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

IN RE: LANDAMERICA 1031 EXCHANGE SERVICES, INC., INTERNAL REVENUE SERVICE § 1031 TAX DEFERRED EXCHANGE LITIGATION	
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; Ann T. Robins, an individual; and Jane T. Evans, an individual; on their own behalf and on behalf of a class of others similarly situated, Plaintiffs, v. SunTrust Bank; Theodore L. Chandler, Jr.; G. William Evans; Stephen Conner; Ronald B. Ramos; Devon M. Jones; and Brenton J. Allen, Defendants.	Case No.: MDL No. 2054 Southern District of California C.A. No. 3:09-cv-00054 District of South Carolina C.A. No.: 8:09-cv-00415

PLAINTIFFS' MEMORANDUM IN OPPOSITION TO MOTION DISMISS OF DEFENDANT SUNTRUST BANKS, INC.

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Plaintiffs submit this Memorandum in Opposition to Defendant SunTrust Banks, Inc.'s Motion to Dismiss the Amended Consolidated Complaint (hereinafter "Am. Complt."). Plaintiffs also incorporate herein fully by reference Plaintiffs' Memoranda in Opposition to Motions to Dismiss of Defendants Conner, Allen, Chandler, Evans, Ramos and Jones.

I. STATEMENT OF FACTS [1]

This multi-district litigation is a consolidation of two class actions brought against SunTrust Banks, Inc. ("SunTrust") and others for the benefit of at least 400 Exchangers who have lost millions of dollars in IRC §1031 Exchange Funds transferred to LandAmerica 1031 Exchange Services, Inc. (LES) to "hold" and deposited by LES at SunTrust. The 400 Exchangers who comprise the class entered into their respective Exchange Agreements with LES and deposited their Exchange Funds at SunTrust between February 2008 and November 26, 2008, when LES filed for bankruptcy. 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. (Am. Complt. ¶¶ 30, 34). Stephen Connor, the Senior Vice President for LES, gave a simple description of the activities performed by Qualified Intermediaries (QIs) like LES. He stated:

> **Question by Lawyer:** What is your understanding of what a QI is?
>
> **Answer by Connor:** A 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 to perform 1031 Exchanges for a $1000 fee and a percentage of

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[1] Plaintiffs' complaint sets forth in great detail the facts on which their claims are based. (Am. Complt. ¶¶ 29 – 167). In lieu of a lengthy rehash, Plaintiffs will reference specific factual allegations throughout this Memorandum as appropriate to each issue.

the interest earned on the deposit of the Exchange Funds at SunTrust. (Am. Complt. ¶¶ 35-47). The Exchangers transferred funds to LES "to hold" for safekeeping, and only safekeeping, pending each Exchanger's § 1031 Exchange. [2] (Am. Complt. ¶ 38). Pursuant to the requirements of the Exchange Agreements, LES deposited the Exchange Funds at SunTrust. (Am. Complt. ¶ 11). The Exchange Agreements required that Exchangers acknowledge the Exchange Funds might exceed the FDIC insurance covering the SunTrust account. (Am. Complt. ¶ 111).

Up until February 2008, SunTrust's subsidiary was selling to LES supposedly liquid Auction Rate Securities (ARS), purchased by LES with the Exchange Funds which passed through LES's SunTrust Account #3318. (Am. Complt. ¶¶ 50-53, 55-61). When the market for ARS froze in February 2008, LES's SunTrust account was in a trust deficit. (Am. Complt. ¶¶ 10, 47, 67-68).

The Plaintiffs' complaint is not predicated on the impropriety of SunTrust's sale of ARS to LES. The investment occurred, it failed, and Exchange Funds of those Exchangers doing business with LES as of February 2008 were lost. The Plaintiffs' complaint arises from the fact that, when LES could not access existing Exchange assets to fund exchanges as they came due, it ignored its operational insolvency. Instead, LES began funding exchange transactions with new Exchangers' money, in a classic Ponzi scheme, using the new Exchange Funds of 400 putative class members as an interim solution to the problems caused by the investment in ARS. (Am. Complt. ¶¶ 10, 64-78).

In August, 2008, SunTrust and its subsidiary settled a class action arising from its sale of ARS. (Am. Complt. ¶ 84). In the wake of this settlement, LES approached SunTrust demanding it buy back the ARS. (Am. Complt. ¶ 85-88). In doing so, LES described to SunTrust the Ponzi scheme it was

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[2] It is entirely implausible that the Exchangers were **paying LES** to take their money (often their life savings) as an unsecured loan to an insolvent corporation for nominal, below market, interest.

using the SunTrust account to operate, confirming that it was actually supposed to be holding the funds "in escrow, "as a fiduciary," for the benefit of" the Exchangers. [3] *Id.*

Despite this very explicit notice, and notice from other sources of LES's mishandling of Exchangers' funds, SunTrust continued to process LES's disbursement requests to fund old Exchange transactions with new Exchangers' funds up to the date LFG and LES went under and filed for bankruptcy protection on November 26, 2008.

II. SUMMARY OF ARGUMENT

A. In General.

SunTrust cites to but a handful of the 138 paragraphs of factual allegations of the complaint, but lambasts Plaintiffs for filing a pleading that purportedly fails to allege any facts supporting the claims. The well-pleaded facts do not go away because SunTrust ignores them.

B. SunTrust's Knowledge.

FRCP 9(b) allows the general pleading of knowledge. Plaintiffs have alleged very detailed facts showing specific and direct knowledge by SunTrust of LES's wrongdoing far surpassing the general pleading standards of Rule 9(b). The Amended Consolidated Complaint, at ¶¶ 11, 63, 84-93, 95-97, 99, 111, 112, 119, 126, 183-85, 186-87, sets forth multiple sources of knowledge by SunTrust.

Most telling, by early October 2008, it is irrefutable that SunTrust knew LES was running a Ponzi scheme through its accounts with SunTrust. LFG, on behalf of LES, wrote directly to SunTrust,

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[3] QIs who pay older exchanges with after-acquired funds when the trust is in a deficit operate a Ponzi scheme. *See Taxel v. Vaca (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 did 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 the action could be termed a "resulting Ponzi scheme or Ponzi scheme by performance").

stating that LES was "us[ing] its remaining non-ARS investments [the incoming Exchange Funds] to satisfy customer obligations" because "virtually all of the remaining escrow investments consist of ARS, of which approximately $152 million consist of illiquid ARS purchased through SunTrust Investment Services, Inc. or SunTrust Robinson Humphrey, Inc." (Am. Complt. ¶ 86).

The LFG/LES letter to SunTrust verified that LES was obligated to hold the Exchange Funds "in escrow as a fiduciary until the funds (with the related interest) are returned to customers to complete the 1031 exchange." LES acknowledged that, as a QI, its essential function was to "hold in escrow" the proceeds from the sales. The letter to SunTrust refers to LES's Exchange Clients' money as "escrow funds" and "escrow investments." (Am. Complt. ¶ 87).

The notice provided by the October 2008 letter to SunTrust was direct, irrefutable and could not be ignored.

C. Substantial Assistance by SunTrust.

SunTrust also contends that Plaintiffs did not allege substantial assistance or participation by SunTrust in LES's Ponzi scheme. As shown above, at least by October, 2008, SunTrust had specific knowledge that LES was receiving into the SunTrust account Exchange Funds which LES had communicated to SunTrust were escrow funds that LES was obligated to hold as a fiduciary. LES had also informed SunTrust that it was drawing out those new Exchange Funds to pay off obligations to older exchangers in a classic Ponzi scheme. (Am. Complt. ¶¶ 84-88). SunTrust, as the depository bank, made the transfers of the money out of the SunTrust 3318 account to allow LES to fund the older exchanges with Plaintiffs' Exchange funds. (Am. Complt. ¶¶ 171, 186). It moved the money even though doing so was clearly in aid of a Ponzi scheme.

SunTrust is correct that, without some notice or knowledge of wrongdoing by LES, its actions

in leaving the account open and honoring LES's requests for the disbursements would not be actionable. But it did have knowledge. Banks owe a duty to refrain from knowingly assisting fiduciaries in breaching their fiduciary duties. *City of Atascadero v. Merrill Lynch*, 68 Cal. App. 4th 445, 466 (Cal. App. 1st Dist. 1998); *Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d 1101, 1134 (C.D.Cal. 2003).[4]

Although a bank normally has no duty to monitor an escrow account, "where it has notice that the fiduciary is breaching its duties with respect to the account, the bank cannot continue to provide assistance and willfully ignore the breach." *Lawyers Title Ins. Corp. v. United American Bank of Memphis*, 21 F. Supp. 2d 785, 798-801 (W.D.Tenn. 1998).

In *Hartford Accident & Indemnity Co. v. Farmers National Bank*, 24 Tenn.App. 699, 149 S.W.2d 473, 476 (1940), the court stated:

> [I]f the bank with such notice [of misappropriation] pays the fiduciary's check and thus aids him in the accomplishment of his unlawful purpose it participates in his breach of trust and is liable for his misappropriations.

Plaintiffs have, thus, alleged actions on the part of SunTrust that substantially assisted LES's wrongdoing and resulted in losses to the Plaintiffs.

D. The Underlying Wrongs of LES.

Incredibly, SunTrust contends that Plaintiffs have not pled that "LES committed any of the underlying wrongs." The Amended Consolidated Complaint sets forth in great detail the wrongs of LES that support the aiding and abetting, conversion, and conspiracy claims against SunTrust. See, e.g., Am.

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[4] Shepardizing *Neilson* demonstrates that since its issuance, the opinion has been cited 92 times, including citations from the District Courts of the First, Second, Fifth, Sixth and Eighth Circuits. This is in addition to the dozens of citations from the District Courts in the Ninth Circuit, including Washington and Hawaii and all of the California courts.

Complt. ¶¶ 37-39, 43, 44- 54 (re the Exchange Agreements and LES's obligation **to hold** the Exchange Funds); Am. Complt. ¶¶ 64-78 (re LES's operation of a Ponzi scheme); Am. Complt. ¶¶ 88-93 (re LES's internal acknowledgments of fiduciary duties, and its admissions to SunTrust, the SEC and others that the Exchange Funds were trust funds); Am. Complt. ¶¶ 95-98 (re LES's fiduciary duties as a member of the Federation of Exchange Accommodators); Am. Complt. ¶¶ 99-106 (re LES's public characterizations of its fiduciary duties and holding of funds in trust); Am. Complt. ¶¶ 107-110 (re LES's statutory and common law fiduciary duties); Am. Complt. ¶¶ 113-167 (re LES's bad acts through individual officers and directors).

