chairman of Chemical's concerns about the Wolas sub-account, these allegations at most establish "but for" causation. Simply put, the direct and proximate cause of RFIN's loss was Wolas's fraud, not Chemical's representation about the status of the Wolas sub-account.

2. *Duty to Disclose*

In addition, RFIN asserts that it has a claim of fraudulent [*15] concealment based on Chemical's failure to disclose to RFIN's Chairman that (i) Chemical had notified Wolas and SEV that it would close the accounts as of June 5, 1995; (ii) Chemical suspected fraudulent activity in the accounts; (iii) H&W did not maintain an escrow account at Chemical; and (iv) Wolas's escrow account was a sub-account of the SEV account.

To establish a claim of fraudulent concealment under New York law, the plaintiff must prove the aforementioned elements of common law fraud *and* that "the defendant had a duty to disclose the material information." *Banque Arabe*, 57 F.3d at 153. A duty to disclose may arise in two circumstances: (i) "where the parties enjoy a fiduciary relationship" and (ii) "where one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge." *Aaron Ferer & Sons Ltd. v. Chase Manhattan Bank, N.A., 731 F.2d 112, 123 (2d Cir. 1984).*

RFIN claims that Chemical's duty to disclose arose from its superior information about the status of the Wolas sub-account. It argues that such information was not readily available to RFIN, and that [*16] Chemical knew that RFIN was acting, or attempting to act, on the basis of mistaken knowledge when RFIN attempted to transfer $ 500,000 to the account after it was closed.

As an initial matter, I question whether RFIN may bring a fraudulent concealment claim against Chase since such a claim "ordinarily arises only in the context of business negotiations where parties are entering a contract." *Ray Larsen Assocs., Inc. v. Nikko Am., Inc., 1996 U.S. Dist. LEXIS 11163*, No. 89 Civ. 2809 (BSJ), 1996 WL 442799, at *5 (S.D.N.Y. Aug. 6, 1996); *see also Renner v. Chase Manhattan Bank, 2000 U.S. Dist. LEXIS 8552*, No. 98 Civ. 926(CSH), 2000 WL 781081, at *9 n.5 (S.D.N.Y. June 14, 2000) (questioning in *dicta* whether defendant bank had duty to disclose where plaintiff neither conducted business nor negotiated contracts with bank or bank employee); *Williams v. Bank Leumi Trust Co., 1998 U.S. Dist. LEXIS 10636*, No. 96 Civ. 6695(LMM), 1998 WL 397887, at *8 (S.D.N.Y. July 15, 1998) (questioning in *dicta* whether insurance company receiver had standing to bring fraudulent concealment claim where defendant bank and insurance company "never stood on opposite sides of the same transaction").

However, even if RFIN can state a fraudulent [*17] concealment claim in these circumstances, it has not done so. Chase cannot properly be held accountable for failing to disclose information about the Wolas's sub-account to RFIN. "[A] bank should keep its own customers' affairs confidential." *Aaron Ferer, 731 F.2d at 123* (citing *Graney Dev. Corp. v. Taksen, 92 Misc. 2d 764, 400*

N.Y.S.2d 717, 719 (Sup. Ct.), *aff'd*, 66 A.D.2d 1008, 411 N.Y.S.2d 756 (4th Dep't 1978)); *see also Graney, 400 N.Y.S.2d at 719* ("It is implicit in the contract of the bank with its customer or depositor that no information may be disclosed by the bank or its employees concerning the customer's or depositor's account.") (internal quotation marks and citations omitted); *Renner*, 2000 WL 781081, at *9 (citing *Aaron Ferer* and *Graney* and noting that bank officer had no duty to respond to plaintiff's letters inquiring about bank customers); *cf. Young v. United States Dep't of Justice, 882 F.2d 633, 640-43 (2d Cir. 1989)* (encouraging New York courts to recognize duty of confidentiality between bank and customer). Thus, Chemical had no duty to volunteer to RFIN [*18] additional information about the alleged suspicious activity in the Wolas sub-account.

Finally, even if Chemical was obligated to disclose this additional information, there is no indication that Chemical knew that RFIN was acting on the basis of mistaken knowledge concerning the financial transaction between Wolas and RFIN. According to the plaintiff's allegations, Chemical knew only that RFIN inquired about the sub-account and attempted to transfer funds to the account after it had been closed. This attempted transfer does not support an inference that RFIN was acting on its mistaken information that Wolas was not engaging in fraud. For all Chemical knew, assuming Chemical knew of the scheme at all, RFIN was a cohort of Wolas, not a potential defrauded investor. Accordingly, RFIN has not stated claim for fraudulent concealment. [5]

