IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA
ANDERSON DIVISION

IN RE: LANDAMERICA 1031 EXCHANGE SERVICES, INC., INTERNAL REVENUE SERVICE § 1031 TAX DEFERRED EXCHANGELITIGATION	**Case No.: MDL No. 2054**
Angela M. Arthur, as Trustee of the Arthur Declaration of Trust, dated December 29, 1988; Vivian R. Hays, an individual; Leapin Eagle, LLC, a limited liability company; Denise J. Wilson, an individual; Gerald R. Terry, an individual; Ann T. Robbins, an individual; and Jane T. Evans, an individual; on their own behalf and on behalf of a class of others similarly situated, Plaintiffs, vs. SunTrust Bank; Theodore L. Chandler, Jr.; G. William Evans; Stephen Conner; Ronald B. Ramos; Devon M. Jones; and Brenton J. Allen, Defendants.	Southern District of California C.A. No. 3:09-cv-00054 District of South Carolina C.A. No. 8:09-cv-00415

PLAINTIFFS' CONSOLIDATED MEMORANDUM IN OPPOSITION TO MOTION TO DISMISS FOR LACK OF STANDING AND PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE FRCP 12(b)(6) OF DEFENDANTS CHANDLER, EVANS, RAMOS AND JONES (Docket Entry #50), AND MOTIONS TO DISMISS PURSUANT TO FRCP 12(B)(6) OF DEFENDANT STEPHEN CONNOR (Docket Entry # 48) AND DEFENDANT BRENTON J. ALLEN (Docket Entry # 56)

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I. PRELIMINARY STATEMENT

The Plaintiffs file this Memorandum in Opposition to Motions to Dismiss based on standing and pursuant to FRCP 12(b)(6) filed by Theodore L. Chandler, Jr., G. William Evans, Stephen Connor, Ronald R. Ramos, Devon M. Jones and Brenton J. Allen (collectively the "Individual Defendants")[1]. The Individual Defendants are senior executives at LandAmerica 1031 Exchange Services, Inc. ("LES") and LandAmerica Financial Group, Inc. ("LFG") who directed the affairs of LES before and after the collapse of the ARS market in February of 2008. The 400 Exchangers who comprise the class entered entrusted their Exchange Funds to LES after February 2008 and before LES filed for bankruptcy on November 26, 2008.

The Plaintiffs' Complaint is not predicated on the propriety or impropriety of LES investing Exchange Funds in ARS. The investment occurred, it failed, and damages were suffered by the Exchangers doing business with LES as of February 2008. The Plaintiffs' claims are predicated on the fact that their money was used as an interim solution to the problems caused by the earlier investment in ARS.

Each of the 400 Exchangers who comprise the class received an Exchange Agreement executed by LES after February 2008 (after the ARS market froze). The Agreements and the relationship created thereunder gave rise to specific fiduciary duties governing the holding and safekeeping of the Exchange Funds for the benefit of the Exchangers. Plaintiffs allege that the Individual Defendants knew, approved, and directed the misuse of their funds. The Individual Defendants, working as agents of LES, cannot knowingly participate in tortuous conduct and the claim no civil liability arises because they were merely servants of the defrauding principal. A

[1] Plaintiffs also incorporate by reference their Opposition to the Motion to Dismiss filed by Defendant SunTrust.

corporation can only act through its agents. Misconduct by an agent on behalf of a corporation is still a tort of the agent.

The Individual Defendants' standing argument defies common sense. The Individual Defendants assisted LES in wrongfully diverting the Plaintiffs' funds. The Plaintiffs have a direct cause of action against the Individual Defendants irrespective whether the claims are ultimately subjected to a temporary injunction by the Bankruptcy Court. Any such injunction arises, if at all, from concerns regarding depletion of insurance proceeds, not any issue of standing. Availability of insurance proceeds is not a matter that should be of concern to this Court on Motion to Dismiss.

The Individual Defendants' reliance on the Bankruptcy Court's conclusion that Exchange Funds are property of the LES bankruptcy estate is also misplaced. The presumptions utilized by the Bankruptcy Court do not apply in this case. The presumptions intended to foster the equitable distribution of assets to like-kind creditors, not to act as a shield for the Individual Defendants from liability for their own wrong-doing. The Plaintiffs' arguments as to why the Bankruptcy Court's ruling has no binding effect, is of no precedential value, and is simply wrong are contained in their Memorandum in Opposition to Motion to Dismiss of Defendant SunTrust, which is incorporated herein in full by reference. The Plaintiffs pled causes of action against the Individual Defendants for breach of fiduciary duty (Fourth Cause of Action), negligence (Fifth Cause of Action), fraud and fraudulent concealment (Sixth Cause of Action) and constructive fraud (Seventh Cause of Action). Plaintiffs believe the fraud claims are already pled in sufficient detail. However, in the last week Plaintiffs have received from LES more than 90,000 pages of discovery produced in the bankruptcy lead cases. Rather than respond to the Individual Defendants' assertions of inadequate pleading detail, out of an abundance of caution,

Plaintiffs, once an appropriate Protective order is in place allowing them to share the documents with Defendants, will be filing a Motion to Amend to re-plead in even more detail the fraud claims based on the newly discovered evidence. The Plaintiffs hereby proceed in this Memorandum on their breach of fiduciary duty and negligence claims. [2]

II. STATEMENT OF FACTS

IRC §1031 allows for the deferral of capital gains when like-kind property is exchanged by the taxpayer within 180 days and the taxpayer does not constructively receive the proceeds of the sale (Complt. ¶¶ 30,34).