SunTrust cannot rely on the order issued by the bankruptcy court for the Eastern District of Virginia,[5] finding the Exchange Funds remaining in LES's possession were property of LES's bankruptcy estate because:

(a) the bankruptcy order has no preclusive effect through *res judicata* or collateral estoppel, and SunTrust does not and cannot argue that it does;

(b) the bankruptcy order arose from a bankruptcy presumption that assets held in an account in the debtor's name are presumed to be property of the bankruptcy estate, which presumption does not apply to this civil action;

(c) the Bankruptcy Court improperly refused to consider highly probative extrinsic evidence, including LFG's regulatory and accounting treatment of the Exchange Funds as Exchanger property, LES's public declarations that it held the Funds in trust as a fiduciary, etc.

(d) the bankruptcy order was based solely on express trust and improperly rejected the applicable Virginia case regarding resulting trusts;

(e) the Bankruptcy Court's reliance on the "dominion and control" language in each Exchange Agreement was improper under Treas. Reg. §1.1031(k)-1(n), which precludes such inferences for any purposes other than the tax deferral analysis.

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[5] Neither the Plaintiffs nor SunTrust were parties to that proceeding, which was a "Lead Case" adversary proceeding.

(f) the Bankruptcy Court's order is wrong for many reasons, including the authority of *Dameron v. Old Republic National Title Insurance Company*, 155 F.3d 718 (4th Cir. 1998), which the Bankruptcy Court mis-cited.

E. LES's Fiduciary Duties.

Plaintiffs have alleged multiple sources of fiduciary duty, [6] including (1) duties based on the Exchange Agreements (Am. Complt. ¶¶ 43-45, 48); (2) duties based on the trust relationship (Am. Complt. ¶¶ 148, 150, 181, 184); (3) LES's agency relationship for all purposes other than the statutory "actual or constructive receipt" analysis of 26 U.S.C. § 1031(a) and 26 C.F.R. § 1031(k)-1(f) and (g) (Am. Complt. ¶¶ 107, 180); (4) LES's statutory duties, including duties as a broker under § 54.1-2100 *et seq. Va. Code Ann.* (Am. Complt. ¶¶ 107-110, 181); and (5) duties assumed by LES pursuant to the Code of Ethics and Conduct of the Federation of Exchange Accommodators (the "FEA"), of which LES was a member (Am. Complt. ¶¶ 95-97).

The existence of a fiduciary relationship is a question of fact for the jury. *Allen Realty Corp. v. Holbert*, 227 Va. 441, 318 S.E.2d 592 (1984). SunTrust's contention that Plaintiffs "allege[d] no source for the fiduciary duties LES supposedly owed to Plaintiffs other than their allegation that LES held their funds 'in escrow,'" has no merit.

F. Exchangers' Right to Possession of the Exchange Funds.

The Exchangers were entitled to immediate possession of their Exchange Funds. If fact, LES's possession of the Exchange Funds was the possession of the Exchangers because LES received the

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[6] The Bankruptcy Court's ruling that the disclaimer language in the Exchange Agreements – that LES was not undertaking any duties not expressly set forth in the Exchange Agreements – "eliminates any argument that LES had a duty to act as a fiduciary for Plaintiffs" misstated the law. *See, e.g. Gordonsville Energy, L.P. v. Virginia Elec. and Power Co.*, 257 Va. 344, 355-356, 512 S.E.2d 811, 818 (1999) (requiring knowledge of the right to be waived and an intention to waive it); *Restatement (Third) of Torts* §§ 77-78 (implied duties of a trustee can't be waived despite language in the document purporting to do so).

funds as the Exchangers' agent under state law.

In addition, pursuant to the Exchange Agreements, the Exchangers had the right to immediate possession because, at any time after the sale of their relinquished property, they had the right to require that the exchange funds be used to acquire their replacement property. This right supports a conversion by SunTrust given SunTrust's knowledge that the funds were Exchange Funds to be held for the benefit of the Exchangers . *Simmons v. Miller*, 261 Va. 561, 544 S.E.2d 666 (2001) (any act of dominion wrongfully exerted over property in denial of, or inconsistent with, the owner's rights is a conversion); *PGI, Inc. v. Rathe Prods., Inc.*, 265 Va. 334, 576 S.E.2d 438 (2003) (same).

G. Elements of Conspiracy.

Plaintiffs allege sufficient details of time and place and effect of the conspiracy to meet Virginia's pleading requirements for a conspiracy claim.

. H. Complaint is not a Fraud Pleading *vis-a-via* SunTrust.

Plaintiffs' pleading against SunTrust does not sound in fraud so as to mandate a heightened pleading requirement. Even so the bad acts are pled in sufficient detail to satisfy of FRCP 9(b).

III. LEGAL STANDARD

FRCP 8(a)(2) requires "a short and plain statement of the claim showing that the pleader is entitled to relief." The United States Supreme Court has recently stated: "Specific facts are not necessary; the statement need only 'give the defendant fair notice of what the . . . claim is and the grounds upon which it rests.'" *Erickson v. Pardus*, 551 U.S. 89, 93-94 (2007) (citations omitted). The Supreme Court has also recently noted:

> To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to "state a claim to relief that is plausible on its face." A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw

> the reasonable inference that the defendant is liable for the misconduct alleged. The plausibility standard is not akin to a "probability requirement," but it asks for more than a sheer possibility that a defendant has acted unlawfully.

Ashcroft v. Iqbal, ____ U.S. ____, 129 S. Ct. 1937, 1949 (2007) (citations omitted).

The Supreme Court said in *Bell v. Twombly*: "once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 563 (2007).

"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 draw all reasonable inferences from those facts in favor of the plaintiff." *City of North Myrtle Beach v. Hotels.com L.P.*, C.A. No.: 4:06-CV-3063, 2007 U.S. Dist. LEXIS 85886, *6-7 (D.S.C. Sept. 30, 2007) (citations omitted). Exhibit 1 – appendix of cases. When ruling on a defendant's motion to dismiss, the judge must accept as true all of the factual allegations contained in the complaint. *Erickson v. Pardus*, 551 U.S. at 94.

IV . ARGUMENT

A. Plaintiffs' Allegations with Regard to Knowledge on the Part of Suntrust Are Sufficient.

Plaintiffs allege that SunTrust had knowledge that LES was a fiduciary breaching its fiduciary duties and converting Plaintiffs' funds, and further allege that SunTrust provided substantial assistance to LES. SunTrust moves to dismiss, contending that it did not have the requisite knowledge. FRCP 9(b) allows the general pleading of knowledge. *See, e.g., Decker v. GlenFed, Inc. (In re GlenFed, Inc. Sec. Litig.)*, 42 F.3d 1541, 1547 (9th Cir. 1994) (*en banc*) ("Plaintiffs may aver [state of mind] generally"). In this case, inferences are not needed because SunTrust was told by LES all that it needed

to know to be liable as an aider and abettor of LES's breach of fiduciary duty and conversion of Plaintiffs' Exchange Funds.

After the ARS market froze, class actions were filed against SunTrust. In early August 2008, SunTrust agreed to repurchase outstanding ARS from individual "retail investors." (Am. Complt. ¶ 84). LES asked SunTrust to be included in this settlement, arguing that ARS were Exchange assets, and that the Exchangers were "retail clients" of SunTrust because LES was holding their money as a fiduciary. (Am. Complt. ¶ 84). Minutes of an LFG Investment Funds Committee meeting on October 1, 2008 discuss the strategy and states in part, "[t]o date, there is no prospect of a loan with SunTrust . . . and the company is participating in the appeal process with both brokers [SunTrust and Citibank] to be considered as part of the settlement, since the Company [LES] is acting **in a fiduciary capacity, with the funds ultimately belonging to the retail client**." (Am. Complt. ¶ 85) (emphasis added).

By letter dated October 7, 2008 from Michelle H. Gluck ("Gluck"), Executive Vice President and Chief Legal Officer for LFG, to SunTrust, LFG, on behalf of LES, requested that SunTrust provide liquidity to LES because of the ARS. (Am. Complt. ¶ 86-87). The letter to SunTrust disclosed what SunTrust had already known since February 2008, that LES was using "its **remaining non-ARS investments** [the incoming exchange money] to satisfy Clients' obligations" because "virtually all of the remaining escrow investments consist of ARS. . ." *Id.* (emphasis added). The letter implores SunTrust to either repurchase the ARS or provide full liquidity with respect to the ARS. *Id.*

When describing the function of LES, the letter states that LES holds Exchange proceeds in "**escrow as a fiduciary until the funds are returned**." (Am. Complt. ¶¶ 85-87) (emphasis added). The letter states that an essential function of the QI is to "hold in escrow" the proceeds from the sale. *Id.* The letter refers to Exchangers' funds as "escrow funds" and "escrow investments" being used to

invest in ARS. *Id.* SunTrust rejected LES's plea for liquidity to recharge the deficit in the trust account, but rather continued to assist LES in running a 1031 Ponzi scheme by defrauding new Exchangers out of their money.

SunTrust addresses these direct, specific and irrefutable allegations of actual notice from the horse's mouth only by way of a footnote, calling Gluck's letter self-serving and stating the letter did not contain any source for LES's belief that it was acting as a fiduciary. SunTrust Memo at 12, n. 6. Whether SunTrust rejected or disbelieved the letter is not a valid basis to move to dismiss. SunTrust had the knowledge of LES's wrongdoing. What SunTrust did or did not do with that knowledge is the subject of this litigation.