5 RFIN's fraudulent concealment claim also fails due to the absence of proximate cause. *See supra.*

3. *Intent to Defraud Under Rule 9(b)*

Lastly, RFIN's fraud claim must [*19] also be dismissed for the failure to plead Chemical's intent to defraud with the requisite particularity to satisfy *Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b)* provides, in pertinent part, that "in all averments of fraud . . . , the circumstances constituting fraud . . . shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." *Fed. R. Civ. P. 9(b)*. The rule is designed to "provide a defendant with fair notice of a plaintiff's claim, to safeguard a defendant's reputation from improvident charges of wrongdoing, and to protect a defendant against the institution of a strike suit." *Acito v. Imcera Group, Inc., 47 F.3d 47, 52 (2d Cir. 1995)* (quoting *O'Brien v. National Property Analysts Partners, 936 F.2d 674, 676 (2d Cir. 1991))* (internal quotation marks omitted). Allegations of fraud, therefore, must be specific enough to provide a defendant with "a reasonable opportunity to answer the complaint and . . . adequate information to frame a response." *Ross v. A.H. Robins Co., 607 F.2d 545, 557-58 (2d Cir. 1979).*

Four essential requirements comprise [*20] *Rule 9(b)*. A plaintiff must (i) "'specify the statements that the plaintiff contends were fraudulent'"; (ii) "'identify the speaker'"; (iii) "'state where and when the statements were made'"; and (iv) "'explain why the statements were fraudulent.'" *Acito, 47 F.3d at 51* (quoting *Mills v. Polar Molecular Corp., 12 F.3d 1170, 1175 (2d Cir. 1993)).* Although a plaintiff need not plead detailed evidentiary matters, *see Credit & Fin. Corp. v. Warner & Swasey Co., 638 F.2d 563, 566 (2d Cir. 1981)*, it must plead "facts that give rise to a strong inference of fraudulent intent," *see Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1128 (2d Cir. 1994)*. This inference may be established either (i) "by alleging facts to show that defendants had both motive and opportunity to commit fraud," or (ii) "by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." *Id.*

RFIN concedes that it does not rely on evidence of motive and opportunity to commit fraud to satisfy its burden under *Rule 9(b)*. Accordingly, I will restrict my analysis to whether RFIN's allegations establish circumstantial [*21] evidence of recklessness to give rise to the requisite inference of fraudulent intent.

Recklessness is established by conduct which is "'highly unreasonable and which represents an extreme departure from the standard of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" *Chill v. General Elec. Co., 101 F.3d 263, 269 (2d Cir. 1996)* (quoting *Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1978))* (alteration in *Rolf*). In some instances, an inference of recklessness may be raised by "'an egregious refusal to see the obvious, or to investigate the doubtful.'" *Id.* (quoting *Goldman v. McMahan, Brafman, Morgan & Co., 706 F. Supp. 256, 259 (S.D.N.Y. 1989)).* Nonetheless, the plaintiff bears a "significant burden . . . in stating a fraud claim based on recklessness." *101 F.3d at 270.*

Here, RFIN has failed to allege facts that constitute strong circumstantial evidence of recklessness. First, in March 1995, when the accounts were opened, Chemical had no actual knowledge that Dolan and Wolas had previously engaged in [*22] fraudulent activity. Rather, Chemical's officer, Bruce Whitcomb, had been "suspicious" of fraud in 1994, and had referred the matter to the fraud unit, which had concluded that it was "probably an advance fee scam." (Compl. P 112.) Likewise, neither the anonymous report to Chemical's Assistant General Counsel, Mark Segall, that Wolas had fraudulently overbilled Chemical's predecessor on a litigation matter nor the allegation that Chemical closed down a Wolas family business account due to a bounced check (both of which occurred in 1994) establishes that Chemical knew Wolas was engaged in fraud in 1995. (*See* Compl. PP 113-14.) Thus, these allegations do not give rise to any inference of Chemical's fraudulent intent.

Second, the allegations that Chemical's branch officer, Kevin O'Dea, approved various internal transfers between the SEV account and the sub-account, (*see* Compl. PP 119-20), similarly do not satisfy *Rule 9(b)*'s requirement. *See Williams v. Bank Leumi Trust Co., 1997 U.S. Dist. LEXIS 7538*, No. 96 Civ. 6695 (LMM), 1997 WL 289865, at *3 (S.D.N.Y. May 30, 1997) (mere transfer of funds between accounts was insufficient to raise inference of knowledge of check-kiting scheme to satisfy [*23] *Rule 9(b)* or *Rule 12(b)(6)* for claim of fraudulent concealment).

Third, as soon as Chemical's fraud investigative unit alerted O'Dea of the prior suspected advance fee scam and urged that Chemical shut down the accounts, O'Dea notified Dolan that the SEV account and the Wolas sub-account would be closed in one month. (*See* Compl. PP 117-18.) Although Chemical may have shown greater vigilance by closing the accounts immediately, rather than continuing to approve transfers and bank checks until the accounts were closed one month later, this failing does not establish recklessness sufficient to raise a strong inference of Chemical's intent to defraud RFIN. *See Chill, 101 F.3d at 269*; *see also Renner*, 2000 WL 781081, at *14 (bank's failure to detect fraud sooner insufficient to satisfy *Rule 9(b)* burden of pleading fraudulent intent for aiding and abetting fraud claim); *Nigerian Nat'l Petroleum Corp. v. Citibank, N.A., 1999 U.S. Dist. LEXIS 11599*, No. 98 Civ. 4960(MBM), 1999 WL 558141, at *7-*8 (S.D.N.Y. July 30, 1999) (bank's negligent failure to investigate several red flags and to prevent additional wire transfers after second fraudulent transfer uncovered by [*24] transferring bank did not give rise to strong inference of fraudulent intent to satisfy *Rule 9(b)* for claims of commercial bad faith and aiding and abetting fraud).