Stephen Connor, the Senior Vice President for LES, described the physical activities performed by a QI, like LES:

> **Question by Lawyer:** What is your understanding of what a QI is?
>
> **Answer by Connor:** QI is any party that is not disqualified, who takes control and possession of a taxpayer's relinquished property, sells it, transfers it, receives the funds, and acquires replacement property or property of like kind within the parameters of Section 1031. (Am. Complt. ¶ 41)

LES was a QI assisting clients perform 1031 Exchanges for a $1000 fee and a percentage of the interest earned on the deposit of the Exchange Funds at SunTrust. (Am. Complt. ¶¶ 35-47). The Exchange Funds were transferred to LES "to hold" for safekeeping, and only safekeeping, pending each Exchanger's 1031 Exchange (Am. Complt. ¶ 38). The Exchange Agreements executed after February 2008 and before LES filed for bankruptcy (November 26, 2008) by the 400 Exchangers who lost their Exchange Funds state that the "Exchange Funds" will be used solely by LES to purchase each client's replacement property. LES ran a Ponzi

[2] This is not a breach of contract action against LES but a tort action against SunTrust Bank and the Individual Defendants, none of whom were parties to the Plaintiffs' Exchange Agreements with LES. Therefore the reference by Defendants Chandler, Evans, Ramos and Jones in footnote 6, p.17 of their Memorandum to a waiver of jury trial in the Exchange Agreements is inapplicable to this action.

scheme after February of 2008. (Am. Complt. ¶¶ 64-78).[3] The Individual Defendants participated in the Ponzi scheme (Am. Complt. ¶¶ 22-27), as evidenced by the allegations applicable to each as set out in paragraphs 113-167 of the Complaint.

Defendant Ronald Ramos served as Vice President and Treasurer of LES, as well as Senior Vice President and Treasurer of LFG. (Am. Complt. ¶ 113). He also served as Executive Vice President and Chief Financial Officer of LFG. *Id.* His functions were oversight of cash management and investment management, as well as involvement with establishing investment guidelines, which drove acceptable investments. *Id.* During the 2008 time frame, Ramos reported directly to Defendant William Evans. *Id.* Evans served on the Board of Directors of LES and at some point in 2008, was an officer of LES. (Am. Complt. ¶ 134). Evans directed Ramos's day-to-day activities. (Am. Complt. ¶¶ 113, 135).

Defendant Devon Jones served as Vice President and Assistant Treasurer with LES and LFG. Jones was responsible for LES's cash management process, handling the daily cash operations and the administration of the bank accounts. (Am. Complt. ¶ 114). She reported directly to Defendant Ramos. *Id.*

A part of Defendant Ramos's responsibilities as Treasurer of LES was to oversee all of the Funds that LES was holding for its Exchange clients. (Am. Complt. ¶ 115). He had full authority to direct the SunTrust 3318 account where the Exchange Funds of Plaintiffs and other Exchangers were deposited by LES. *Id.*

Ramos and Jones did not have in place any written internal controls regarding the

[3] QIs who pay older exchanges with after-acquired funds when the trust is in a deficit operate a Ponzi scheme. *See Taxel v. Surnow (In re San Diego Realty Exch., Inc.)*, 132 B.R. 424 (Bankr. S.D. Cal. 1991), *rev'd on other grounds*, 1994 U.S. App. LEXIS 10317 (9th Cir. Cal. May 2, 1994) Even when a QI does not start out as a Ponzi scheme, "once [the company] mismanaged and converted the funds of some clients, and kept taking in the business and assets of others, it quickly became that." *Manty v. Miller & Holmes, Inc*. (*In re Nation-Wide Exch. Services*), 291 B.R. 131, 149 n. 20 (Bankr. D. Minn. 2003) (stating that this case could be termed a "resulting Ponzi scheme or Ponzi schemes by performance").

SunTrust 3318 account. They allowed LES to use the account as an operating account, commingling fees due to LES with Exchange Funds. (Am. Complt. ¶ 116).

Ramos was a member of the LES's Investment Funds Committee and signed the minutes as Secretary. (Am. Complt. ¶ 117). Jones attended the meetings. (Am. Complt. ¶ 117).

Ramos and Jones made the decision to invest the Exchange Funds in ARS. (Am. Complt. ¶ 118). The decision was made so that LES could earn additional income and be paid more interest. *Id.*

Following the February 2008 market freeze on ARS, Ramos had regular conversations with SunTrust, as did Defendant Jones. (Am. Complt. ¶ 119). These conversations involved seeking a solution from SunTrust for LES's liquidity problems. *Id.*

Following the February 2008 market freeze on ARS, Jones began preparing a weekly chart of outflows and potential inflows to set up best-case and worst-case scenarios on "liquidity." (Am. Complt. ¶ 120). These charts were essentially a roadmap for operation of the Ponzi scheme. *Id*. These charts also warned when and whether LES would run out of funds if it were not able to secure sufficient uninformed Exchangers to keep the money flowing. *Id.* Defendants Ramos and Evans were privy to these charts. (Am. Complt. ¶¶ 120, 136).