In addition, to the direct knowledge conveyed Gluck's October letter, Plaintiffs assert extensive prior knowledge [7] on the part of SunTrust that the LES's conduct was tortious:

(a) SunTrust's subsidiary sold the ARS to LES and SunTrust knew that the money used to purchase the ARS came from Exchange Funds on deposit at SunTrust (Am. Complt. ¶¶11, 58);

(b) SunTrust owned an exchange subsidiary that was an affiliated member of the FEA (Am. Complt. ¶ 95) and:

  (i) the FEA Code of Ethics states that QIs are fiduciaries (Am. Complt. ¶ 96);

  (ii) the FEA Code of Ethics prohibits QI's from commingling Exchange Funds with the operating accounts of the QI, which SunTrust knowingly allowed (Am. Complt. ¶ 97);

  (iii) the FEA Code of Ethics prohibits the loan or transfer of Exchange Funds to any person or entity affiliated with or related to the QI which is what the bankruptcy judge concluded LES did (Am. Complt. ¶ 97);

  (iv) the FEA Code of Ethics prohibits the investment of Exchange Funds in a manner that does not provide sufficient liquidity to meet the QI's contractual

[7] See, generally, Am. Complt. ¶ 111.

obligations to its clients and does not preserve the principal of the exchange funds, which SunTrust knew had occurred (Am. Complt. ¶ 97);

(c) As an affiliated member of the FEA and through owning its own QI, SunTrust would know that no Exchange Agreement in use in the country can legally and ethically transfer both legal and equitable title to the Exchange Funds to the QI for the QI's own benefit (Am. Complt. ¶ 97);

(d) SunTrust's posture as a creditor of LFG/LES gave it unique insight into the financial condition of the company from February through November 2008, including financial statements that classified Exchange Funds as assets of the Exchangers, held for their benefit, not assets of LFG/LES (Am. Complt. ¶¶ 69-72, 89-93);

(e) SunTrust knew LES would potentially make claims against it based on its sale of the ARS. (Am. Complt. ¶ 85-86).

(f) SunTrust knew that liquid Exchange Funds on deposit with the QI must equal the liabilities owed to the Exchangers by the QI (Am. Complt. ¶ 97); and

(g) SunTrust had access to the inflows and outflows of LES's SunTrust 3318 account which, after February 2008, suffered massive and historic deficits in inflows and outflows (Am. Complt. ¶¶ 64, 68).

(h) Subsequent to February 2008, LES Treasurer Ramos and Assistant Treasurer Jones had regular conversations with SunTrust seeking a solution from SunTrust for LES's liquidity problems. (Am. Complt. ¶ 119).

SunTrust cites to *Casey v. U.S. Bank Nat'l Ass'n*, 127 Cal. App. 4th 1138 (Cal. Ct. App. 2005). This case, however, supports the denial of SunTrust's Motion to Dismiss. The Court in *Casey* cited with approval *Neilson, supra,* wherein the court "denied a motion to dismiss aiding and abetting claims because the plaintiffs clearly alleged the defendants' actual knowledge of the underlying wrong they substantially assisted:

> The *Neilson* case was a class action in which hundreds of investors sued four banks for allegedly assisting a crooked investment adviser, Slatkin, in running "a classic Ponzi scheme." . . . [T]he court concluded the plaintiffs' aiding and abetting claims sufficiently alleged the requisite knowledge on the part of the banks: The allegations established the banks knew Slatkin was running a Ponzi scheme and was thereby defrauding investors and violating his fiduciary duties to these investors (some of whom

> had individual "custodial" or "trustee" accounts at the banks). . . . The court concluded these allegations established the banks' actual knowledge of the primary violation, and thus satisfied the knowledge element of the aiding and abetting claims.

Casey, 127 Cal. App. 4th at 1147.

SunTrust also cites to *Nigerian National Petroleum Corp. v. Citibank*, Case No. 98 Civ. 4960, 1999 U.S. Dist. LEXIS 11599 (S.D.N.Y July 30, 1999). The case does not support SunTrust's position because the allegations therein related to "suspicious circumstances" and "red flags," versus the specific actual knowledge Plaintiffs herein have alleged. *Id*. at *8.

B. Plaintiffs Have Alleged Sufficient Acts of Substantial Assistance by Suntrust to Support a Claim for Aiding and Abetting Breach of Fiduciary Duty and Aiding and Abetting Conversion Claims.

Banks owe a duty to refrain from knowingly assisting a fiduciary in breaching fiduciary duties. *City of Atascadero v. Merrill Lynch*, 68 Cal. App. 4th at 466; *Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d at 1113. Plaintiffs are cognizant of the Court's need to reconcile two competing principals – one that limits a bank's duties to non-depositors to facilitate the free flow of commerce, contrasted with the extension of tort liability to banks who knowingly aid and abet tortious conduct by their depositors. In resolving this tension, courts look to the knowledge of the depository bank.

SunTrust had the requisite knowledge based on information provided directly from its depositor, LES. Once the bank has knowledge of the wrong, it has to cease assisting in the tort.

Contrary to what SunTrust argues, Plaintiffs' complaint does not rely on mere "inaction or failure to investigate." SunTrust Memo. at pp. 21-22. Everything SunTrust needed to know, it was told by LES. Unquestionably by October 2008, SunTrust had to stop processing wrongful disbursements of Plaintiffs' Exchange Funds to buy replacement property for older Exchangers. Continuing with the practice, in the face of actual knowledge, was substantial assistance.

Within this context, Plaintiffs' case is somewhat unique because of the outstanding debt owed to SunTrust by LFG [8] and SunTrust's potential liability to LES associated with its sale of the ARS to LES. While motive is not a necessary element of Plaintiffs' claims against SunTrust, the existence of motive furthers the inferences to be drawn from the evidence against SunTrust.

SunTrust clearly had a motive to align its interests with LES when the law required SunTrust refrain from assisting LES. After the collapse of the ARS market, SunTrust needed to stop working on the account because it was clear at that time that LES could not be funding exchanges with those Exchangers' money. At least by early October, 2008 SunTrust was told directly by LES that money coming into the account from new Exchangers was funding the obligations to old Exchangers as they came due. SunTrust still did not cease processing the disbursement requests by LES.

The cases cited by SunTrust do not support its Motion to Dismiss because none focus on actions alleging the torts of aiding and abetting breach of fiduciary duty and conversion in the context of direct and actual knowledge by the aider and abettor. In *Renner v. Chase Manhattan Bank,* Case No. 98 civ 926, 1999 U.S. Dist. LEXIS 978, *42 (S.D.N.Y. Feb. 3, 1999), the court addressed the duty of banks to non-customers in context of a negligence claim, stating "in order for a bank to be liable for the diversion of fiduciary funds, plaintiff must show that the bank either benefitted from the transaction or

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[8] SunTrust represents that, as a lender group member, its potential lending share was only $31 million. SunTrust Memo at pp. 25-26. If fact, the documents filed by SunTrust also show a note to SunTrust as sole "Swingline Lender" of $10 million, putting SunTrust at risk for $41 million, not $31 million . See, SunTrust Memo at Ex. 5, Annex B. How much of the outstanding $100 million lender claim against LFG/LES was Swingline credit owed only to SunTrust is not shown; however, even assuming SunTrust's numbers are correct, its contention that at risk debt of more than $15 million was not sufficient motive for it to close its eyes to LES's conduct and hope for the best, is preposterous.

that it had notice or knowledge that a diversion was intended or was in progress."[9] (Emphasis added). The court in *Ryan v. Hunton & Williams*, Case No. 99-cv-5938, 2000 U.S. Dist. LEXIS 13750, *25 (E.D.N.Y. Sept. 20, 2000), dealt with securities, RICO, and aiding and abetting fraud claims, alleging that defendant "**suspected** [third parties] were running an advance fee scam") (emphasis added).[10] The proposition cited in *Scott v. Branch Banking and Trust Co.*, 588 F. Supp. 2d 667, 673 (W.D.Va. 2008) that a bank owes a duty of care only to its customers, did not arise in an aiding and abetting context and is inapposite. In *Fiol v. Doellstedt*, 50 Cal.App. 4th 1318 (Cal. Ct. App. 1996), perhaps the least applicable case, the court analyzed the liability of a supervisory employee for aiding and abetting a breach of the Fair Employment and Housing Act.

In particular, SunTrust's citation to *Cahaly v. Benistar Prop. Exch. Trust Co.*, 451 Mass. 343, 885 N.E.2d 800 (2008) supports Plaintiffs' claims against SunTrust. In the *Cahaly* case, the QI used Exchange Funds to trade technology stocks with the assistance of brokers at Merrill Lynch. The Exchange Funds were lost and Cahaly sued Merrill Lynch for assisting the QI in breaching its fiduciary duty. Cahaly prevailed in front of a jury, but the trial court granted Judgment Notwithstanding the Verdict (JNOV), concluding that the facts presented at trial did not establish that Merrill Lynch knew that Benistar was a QI or that the money used to buy the stocks was not the property of Benistar, but Exchange Funds. After the JNOV, Cahaly's attorneys discovered new evidence that showed Merrill Lynch knew that Benistar was a QI, that it was familiar with the nature of 1031 exchanges, and that it

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[9] Plaintiffs allege that SunTrust had knowledge of the diversion in progress.

[10] Plaintiffs allege not what SunTrust suspected, but what it knew.

had seen a copy of Benistar's exchange agreement.[11] With this new evidence, the trial court granted Cahaly's motion for a new trial. *Id*. Re-trial resulted in a verdict against Merrill Lynch. Exhibit 2. SunTrust is liable for aiding and abetting a breach of fiduciary duty and *Cahaly* supports this conclusion.

In this case, Plaintiffs have pled that SunTrust knew LES was a QI, knew the nature of the QI business, was a member of the FEA and knew its mandates regarding fiduciary duties and handling of funds, knew that the ARS bought with Exchange Funds were illiquid and could not be accessed by LES, knew that LES did not have other assets to recharge the trust, knew that LES considered the Exchange Funds as escrow funds that it held as a fiduciary for the benefit of the Exchangers and knew that LES was operating a Ponzi scheme by paying off old clients' Exchanges with incoming exchange deposits. Plaintiffs allege that SunTrust assisted the breach by physically accepting deposits into its account and transferring funds out of the same account to allow LES to fund old Exchanges and pay for its operating expenses in hopes that LES's viability could be extended until the ARS unfroze. Plaintiffs' allegations must be accepted as true.

Even ordinary business transactions, such as those performed by SunTrust, may provide substantial assistance to the commission of a tort. Knowledge by SunTrust is the crucial element and such knowledge has been appropriately pled. *Henry v. Lehman Commer. Paper, Inc.*, *(In re First Alliance Mortg. Co.),* 471 F.3d 977, 995 (9th Cir. 2006). *See, also, Chance World Trading E.C. v. Heritage Bank of Commerce,* 2004 U.S. Dist. LEXIS 21451, *11 (N.D. Cal. Oct. 15, 2004) (finding "substantial assistance" where third party depositor was wrongfully allowed to withdraw funds, which

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[11] SunTrust may try to distinguish *Cahaly* based on its claim that Plaintiffs have not adequately pled that SunTrust received a copy of the LES Exchange Agreement. However, the October 2008 Gluck letter to SunTrust contained as much or more information than the "newly discovered evidence" in *Cahaly* which warranted a retrial and resulted in a verdict against Merrill Lynch.

action "substantially contributed to the harm suffered by plaintiff."). One court has noted:

> Neither a large bank nor a small bank may urge that it is ignorant of facts clearly disclosed in the transactions of its customers with the bank – disclosed, too, without the need of artificial synthesis of notice of separated operations; nor may a bank close its eyes to the clear implications of such facts. By ignoring these facts and their necessary implications, the bank became a guilty participant in the trustee's embezzlement of trust funds deposited in the trust account in the bank and from that date it became liable as a joint wrongdoer for all moneys which the trustee embezzled. So we held in *Bischoff v. Yorkville Bank* (*supra*) and again in *Gilliland v. Lincoln-Alliance Bank & Trust Co.* (264 N. Y. 517). That holding has been criticized at times because it is said that it places an undue burden upon the bank. Experience has failed to show that a bank is subjected to an undue burden by the ruling that it may not ignore clear indications that a debtor is paying a personal indebtedness out of funds which do not belong to him.

