+SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 42

----------X

ALEXANDROS DEMETRIADES

Plaintiff

Index No. 156478/2012

v

DECISION AND ORDER

ROYAL ABSTRACT DEFERRED, LLC

Defendant.

MOT SEQ 004

----------X

NANCY M. BANNON, J.:

I. INTRODUCTION

In this action to recover damages for negligence, breach of fiduciary duty, and breach of contract, the defendant moves pursuant to CPLR 3212 for summary judgment dismissing the complaint. The motion is granted in part and denied in part.

II. BACKGROUND

The plaintiff is a real estate developer and investor, who, in order to take advantage of section 1031 of the Internal Revenue Code (26 USC § 1031) (hereinafter section 1031), deposited large sums of money with the defendant, which is a "qualified intermediary" under the Internal Revenue Code, and thus authorized to temporarily hold the proceeds of real estate transactions subject to section 1031.

Section 1031 permits persons or entities that sell certain

real estate to defer payment of taxes on the capital gains imposed on the taxable proceeds of the sale of any relinquished property by using the proceeds to purchase a replacement property. To qualify for tax-deferral treatment under 1031, the seller of the relinquished property, also denominated in the statute and implementing regulations as the "exchanger" or the "taxpayer," must identify like-kind replacement property within 45 days of the sale of the relinquished property, and then purchase the replacement property within 180 days from the sale of the relinquished property. The proceeds of the sale of relinquished property must be deposited in a safe harbor. The Internal Revenue Service has defined four safe harbors available to ensure a determination that an exchanger of real property, such as the plaintiff here, did not receive the proceeds of the sale of relinquished property purely for its own benefit, but uses the proceeds for the purchase of replacement property. These safe harbors include a qualified escrow account, a qualified trust, certain security or guarantee arrangements, or, as here, a "qualified intermediary" such as the defendant. See 26 CFR 1.1031(k)-1(g).

The plaintiff alleges that he had instructed the defendant to disburse or transfer the money that he had deposited with it only at the express direction of himself or his daughter-in-law, Eleni Demetriades (Eleni), who served as his bookkeeper. He

states that, on several occasions, the defendant wired funds on deposit to improper recipients, without authorization from either Eleni or himself. The plaintiff claims that he and Eleni initially believed that the transfers were made to legitimate sellers of replacement property or their agents in order to consummate bona fide real-estate transactions, but ultimately learned that they were made to accounts personally controlled by James Kalpakis, an attorney he had recently retained to represent him at the closing of one of the sales. The plaintiff further avers that the defendant made the transfers at Kalpakis's direction, but that neither he nor Eleni authorized Kalpakis to initiate any transfers, and neither he nor Eleni ever informed the defendant that Kalpakis had authority to do so, or even that Kalpakis had been retained as his attorney.

On February 6, 2014, Kalpakis was convicted in the County Court, Nassau County, of grand larceny in the first degree, grand larceny in the second degree, offering a false instrument for filing in the first degree, and identity theft in the first degree in connection with his diversion of the plaintiff's funds. Kalpakis was sentenced to an indeterminate term of imprisonment of 3 1/3 to 10 years.

The defendant now moves for summary judgment dismissing the complaint. In support of its motion, it submits the pleadings, transcripts of the parties' depositions and depositions of

nonparty witnesses, written and email correspondence between the parties, and the subject exchange agreements. In addition, the defendant submits an affidavit of its vice-president, Harry Erreich, cancelled checks and closing statements, an unexecuted power of attorney drafted so as to designate Kalpakis as the plaintiff's attorney-in-fact, and Kalpakis's indictment and plea of guilty. It also submits the pleadings and affidavits in other actions commenced by the plaintiff in connection with Kalpakis's diversion of funds.

The defendant contends that the sole basis for the plaintiff's losses was the criminal conduct of his attorney, and that it is not liable for those losses since only a principal, and not a third party, must bear the losses caused by the wrongful conduct of his or her agent. It further contends that it had no duty to inquire as to Kalpakis's authority to initiate wire transfers on the plaintiff's behalf, inasmuch as it learned that Kalpakis was indeed the plaintiff's attorney at law.