Finally, in light of the aforementioned case law concerning the confidential nature of bank customer information, Chemical's failure to provide information to RFIN about Wolas's sub-account beyond the representation that it was in good standing cannot give rise to an inference of an intent to defraud.

In sum, RFIN has failed its significant pleading burden. Its allegations do not raise any inference, let alone a strong inference, of an intent to defraud. Accordingly, RFIN's fraud and fraudulent concealment claims must be dismissed.

C. *Aiding and Abetting Fraud*

To establish a claim of aiding and abetting fraud under New York law, a plaintiff must establish (i) the existence of a violation by the primary wrongdoer; (ii) knowledge of this violation by the aider and abettor; and (iii) proof that the aider and abettor substantially assisted in the primary wrong. *See Armstrong v. McAlpin, 699 F.2d 79, 91 (2d Cir.1983).* Chase contends, and I agree, that RFIN and DOIT have failed to allege either Chemical's [*25] knowledge of Wolas's fraud or that Chemical substantially assisted in the commission of the fraud.

1. *Actual Knowledge*

New York law requires a plaintiff to establish that the alleged aider and abettor had "'actual knowledge'" of the primary wrong. *Renner*, 2000 WL 781081, at *6 (quoting *Kolbeck v. LIT Am., Inc., 939 F. Supp. 240, 246 (S.D.N.Y. 1996))*; *see also Wight v. Bankamerica Corp., 219 F.3d 79, 91 (2d Cir. 2000)* (stating that "knowledge of the underlying wrong" is "required element" under New York law).

Here, the plaintiffs have failed to allege that Chemical had actual knowledge of Wolas's fraud. As explained *supra*, the allegations that Chemical suspected that Dolan and SEV were running an advance fee scam in 1994, (*see* Compl. P 112), that Wolas allegedly overbilled Chemical's predecessor in connection with litigation, (*see id. P 113*), and that Chemical shut down a

Wolas family account in 1994 due to a bounced check, (*see id. P 114*), do not establish that Chemical had actual knowledge of Wolas's fraudulent scheme in 1995.

Turning to the allegations in 1995, O'Dea requested Chemical's [*26] fraud investigation unit to review the SEV account and the Wolas sub-account based on suspicions -- not actual knowledge -- of fraudulent activity. (*See id. P 115, 117.*) Subsequently, upon receiving the recommendation of the fraud unit that the accounts be closed, O'Dea informed Dolan that Chemical would close the accounts in one month. (*See id. P 117-18.*) Allegations that Chemical suspected fraudulent activity, however, do not raise an inference of actual knowledge of Wolas's fraud. [6]

6 This case is closely analogous to Judge Haight's opinion in *Renner*, 2000 WL 781081. In that case, the plaintiff alleged that Chase aided and abetted a prime bank guarantee scam. The allegation of actual knowledge on the part of Chase was based on, *inter alia*, its officials' rejection of a letter of credit proposal based on their suspicion that the letters were potential vehicles for fraud. *See id.* at *12. The court rejected this argument, however, and concluded that there was "no factual basis for the assertion that Chase officials actually knew the fraud [they suspected] was, in fact, occurring." *Id.*

[*27] Finally, O'Dea's authorization of transfers between the SEV account and the sub-account, (*see id. P 119*), and his approval of multiple wire transfers, (*see id. P 122*), do not create an inference of knowledge of the scheme. In *Williams*, 1997 WL 289865, a statutory receiver for an insurance company brought an action for, *inter alia*, aiding and abetting fraud, and alleged that the defendant bank had actual knowledge of a check-kiting scheme where the bank had approved various bank transfers. *See id.* at *4. The court rejected this argument, concluding that the account transfers and other allegations established only constructive knowledge on the part of the bank, which is insufficient to state a claim for aiding and abetting fraud. *See id.* Similarly, in this case, the plaintiffs have failed to establish that Chemical had any actual knowledge of Wolas's fraud, and thus, their aiding and abetting fraud claim must be dismissed. [7]

7 The plaintiffs' remaining allegations, that Chemical improperly permitted Dolan, a non-lawyer, to be a signatory on the Wolas's attorney escrow account, (*see* Compl. P 116), that Chemical knew that a check drawn on the SEV account had been altered to reflect that it was issued from the Wolas sub-account, (*see id. P 120*), and that Chemical knew that H&W did not maintain a firm escrow account at Chemical, (*see id. P 123*), do not establish that Chemical knew of Wolas's fraud. These allegations only support a finding that Chemical had constructive notice of the fraud.

[*28] 2. *Substantial Assistance*

The second element of an aiding and abetting fraud claim is substantial assistance. "A defendant provides substantial assistance only if it 'affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables [the fraud] to proceed.'" *Nigerian Nat'l*, 1999 WL 558141, at *8 (quoting *Diduck v. Kaszycki & Sons Contractors, Inc., 974 F.2d 270, 284 (2d Cir. 1992))* (alteration in *Nigerian Nat'l*).