Grace v. Corn. Exchange Bank, 287 N.Y. 94, 107, 38 N.E.2d 449, 454 (1941).

In *In re Nat'l Century Fin. Enters.*, 580 F. Supp. 2d 630, 655 (S.D. Ohio 2008) the court commented on the opinion cited by SunTrust, *Cromer Fin'l Ltd. v. Berger*, 137 F.Supp. 2d 452 (S.D.N.Y. 2001) (emphasis added):

> In *Cromer*, a clearing broker was sued for clearing trades that a fund manager had ordered. Noting that the defendant had merely done what a clearing broker routinely does, the court held that the injury caused by the fund manager's later fraudulent actions were not a 'foreseeable result of the conduct" of the clearing broker. *Cromer,* 137 F.Supp.2d at 470.
>
> Fitch's broad contention that the element of substantial assistance can never be satisfied by an ordinary act or transaction must be rejected. "Executing transactions, even ordinary course transactions, can constitute substantial assistance under some circumstances, such as where there is an extraordinary economic motivation to aid in the fraud." *Primavera*, 130 F.Supp.2d at 511; *see also Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 48 (2d Cir. 1978) ("[S]ubstantial assistance might include . . . executing transactions or investing proceeds, or perhaps . . . financing transactions."). **What is important is examining the particular facts of the case to determine the foreseeability of the result of the conduct or transaction**. *See Aetna,* 219 F.3d at 537 (stating that "the nature of the act" and "the amount of assistance" must be considered).[12]

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[12] It required no foresight at all to anticipate that SunTrust's processing of LES transfers of (continued...)

In *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 287-90 (2nd Cir. 2006) (citations omitted), the Second Circuit verified proximate cause in the context of bank misconduct *vis-a-vis* non-customer funds:

> "[A] bank may be liable for participation in [such a] diversion, either by itself acquiring a benefit, or by **notice or knowledge that a diversion is intended or being executed.**" "Adequate notice may come from circumstances which reasonably support the sole inference that a misappropriation is intended, as well as directly." "Having such knowledge, [the bank is] under the duty to make reasonable inquiry and endeavor to prevent a diversion." ("Facts sufficient to cause a reasonably prudent person to suspect that trust funds are being misappropriated will trigger [such] a duty of inquiry on the part of a depositary bank, and the bank's failure to conduct a reasonable inquiry when the obligation arises will result in the bank being charged with such knowledge as inquiry would have disclosed.").
>
> * * *
>
> *Home Savings* also makes clear that the banks' alleged breaches of their duty to investigate and, if necessary, safeguard the funds in its trust account, would qualify as a proximate cause of the [lawyers's] clients' losses. ("[T]here can be little doubt in light of the . . . Audit [in question] or the banks own internal investigation performed [during the following months] that a reasonable investigation by the bank initiated at an earlier date would have uncovered [the embezzlement].")

The *Lerner* case involved a lawyers' bank account that was not denominated a trust or IOLTA account. *Id.* at 281. The Court found that the bank had actual knowledge of the nature of the funds based on information it received from the lawyer about the escrow nature of the funds and notice from the lawyer that "the funds involved were the property of others,." SunTrust had the same sort of knowledge directly from LES. Thus, whatever LES and SunTrust called the #3318 account is not relevant. Viewing the facts alleged in the light most favorable to the Plaintiffs mandates the conclusion

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[12](...continued)
new Exchangers' funds to pay for replacement property of old Exchangers, in the context of LES's dire financial situation, would result in losses to the new Exchangers. It was a certainty. The music was going to stop and the new Exchangers were going to be left standing empty-handed.

that proximate causation is adequately pled. [13]

C. Plaintiffs' Pleading with Regard to the Underlying Wrongs of LES is Sufficient.

1. The Bankruptcy Court Opinion

SunTrust contends that the Plaintiffs cannot plead an underlying wrong by LES because the Bankruptcy Court in Virginia concluded that the Exchange Funds remaining in LES's possession were owned by LES's bankruptcy estate. SunTrust Memo. at 1-2, 11-13, citing *Millard Refrigerated Servs. v. LandAmerica 1031 Exch. Servs. (In re LandAmerica Fin. Group, Inc.)*, 2009 Bankr. LEXIS 940 (Bankr. E.D. Va. Apr. 15, 2009) (attached at Ex. 1). SunTrust asks this Court to adopt the Bankruptcy Court's opinion in *Millard* rather than make its own independent determination as to whether LES owed Plaintiffs a fiduciary duty in handling their Exchange Funds and/or converted the funds to its own use. This Court should decline the invitation for three reasons.

First, under Ninth and Fourth Circuit law related to collateral estoppel and *res judicata*, the *Millard* opinion is not binding on the Plaintiffs or the Court. Second, the Bankruptcy Court's legal interpretation of the applicable Exchange Agreements was based on presumptions arising under the Bankruptcy Code, which are not applicable in this case. Third, the opinion was based on clear errors of law, including the rejection of compelling extrinsic evidence. As such, the *Millard* opinion has no binding or precedential effect and is simply wrong.

(a) Res Judicata and Collateral Estoppel are not Applicable.

The application of collateral estoppel and *res judicata* to non-parties "runs up against the

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[13] *See, Unencumbered Assets Trust v. JP Morgan Chase Bank (In re Nat'l Century Fin. Enters.)*, 604 F. Supp. 2d 1128, 1155- 56 (S.D. Ohio 2009) (citing to *Lerner* and stating "a failure to act constitutes substantial assistance when, as alleged here, there is a duty to act" and concluding Suisse failed in its fiduciary duty to act in response to the Founders' tortious conduct.

deep-rooted historic tradition that everyone should have his day in court." *Taylor v. Sturgell*, ____ U.S. _____, 128 S. Ct. 2161, 2172 (2008) (citations omitted). None of the privity exceptions cited in *Taylor* are applicable in this case. Recent attempts to broaden these exceptions, most notably under a theory of "virtual representation," have been rejected by the Supreme Court and deemed an unwarranted and unjustifiable departure from traditional privity analysis. *Taylor*, 128 S. Ct. at 2178.

Neither the named Plaintiffs nor SunTrust were parties to the *Millard* adversary test case in the Bankruptcy Court. In fact, the Bankruptcy Court's "Order Establishing Scheduling Protocol for Adversary Proceedings" ("the Protocol Order"), specifically prohibited other creditors, including Plaintiffs, from intervening. Exhibit 3, at p. 5, ¶ 16.

The Ninth Circuit has stated that the principle that only parties to prior actions and parties in privity with them may be barred from relitigating claims or issues in a subsequent action is "central to the concepts of *res judicata* and collateral estoppel." *Sandpiper Vill. Condo. Ass'n v. Louisiana-Pacific Corp*. 428 F.3d 831, 849 (9th Cir. 2005).

(b) Bankruptcy Code Presumptions Drove the *Millard* Opinion

The issue litigated in *Millard* was quite narrow, i.e. whether Millard's Exchange Funds remaining on deposit with LES were the property of the bankruptcy estate as defined in 11 U.S.C. §541. For the purpose of that analysis, the bankruptcy judge used the very broad definition of "property" mandated by the case law interpreting §541, including the presumption that money held in a bank account in the name of a debtor is the property of the bankruptcy estate. [14]

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[14] "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 (continued...)

In essence, the policy rationale behind the presumption of ownership is that any funds transferred to one particular creditor or class of creditors would deprive the bankruptcy estate of funds which could otherwise be used to satisfy the claims of all creditors on an equitable basis. *In re Bullion Reserve v. Bozek*, 836 F.2d 1214, 1215 (9th Cir. 1988). Thus, what the Bankruptcy Court considered was that a recovery by individual Exchangers would have reduced the amount of funds available in the LES estate to pay the remaining creditors.[15]

The policy underlying the bankruptcy presumption does not apply in this case because Plaintiffs are not seeking to recover funds from LES's bank accounts. Instead, Plaintiffs seek damages from SunTrust Bank based on its independent tortious conduct in aiding and abetting LES's breach of fiduciary duty and conversion, as well as engaging in a conspiracy. For that reason, this Court should not give credence to an opinion wherein the burden was on the plaintiff to rebut bankruptcy presumptions not application in the civil court context. To do so would thwart the policy that a defendant such as SunTrust is liable for its own independent tortious conduct. The *Millard* opinion

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[14](...continued)
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)." *Millard* at *7.

[15] The Bankruptcy Court, in the companion order in *Frontier Pepper's Ferry, LLC v. Landamerica 1031 Exch. Servs., Inc. (In re Landamerica Financial Group, Inc.)*, No. 08-35994-KRH (Bankr. E.D. Va. May 7, 2009), concluded that inclusion of exchange funds in the bankruptcy estate furthers one of the primary policies of bankruptcy law – equitable distribution of property among similarly situated creditors allowing a collective action to avoid separate claims of 450 trusts." *Frontier,* at 25.

should, therefore, be accorded no deference at all.

(c) The Bankruptcy Court Failed to Consider Extrinsic Evidence Which Was Admissible under Virginia Law.

The Bankruptcy Court in *Millard* rejected extensive extrinsic evidence clarifying LES's role as QI, including LES's own admission that it was a fiduciary and was obligated to hold the Exchange Funds in trust. This was improper because § 8.1-205 *Va. Code Ann.* provides that even an integrated contract may be explained or supplemented by evidence of "usage of trade." [16] At a minimum the Exchange Agreements are ambiguous as to LES's role. Extrinsic evidence is admissible to explain an ambiguity in a contract. *Cohan v. Thurston*, 223 Va. 523, 292 S.E.2d 45 (1982).