In opposition, the plaintiff submits his own affidavit, a prior exchange agreement between the defendant and him, the subject exchange agreements, the Code of Ethics and Conduct of the Federation of Exchange Accommodators (FEA), and an affidavit of David Schectman, an attorney who holds himself out as an expert in tax law and transactions under section 1031.

The plaintiff argues that the situation here presents an

exception to this general rule that a principal is liable for the wrongdoing of his or her agent, since he had given the defendant express instructions that it could only initiate wire transfers at his or Eleni's direction. The plaintiff thus contends that (1) the defendant assumed a fiduciary obligation to him, which it breached by failing to use the care required of fiduciaries in ascertaining whether Kalpakis had authority to initiate transfers, (2) the defendant breached its common-law duty of care by failing to follow the plaintiff's instructions and violating accepted industry standards promulgated by the trade association to which it belonged, thus giving rise to a negligence cause of action, and (3) the exchange agreements between the defendant and him imposed an express contractual obligation upon the defendant to follow his instructions, as well as additional, express contractual obligations to review all transactions and exercise due diligence, which it breached, thus causing his losses.

III. DISCUSSION

A. NEGLIGENCE--FIRST CAUSE OF ACTION

To establish negligence, a plaintiff must prove that the defendant owed him or her a duty of care, and breached that duty, and that the breach proximately caused the plaintiff's injury. See Solomon v City of New York, 66 NY2d 1026 (1985); Wayburn v Madison Land Ltd. Partnership, 282 AD2d 301 (1st Dept. 2001).

Here, the plaintiff bases his negligence cause of action on allegations that the defendant deviated from accepted industry standards and breached its common-law duty to inquire into Kalpakis's actual authority to initiate wire transfers.

1. Deviation From Industry Standards

In connection with a negligence cause of action "ordinarily, the opinion of a qualified expert that a plaintiff's injuries were caused by a deviation from relevant industry standards would preclude a grant of summary judgment in favor of the defendants." Murphy v Conner, 84 NY2d 969, 972 (1994); see also Trimarco v Klein, 56 NY2d 98 (1982). "Where the expert's ultimate assertions are speculative or unsupported by any evidentiary foundation, however, the opinion should be given no probative force and is insufficient to withstand summary judgment." Diaz v New York Downtown Hosp., 99 NY2d 542, 544 (2002).

The FEA's Code of Ethics and Conduct constitutes a set of guidelines rather than rules, and the affidavit of the plaintiff's expert asserts only in a general fashion that the Code reflects "industry practice."

The plaintiff's expert "failed to provide any factual basis for [his] conclusion that the guidelines establish or are reflective of a generally-accepted standard or practice" of qualified intermediaries. Diaz, supra, at 545. In this regard,

he "made no reference either to [his] own personal knowledge acquired through professional experience or to evidence that any" particular qualified intermediaries "have implemented such a standard. Thus, the expert's affirmation lacked probative force and was insufficient as a matter of law to overcome the [defendant's] motion for summary judgment" in connection with the negligence cause of action. Id. In any event, the defendant's alleged deviation from the Code implicates only its failure to adhere to contractual obligations imposed upon it by the several exchange agreements it entered into with the plaintiff, and thus would not constitute a basis to impose tort liability.

2. Failure To Inquire Into Agent's Actual Authority

An attorney-at-law acts as an agent for his or her client. See Burger v Brookhaven Med. Arts Bldg., 131 AD2d 622 (2nd Dept. 1987). Generally, "[o]ne who deals with an agent does so at his [or her] peril, and must make the necessary effort to discover the actual scope of authority." Ford v Unity Hosp., 32 NY2d 464, 472 (1973). However, this rule, which appears to impose an obligation to make inquiry into an agent's actual authority, applies only to a third party who seeks to avoid liability to a principal because the agent had no actual authority to bind the principal. See William Penn Life Ins. Co. v Irving Trust Co., 145 AD2d 174 (1st Dept. 1989). In those circumstances, if no

inquiry is made, the third party may be held liable to the principal; if inquiry is made, the third party may avoid liability if the agent's authority is misrepresented.