Defendants Jones and Ramos both participated in the preparation of disclosure language for the LFG's quarterly reports, the 10-Qs, to the SEC, including the specific language used in the March, June and September quarterly reports that "like-kind exchanges not held at Centennial are not considered our assets and are not included in the accompanying consolidated balance sheets." (Am. Complt. ¶ 121). Defendant Evans was responsible for the integrity of all financial information underlying LandAmerica's balance sheet and was the primary spokesperson on all financial matters necessary to meet public financial reporting needs

mandated by the SEC. (Am. Complt. ¶ 134). He was responsible as well for budgeting, business planning, performance, and improving profitability. *Id.*

During the 2008 time frame, Defendant Steven Conner[4] was responsible for the presentation of the company to the public, design of marketing content, and messaging. (Am. Complt. ¶ 144). He approved all LES's marketing materials, as well as website content. (Am. Complt. ¶ 145).

In the wake of the highly publicized failure of several QIs around the country LES disseminated an Internet advertisement, also reduced to the form of a hard copy brochure sent to its field offices entitled "The Financial Stability of LandAmerica." (Am. Complt. ¶ 148). This is the brochure that referenced "Funds Held in Trust" followed by the statement: "escrow and 1031 Exchange customers entrusted more than $3.2 billion to LandAmerica as of December 31, 2007." (Am. Complt. ¶ 148). Defendant Conner approved the brochure, but has since denied that the reference to "Funds Held in Trust" meant that LES held funds in trust. (Am. Complt. ¶ 150).

Defendant Brenton Allen, Vice President and National Underwriting Counsel of LES and Assistant Secretary of LFG, also was responsible for reviewing LES advertising materials. (Am. Complt. ¶ 153). Mr. Allen answered to and reported to Steve Connor. (Am. Complt. ¶ 152). He was responsible for editing and approving LES promotional materials. (Am. Complt. ¶ 153).

Allen also played a role in drafting the language of the Exchange Agreements. (Am. Complt. ¶ 159). The Agreements contain the language providing that LES had "sole and

[4] Defendant Conner was Senior Vice President of LES and LFG. (Am. Complt. ¶143). He was responsible for the day-to-day running of LES. *Id.* Defendant Conner's duties with LES were to manage growth, profitability, and servicing capabilities of LES. (Am. Complt. ¶ 144).

exclusive possession, dominion, control and use of all Exchange Funds" (the "Sole Possession Language"). (Am. Complt. ¶ 159). Allen agrees that this language was included to satisfy the IRC requirement that the Exchanger not receive the sale proceeds and for no other purpose. (Am. Complt. ¶ 159).

Allen, who holds J.D. and L.L.M. degrees, currently views the reference to "trust in LES promotional materials he reviewed and approved as having been included because "it's advertising," and simply meaning "entrusted," not "in trust." (Am. Complt. ¶ 154). LES promotional materials edited and approved by Allen were disseminated by LES at trade shows, to real estate brokers, attorneys and developers of real estate, through direct mailings to potential customers, by email and by hard copy mail. (Am. Complt. ¶ 155). Allen considers certain LES advertising material he approved to be incorrect. (Am. Complt. ¶ 157).

Throughout 2008, LES's Treasury Department, through Ramos and Jones, encouraged LES employees to use commingled exchange agreements whenever possible and to set up the products accordingly. (Am. Complt. ¶ 122).

In August of 2009, Defendants Ramos and Jones participated in on-going discussion with Defendants Evans regarding LES's lack of liquidity. (Am. Complt. ¶¶ 123, 137). The substance of these discussions was that LES was running out of cash. (Am. Complt. ¶¶ 123, 165). Defendant Theodore Chandler was privy to these discussions. *Id.* Chandler was Chairman of the Board of Directors and Chief Executive Officer of LFG, the corporate parent of LES. *Id.* Chandler had been kept in the loop throughout 2008 concerning LES's liquidity problems. (Am. Complt. ¶ 165).

By early October 2008, Defendant Ramos was aware there was a reasonable potential that LES would have to cease operating. (Am. Complt. ¶ 125). On October 1, 2008, Ramos and

Jones participated in an LFG Investment Funds Committee meeting. Ramos, as Secretary, prepared minutes of the meeting, noting that LES was appealing to be a part of the SunTrust ARS settlement, "since the company is acting in a fiduciary capacity, with the funds ultimately belonging to the retail client." (Am. Complt. ¶ 126).