Again, the plaintiffs have failed to allege that Chemical substantially assisted Wolas's fraud. The affirmative acts of opening the accounts, approving various transfers, and then closing the accounts on the basis of suspected fraud, without more, do not constitute substantial assistance. In *Williams*, the court considered whether the use of bank accounts by the participants in the fraudulent scheme constituted substantial assistance by the bank in the participants' fraud. *See* 1997 WL 289865, at *4. Rejecting the claim, the court held that "the mere fact that all the participants in the alleged scheme used accounts at [the bank] to perpetrate it, without more, does not rise [*29] to the level of substantial assistance necessary to state a claim for aiding and abetting liability." *Id.; see also Nigerian Nat'l*, 1999 WL 558141, at *8 (bank's execution of repeated wire transfers for millions of dollars did not constitute substantial assistance for an aiding and abetting fraud claim); *Renner*, 2000 WL 781081, at *12 (Chase did not give substantial assistance to participants of prime bank guarantee scam simply because participants used accounts at Chase).

Turning to the plaintiffs' allegations of Chemical's inaction, *e.g.*, failing to shut down the accounts sooner or to inform the plaintiffs about the suspected fraud, these omissions likewise do not rise to the level of substantial assistance. As previously stated, a defendant may provide substantial assistance by failing to act only when it was required to act. *See Nigerian Nat'l*, 1999 WL 558141, at *8. Absent a confidential or fiduciary relationship between the plaintiff and the aider and abettor, the inaction of the latter does not constitute substantial assistance warranting aider and abettor liability. *See King v. George Schonberg & Co., 233 A.D.2d 242, 650 N.Y.S.2d 107, 108* [*30] (1st Dep't 1996); *see also Renner*, 2000 WL 781081, at *12 ("Absent a fiduciary duty, inaction does not constitute substantial assistance."). Here, the plaintiffs and Chemical do not have a fiduciary relationship. The relationship between a bank and its depositor is not a fiduciary one, but only that of a debtor and creditor. *See Aaron Ferer & Sons, Ltd. v. Chase Manhattan Bank, N.A., 731 F.2d 112, 122 (2d Cir. 1984).* Thus, RFIN or RFIN's Chairman, who had an account at Chemical's Private Banking Group, did not have a fiduciary relationship with Chemical. DOIT is not even a client of Chemical. Moreover, even assuming that RFIN had a confidential relationship with Chemical by virtue of its status as a customer, *see id. at 123* ("[A] bank should keep its own customers' affairs confidential." (citing *Graney Dev. Corp. v. Taksen, 92 Misc. 2d 764, 400 N.Y.S.2d 717, 719* (Sup. Ct.), *aff'd*, 66 A.D.2d 1008, 411 N.Y.S.2d 756 (4th Dep't 1978))), Chemical was under no obligation to disclose confidential information about Wolas, another customer. The plaintiffs, therefore, have failed to establish that Chemical [*31] substantially assisted in Wolas's fraud. Accordingly, their aiding and abetting fraud claim must be dismissed.

D. *Commercial Bad Faith*

A claim for commercial bad faith against a depository bank will lie if the "bank acts dishonestly -- where it has actual knowledge of facts and circumstances that amount to bad faith, thus itself becoming a participant in the fraudulent scheme." *Prudential-Bache Sec., Inc. v. Citibank, N.A., 73 N.Y.2d 263, 275, 539 N.Y.S.2d 699, 536 N.E.2d 1118 (1989).* Thus, "knowledge of the underlying wrong" is a "required element" of commercial bad faith under New York law. *Wight v. Bankamerica Corp., 219 F.3d 79, 91 (2d Cir. 2000).*

As I have already concluded that the complaint fails adequately to allege that Chemical had actual knowledge of Wolas's fraud, the plaintiffs' claim for commercial bad faith must also be dismissed. At most, the plaintiffs have alleged that Chemical negligently failed to monitor the accounts adequately and close them promptly. However, pleading "'merely a lapse of wary vigilance or even suspicious circumstances which might well have induced a prudent banker to investigate'" is insufficient to [*32] state a claim of commercial bad faith. *Renner*, 2000 WL 781081, at *17 (quoting *Prudential-Bache, 73 N.Y.2d at 275*); *see also Nigerian Nat'l*, 1999 WL 558141, at *8 (bank's alleged failure to investigate "red flags" and negligent approval of additional wire transfers, even after bank was alerted to fraudulent transfer, insufficient to state commercial bad faith claim).