There is no common-law duty of inquiry imposed upon the defendant here, since the plaintiff, as principal, seeks to disavow the authority of Kalpakis, his putative agent, and hold the defendant liable for that agent's wrongful acts. See William Penn Life Ins. Co. v Irving Trust Co., supra. Specifically, the defendant did not owe the plaintiff a common-law duty to inquire as to whether Kalpakis had authority to initiate wire transfers from the funds that the plaintiff had on deposit with it, or as to the legitimacy of the recipients of those transfers. See id. Thus, to the extent that the negligence claim is premised on the defendant's failure to inquire into Kalpakis's authority, it fails to state a cause of action.

B. BREACH OF FIDUCIARY DUTY--SECOND CAUSE OF ACTION

The elements of a cause of action to recover damages for breach of fiduciary duty are (1) the existence of a fiduciary relationship, (2) misconduct by the defendant, and (3) damages directly caused by the defendant's misconduct. See Rut v Young Adult Inst., Inc., 74 AD3d 776 (2nd Dept. 2010); Kurtzman v Bergstol, 40 AD3d 588 (2nd Dept. 2007). The defendant established its prima facie entitlement to judgment as a matter

of law dismissing the cause of action alleging breach of fiduciary duty by submitting the exchange agreements, pursuant to which it expressly disavowed that it was acting as the plaintiff's agent and, hence, assumed no fiduciary duty to him.

The relevant Treasury Department regulation characterizes a qualified intermediary as acquiring and transferring relinquished properties "either on its own behalf or as the agent" of a party to the transaction. 26 CFR 1.1031(k)-1(g)(4)(iv)(B) (emphasis added). Here, the subject agreements explicitly recited that the defendant was not the plaintiff's agent, and that the defendant contracted on its own behalf with all other parties to proposed real estate transactions. The agreements designating the defendant as the party that was to "acquire" the replacement property pursuant to those transactions. Moreover, the safe-harbor regulation provides that, for purposes of determining whether a taxpayer "received" property, and thus whether the taxpayer is eligible for section 1031 treatment, the qualified intermediary is treated "as if [it] is not the agent of the taxpayer." 26 CFR 1.1031(k)-1(g)(4).

Although the defendant was contractually obligated to facilitate the purchase of replacement property, the nature and extent of that obligation did not render the defendant an agent of the plaintiff. "In a wide variety of contexts, parties execute contracts, like the Agreement here, that allow one party

to direct another to perform certain actions. Such obligations do not automatically create fiduciary relationships. Only those where the agent assents to act on the principal's behalf and subject to the principal's control does a fiduciary relationship arise." Terry v SunTrust Banks, Inc., 493 Fed. Appx. 345, 355 (4th Cir. 2012) (citation and internal quotation marks omitted). Thus, "although the Treasury Regulations do not prohibit a Q[ualified] I[ntermediary] from being an agent of its customer, and treat a QI 'as if' it were not the Exchangers' agent, nothing in those regulations requires that result either. The language of the Agreement controls, and that language is inconsistent with [the defendant] having become a fiduciary under agency law." Id.

In opposition to the defendant's showing that the exchange agreements negated any inference that it became the plaintiff's agent, the plaintiff failed to raise a triable issue of fact, since neither his deposition testimony, nor his affidavit, nor the deposition testimony of any other witness, described any conduct by the defendant that would support the inference that an agency relationship existed between the plaintiff and the defendant, or that any such relationship was created. See Hill v Raziano, 63 AD3d 682 (2nd Dept. 2009); Unistar Leasing v Lipkin, 12 AD3d 1166 (4th Dept. 2004); Tonking v Port Auth. of N.Y. & N.J., 2 AD3d 213 (1st Dept. 2003)

C. BREACH OF CONTRACT--THIRD CAUSE OF ACTION

The breach of contract cause of action is primarily based on the allegation that the contract obligated the defendant to comply with the plaintiff's instructions in the course of purchasing replacement property, and that it failed to adhere to those instructions in making wire transfers at Kalpakis's direction. The cause of action also alleges that the defendant failed to satisfy its contractual obligations to review or approve closing statements referable to the replacement property, ascertain the identity of the title company involved in the closing of the sales of the replacement property, and obtain copies of the contracts of sale referable to the replacement property. It also asserts that the defendant breached its contractual obligations to timely accept notification identifying the replacement property, enter into a proper exchange account agreement, and maintain a proper exchange account.