On October 18, 2008, Defendants Ramos, Evans, Chandler, Conner, Allen and corporate counsel Michelle Gluck, were involved in extensive discussion regarding a prior directive that would have stopped Exchange Funds from flowing into the commingled SunTrust 3318 account. (Am. Complt. ¶¶ 128, 140, 156, 165, 166). They collectively made the decision to rescind that directive and to continue to encourage prospective exchangers to sign up for commingled exchanges. *Id.* In making this decision Ramos knew that unless liquidity returned to the ARS market, the cash in the commingled 3318 account would not be sufficient to meet all the obligations of LES per the exchange agreements. *Id*. It was his belief that going forward on the directive not to open any more commingled accounts, combined with other factors, would put LES in a position where it would be out of cash within two weeks. *Id*. Ramos was aware that continued operation of the Ponzi scheme required an influx of new Exchange Funds into the SunTrust 3318 account. *Id.*

Part of the October 18, 2008 discussion was the manner in which LES should respond to due-diligence inquiries. (Am. Complt. ¶¶ 129, 141). The decision made by the Individual Defendants was that LES would continue to do business as usual. *Id*. The discussions also involved whether there were changes that could be made to make the exchange documents more advantageous to LES. (Am. Complt. ¶ 156). That same weekend Chandler was involved in drafting a letter to Treasury Secretary Henry Paulson seeking liquidity assistance. (Am. Complt. ¶ 167). This letter, which referred to LES "as a fiduciary to facilitate IRS Section 1031 real

estate transactions," requested immediate financial assistance from the federal government and referenced the potential for "a disastrous chain reaction." (Am. Complt. ¶ 167).

Ramos reviewed, but did not correct correspondence sent by Defendant Chandler dated October 20, 2008 to Treasury Secretary Paulson stating: "These suddenly unmarketable securities . . . are held by LandAmerica as a fiduciary to facilitate IRS Sec. 1031 real estate transactions made mostly by small businesses and individuals." (Am. Complt. ¶ 130).

Neither Ramos nor Evans advised or contemplated advising marketing or sales personnel that they should inform exchangers that there were occasions when their incoming monies would be used to satisfy obligations owed to older exchangers. (Am. Complt. ¶¶ 131, 142).

In October of 2008, Defendant Conner instructed his employees to remove from the LES website references to LES's financial stability, acknowledging that the materials were outdated because they referred to ratings by ratings agencies and amounts of reserves by underwriters and that all those numbers had changed and were no longer accurate. (Am. Complt. ¶ 146). Defendant Conner did not, however, recall any hard copy marketing materials located in LES field offices. (Am. Complt. ¶ 147).

On two occasions in the third quarter of 2008 and one to two occasions in the fourth quarter there were insufficient Exchange Funds in the SunTrust 3318 account to fund operating expenses, dividends, and Exchange transactions, even by expending all new Exchange clients' incoming Funds. (Am. Complt. ¶ 132). Rather than accept the insolvency and advise prospective Exchange clients of this highly material state of affairs, Ramos, with Defendant Evans made the decision to transfer funds from LFG as "lulling" payments to keep the fact of insolvency and imminent failure secret from prospective Exchange clients whose Funds were needed to keep LES going in the short term. (Am. Complt. ¶ 132, 138).

By mid-November 2008, Ramos was aware of the potential for an LES bankruptcy but no changes were made to LES's business as usual Ponzi scheme. (Am. Complt. ¶ 133).

Ramos, Conner and Allen, rather than meet the fiduciary duties demanded of them in their role as representatives of LES, instead signed non-disclosure agreements assuring Exchangers would be kept in the dark so that new money would keep flowing in to feed the Ponzi scheme. (Am. Complt. ¶¶ 124, 151, 163).

Plaintiffs did not fail to plead the "who, what, when, where and how" of LES's misconduct. The workings of the Ponzi scheme perpetuated by LES at the direction of the Individual Defendants is described throughout the Amended Consolidated Complaint and can be seen clearly in the October 17, 2008 email from Defendant Ramos to Defendant Evans:

> I made the decision to move $25 million from LFG holdco to LandAmerica Exchange [LES] this afternoon in anticipation of meeting 1031 Exchange disbursement requests we received totaling approximately $22 million for early next week . . . Also contributing to this decision was my concern that the bank group, Suntrust in particular, might "freeze" the LandAmerica holdco [LFG] account and not permit a transfer of funds to the exchange Company [LES] triggering a liquidity event early next week.
>
> At close of business today, following the activity outlined above, LandAmerica holdco [LFG] has about $17 million on hand. The Exchange Company [LES] has about $30 million in cash on hand, a $10 million par value bond (worth about $9 million) and the $290.5 million in ARS. With the decision not to open any more commingled accounts [for LES at SunTrust] and the large disbursements early next week, I suspect we have a week, two at most before the Exchange Company [LES] runs out of cash if we make all remaining holdco [LFG] cash available. (Am. Complt. ¶ 76).

III. ARGUMENT

A. THE 400 EXCHANGERS HAVE STANDING TO BRING A DIRECT CAUSE OF ACTION AGAINST THE INDIVIDUAL DEFENDANTS.

"It is fundamental that a beneficiary of a trust may maintain a suit against the trustee for

breach of fiduciary obligations." *Makel v. Tredegar Trust Co.*, 69 Va. Cir. 204 (Va.Cir.Ct.,2005) (citing *Broaddus v. Gresham*, 181 Va. 725, 733 (1943) and *Ivey v. Lewls*, 133 Va. 122, 136, 112 S.E. 712 (1922); see also *Restatement (Second) of Trusts*, §§ 198 and 200 (1992). LES was a defalcating corporate trustee and its officers who knowingly participated in the tortious breaches by LES are jointly and severally liable to Plaintiffs, along with LES. *Cook Jr. v. The 1031 Exchange Corp.*, 29 Va. Cir. 302 (1992); *Airlines Reporting Corp. v. Pishvaian*, 155 F. Supp. 2d 659 (E.D. Va. 2001); *Sit-Set, A.G. v. Universal Jet Exchange, Inc*., 747 F.2d 921 (4th Cir. 1984). In the context of trusts, the beneficiaries of the trust (the 400 Exchangers) have exclusive standing to sue third parties who assisted the defalcating corporate trustee in its breach of duty. *City of Atascadero v. Merrill Lynch*, 68 Cal. App. 4th 445 (1984).