The plaintiffs' reliance on *Prudential-Bache, 73 N.Y.2d 263, 539 N.Y.S.2d 699, 536 N.E.2d 1118*, and *Peck v. Chase Manhattan Bank, N.A., 190 A.D.2d 547, 593 N.Y.S.2d 509* (1st Dep't 1993), to support their contention that Chemical had actual knowledge of Wolas's fraud is unpersuasive. Indeed, these cases support Chase's position. In *Prudential-Bache*, two bank officers were convicted of accepting bribes in connection with participation in a fraudulent scheme. The bank officers set up accounts without proper opening records and corporate resolutions, and with fictitious corporate officers, and also agreed not to prepare certain records required to be filed with the Internal Revenue Service. *See 73 N.Y.2d at 267.* To implement the embezzlement scheme, one of the co-conspirators [*33] cashed several checks on a single day and often left the branch with large quantities of cash or cashiers' checks. Furthermore, other bank employees, including managers, were also allegedly aware of the fraud due to a co-conspirator's frequent visits to the bank, his repeated large cash withdrawals at teller windows, and his conversations with other bank employees. *See id. at 268.* Although the bank argued that the conduct of its agents, the convicted officers, could not be imputed to it under the adverse agent doctrine, the New York Court of Appeals declined to decide that issue and held that the plaintiff had stated a commercial bad faith claim against the bank. *See id. at 276-77.* In *Peck*, the plaintiff alleged that an internal bank memorandum reflected that bank employees actually knew that checks payable to third parties were being deposited into the thief's account, but no action was taken. *593 N.Y.S.2d at 511.* The trial court granted the bank's motion to dismiss, but the Appellate Division reversed, holding that the allegations of actual knowledge adequately stated a claim for commercial bad faith. *See id.*

Here, the plaintiffs' [*34] allegations fall short of these cases, which involved either active participation in the fraud by bank officials or actual knowledge on their part of the ongoing fraud, as they have failed to allege either on the part of Chemical. Accordingly, their commercial bad faith claim must be dismissed.

E. *Leave to Amend*

The plaintiffs argue, in the alternative, that if I grant Chase's motion I should give them leave to replead. I decline to do so.

A district court may deny leave to amend a complaint if the amendment would be futile. *See Foman v. Davis, 371 U.S. 178, 182, 9 L. Ed. 2d 222, 83 S. Ct. 227 (1962)*. As the plaintiffs drafted their complaint well after discovery had been taken in a related case, *see Accousti v. Wolas*, 95-CV-5267 (JG) (E.D.N.Y. filed Dec. 20, 1995), an opportunity to amend would be futile. *See Billard v. Rockwell Int'l Corp., 683 F.2d 51, 57 (2d Cir.1982)* (denial of leave to amend not abuse of discretion where plaintiff had "access to full discovery" in a related case).

CONCLUSION

For the aforementioned reasons, Chase's motion to dismiss is granted.

So Ordered.

JOHN GLEESON, U.S.D.J.

DATED: September 20, 2000

[*35] Brooklyn, New York

EXHIBIT 2

511

COMMONWEALTH OF MASSACHUSETTS

SUFFOLK, ss.

SUPERIOR COURT
CIVIL ACTION
NO. 01-116-BLS2
(and Consolidated
Actions)

GAIL A. CAHALY, JEFFREY JOHNSTON, MASSACHUSETTS LUMBER COMPANY, JOSEPH IANTOSCA, Individually and as Trustee of FAXON HEIGHTS REALTY TRUST and FERN REALTY TRUST, BELRIDGE CORPORATION, and BELLEMORE ASSOCIATES, LLC,

Plaintiffs,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH,

Defendant

SPECIAL JURY VERDICT

I. Aiding and Abetting Breach of Fiduciary Duty

1. Did Merrill Lynch have actual knowledge that Benistar Property Exchange Trust Company, Inc. ("Benistar") was breaching the fiduciary duty it owed to Benistar's clients?

Yes __X__ No ______

If your answer to Q.1 is Yes, go to Q.2. If your answer to Q.1 is No, go to Q.6.

2. Did Merrill Lynch provide substantial assistance to Benistar in connection with Benistar's breach of fiduciary duty to one or more of the plaintiffs?

Yes __X__ No ______

If your answer to Q.2 is Yes, go to Q.3. If your answer to Q.2 is No, go to Q.6.

3. Was Merrill Lynch's substantial assistance a proximate cause of injury or harm to one or more of the plaintiffs listed below:

(a) Gail Cahaly	Yes X	No ______
(b) Jeffrey Johnston	Yes X	No ______
(c) Joseph Iantosca	Yes X	No ______
(d) Joseph Iantosca, as trustee for Faxon Heights Realty Trust	Yes X	No ______
(e) Joseph Iantosca, as trustee for Fern Realty Trust	Yes X	No ______

Go to Q.4.

4. Was Merrill Lynch's substantial assistance a proximate cause of injury or harm to one or more of the plaintiffs listed below while their funds were deposited and held in Benistar's accounts at Merrill Lynch:

(a) Massachusetts Lumber Co.	Yes X	No ______
(b) Belridge Corporation	Yes X	No ______
(c) Bellemore Associates LLC	Yes X	No ______

Go to Q.5.

5. Was Merrill Lynch's substantial assistance a proximate cause of injury or harm to one or more of the plaintiffs listed below while their funds were deposited and held in Benistar's account at PaineWebber:

(a) Massachusetts Lumber Co.	Yes X	No ______
(b) Belridge Corporation	Yes X	No ______
(c) Bellemore Associates LLC	Yes X	No ______

Go to Q.6.

II. Aiding and Abetting Conversion

6. Did Merrill Lynch have actual knowledge that Benistar was converting funds of Benistar's clients?

Yes X No ____

If your answer to Q.6 is Yes, go to Q.7. If your answer to Q.6 is No, go to Q.11.