The extrinsic evidence showing LES was a fiduciary and that the Exchange Funds were trust funds included:

- The accounting practice of LFG to treat the Exchange Funds as assets of the Exchangers on its consolidated balance sheets;
- The public SEC reports filed by LFG, the parent company of LES, affirming that "consistent with industry practice, these like-kind Exchange Funds are held by us for the benefit of our customers;"
- LES's marketing brochures touting "Funds **Held in Trust**;"
- Language in LFG correspondence to Treasury Secretary Henry Paulson referring to LES's function "as a fiduciary for Section 1031 exchanges" and "as a fiduciary to facilitate IRS Section 1031 real estate transactions;"
- Correspondence sent by LES to the Chief Examiner for the Nebraska Department of Insurance, describing the essential function of LES as a QI "to hold **in escrow** the proceeds from the sale of one property and to disburse **the same** upon the purchase or

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[16] LES was a member of the Federation of Exchange Accommodators ("FEA"), the primary industry trade group for qualified intermediaries. LES covenanted to execute the duties of a QI in its Exchange Agreements and the FEA's Code of Ethics expressly provides that members serve as "fiduciaries" when holding clients funds. (Am. Complt. ¶ 95-98).

exchange of a new property of 'like kind.'" The letter also noted that "at any given point, the Exchange Company **is holding in escrow** proceeds from the sale of properties for the purchase of new property of like kind."

- The LES Executive Summary noting: "LandAmerica serves in a **fiduciary capacity**" for its Exchange clients.

- Correspondence sent by LES to SunTrust, verifying that LES "holds these funds **in escrow as a fiduciary** until the funds (with the related earnings) are returned to customers to complete the 1031 Exchange," consistent with usage of trade and industry practice established by the FEA Code of Ethics;

- Correspondence sent by LES to SunTrust verifying that LES "is acting **in a fiduciary capacity**, with the **funds ultimately belonging to the retail client** [exchanger]," again consistent with usage of trade and industry practice;

- The correspondence sent by LES to SunTrust verifying that an essential function of the QI is to "**hold in escrow**" the proceeds from the sale, again consistent with the usage of trade and industry practices;

- The LES website on which it represented that Exchange Funds are held "**in trust**;"

- Language in the FEA Code of Ethics and Conduct, that "Exchange Accommodators recognize that **the fiduciary nature of the industry** imposes obligations beyond those of ordinary commerce;"

- Language in the FEA Code of Ethics and Conduct, noting that an Exchange Accommodator shall act in the best interest of its customers;

- Language in the FEA Code of Ethics and Conduct, noting that Exchange Accommodators are held to the "Prudent Investor Standard" and listing a series of duties, all of which LES violated by paying old Exchangers with new Exchangers' Exchange Funds.

In addition, the bankruptcy judge did not consider, the following:

- The impact of the Virginia real estate broker statutes at §§54.1-2100 *et seq., Va. Code Ann.*;

- The impact of Virginia's law of agency on the fiduciary duties owed by LES; and

- Authority from *Restatement (Third)) Trusts*, §5: "If [relinquished] property transferred by one person [the Exchanger] to another [LES] and the transferee [LES] agrees to sell

> that property and to pay its proceeds or a certain amount of proceeds to a third person [the seller of the replacement property], ordinarily a trust of the property is created."

(d) The Bankruptcy Opinion Is Governed by Myriad Errors of Law.

The *Millard* opinion is simply wrong. First, the bankruptcy court focused on the absence of words such as "trust" or "escrow." Yet in the case of *Dameron v. Old Republic National Title Insurance Company*, 155 F.3d 718, 722 (4th Cir. 1998) (citations omitted), such words were deemed unnecessary, holding: "An express trust is created when the parties affirmatively manifest an intention that certain property be held in trust for the benefit of a third party. An express trust may be created 'without the use of technical words.'"

In *Dameron*, the Fourth Circuit held:

> The language of the parties' agreements and the circumstances under which the Lenders advanced their funds to Dameron leave no doubt that the parties intended Dameron **to act merely as an intermediary**. There was plainly no expectation that Dameron would keep the Lenders' funds after closing or that he would develop any equitable interest in the funds. In fact, under Virginia law, a trust fiduciary is prohibited from acquiring an equitable interest in trust property adverse to his principal. Therefore, under Virginia law and the law of trusts generally, we have no doubt that an express trust was created.

Id. at 722. (citations omitted) (emphasis added).

Dameron describes virtually the exact experience of the Exchangers herein. The Bankruptcy Court also focused on the language in ¶ 2(c) of the Exchange Agreement, that LES had sole and exclusive possession, dominion and control of the Exchange Funds during the exchange period, and the disclaimer language whereby the Exchangers "also disclaimed any right, title or interest in and to the Exchange Funds." The Bankruptcy Court concluded that the "conveyance combined with that disclaimer is inconsistent with the establishment of a trust." *Millard* at *8.

However, the "dominion and control" language cited by the Bankruptcy Court as controlling the

intent of the parties "not to create a trust," is language mandated by Treas. Reg. § 1.1031(k)-1(g)(4)(vi):

> Paragraph (g)(4)(I) of this section [the QI Safe Harbor] ceases to apply at the time the taxpayer has an immediate ability or unrestricted right to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary. Rights conferred upon the taxpayer under state law to terminate or dismiss the qualified intermediary are disregarded for this purpose.

The Exchange Agreement had to transfer "dominion and control" of and "right, title and interest" in the Exchange Funds to LES in order to avoid constructive receipt by the Exchanger, but that is all. The "no right, title or interest in" phrase cited by the Bankruptcy Court is also mandated by Treas. Reg. § 1.1031(k)-1(g)(6)(i):

> An agreement limits a taxpayer's rights as provided in this paragraph (g)(6) only if the agreement provides that the taxpayer has no rights . . . to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period.

As noted in Treas. Reg. § 1.1031(k)-1(n), this language does not create any inference about the relationship between LES and the Exchangers. Under the regulation such language is to be considered solely with regard to issues of actual or constructive receipt. The testimony of Defendant Allen, Vice President and National Underwriting Counsel of LES is consistent. He states the language was included to satisfy the IRC requirement that the Exchanger not receive the sale proceeds and for no other reason. (Am. Complt. ¶ 159).

In addition, the Bankruptcy Court relied on the phrase used in Treas. Reg. § 1.103 (k)-1(g)(4)(I) as suggesting intent of the IRS to treat Exchange Funds as not those of the taxpayer. *Millard* at * 16, n. 10. This provision states:

> "[D]etermination 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 qualified intermediary is not the agent of the taxpayer."

In fact, the clear inference of this provision is the exact opposite. Otherwise, the "as if"

language has no meaning. The Bankruptcy Court ignored the application of the "no inference" language of §1.1031(k)-1(n):

> **No inference with respect to actual or constructive receipt rules outside of section 1031 [26 USCS 1031].** The rules provided in this section relating to actual or constructive receipt are intended to be rules for determining whether there is actual or constructive receipt in the case of a deferred exchange. **No inference is intended regarding the application of these rules for purposes of determining actual or constructive receipt exists for any other purpose**.

Finally, the QI clearly may be considered the agent of the Exchanger for state law purposes. See, example 3 and 4, Treas. Reg. §1.103 (k)-1(g)(8): "This result is reached for purposes of this section **regardless of whether [the QI] was [the exchanger's] agent under state law**."

The Bankruptcy Court's interpretation of the "disclaimer" language is manifestly at odds with the expressed intention of LES in ¶ 6(b) to "enter[] into this Exchange Agreement **solely** for the purpose of facilitating taxpayer's exchange of the relinquished property for the replacement property." (Am. Complt. Ex 1). The facilitation of a compliant tax-deferred exchange **does not** include acquisition by the QI of equitable title, only legal title. The Bankruptcy Court also failed to consider that the "disclaimer" provision of the Exchange Agreement stating that the Exchanger shall have no right, title or interest in the Exchange Funds is qualified by the language: "**except that** the balance of the Exchange Funds shall be **held by LES** and **after applying** such Exchange Funds in accordance with the Exchange Agreement **shall be paid** to taxpayer on the applicable Termination Date." (Am. Complt. Ex. 1) (emphasis added). At a minimum, the potential ambiguity between the "disclaimer" language and the "sole purpose" language required consideration of extrinsic evidence.

The Bankruptcy Court opinion in *Millard* is further flawed because:

- The Bankruptcy Court relied on the fact that the Exchange Agreement did not restrict the ability of LES to pledge, encumber, borrow, or otherwise receive the benefits of the

Exchange Funds when the analysis should have focused on the fact that the Exchange Agreement did not affirmatively provide that LES could pledge, encumber, borrow the Exchange Funds, only deposit them in an FDIC-insured account at SunTrust;

- The Bankruptcy Court did not recognize that LES's disclaimer of duties or obligations implied or imposed by operation of law could not negate statutory duties imposed upon LES by the regulatory statutes of the State of Virginia, its chosen forum;

- The Bankruptcy Court wrongly concluded that LES's disclaimer effectively waived any duty LES had to act as a fiduciary. The Court's reliance on *Metric Constructors, Inc. v. Bank of Tokyo-Mitsubishi, Ltd.*, C.A. No. 99-2330, 2000 U.S. App. LEXIS 23185 (4th Cir. Sept. 13, 2000) was misplaced because the agreements in that case expressly disclaimed any relationship of trust or fiduciary relationship and did not involve a statutorily-imposed fiduciary duty;

- The Bankruptcy Court wrongly concluded that LES's disclaimer effectively waived any duty LES had to act as a fiduciary, ignoring that LES expressly assumed the duties to act as QI, which is a fiduciary role according to industry practice;

- The Bankruptcy Court wrongly concluded that the Exchangers retained no equitable interest in the Exchange Funds and thereby ignored language of the Exchange Agreement that required LES to "hold and apply" the Exchange Funds per the terms of Agreement, defined the Exchange Funds as the compensation paid for the relinquished property less certain deductions, and required LES to purchase the replacement property from the Exchange Funds;

- The Bankruptcy Court wrongly concluded that the Exchangers retained no equitable interest in the Exchange Funds and thereby ignored language that stated LES's sole intent was to be a "qualified intermediary" within the meaning of Section 1.1031(k) - 1(g)(4)(iii) and to remain in that role until all the Exchange Funds were disbursed;

- The Bankruptcy Court wrongly concluded that the language of the Exchange Agreement demonstrated that the parties intended their relationship to be one of obligor and obligee, without describing the obligations assumed by LES in the Exchange Agreement *vis-a-vis* the Exchange Funds which included **holding and applying** them for the specific purposes stated therein;

- The Bankruptcy Court wrongly relied on authorities dealing **parol** evidence to decline consideration of clear **written** statements of intent by LES occurring before, during and after execution of the Exchange Agreements at issue;

- The Bankruptcy Court wrongly concluded that the language of the Exchange Agreements precluded consideration of purported "subjective beliefs" of the parties,

when, in fact, the evidence offered was of unequivocal written statements and positions taken by LES, including verification of its accounting practices in regulated SEC filings, which acknowledged the Exchangers' beneficial ownership of the Exchange Funds;

- The Bankruptcy Court wrongfully invoked the bankruptcy policy of ratable distribution in applying the state law governing resulting trusts, when such policy may only be applied in the context of constructive trusts. *Siegel v. Boston (In re Sale Guar. Corp.)*, 220 B.R. 660, 667 (Bankr. Cal.1998), *aff'd* 199 F.3d 1375 (9th Cir. 2000).