The Individual Defendants contend that the 400 Exchanger claims against them "share the same underlying focus" as the claims to be asserted by the bankruptcy trustees for LES and that the 400 Exchangers must wait until "there is an **abandonment** by the trustee of his claim." The claims of the 400 Exchangers are not the same alleged claims to be brought by the LES trustee against its own officers.

The operation of the Ponzi scheme did not injure LES. LES was injured because ARS market froze. At that point, the Individual Defendants needed to stop directing other employees at LES to solicit solicitation of new Exchangers and deal with the damages caused to LES and the Exchangers already doing business with LES at that crucial moment. Instead, the Individual Defendants decided to substitute the "roll call" of victims from old clients to new clients as an involuntary interim solution to someone else's unfortunate business situation. The acts and omissions of the Individual Defendants in operating the Ponzi scheme were clearly in breach of fiduciary duties owed by LES, through these Individual Officers and Directors to the

Exchangers, based on the sources of fiduciary duty enumerated at length in Plaintiffs' Memorandum in Opposition to Motion to Dismiss of Defendant SunTrust At a minimum the individual defendants were negligent because they continued to take new exchangers' money as it because increasingly clear that LES was building a house of cards that would fall. They could not simply close their eyes, place the Exchangers' money at grave risk and hope for the best. In the exercise of reasonable care, they knew or should have known that the music would stop and the Exchangers would be left standing empty-handed.

B. THE PLAINTIFFS' PLEADING WITH REGARD TO BREACH OF FIDUCIARY DUTY BY INDIVIDUAL DEFENDANTS IS SUFFICIENT.

Defendant Connor claims that officers of a corporation do not owe fiduciary duties to the corporation's customers. See Memo. of Connor at p. 2. Defendants Chandler, Evans, Ramon and Jones and Defendant Connor submit that the Individual Defendants did not assume fiduciary duties towards the Plaintiffs and thus seek to escape liability for breach of fiduciary duty. Defendant Allen specifically seeks dismissal of the Plaintiffs' Fourth and Fifth Causes of Action for breach of fiduciary duty and negligence against him, and incorporates by reference the briefs of Chandler, Evans, Ramos, and Jones. All five moving Individual Defendants submit the defense that LES owed no fiduciary duty based on the holding of the Bankruptcy Court and therefore they owe no such duties.

For the reasons stated in Plaintiffs' Memorandum in Opposition to Motion to Dismiss of Defendant SunTrust, Defendants' reliance on the Bankruptcy Court's ruling is without merit. The Bankruptcy's Court's opinion is not binding, is without precedential effect and simply wrong.

LES owed clear fiduciary duties to the Plaintiffs as their trustee, fiduciary, broker and agent, duties described in detail in Plaintiffs' Memorandum in Opposition to Motion to Dismiss

of defendant SunTrust, which is incorporated herein. The Individual Defendants, as directors and/or officers of LES, owed commensurate fiduciary duties to the exchange customers of LES. The Individual Defendants who directed the affairs of LES in operating a Ponzi scheme are liable for the breach of the same common law duties that LES owed to the LES Exchangers. *Cook Jr. v. The 1031 Exchange Corp.,* 29 Va. Cir. 302 (Va. Cir. Ct. 1992) (when corporation acts in a fiduciary capacity, an officer or director participating in converting entrusted §1031 exchange funds is automatically liable for breach of duty). It is no defense that one is an employee while actively operating a Ponzi scheme. The employees of LES who directed its affairs are directly liable to the Exchangers for their own torts. *Id.* Any corporate officer or director who knowingly causes misappropriation of trust property by the corporation is personally liable for participating in the breach of trust committed by the corporation. *In Re Regan*, 311 B.R. 271, 278 (Bankr. D. Colo. 2004) (president who controlled corporate debtor/fiduciary was also personally liable for breach of fiduciary duty even if officer did not personally benefit from diversion of funds); see also *Virginia-Carolina Chemical Co. v. Ehrich*, 230 F. 1005 (D.S.C. 1916) (directors and officers personally liable in negligence for corporation's misapplication of funds held by corporation as agent and trustee of plaintiff).