"The elements of a breach of contract claim are formation of a contract between the parties, performance by the plaintiff, the defendant's failure to perform, and resulting damage." Flomenbaum v New York Univ., 71 AD3d 80, 91 (1st Dept 2009). The subject agreement provides, at Section II.B that, once the plaintiff has identified real estate suitable as replacement property, he "shall instruct [the defendant] to acquire the ownership interest in the replacement property." A reasonable interpretation of

this provision, which was drafted by the defendant, is that the plaintiff is empowered by contract to give instructions to the defendant as to the means of acquiring the property, including limitations on the persons who were authorized to initiate wire transfers to pay for the acquisition of the property. A claim that the defendant failed to follow instructions may be based on the terms of the contract itself, and give rise to a breach of contract cause of action. See Internationale Nederlanden (U.S.) Capital Corp. v Bankers Trust Co., 261 AD2d 117 (1st Dept. 1999). As such, an obligation was imposed upon the defendant to comply with those instructions, and the defendant's failure to follow these instructions constitutes a breach. See id.

The rule enunciated in William Penn that the defendant has no common-law duty of inquiry does not, by its terms, extend to circumstances in which there is a statute, rule, custom, or agreement that imposes an obligation upon a third party to make an inquiry into the authority of an agent, or obligated the third party to take instruction from an agent. Here, unlike the situation presented in William Penn, there is privity of contract between the third party and the principal whose agent acted wrongfully and, hence, a contractual obligation running from the third party to the principal. Moreover, unlike the situation presented in William Penn, here, the plaintiff did not "place[ ] [Kalpakis] in a position of trust enabling him to perpetrate the

wrong" (William Penn Life Ins. Co. v Irving Trust Co., supra, at 179), since he never executed a power of attorney appointing Kalpakis as his attorney-in-fact, and never informed the defendant that Kalpakis was either his attorney-at-law or had authority to initiate wire transfers.

Thus, in opposition to the defendant's prima facie showing that it did not breach the exchange agreements when it transferred funds upon Kalpakis's directives, the plaintiff raised a triable issue of fact as to whether the defendant breached the exchange agreements by failing to follow his instructions that the defendant was not to transfer funds unless expressly authorized by Eleni or him. See Internationale Nederlanden (U.S.) Capital Corp. v Bankers Trust Co., supra. Contrary to the defendant's contention, an ambiguous email message that Eleni sent to it months after the unauthorized transfers does not constitute a ratification of Kalpakis's conduct. See Allen v Riese Org., Inc., 106 AD3d 514 (1st Dept. 2013). Whether or not the statement contained therein constitutes an admission that the plaintiff was aware at an earlier time that Kalpakis was initiating transfers of the subject funds presents a question of fact for the jury.

The defendant failed to establish its prima facie entitlement to judgment as a matter of law dismissing the remainder of the breach of contract cause of action. In connection with those claims, the deposition testimony of the defendant's officers revealed that it had not undertaken the

necessary review and approval of closing statements, ascertained the identity of the relevant title company, or obtain copies of the contracts of sale it accepted late notification identifying the replacement property, and neither entered into a exchange account agreement, nor maintained a proper exchange account. The exchange agreements submitted by the defendant itself reflects that those obligations were contractually imposed upon it.

Although claims for both breach of contract and negligence arising out of the same nucleus of fact may sometimes be prosecuted together (see Sommer v Federal Signal Corp., 79 NY2d 540 [1992]), those situations are rare, and the circumstances presented here do not give rise to a claim for tortious conduct (see generally Verizon N.Y., Inc. v Optical Communications Group, Inc., 91 AD2d 176 [1st Dept. 2011]). Thus, as explained above, the negligence cause of action asserted here is not viable, since it is premised both on a deviation from an industry standard requiring compliance with contractual obligations and a breach of a duty to make inquiry into who had authority to initiate wire transfers, which is solely contractual in nature.

IV. CONCLUSION

In light of the foregoing, it is

ORDERED that the defendant's motion for summary judgment is granted to the extent that it is awarded summary judgment dismissing the first cause of action, which alleges negligence, and the second cause of action, which alleges breach of fiduciary

duty, and the motion is otherwise denied.

This constitutes the Decision and Order of the court.

Dated: 5/2/17

ENTER:

J.S.C.

HON. NANCY M. BANNON