7. Did Merrill Lynch provide substantial assistance to Benistar in connection with Benistar's conversion of funds of one or more of the plaintiffs?

Yes X No ____

If your answer to Q.7 is Yes, go to Q.8. If your answer to Q.7 is No, go to Q.11.

8. Was Merrill Lynch's substantial assistance a proximate cause of injury or harm to one or more of the plaintiffs listed below:

(a) Gail Cahaly	Yes X	No ____
(b) Jeffrey Johnston	Yes X	No ____
(c) Joseph Iantosca	Yes X	No ____
(d) Joseph Iantosca, as trustee for Faxon Heights Realty Trust	Yes X	No ____
(e) Joseph Iantosca, as trustee for Fern Realty Trust	Yes X	No ____

Go to Q.9.

9. Was Merrill Lynch's substantial assistance a proximate cause of injury or harm to one or more of the plaintiffs listed below while their funds were deposited and held in Benistar's accounts at Merrill Lynch:

(a) Massachusetts Lumber Co.	Yes X	No ____
(b) Belridge Corporation	Yes X	No ____

(c) Bellemore Associates LLC Yes X No ______

Go to Q.10.

10. Was Merrill Lynch's substantial assistance a proximate cause of injury or harm to one or more of the plaintiffs listed below while their funds were deposited and held in Benistar's account at PaineWebber:

(a) Massachusetts Lumber Co. Yes X No ______

(b) Belridge Corporation Yes X No ______

(c) Bellemore Associates LLC Yes X No ______

Go to Q.11.

III. Violation of the New York Consumer Protection Statute

11. Did Merrill Lynch engage in a consumer-oriented act or practice in connection with its dealings with Benistar's accounts held at Merrill Lynch?

Yes X No ______

If your answer to Q.11 is Yes, go to Q.12. If your answer to Q.11 is No, go to Q.16

12. Was such an act or practice deceptive or misleading in any material way?

Yes X No ______

If your answer to Q.12 is Yes, go to Q.13. If your answer to Q.12 is No, go to Q.16.

13. Was Merrill Lynch's deceptive or misleading act or practice a proximate cause of injury or harm to one or more of the plaintiffs listed below:

(a) Gail Cahaly Yes X No ______

(b) Jeffrey Johnston Yes X No ______

(c) Joseph Iantosca Yes X No ______

(d) Joseph Iantosca, as trustee for Faxon Heights Realty Trust — Yes X — No ______

(e) Joseph Iantosca, as trustee for Fern Realty Trust — Yes X — No ______

Go to Q.14.

14. Was Merrill Lynch's deceptive or misleading act or practice a proximate cause of injury or harm to one or more of the plaintiffs listed below while their funds were deposited and held in Benistar's accounts at Merrill Lynch:

(a) Massachusetts Lumber Co. — Yes X — No ______

(b) Belridge Corporation — Yes X — No ______

(c) Bellemore Associates LLC — Yes X — No ______

Go to Q.15.

15. Was Merrill Lynch's deceptive or misleading act or practice a proximate cause of injury or harm to one or more of the plaintiffs listed below while their funds were deposited and held in Benistar's account at PaineWebber:

(a) Massachusetts Lumber Co. — Yes X — No ______

(b) Belridge Corporation — Yes X — No ______

(c) Bellemore Associates LLC — Yes X — No ______

Go to Q.16.

IV. Violation of the Connecticut Unfair Trade Practices Act

16. Did Merrill Lynch engage in or commit one or more unfair or deceptive trade practices in connection with its dealing with the Benistar accounts held at Merrill Lynch?

Yes X — No ______

If your answer to Q.16 is Yes, go to Q.17. If your answer to Q.16 is No, stop here, sign the verdict slip, and return to the courtroom.

17. Were Merrill Lynch's unfair or deceptive trade practices a proximate cause of injury or harm to one or more of the plaintiffs listed below:

(a) Gail Cahaly	Yes X	No ______
(b) Jeffrey Johnston	Yes X	No ______
(c) Joseph Iantosca	Yes X	No ______
(d) Joseph Iantosca, as trustee for Faxon Heights Realty Trust	Yes X	No ______
(e) Joseph Iantosca, as trustee for Fern Realty Trust	Yes X	No ______

Go to Q.18.

18. Were Merrill Lynch's unfair or deceptive trade practices a proximate cause of injury or harm to one or more of the plaintiffs listed below while their funds were deposited and held in Benistar's accounts at Merrill Lynch:

(a) Massachusetts Lumber Co.	Yes X	No ______
(b) Belridge Corporation	Yes X	No ______
(c) Bellemore Associates LLC	Yes X	No ______

Go to Q.19.

19. Were Merrill Lynch's unfair or deceptive trade practices a proximate cause of injury or harm to one or more of the plaintiffs listed below while their funds were deposited and held in Benistar's account at PaineWebber:

(a) Massachusetts Lumber Co.	Yes X	No ______
(b) Belridge Corporation	Yes X	No ______
(c) Bellemore Associates LLC	Yes X	No ______

Go to next page.

I certify that each of the questions answered above was so answered by at least 11 of the jurors.