The Individual Defendants have asserted that because the Complaint contains no allegations of direct contact or communications among the Plaintiffs and the Individual Defendants, there can be no duty owed to the Plaintiffs. See Memo. of Chandler, *et al*. at p.37. However, under Virginia law, a corporate officer or director is liable not only for the torts he or she commits, but also for those torts the officer authorizes on behalf of the corporation. See *Airlines v. Pishvaian*, 155 F.Supp.2d 659, 666 (E.D. Va. 2001). In *PTS Corp. v. Buckman*, 263 Va. 613, 561 S.E.2d 718 (2002), the Virginia Supreme Court held the officer of the corporate

defendant subject to liability for tortious conduct in an action for improper use of plaintiff's name. In that case there was no contact between the plaintiff and the corporate officer required to hold the corporate office liable. Direct personal contact or not, corporate officers may be liable for obligations arising out of their tortious conduct that subject the corporation to liability. See *Sit-Set, A.G.* v. *Universal Jet Exchange, Inc.*, 747 F.2d 921, 929 (4th Cir. 1984) (applying Virginia law and citing *Restatement(Second) of Agency* §343 (1957).

In a claim for breach of fiduciary duty, a plaintiff is required to allege actual knowledge of the fiduciary duty and its breach and that the defendant somehow recruited, enticed, or participated in the fiduciary's breach of its duty. See *Halifax Corp. v. Wachovia,* 268 Va. 641, 661, 604 S.E.2d 403, 413 (2004). The Plaintiffs have amply pled, with more than sufficient specificity, the actions taken by the Individual Defendants that constitute the breaches of fiduciary duty by LES. (Am. Complt. ¶¶ 113-167).

Defendant Ramos was one of the persons closest to the unfolding crisis at LES. The relevant allegations concerning the knowledge of Defendant Ramos of the fiduciary duty of LES include, but are not limited to, those allegations set forth in paragraphs 113, 115, 117 – 121, 123 – 124, 126 – 130, and 133. The pertinent allegations about the participation of Ramos in LES's breach of fiduciary duty include, but are not limited to, those allegations set forth in paragraphs 115 – 117, 119 – 120, 122 – 124, 128 – 129, 131 – 133.

Defendant Jones was responsible for LES's cash management process, handling the daily cash operations and the administration of the bank accounts. In that role, she would arguably have had the most day-to-day involvement in the liquidity crisis at LES and would possess information about the operation of the Ponzi scheme. The relevant allegations concerning the knowledge of Defendant Jones of the fiduciary duties of LES include, but are not limited to,

those allegations set forth in paragraphs 114, 117 – 121, 123, 126 and 129. The pertinent allegations about the participation of Jones in LES's breach of fiduciary duty include, but are not limited to, those allegations set forth in paragraphs 117, 119 – 120, 122 – 123 and 129.

Defendant Evans was responsible for the integrity of all financial information underlying LandAmerica's balance sheet and was the primary spokesperson on all financial matters necessary to meet public financial reporting needs mandated by the SEC. He was responsible as well for budgeting, business planning, performance, and improving profitability and directed the day-to-day activities of LES Treasurer Ronald Ramos. (Am. Complt. ¶¶ 134 – 135). As chief financial officer, decisions regarding operation of a corporate Ponzi scheme would have to be carried out with his knowledge and under his direction. The relevant allegations concerning the knowledge of Defendant Evans of the fiduciary duty of LES include, but are not limited to, those allegations in paragraphs 134 – 137 and 139. The pertinent allegations about the participation of Evans in LES's breach of fiduciary duty include, but are not limited to, those allegations set forth in paragraphs 132, 138, 140 – 142.

Defendant Conner was responsible for the day-to-day running of LES. (Am. Complt. ¶ 143). As the general manager of LES, it certainly is plausible that he would know and participate in implementation of the LES Ponzi scheme and was aware of the scheme by the time of the October 2008 meetings. Consistent with such knowledge, Conner signed a non-disclosure agreement with LFG to keep quiet about the ARS and the liquidity crisis. (Am/ Compl. ¶ 151). The relevant allegations concerning the knowledge of Defendant Connor of the fiduciary duties of LES include, but are not limited to, those allegations in paragraphs 143 – 144, 146, 148 – 149 and 151. The pertinent allegations about the participation of Connors in LES's breach of fiduciary duties include, but are not limited to, those allegations set forth in paragraphs 143–151.

Defendant Allen was played a role in drafting the Exchange Agreements that impacted every exchanger. (Am. Compl. ¶ 159). His possession of knowledge pertaining to the fiduciary obligations of LES is unmistakable. The relevant allegations concerning the knowledge of Defendant Allen of the fiduciary duties of LES include, but are not limited to, those allegations in paragraphs 152, 154 – 161 and 163. The pertinent allegations about the participation of Allen in LES's breach of fiduciary duties include, but are not limited to, those allegations set forth in paragraphs 153 – 156, 159 – 160 and 162 - 163.

Defendant Chandler was Chairman of the Board of Directors and Chief Executive Officer of LFG, the corporate parent of LES. (Am. Complt. ¶164) That position would require knowledge about the events that led to the demise of the corporation he captained. The relevant allegations concerning the knowledge of Defendant Chandler of the fiduciary duties of LES include, but are not limited to, those allegations in paragraphs 164 – 165 and 167. The pertinent allegations about the participation of Chandler in LES's breach of fiduciary duties include, but are not limited to, those allegations set forth in paragraphs 166 and 167.

It is widely recognized that tortious acts committed by corporate officers on behalf of the corporation, including intentional torts, will subject the officers to liability to third parties.

