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MEMORANDUM

TO: Dario Machado, Managing Partner 
FROM: Applicant
SUBJECT: Richard Burnsen and B-G Investors
DATE: February 24, 2015

Please find below a memorandum I have prepared in relation to the queries you have raised in relation to the stalled stock transfer deal between our clients Richard Burnsen and B-G Investors (BG) and, Jordan Virta. 

I. Background 

Our client Mr Burnsen and his company BG, proposed to buy 2,000,000 shares of Burnsen Technologies, Inc. (BTI) from the former chief scientist and vice president of BTI, Jordan Virta, for \$1.50 per share.

The parties agreed that Virta would receive \$500,000 on signing the stock purchase agreement and BG would execute a promissory note for the remainder of the purchase price, payable to Virta over the next 2 years, secured by the shares. As part of the deal, Mr Burnsen agreed to cancel a BTI consulting agreement that was hindering Virta's ability to work elsewhere.

The parties agreed that, on closing, Virta's signed share certificates would go to BTI's transfer agent to be reissued in BG's name. The shares would then be deposited in an escrow account at Columbia State Bank and Trust Company, as security for the note, and thereafter be distributed by the Trust Company to BG.

The closing was scheduled to take place on February 18th, but there has been a delay in closing due to a disagreement between the parties regarding the

payment schedule. Negotiations appear to have broken down, and as a result Mr Connor of this firm is currently holding the signed promissory note, stock purchase agreement and share certificates pending closing. Mr Virta's lawyers wrote to Mr Connor on February 24th demanding that Mr Connor return the stock certificates and related documents to their client.

Mr Virta's lawyers have alleged that Mr Connor is currently acting as an escrow agent for the parties. I set out below an analysis as to whether this is indeed the case, and explain any ethical or fiduciary duties associated with this position. I also discuss below what options Mr Connor has at this stage in an attempt to resolve this matter.

II. Ethical / Fiduciary issues



In order to determine the extent of any ethical or fiduciary duties owed from Connor to the parties in relation to the B-G Investors stock purchase deal, there are a number of issues to consider, as set out in detail below.

The leading case on this area is the case of *Wasman v Seiden* (1998). The case concerned a tort claim brought by Mr Wasman against his ex-wife and others for torts arising out of a marital dissolution. One of the named Defendants was an attorney who arranged a property settlement on behalf of the wife.





In that case, the key issue which the Columbia Court of Appeal considered was whether an attorney has a duty to safeguard property entrusted to him during settlement negotiations by an adverse party.


The Court accepted in *Wasman* that there are limited circumstances when third parties are the intended beneficiaries of an attorney's services that they are entitled to bring actions for professional negligence. The Court in *Wasman* concluded that although there was no professional duty owed by the attorney to

the opposing party (Wasman), his acceptance of Wasman's deed gave rise to a duty of care. The Court confirmed that this duty originates from the fiduciary role of an escrow holder.

A. Did Conner become an escrow holder for all the parties?

 As provided in the Columbia Professional Code, Section 17003, an escrow is created when, for the purpose of facilitating a transaction, property is delivered to an escrow holder to be held until the conditions specified in agreed-upon instructions are fulfilled, when the property is to be delivered to another according to the instructions.

 Based on the above, it would appear that Mr Connor is in fact holding the documents for the closing as an escrow holder for the parties. He has been asked to hold on to the documents until the deal completes and then transfer them to BTI to be renamed and then deposited with the Columbia State Bank and Trust Company.


 In *Wasman*, the court considered whether the Defendant attorney had become an escrow holder for his client and her ex-husband. In particular, the court drew inference from the fact that the attorney had "undertaken to exercise reasonable care to protect the Plaintiff's deed" and "voluntarily accepted the trust and confidence reposed in with him with regards to the Plaintiff's grant deed". Turning to the present case, it is necessary to consider each of these elements in turn.

Undertaking to exercise reasonable care

Regarding the stock purchase deal with B-G Investors (BG), Mr Virta's solicitors deposited the stock certificates and related documents with Mr Connor. In doing so, it is clear that it was the parties intention that Mr Connor would look after

these documents for Mr Virta pending the closing.


Accepting the trust and confidence placed in him regarding the property

 In *Wasman*, the court found that because of the Defendant's role as an attorney, Mr Wasman and his attorney Hartman reasonably relied on him because of his professional status and role as attorney for his ex-wife Barbara. By failing to promptly return the deed to Wasman, the court inferred that this was sufficient evidence of an acceptance of Mr Wasman's entrustment and of its conditions.

It is worth noting that pursuant to Section 17002 of the Columbia Professional Code, Mr Connor is not likely to be an authorized Escrow Agent, unless he has the appropriate authority.


B. If Connor acted as an escrow holder, was it proper for him to be an attorney for one party and an escrow holder for all parties? 

In the case of *Wasman*, the court held that the Attorney was not in breach of his professional duties as an attorney by holding the deed for Mr Wasman, the opposing party.

 Here, the facts are similar. Mr Connor has been asked to hold the documents pending the closing. He is not advising Mr Virta.

C. If Connor acted in this dual capacity, does it restrict his ability both to advise his clients and to follow their instructions?

From the internal discussions with Mr Connor, it is clear that he feels a sense of conflict in the current situation. He feels a duty of loyalty to his client and wishes to complete the deal so that their interests may be upheld.