Foreperson

Date: June 25, 2009

I HEREBY ATTEST AND CERTIFY ON June 29, 2009, THAT THE FOREGOING DOCUMENT IS A FULL, TRUE AND CORRECT COPY OF THE ORIGINAL ON FILE IN MY OFFICE, AND IN MY LEGAL CUSTODY.

MICHAEL JOSEPH DONOVAN
CLERK / MAGISTRATE
SUFFOLK SUPERIOR CIVIL COURT
DEPARTMENT OF THE TRIAL COURT

BY Assistant Clerk

EXHIBIT 3

Paul V. Shalhoub (Admitted *Pro Hac Vice*)
Rachel C. Strickland (Admitted *Pro Hac Vice*)
Lawrence O. Kamin (Admitted *Pro Hac Vice*)
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Attorneys for the Debtors and
Debtors in Possession

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

In re:	:	Chapter 11
LandAmerica Financial Group, Inc., et al.,	:	Case No. 08-35994 (KRH)
Debtors.	:	Jointly Administered

ORDER ESTABLISHING SCHEDULING PROTOCOL
FOR ADVERSARY PROCEEDINGS

The Joint Motion of LandAmerica 1031 Exchange Services, Inc. (the "**Debtor**") and the Official Committee of Unsecured Creditors of LandAmerica 1031 Exchange Services, Inc. (the "**Committee**") to Establish Scheduling Protocol for Adversary Proceedings (the "Joint Motion") is GRANTED.

IT IS ORDERED that the following schedule is established for adversary proceedings filed in the above-captioned cases:

1. *Millard Refrigerated Services, Inc. v. LandAmerica 1031 Exchange Services, Inc.*, Adv. Proc. No. 08-03147, *Frontier Pepper's Ferry LLC v. LandAmerica Exchange Services, Inc.*, Adv. Proc. No. 08-03148, *HealthCare REIT, Inc. v. LandAmerica 1031 Exchange Services, Inc.*, Adv. Proc. No. 08-03149, another case involving a Commingled Type A Case as defined in the Joint Motion to be determined by Debtor, the Committee, and the Official Committee of Unsecured Creditors for LandAmerica Financial Group, Inc. (the "LFG Committee"); and *Howard Finkelstein v. LandAmerica 1031 Exchange Services, Inc.*, Adv. Proc. No. 08-03171, shall serve as the lead adversary proceedings (the "**Lead Cases**") in this matter because they provide a representative sampling of the adversary proceedings filed to date with respect to the terms and conditions of the parties exchange agreements, use of the exchange funds, and applicable governing law, and provided that no Lead Case shall include LandAmerica Financial Group, Inc. ("LFG") as a party or involve adjudication of any claims by or against LFG.

2. All adversary proceedings in the above-captioned cases other than the Lead Cases, all adversary proceedings filed in these cases subsequent to the entry of this Order, and all motions or other requests for relief (whether pending as of the entry of this Order or filed subsequent to entry of this Order) directed to the disposition of Exchange Funds (as defined in the Joint Motion) or concerning the parties' rights and obligations under an Exchange Agreement(s) (as defined in the Joint Motion) are hereby stayed pending further order of this Court. The stay imposed hereto includes, but is not limited to, the requirement to file an answer or other responsive pleading, pretrial conference, discovery (including discovery related motion

practice), the amending of pleadings (including complaints), and the filing of dispositive motions and responses thereto.

3. The LFG Committee is hereby authorized to intervene into any or all of the Lead Cases by filing with the Court a Notice of Intervention in the bankruptcy case and in each applicable adversary proceeding on or before January 19, 2009.

4. On or before January 19, 2009, the Plaintiffs in the Lead Cases, the Debtor, the Committee, and the LFG Committee to the extent the LFG Committee has elected to intervene in the Lead Cases (the "**Parties**") shall submit to the Court a proposed Agreed Protective Order or, if not agreed, a proposed Protective Order indicating where agreement could not be reached.

5. On or before January 19, 2009, Debtor shall answer or otherwise respond to the complaints in the Lead Cases.

6. On or before January 19, 2009, the Parties shall serve any written discovery to Parties, with responses due ten (10) days after the date of service. No Party shall serve more than ten (10) Interrogatories, including subparts, or twenty (20) Requests for Admission on another Party. Nothing herein shall prevent the Parties from serving discovery requests or responses prior to the filing of the Debtor's responsive pleading(s).

7. On or before January 19, 2009, Debtor shall produce (1) all books, records, and account and transaction detail (electronically and in native format where available) relating to all accounts holding customer funds of the Lead Plaintiffs at any time during the previous 12 months, any transactions impacting such accounts, or the tracing of funds into, out of, or among such accounts; (2) back-up documentation or data, if any, to the spreadsheets submitted as Exhibit A to the Declaration of Ronald Ramos in Support of Debtor's Motion for an Order Pursuant to Sections 105(a) and 363(b) of the Bankruptcy Code and Bankruptcy Rule 9019

Establishing Procedures to Settle Claims Involving Segregated Exchange Funds filed on December 15, 2008 (Exhibit 1, docket entry no. 334); and (3) readily available and identifiable general information describing the movement of exchange funds in or through all accounts holding exchange funds.