> Corporate officers whose acts result in conversion by the corporation are personally liable though receiving no personal benefit. Good intentions are no defense to conversion. Further, it is not necessary that the corporate veil be pierced in order to impose personal liability when the records shows that the corporate officer knowingly participated in the conversion…A corporate officer's individual liability for conversion committed on behalf of the corporation is established n the same manner as liability for any other tort—by proof of active participation in the conversion.

3A Fletcher, Cyclopedia of the Law of Corporations § 1140 (rev. ed. 1994)(footnotes omitted).

The Fourth Circuit Court of Appeals has also upheld the liability of directors for acts performed on behalf of the corporation. In *Strauss v. U.S. Fid. & Grnty Co,* the Court stated:

> The liability of the defendant directors is founded on the fact that they did not direct the business of the corporation so that a breach of trust would not have occurred, but on the contrary, they participated in the dereliction, and are personally responsible therefore.

Strauss v U.S. Fid. & Grnty Co, 63 F.2d 174 (4th Cir. 1933)(applying S.C. law)

In an opinion issued last week, the Federal Court for the Eastern District of Virginia continues to adhere to this principle of director and officer liability. See *U.S. v. B.C. Enterprises, Inc*., ___ F.Supp.2d _____, WL 3683122, p.6, fn. 4 (E.D.Va. Nov. 6, 2009) ("Officers and directors may be held individually liable for personal participation in tortious acts even though performed solely for the benefit of the corporation, and such liability does not require that the 'corporate veil' be pierced.")(quoting 3A W. FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 1137 (rev. ed. 1994)). **(Exhibit 1)**

Clearly, Plaintiffs have included in the Amended Consolidated Complaint sufficient allegations of knowledge, direction and participation of the officers and directors in the Ponzi scheme that resulted in the misuse, diversion and loss of Plaintiffs' exchange funds, to state a claim at this stage of the litigation.

C. PLAINTIFFS HAVE PROPERLY PLED THEIR CAUSE OF ACTION FOR NEGLIGENCE.

Defendants Connor, Chandler, Evans, Ramos and Jones assert that they have no duty of care towards the Plaintiffs. See Memo. of Connor pp. 6-7; see also Memo. of Chandler, *et al.*, p. 40. However, in cases involving claims of officer liability, the Virginia Supreme Court has held:

> [A]n agent has a *tort* liability for injuries to a third party resulting from the agent's negligent act while acting within the scope of his employment by the principal.
>
> * * * *
>
> Both principal and agent are jointly liable to injured third parties for the agent's negligent performance of his common-law duty of reasonable care under the circumstances.

Miller v. Quarles, 242 Va. 343, 347, 410 S.E.2d 639, 641-642 (1991) (emphasis in original). The

Virginia Supreme Court has found corporate officers subject to a duty of care to the corporation's clients despite claims that there was no individual enrichment. *Miller,* 242 Va. at 346, 410 S.E.2d at 641; see *Allen Realty Corp. v. Holbert*, 227 Va. 441, 450, 318 S.E.2d 592, 597 (1984) (under Virginia law, an agent can be held liable for negligent performance of a contract to which he is not a party, but to which his principal is a party).

The great weight of authority has recognized that officers of a corporation are personally liable, or are jointly and severally liable with the corporation, to one whose money or property has been misappropriated or converted to the uses of the corporation, although they derived no personal benefit therefrom and acted merely as agents of the corporation -- the theory being that an agent cannot escape the consequences of his tort by the fact that he committed the tort as agent for his principal. P.H. Vartanian, *Personal liability of corporate directors or officers to third persons for restitution, or for damages for conversion, under circumstances rendering the corporation itself liable***,** 152 A.L.R. 696 (1944).

Where there is an unlawful conversion by a corporation, those who participate therein by instigation, aid, or assist are liable. See *Rose v. Bernhardt*, 107 N.J.L. 501, 153 A. 609 (1931) (holding that the mere fact that the defendants were acting as the president and treasurer of the corporation, and that they individually did not receive any of the money, was immaterial and insufficient to relieve them from personal liability since there was evidence of a conversion by the corporation which was directed by them). The fact that these defendants' conduct may have been negligent, reckless and willful as well does not alter this conclusion.

Similarly, where the president and other officers of an investment company, despite the corporate employer being in bankruptcy, deposited part of the plaintiff's money in the corporation's general checking account prior to the corporation filing bankruptcy, with the result

that the plaintiff could claim only her pro rata share of the bankrupt corporation's assets as a general creditor of such corporation, it was held that the officers of the corporation were personally liable to the plaintiff for the loss of the fund, even if they acted in good faith and without fraudulent intent. *Duncan v. Williamson*, 18 Tenn. App. 153, 74 S.W.2d 215 (1933).