- The Bankruptcy Court wrongfully refused to consider a resulting trust based on its mistaken finding of an intent not to create an express trust. The court erroneously used this finding to negate the equitable presumption that exists under Virginia law that "one who advances money for the purchase of real property is entitled to its benefits." *Morris v. Morris*, 248 Va. 590, 593, 449 S.E.2d 816 (1994). The Bankruptcy Court ignored Virginia case law which states that resulting trusts are found even when to do so "contravenes the express language of the written transaction documents." *1924 Leonard Rd., L.L.C. v. Van Roekel*, 272 Va. 543, 552, 636 S.E.2d 378, 383 (2006).

2. The Exchange Funds were Trust Funds

a. <u>The Exchange Agreements created an express trust under which LES held the Exchange Funds for the benefit of each Exchanger.</u>

Each Exchange Agreement contains a "choice of law" clause which states that Virginia law applies. Under Virginia law, "an express trust may arise from 'words or circumstances which unequivocally show an intention that the legal estate was vested in one person, to be held in some manner or for some person on behalf of another . . . .'" *Cody v. United States*, 348 F. Supp. 2d 682, 692 (E.D. Va. 2004) (citations omitted). Whether an express trust has been created does not turn on the use of particular words or phrases like "trust" or "trustee." *Thomas v. House,* 145 Va. 742, 746, 134 S.E. 673 (1926). Rather, "the Court has an obligation to go beyond the terminology used in an effort to determine the substance of the relationship between the parties." *Airlines Rptg. Corp. v. Pishvaian*, 155 F. Supp. 2d 659, 664 (E.D. Va. 2001); *see, also, Restatement (Third) of Trusts* § 5.

The LES Exchange Agreements do not describe a gift, a loan, a bailment, or a purchase. The

Exchange Agreements describe a personal service contract, whereby the Exchangers paid approximately $1000 for services rendered by LES.

Restatement (Third) of Trusts § 5 at 57 (emphasis added) describes the creation of a trust:

> If [relinquished] property transferred by one person [the Exchanger] to another [LES] and the transferee [LES] agrees to sell that property and to pay its proceeds or a certain amount of proceeds to a third person [the seller of the replacement property], ordinarily a trust of the property is created. If, however, property is transferred by one person [the Exchanger] to another [LES] **who agrees in consideration thereof to assume a personal liability** to a third person [the seller of the replacement property], a contract for the benefit of the third person and not a trust is created.

LES did not assume, and in fact disclaimed, personal liability to the third party seller of the replacement property. While ¶ 2(a) of the Exchange Agreement states that "LES shall make payments from the Exchange Funds to acquire the replacement property," ¶ 5(a) provides that **LES assumes no liability or other obligations** "in connection with the acquisition of any property" because the Exchanger "shall assign its rights, **but not its obligations,** under the replacement property contract to LES." (Am. Complt. Ex. 1). The same paragraph of the Exchange Agreement goes on to provide that LES's only obligation was to the Exchanger and that obligation was **to hold and then deliver the Exchange Funds** to the seller of the replacement property. *Id.* Thus, the Exchange Agreement clearly creates a trust and not a contract for the benefit of another.

Paragraph 2(a) of the Exchange Agreements defines "the Exchange Funds" as the consideration received from the sale of the relinquished property. (Am. Complt. Ex. 1) That provision requires that LES "**hold and apply** the Exchange Funds in accordance with the terms and conditions of this Exchange Agreement." *Id.* Thus, LES was limited in what it could do with the Exchange Funds because LES was required LES to "make payments **from the Exchange Funds** to acquire the replacement property." *Id*. It would be impossible for LES to use Exchange Funds to acquire replacement property

if the Exchange Funds had been used up by LES, whether for lulling payments on older exchanges, to make payroll, or to gamble in Las Vegas.

Paragraph 2(c) of the Exchange Agreement does state that LES shall have "sole and exclusive possession, dominion, control and use of all Exchange Funds." *Id.* However, this control provision was expressly limited by the requirement that LES deposit the Exchange Funds at SunTrust in the FDIC-insured account and further by the requirement that LES hold and apply the funds to acquisition of replacement property. The Exchange Agreement at ¶ 3(a) stated:

> Taxpayer acknowledges and agrees that the amount of the Exchange Funds may be in excess of the maximum amount of the deposit insurance carried by the depository institution indicated above [SunTrust]; however LES unconditionally guarantees the return and availability of the Exchange Funds and the guaranteed interest stated above.

(Am. Complt. Ex 1).

There is no possible construction of the Exchange Agreement statement regarding FDIC insurance that is consistent with an intention that the Exchange Funds would be withdrawn from the SunTrust FDIC-insured account and used for any and all LES purposes At no time did LES possess legal and equitable title to the Exchange Funds to use on its own account.

In addition, LES explicitly acknowledged in the Exchange Agreements that its role with respect to the Exchange Funds was limited. Paragraph 6(a) of each Exchange Agreement recites that "LES has entered into this Exchange Agreement with the intention of being a 'qualified intermediary' within the meaning of Section 1.1031(k)-1(g)(4)(iii) of the Regulations and both parties acknowledge that the Exchange Agreement is intended to satisfy the 'safe harbor' provisions of Section 1.1031(k)-1(g) of the Regulations." [17] (Am. Complt. Ex 1). Subsection (b) of ¶ 6 goes on to provide that "LES is entering

[17] What LES does not state is an intention to become a debtor or obligor. Nor does any (continued...)

into this Exchange Agreement **solely for the purpose of facilitating taxpayer's exchange** of the relinquished property for the replacement property." *Id.* Because LES's "sole" purpose was to comply with the Treasury Regulations to defer a tax, it is necessary to examine what interest the regulations require the taxpayer transfer to the QI in order to effectuate a tax-deferred exchange. As acknowledged by SunTrust, the requirement for a §1031 Exchange is that "the seller of property is prohibited from taking actual or constructive **legal title** of the proceeds at any time during the 1031 exchange. . . ." SunTrust Memo at pp. 3-4. The regulations at Treas. Reg § 1.1031(k)-1 subsection (g)(4)(iv)(A) provide that "an intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers **legal title** to that property." *Id.* (emphasis added). The reference to legal title demonstrates a clear legislative intent that the transfer of equitable title to the QI is never necessary. Courts have agreed that §1.1031(k)-1 does not require the taxpayer to transfer its equitable interest to the QI. "A taxpayer need not abandon all equitable interest in the proceeds from the downleg property for a transaction to qualify as a non-taxable event under section 1031." *Cook v. Garcia*, Case No. 96-55285, 1997 U.S. App. LEXIS 5980, *4 (9th Cir. Cal. Mar. 27, 1997); *see, also, State of Washington v. Grimes*, 111 Wash. App. 544, 46 P.3d 801 (2002). Instead of requiring the taxpayer to abandon all equitable interest in the proceeds, the regulations only require that the taxpayer not be in "actual or constructive receipt." *DeGroot v. Exchanged Titles, Inc. (In re Exchanged Titles, Inc.)*, 159 B.R. 303, 306 (Bankr. C.D. Cal. 1993) (quoting *Alderson v. Commissioner of Internal Revenue Service*, 317 F. 2d 790, 795 (9th Cir. 1963).

Thus, as the regulations make clear and SunTrust acknowledges, the §1031 exchange

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[17](...continued)
Exchanger acknowledge an intention to become a mere creditor or obligee.

transaction does not require anything other than transfer of legal title to the QI and there is no rationale under §1031 or the regulations for transfer of anything more. Since LES explicitly limited its purpose in the transaction to serving as QI and satisfying the requirements of the statute for a tax-deferred exchange, the transfer of legal title to the Exchange Funds is clearly what was intended and nothing more. Any interpretation of the Exchange Agreement to transfer more defeats the clear intent of the parties and is simply wrong.

In addition, the nature of the transaction renders any other interpretation implausible. No reasonable exchanger would knowingly consent to a 180-day unsecured loan, to an insolvent borrower, on nominal interest, so that LES could take their Exchange proceeds to fund other exchanges, make payroll or buy jets, at LES's sole discretion. Under SunTrust's analysis, if LES took the money to Las Vegas and doubled it, the profits went to LES. But if LES lost the money, it was simply in breach of a contract to return the money. No reasonable person would suggest that this was the paradigm contemplated by these exchange transactions of hundreds of thousands up to millions of dollars. During the 180-day exchange window, there clearly was no intended assumption of risk on the safety of the Exchange Funds by the Exchangers, other than the risk of bank failure by SunTrust on funds exceeding the FDIC limit, a risk explicitly disclosed in the Exchange Agreement.

Courts have analyzed Exchange Transactions in just this way to conclude that a bankruptcy estate of a QI does not include the beneficial interest in the property transferred to the debtor to effectuate the exchange. In *In re Exchanged Titles, Inc.* the court noted that the parties' real intent in transferring the property was solely to effectuate a Section 1031 exchange so that the taxpayer retained the equitable interest in the transferred property. *DeGroot v. Exchanged Titles (In re Exchanged Titles)*, 159 B.R. 303 (Bankr. C.D. Cal. 1993); *see also Siegel v. Boston (In re Sale Guar. Corp.)*, 220 B.R. 660

(B.A.P. 9th Cir. 1998).