8. On or before February 20, 2009, all fact depositions and third party discovery to be completed, at which time motions for summary judgment may be filed.

9. In the event a Party intends to rely upon expert opinion(s), on or before February 20, 2009, the Party shall make the disclosure of expert testimony required by Rule 7026(a)(2) of the Federal Rules of Bankruptcy Procedure; or if the evidence is intended solely to contradict or rebut evidence on the same subject matter identified by another party under Rule 7026(a)(2)(B) of the Federal Rules of Bankruptcy procedure, disclosures shall be made on or before fourteen (14) days after the disclosure made by the other party.

10. Where designated, all expert discovery and expert depositions to be completed on or before March 13, 2009.

11. On or before March 13, 2009, the Parties shall file all motions, including motions for summary judgment and motions objecting to the reliability of expert testimony. Responses to motions for summary judgment shall be due on the later of twenty-one (21) days after the date of filing or the deadline for fact discovery set forth above. Responses to all other motions shall be due ten (10) days after the date of filing.

12. On or before ten (10) days prior the Trial Date (as defined below), counsel for each of the Parties shall file (a) a list of witnesses the Party intends to call at trial, (b) a list of proposed exhibits and the proposed exhibits, (c) motions in limine, and (d) a designation of witnesses whose testimony is expected to be presented by means of a deposition and a redacted

transcript of the pertinent portions of the deposition testimony. Any other Party may file counter designations to the redacted portions designated of a deposition transcript they deem relevant on or before five (5) days prior to the Trial Date.

13. On or before seven (7) days prior to the Trial Date, counsel for each of the Parties shall file (a) any objections to proposed exhibits, (b) responses to motions in limine, (c) any objections to the use under Rule 7032(a) of the Federal Rules of Bankruptcy Procedure of a deposition so designated, and (d) a list of any rebuttal witnesses. Exhibits to which no timely objection has been made will stand as admitted into evidence.

14. The Pre-Trial Hearing for the Lead Cases shall take place on or about April 7, 2009, at which time the Court shall select the order of trial for the four Lead Cases.

15. The trial of the first of the Lead Cases shall commence on or before April 23, 2009 at 10:00 a.m. (the "**Trial Date**").

16. Plaintiffs in adversary proceedings filed in this case other than the Lead Cases and other customers of LES shall not be allowed to intervene in the Lead Cases; provided that: (a) such plaintiffs and customers on whose behalf counsel has filed a notice of appearance shall be entitled to receive copies of documents and deposition testimony from the Lead Cases upon request and at their cost if they have agreed to be bound by the terms of the protective order referenced above; and (b) such plaintiffs and customers shall be authorized to file amicus briefs in connection with summary judgment motions or pre-trial proceedings in accordance with the deadlines set forth above.

17. Counsel to the Parties may by agreement continue discovery beyond the deadlines set forth herein, but shall not have the authority to continue motions, pretrial, or trial deadlines.

The Parties may also agree to shorten the deadlines should the need for discovery in the particular case not warrant the length of time accorded.

18. Entry of this Order is without prejudice to Debtor's right to seek to settle any adversary proceeding under Rule 9019 of the Bankruptcy Rules, on motion and two-days' notice. *See* Hr'g Tr. (12/16/08; recorded by electronic sound recording) at 44.

19. The Court may modify this Order on motion of Debtor, Committee, or any Lead Plaintiff for cause shown.

20. The Clerk of Court is directed to enter this Order on the docket of each adversary proceeding commenced in this case.

Dated: January ______, 2009

Jan 16 2009

/s/ Kevin Huennekens

KEVIN R. HUENNEKENS
UNITED STATES BANKRUPTCY JUDGE

Entered on docket: Entered on docket: January 16, 2009

STIPULATED AND AGREED:

January 16, 2009

Lawrence O. Kamin Terence K. McLaughlin Elizabeth J. Bower WILLKIE FARR & GALLAGHER LLP 787 Seventh Avenue New York, New York 10019 (212) 728-8000 - and - /s/ John H. Maddock III Dion W. Hayes (VSB No. 34304) John H. Maddock III (VSB No. 41044) McGUIREWOODS LLP One James Center 901 East Cary Street Richmond, Virginia 23219 (804) 775-1000 Counsel to the Debtor and Debtor in Possession	Mary A. House (VSB No. 66613) AKIN GUMP STRAUSS HAUER & FELD LLP 1333 New Hampshire Avenue, NW Washington, DC 20036 (202) 887-4000 -and- Charles R. Gibbs Keefe Bernstein Sarah Link Schultz AKIN GUMP STRAUSS HAUER & FELD LLP 1700 Pacific Avenue, Suite 4100 Dallas, Texas 75201 (214) 969-2800 -and- /s/ Lynn L. Tavenner (with permission via email dated January 16, 2009) Lynn L. Tavenner (VSB No. 30083) Paula S. Beran (VSB No. 34679) TAVENNER & BERAN, PLC 20 North Eighth Street, 2nd Floor Richmond, Virginia 23219 Counsel to the Official Committee of Unsecured Creditors for LandAmerica 1031 Exchange Services, Inc.

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