A corporate director or officer may be held liable for negligence in permitting conversion of property of third persons by the corporation when specific acts and omissions, singly or in combination with others, constitute actionable negligence. Such acts or omissions which courts have recognized include negligence in failing to learn of and prevent the conversion; in selecting, or conferring a certain extent of power upon, the officer who directly appropriated the property to the use or purposes of the corporation; in failing to observe customary business practices in supervising the work of subordinate officers; in failing to examine corporate books and records; in failing to protest or object to the conversion and to take steps to prevent loss accruing to the third person; and in ignoring warnings of mismanagement. See E.T. Tsai, *Liability of corporate directors or officers for negligence in permitting conversion of property of third persons by corporation*, 29 A.L.R.3d 660 (1970)(and collection of cases at §5). Thus, a director of a corporation engaged in fiduciary activities who, with knowledge of shortages on trust accounts, failed to pay any attention to the corporate business, to the weekly corporate reports sent to his office, and to the fact that he was not called to meetings of the corporation, was held personally liable on the ground of gross negligence in permitting conversion of property of third persons by the corporation. *Mann v. Commonwealth Bond Corp.***,** 27 F.Supp. 315 (D. N.Y. 1938).

As outlined above, the Plaintiffs have alleged that the Individual Defendants had abundant knowledge of the dire financial straits of the company, that it was running out of money, and that the newly solicited funds were being used to pay off old obligations. No more

clear conduct or participation is needed than details of the October 18, 2008 meeting at which these Defendants agreed that the company could not abandon the commingled account paradigm because it would immediately go under immediately. Defendants took the Plaintiffs' funds, misapplied them and hoped for a miracle. This is actionable negligence *Airlines v. Pishvaian*, 155 F.Supp.2d 659 (E.D. Va. 2001) (officer's personal liability for conversion based upon participation, knowledge amounting to acquiescence, or the breach of some duty owed to owner of property).

The Plaintiffs' claims of liability against the Individual Defendants are not based merely on the Individual Defendants' positions as directors and/or officer. The allegations all involve active participation and knowledge and demonstrate actionable liability.

D. VIRGINIA'S ECONOMIC LOSS RULE DOES NOT PRECLUDE PLAINTIFFS' NEGLIGENCE CLAIM.

The Individual Defendants' last argument[5] raises Virginia's economic loss rule, which applies "the common law rule that a party not in privity may not recover damages [in negligence] where there is no physical injury to person or property." *Ward v. Ernst & Young*, 246 Va. 317, 324, 435 S.E.2d 628, 631 (1993) (quoting *Blake Construction Co. v. Alley*, 233 Va. 31, 353 S.E.2d 724 (1987)). The common law economic loss rule has been circumscribed, but not overruled, in Virginia by Va. Code § 8.01-223 which provides that "where recovery of damages for injury to person, including death, or to property resulting from negligence is sought, lack of privity between the

parties shall be no defense." (emphasis added); see *Ward v. Ernst & Young*, 246 Va. 317, 324, 435 S.E.2d 628, 631 (1993). The economic loss rule is not applicable, and recovery in tort is

[5] See Memo. of Chandler, *et al* p.40-41.

available, when there is a breach of a duty "to take care for the *safety* of the person or property of another." *Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.*, 236 Va. 419, 425, 374 S.E.2d 55, 58 (Va.,1988) (quoting *Blake*, 233 Va. at 34, 353 S.E.2d at 726 (citations omitted) (emphasis in original)).

In *Miller v. Quarles*, supra., decided after the current formulation of the economic loss rule in *Blake*, the Virginia Supreme Court held a plaintiff could maintain a cause of action in negligence against a corporate officer for the loss of funds held in escrow by the corporation with whom the plaintiff had contracted. The plaintiff, a prospective real estate purchaser, deposited $50,000 cash in escrow with the defendant finance company. The officer of the corporate defendant negligently allowed an agent of the corporate defendant to abscond with the plaintiff's escrow funds. The plaintiff sued the corporate officer in negligence for failing to prevent the misappropriation of the escrow funds by the unrelated third party. The Court, in *Moore v. Drewry*, 251 Va. 277, 467 S.E.2d 811 (1996), subsequently explained in detail why the economic loss rule did not bar a suit in negligence against the corporation's officer. The *Moore* court stated that the plaintiff's claim against the officer, "although stated in terms of dollars, reflected the direct loss of specific property, the escrow deposit, not an economic loss suffered by" the plaintiff. *Moore v. Drewry*, 251 Va. at 280, 467 S.E.2d at 813 (1996)(discussing *Miller v. Quarles*, supra).

In all key respects regarding the economic loss rule, the allegations of the Amended Consolidated Complaint mirror the facts in *Miller v. Quarles*. The Plaintiffs deposited money in escrow with the corporate entity (LES) with whom they were in privity of contract.[6] Due to

[6] Plaintiffs' detailed argument demonstrating the Exchange Funds were trust or escrow funds to be held for the benefit of the Exchangers is set forth in Plaintiffs' Memorandum in Opposition to Motion to Dismiss of Defendant SunTrust and is fully incorporated herein.

negligent actions of the corporate defendant's officers and directors (the Individual Defendants), the corporation (LES) did not "take care for the *safety* of the property of" the Plaintiffs. Under Va. Code § 8.01-223 and *Sensenbrenner* the Plaintiffs suffered a loss of specific property making the economic loss rule irrelevant.

IV. CONCLUSION

For the reasons set forth in this Opposition in Plaintiffs' Memorandum in Opposition to SunTrust's 12(b)(6) Motion and Plaintiffs' Memorandum in Opposition to Individual Defendants' 12(b)(2) Motion, the Court is respectfully requested to deny the Individual Defendants' Motions to Dismiss.

Respectfully submitted, this 12th day of November, 2009.

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