The fact that LES paid a tiny amount of interest to the Exchangers does not create a debtor-creditor relationship because the interest paid was "merely such interest or other earnings as the funds, being invested, may earn." *Restatement (Third) of Trusts* § 5 at 60. The payment of interest by LES to the Exchangers equal to the Federal Funds Rate, less 150 basis points, would not provide consideration to the Exchangers for LES to have unfettered use of the Exchange Funds as an unsecured 180-day loan. The provision for this below market interest could not morph a trust relationship into an unsecured loan by the Exchangers to financially strapped LES. The intention of the parties was to create a trust, not a loan. No other explanation is plausible.

b. LES's Declarations That it Held the Exchange Funds in Trust Were Sufficient to Create a Trust.

Trusts may be created by a declaration from the owner of the property that he or she holds the property as trustee for one or more persons. *Restatement (Third) of Trusts*, § 10, at 45. Even assuming *arguendo* that the Exchange Agreements, by their literal language, transferred both legal and equitable title to the Exchange Funds to LES, LES still declared that it held the Exchange Funds in trust for the benefit of the Exchangers. *Restatement (Third) of Trusts*, § 45. Such a declaration of trust by LES creates a trust enforceable by the Exchangers as beneficiaries. LES made declarations of trust on its website, in its marketing materials, through its parent in filings with the SEC representing that Exchange Funds were not assets that belonged to LES, to other regulators, and to SunTrust.

c. In the Alternative, the Exchange Funds Were Held as a Resulting Trust Because of the Nature of the Transaction and Because All Parties Intended for the Exchange Funds to Be Held in Trust.

In addition to express trusts, Virginia recognizes resulting trusts. "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 Road, L.L.C.*, 272 Va. 543at 552, 636 S.E.2d at 383. Resulting trusts are presumed to arise when a "beneficiary" pays for property but has legal title conveyed to another without any mention of a trust in the conveyance. Resulting trusts are found if circumstances warrant, even when to do so contravenes express language of the written documents. *Id.* "A resulting trust is based upon a presumed intent or inference of law deduced from the facts and circumstances." *Gibbens v. Hardin*, 239 Va. 425, 389 S.E.2d 478 (1990); *Gifford v. Dennis*, 230 Va. 193, 198, 335 S.E.2d 371 (1985). A basic precept of the Virginia law of resulting trusts recognizes that "one who advances the purchase money for real property is entitled to its benefits." *Gifford*, 230 Va. at 198; *Morris*, 248 Va. at 593 .

After it has been shown that payment of all 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 is the intention of the parties. If no evidence of intent is available, then the presumed intention of the creation of a trust will stand. The burden shifts to the grantee to establish a gift or some other legally cognizable purpose for the transfer because of the lack of consideration. *Gifford*, 230 Va. at 198-99.

The LES Bankruptcy Court wrongfully subordinated the burden shifting rules under Virginia law to the bankruptcy presumption defining property of the estate. This court is not compelled to follow that reasoning.

D. Plaintiffs' Pleading with Regard to the Existence of a Fiduciary Duty is Sufficient

As a preliminary matter, the existence of a fiduciary relationship is a question of fact for the jury. *Allen Realty Corp. v. Holbert*, 227 Va. 441, 318 S.E.2d 592 (1984). The allegations of the

Plaintiffs' Amended Consolidated Complaint, including the terms contained in the Exchange Agreement attached to the Complaint as Exhibit 1, set forth facts sufficient for a jury to find a fiduciary relationship between LES and Plaintiffs based on four independent grounds, either as a trustee, an intermediary, a broker, or a common law agent.

1. LES was Trustee to the Exchange Funds.

As described above, the Exchange transactions created express or resulting trusts clearly giving rise to fiduciary duties on the part of LES *vis-a-vis* the Exchangers.

2. LES was a Fiduciary based on its Duties as QI.

The very nature of the exchange transaction creates a fiduciary relationship based on trust, confidence and fidelity.

LES was an "intermediary," which is defined by the § 1031 statute as requiring transfer of only legal title and is also defined by "usage of trade" in the industry. In particular, the FEA's use of the term "intermediary" is admissible to define the intended meaning of the term. *See Columbia Nitrogen Corp. v. Royster Co.*, 451 F.2d 3 (4th Cir. 1971). The FEA defines an "intermediary" as a "fiduciary" in its Code of Ethics, which LES agreed to bind itself to by being an active member.

3. LES was a Broker

SunTrust contends that LES can handle billions of dollars of Exchange Funds and there is no regulatory oversight in Virginia or elsewhere. Plaintiffs disagree. Pertinent portions of the LES Exchange Agreement and interrelated closing documents clearly bring LES within the statutory definition of an entity acting as a broker under Virginia law.

Virginia Code §54.1-2100 (Emphasis added) defines "real estate broker" as follows:

'Real estate broker' means any person or business entity, including, but not limited to,

> a partnership, association, corporation or limited liability company, **who, for compensation or valuable consideration (I) sells or offers for sale, buys or offers to buy, or negotiates the purchase or sale or exchange of real estate,** including units or interest in condominiums, cooperative interest as defined in § 55-426, or time-shares in a time-share program even though they may be deemed to be securities, or (ii) leases or offers to lease, or rents or offers for rent, any real estate or the improvements thereon for others.

Virginia Code §54.1-2107 (emphasis added) states:

> **One act** for compensation or valuable consideration of buying or selling real estate of or for another, **or offering for another to buy or sell or exchange real estate**, or leasing, or renting, or offering to rent real estate, except as specifically excepted in § 54.1-2103, shall constitute the person, firm, partnership, co-partnership, association or corporation, performing, offering or attempting to perform any of the acts enumerated above, a real estate broker or real estate salesperson.

In apparent recognition that these Code provisions cast a very broad net, the Virginia Legislature codified certain exceptions to the real estate broker definition. A QI is not exempted from the Virginia statutory scheme regulating real estate brokers. See, §54.1-2103.

It is clear from the LES-drafted Exchange Agreement that LES was acting as a real estate broker, as defined above. LES, by the Exchange Agreement, was paid not only to facilitate the like-kind exchanges, but actually to "buy" and "sell" the relinquished and replacement properties. Critical provisions of the Exchange Agreement provide:

a. LES is **to facilitate** the like-kind exchange of real property. (Exchange Agreement, ¶ 1(a));

b. LES is **to acquire** from the exchange client the relinquished property. (*Id.* at ¶ 1(a));

c. LES is **to acquire** the replacement property in a purchase transaction. (*Id.* at ¶ 1(a));

d. LES is **to make payments** from the Exchange Funds **to acquire** the replacement property. (*Id.* at ¶ 2(b));

e. LES is **to convey** the replacement property to the exchange client. (*Id*. at, ¶ 1(a)); and

f. LES is **assigned the exchange client's rights under the sales contract to sell** the

relinquished property. *(Id.* at ¶ 1(b)).

(Am. Complt. Ex. 1) (emphasis added).

The Exchange Agreement requirements make it crystal clear that LES's conduct falls within the definition of a real estate broker under Virginia law, which imposes statutory duties regarding the holding and handling of Exchange Funds pursuant to §54.1-2108 (emphasis added):

> No licensee or any agent of the licensee shall **divert or misuse** any funds held in escrow or otherwise held by him for another. . . .

By the language of the Exchange Agreements, LES was required to "hold and apply" the Exchange Funds according to the Agreement and was to "make payments from the Exchange Funds to acquire the replacement property." (Am. Complt. Ex 1, ¶2(a)). Section §54.1-2131, regarding brokers engaged by sellers, requires among other things, that the broker:

(1) "Account in a timely manner for all money and property received by the licensee in which the seller has or may have an interest;" and

(2) "Disclose to the seller material facts related to the property or concerning the transaction of which the licensee has actual knowledge."

4. LES was an agent.

An agent commonly represents the principal in the creation and performance of contracts with third parties. *Acordia of Virginia Insurance Agency, Inc. v. Genito Glenn, L.P.*, 263 Va.. 377, 560 S.E.2d 246 (2002). Whether an agency relationship exists "is a question to be resolved by the fact finder unless the existence of the relationship is shown by undisputed facts or by unambiguous written documents." Id. at 384. "[T]he evidence and all reasonable inferences fairly deducible therefrom with regard to the issue of agency must be viewed in the light most favorable to [the party pleading agency]. *Id.* At 384-85.

Under *Restatement (Second), Agency* §13, "[a]n agent is a fiduciary with respect to matters

within the scope of his agency." Section 1 of the *Restatement* states, "[a]gency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act." Comment a to §1 states that "the relation of agency is created as the result of conduct by two parties manifesting that one of them is willing for the other to act for him subject to his control, and that the other consents so to act." Virginia case law is also very clear that a principal/agent relationship is a fiduciary relationship. "Agency is a fiduciary relationship between two parties in which one party agrees to act on behalf of and subject to the control of the other party." *Banks v. Mario Indus.*, 274 Va. 438, 650 S.E.2d 687, 695 (2007). Virginia courts have further defined the parameters of the agency relationship:

> A special agent is one who is authorized to perform one or more specific acts in pursuance of particular instructions, or within restrictions necessarily implied from the stated acts to be performed. The powers of a special agent must be strictly construed. The authority of a special agent must be ascertained from the terms of the instrument itself. No authority will be implied from the terms of the instrument, except that authority indispensable to the exercise of the powers expressly conferred.

Hartzell Fan, Inc. v. Waco, Inc., 256 Va. 294, 300, 505 S.E.2d 196, 200 (1998) (citations omitted).

It s clear that LES not only was agent acting as an agent for its Exchangers, but as a special agent charged with carrying out the very specific functions necessary to accomplish a tax compliant IRC §1031 Exchange. That specific and limited function as to hold the funds and then buy replacement property identified by the Exchangers to consummate the exchange transactions.

In this case, LES, for a fee, agreed to act for its 400 Exchange clients, as a corporate QI on their behalf, to consummate the transfer of relinquished property, to receive and hold the proceeds, to acquire the replacement property with the proceeds, and then convey that property to the Plaintiffs. Paragraph 1(a) of the Exchange Agreement specifies that LES is willing to act on behalf of the Plaintiffs to transfer the Relinquished Property and to obtain Replacement Property. (Am. Complt. Ex 1). In

¶ 2(a), "LES agrees to hold and apply the Exchange Funds" from the transfer of the Plaintiffs' relinquished property. *Id.* Under ¶ 2(c), LES agreed to hold the Exchange Funds until certain dates and directives of the Plaintiffs consistent with IRC §1031. *Id.* LES in ¶ 5(b) agreed to act on the Plaintiffs' behalf to acquire and transfer to the Plaintiffs Replacement Property as identified and directed by the Plaintiffs. *Id.* Finally, ¶ 6(b) of the Exchange Agreement provides that "LES is entering into this exchange agreement **solely** for the purpose of facilitating taxpayer's exchange of the relinquished property for the replacement property." *Id.* (Emphasis added). These are all actions of an agent.