However, as an escrow holder, the Court in *Diaz* held that the escrow holder has a fiduciary duty to comply strictly with the instructions of its principals and to exercise reasonable skill and ordinary diligence with respect to the employment. 

Following this logic, there is a clear conflict between Mr Connor's duty of loyalty to his client, and his fiduciary duties as an escrow agent.

D. If Connor is an escrow holder, what are his duties to the opposing party?

III. Options

In order to assess Mr Connor's options and determine how best to proceed, it is worth considering the case of *Diaz v United Columbia Bank (1977)*. This case was brought before the Columbia Court of Appeal and concerned a dispute between Edelso Diaz and Antonio Gil in relation to the sale of Mr Diaz's assets in the restaurant La Lechonera to Mr Gil.

The written agreement provided that the purchase price for Diaz's restaurant was \$19,000, payable by a promissory note payable by instalments of \$300. However, the escrow instructions provided that a note of a value of only \$7000 was to be paid to Mr Diaz in instalments of \$200.

Moreover, a subsequent escrow instruction from Mr Gil reduced the note value by \$2000 due to the alleged costs of repairs he had incurred.

Upon discovering the error in respect of the note value, Mr Diaz's lawyer wrote to the bank to provide notice and request an amendment with reference to the sale contract, which confirmed that the escrow should in fact have been for \$19,000 rather than \$7,000.

However, in spite of this the bank ignored this notice and proceeded to prepare the note for \$5,000. Diaz subsequently sought punitive and compensatory damages from the bank and Gil.

In its decision, the Court of Appeal evaluated the various options which an escrow holder may take in these situations which provides a useful point of reference for the present case and which I shall deal with below in turn.

Option 1: Complete the purchase and forward stock certificates for transfer.

In *Diaz*, the escrow holder bank was criticised for having completed a purchase by closing an escrow in circumstances where it was on notice of a possible error in the instructions with respect to a material matter involving the escrow itself. The court held that when faced with competing demands, an escrow holder must either hold the property or interplead it.

In *Diaz* the court held that closing an escrow is not an acceptable alternative to holding property or interpleading it, in particular as it harbours obvious dangers for an aggrieved party that the latter does not.

In *Diaz*, the Court found that the bank had an option to implead or hold up, but it did not have a right to ignore those options and blindly close the escrow without making a reasonable effort to determine the correctness of the instructions prepared by it on behalf of the parties (who, in *Diaz*, were illiterate).

In *Diaz*, the Court concluded that a reasonable construction of the escrow instructions required the bank, upon receipt of notice, to at least hold up closure of the escrow until the situation was clarified.



Conversely, in the more recent case of *Wasman*, the court held that delivery of a grant deed by the attorney, in the absence of receipt of funds, could be seen as a "good faith attempt to facilitate settlement".

b. Legal Exposure

If the firm decides to proceed to complete on the purchase and close the escrow, the Court has held that there is a risk of liability in Tort and also Punitive Damages.

In *Diaz*, the Court determined that the bank, having closed the escrow knowing full well that there was a dispute, did so in complete disregard of the notice it had received. Such actions were held to be conscious and deliberate and characterized as willful or wanton, thus giving rise to a punitive damages award.



Moreover, in the more recent case of *Wasman* the Columbia Court of Appeal held that violation of an escrow instruction gives rise to an action for negligent performance by an escrow holder creating liability in tort for breach of duty.

In *Wasman* the court also found that the attorney's failure to keep the property and not dispose of it without the authority of the depositor amounted to breach of duty as a bailee, rather than liability founded upon professional negligence. In that case, the Court held the attorney liable for conversion; the wrongful exercise of dominion over the property of another.

Option 2: File an interpleader action against our clients and the seller.

Section 386 of the Code of Civil Procedure permits a party against whom multiple claims are made to bring an interpleader action compelling the claimants to litigate their opposing claims.

As is helpfully summarised in *Diaz* in an interpleader action, the court initially determines the right of the Plaintiff to interplead the funds; if that right is sustained, an interlocutory decree is entered which requires the defendants to interplead and litigate their claims to the funds. Upon deposit of the monies with the court, the plaintiff may then be discharged from liability and dismissed from the interpleader action. The effect of this is to preserve the fund, to discharge the stakeholder from further liability and to keep the fund in the court's custody until the rights of potential claimants of the monies can be adjudicated.

By taking the above steps, ie. to implement an interpleader action and obtain a discharge from further liability, the court has held that this will enable the stakeholder to avoid liability, to the extent that "the conflicted escrow holder may shield himself from liability and protect the interests of the parties to the escrow as well".



In *Diaz* the court went as far as to warn that escrow holders who fail to implead do so at their own peril.

Option 3: Do nothing immediately and retain possession of the stock certificates, until seller sues or parties work out a settlement.

In *Diaz*, the court criticised the bank's suggestion that it was not required to hold the escrow property or interplead it, since neither party requested it or sought those elections. The court held the view that when parties are still in escrow they tend to be "predisposed to resolution". Moreover, the court held that once an escrow has been closed in such a manner as to make one party feel victimized and to force them to hire a lawyer to assert their rights, the chances of a speedy resolution diminish. If anything, the fact that the Plaintiff feels victimized would have a knock on effect on the position it would then take in any subsequent suit.



(Question 1 continued)

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III. Conclusion

Question #1 Word Count = 2197

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