A review of the controlling Treasury Regulations confirms that LES was acting as the Plaintiffs' agent for the purpose of completing the Exchange transactions. The issue raised by §1031 is how much taxpayer dominion and control over Exchange Funds will constitute "property or money received" under §1031(b), which would be taxable gain to the recipient. Treas. Reg. §1.1031(k)-1(f)(2) provides that the general rules of constructive receipt stated in §§1.451-1(a) and 2(a) apply "**except** as provided in paragraph (g)." (Emphasis added). Treas. Reg. §1.1031(k)-1(g)(4) states that the QI "is not considered the agent of the taxpayer **for the purposes of Section 1031(a)**. . . ." even if the QI is considered the agent of the Exchanger under state law. (Emphasis added). "The determination of whether the taxpayer is in actual or constructive receipt of the money. . . is made **as if** the QI is not the agent of the taxpayer." *Id*. (Emphasis added). Under this regulation, at (g)(4)(iv)(B) and (C), the language verifies that the QI can be the agent of a party to the transaction. In addition, Treas. Reg. §1.1031(k)-1(g)(8) Ex. 4 sub- (ii) (emphasis added) notes:

> The exchange agreement entered into by B and C satisfied the requirements of paragraph (g)(4)(iii)(B) of this section… This result is reached for purposes of this section **regardless of whether C was B's agent under state law**.
>
> An enactment must be interpreted, if possible, in a manner which gives meaning to every word.

See, e.g., First Virginia Bank v. O'Leary, 251 Va. 308, 467 S.E.2d 775 (1996); *Monument Assoc. v. Arlington County Bd.*, 242 Va. 145, 149, 408 S.E.2d 889, 891 (1991). The use of the words "as is," "is not considered," "for the purpose of," and "regardless of whether" in Treas. Reg. §1.1031(k)-1(g)(4) and (g)(8) are meaningless other than in recognition that the QI actually is the agent of the Exchanger client under the common law.

Also, Treas. Reg. §1.1031(k)-1(k)(2) directs that "the agent of the taxpayer at the time of the transaction" is disqualified from serving as an intermediary. It also specifies certain relationships that are treated as agents, including those of "real estate agent or broker." The Regulation then provides an exception from the agency disqualification by stating: "[s]olely for purposes of this paragraph (k)(2), performance of the following services will not be taken into account – (i) Services for the taxpayer with respect to exchanges of property intended to qualify for non-recognition of gain or loss under section 1031." §1.1031(k)-1(k)(2)(i). Paragraph (k)(2)(i) thus permits a QI to render broker services limited to qualifying the exchange under §1031. Far from exonerating a QI and its accomplices, (k)(2)(i) recognizes that a broker is an agent of the taxpayer, invoking the common law and statutory fiduciary duties explained above.

There is nothing incompatible with the QI being an agent, broker or trustee for the purposes of fiduciary duties involving safekeeping of Exchange Funds while being treated "as if" not an agent for the actual/constructive receipt analysis. Therefore, Treas. Reg. §1.1031(k)-1(g)(4)(i) does not abrogate the principal-agent relationship and the commensurate fiduciary duties LES owed its Exchangers.

E. Plaintiffs Have Alleged Sufficient Facts to Support a Claim Against Suntrust for Conversion and for Aiding and Abetting the Conversion of the Exchange Funds.

1. Conversion by SunTrust

Under Virginia law "[a] person is liable for conversion for the wrongful exercise or assumption of authority over another's goods, depriving the owner of their possession, **or any act of dominion wrongfully exerted over property in denial of, or inconsistent with, the owner's rights**." *Simmons v. Miller*, 261 Va. 561, 582 594 S.E.2d 666, 679(emphasis added); *PGI, Inc. v. Rathe Prods., Inc.*, 265 Va. 334, 344, 576 S.E.2d 438 (2003). Money can be the subject of a claim of conversion if the plaintiff seeks to recover a specific, identifiable amount. *PCO, Inc. v. Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, LLP*, 150 Cal. App. 4th 384, 396 (Cal. App. 2d Dist. 2007).

With direct knowledge from LES that the Exchange Funds were escrow funds to be held for the benefit of the Exchangers, SunTrust intentionally exercised dominion and control over the Exchange Funds by moving them out of the 3318 account for payment to fund the purchase of property for older exchangers as requested by LES. This action, without question, interfered with the Exchangers' right to have the Exchange Funds held for their benefit and available to purchase their own replacement property as required under the Exchange Agreements.

As noted above, LES was the Exchangers' agent for the purpose of carrying out the exchange transactions and, as such, receipt of the proceeds of the sale of the relinquished property is receipt by the Exchanger for state law purposes. It is only the constructive receipt provisions of the Treasury Regulation that preclude this result, solely for the purposes of the tax analysis of the transaction. Treas. Reg. Reg. § 1.1031(k)-1(n). From a state law standpoint, LES was in receipt of the Exchange Funds, as the agent and Trustee of the Exchangers, solely to carry out the purpose of the Exchange – the funding of replacement property. Thus, the Exchangers not only had a right to immediate possession at the time of conversion, they were in possession of the funds, through LES as agent, as of the time the

Exchange Funds were converted.

The Exchange Agreements also clearly provide a right to immediate possession by the Exchangers because, at any point from day 1 of the exchange transaction forward, the Exchangers could demand purchase of replacement property with their exchange funds.[18] The transfer of the Exchangers' money to fund replacement property of others was clearly "in denial of, or inconsistent with, the [exchangers'] rights" in their Exchange Fund. *Simmons v. Miller*, 261 Va. at 582.

2. Aiding and Abetting Conversion

SunTrust knew that LES held the Exchange funds for the benefit of Exchangers. LES told SunTrust it did. Yet SunTrust funded the wrongful transactions right up to the day LES declared bankruptcy. "A[n] . . . agent . . . who makes an unauthorized delivery of a chattel is subject to liability for conversion to his bailor, principal, or master unless he delivers to one who is entitled to immediate possession of the chattel." *Restatement (Second) Torts* §234. As such, LES's actions were a conversion and one which could not have taken place without SunTrust. SunTrust, thus, substantially assisted LES in LES's conversion of Exchange Funds.

F. SunTrust conspired with LES.

SunTrust contends that Plaintiffs' conspiracy claim must be dismissed on the purported ground that no "agreement" is sufficiently pled and further that Plaintiffs have a alleged the existence of an underlying tort. For the reasons stated herein, the underlying torts are specifically and definitively pled despite SunTrust's protestations to the contrary.

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[18] Any argument that the right to possession was not "immediate" because the exchange agreements provide for 3 business days notice to process the wire transfer meritless. The notice requirement was for administrative purposes and is no more relevant that a notice provision that might be required to access a safe deposit box. The right to possession must be deemed immediate because the Funds as held by the Exchangers agent and trustee.

As far as an agreement, Plaintiffs allege that SunTrust had full knowledge of LES's operation of a Ponzi scheme and accepted and paid disbursement requests of LES, knowing Exchange Funds were being misused. See, e.g. Am. Complt. ¶¶ 3, 12, 13, 111, 112. Plaintiffs also allege that:

> SunTrust participated in the Ponzi scheme because it wanted to be repaid the $100 million it had loaned to LFG. The plan was to defraud the Exchangers long enough for the ARS market to open back up or for LFG to sell its "good assets" to repay SunTrust. Instead, like the game of musical chairs, the music stopped and the current 400 plus Exchangers were left standing.

Am. Complt. ¶ 13.

Courts of Virginia have recognized that "[d]ue to the nature of conspiracy, all details may not be known at the time of pleading." *Johnson v. Kaugars*, 1988 Va. Cir. LEXIS 213, *8 (Va. Cir. October 21, 1988); *see, also, Helena Chemical Company v. Huggins*, C.A. No. 4:06-cv-2583, 2008 U.S. Dist. LEXIS 92449 (D.S.C. Nov. 13, 2008). "Civil conspiracy may be inferred from the very nature of the act done, the relationship of the parties, the interests of the alleged conspirators and other circumstances. 'Because civil conspiracy is by its nature clandestine, it is usually not provable by direct evidence." *Helena Chemical Co. V. Huggins*, supra at * 25-26. The courts only require the pleading of "some details of time and place and the alleged effect of the conspiracy." *Firestone v. Wiley*, 485 F.Supp. 2d 695, 704 (E.D.Va. 2007).

Plaintiff have alleged time – between February 2008 and November 26, 2008, and particularly between after early October 2008. (Am. Complt. ¶¶ 3, 64-65, 85-88, 111, 119, 182-83, 196). Place is not controversial because all of the actions in furtherance of the conspiracy related to bank transactions that would necessarily have occurred at the depository bank in Richmond. (Am. Complt. ¶¶ 21, 54, 58). Plaintiffs have pled the effect of the conspiracy throughout the Amended Complaint, that their exchange funds were lost and their exchanges defeated, resulting in taxable events. (Am. Complt. ¶¶ 3, 16 – 20, 83, 198).

Without doubt, more details of the SunTrust/LES conspiracy will come to light in discovery. In the meantime, however, the Amended Consolidated Complaint alleges sufficient time, place, and effect to overcome SunTrust's Motion to Dismiss.

G. Plaintiffs' Pleading against SunTrust does not sound in Fraud.

SunTrust states "Plaintiffs' entire Amended Complaint sounds in fraud." SunTrust attempts to re-write the Amended Complaint as a fraud complaint in order to trigger the heightened pleading standard of Rule 9(b)FRCP.

Conversion is not fraud; breach of fiduciary duty is not fraud. The fact that the underlying wrongdoing was sufficiently egregious that it smacks of fraud without pleading it, does not alter the claims the Plaintiffs seek to pursue against SunTrust. Neither aiding and abetting a breach of fiduciary duty, aiding and abetting a conversion, nor actual conversion fall within the parameters of Rule 9(b).

In any event, the Plaintiffs have pled the who, what, when, where and how of SunTrust's involvement in detailed averments in a more than 50 page complaint. The Complaint is sufficient under any pleading standard.

V. CONCLUSION

"Determining whether a complaint states a plausible claim for relief will, as the Court of Appeals observed, be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense. *Ashcroft,* 129 S.Ct. at 1950. In this case common sense compels the conclusion that Plaintiffs' claims are sufficiently pled, should be allowed to go froward and SunTrust's motion to dismiss denied.

Respectfully submitted,

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