Gainor v. Sidley, Austin, Brow Doc. 160

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA
Miami Division

CASE NO.: 06-21748-CIV-MARTINEZ-BANDSTRA

MARK J. GAINOR and ELYSE GAINOR,

Plaintiffs,

v.

SIDLEY AUSTIN LLP, a Delaware limited liability Partnership, f/k/a SIDLEY AUSTIN BROWN & WOOD, f/k/a BROWN & WOOD, R. J. RUBLE, an individual, ARTHUR ANDERSEN, LLP, an Illinois limited liability partnership, MICHAEL S. MARX, an individual, P. ANTHONY NISSLEY, an individual, MERRILL LYNCH & CO., INC., a Delaware corporation, and MARK C. KLOPFENSTEIN, an individual,

Defendants.
_______________________________________/

PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANT SIDLEY AUSTIN LLP'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Plaintiffs, Mark J. Gainor and Elyse Gainor, by and through their undersigned counsel, submit the following Memorandum of Law in Opposition to Defendant Sidley Austin LLP's ("Sidley") Motion for Partial Summary Judgment.

I. INTRODUCTION

Sidley's motion is without merit in both tenor and substance, and should be denied.

With respect to the substance of the motion, Sidley argues that Gainor cannot recover the fees charged by Defendants for their fraudulent tax scheme because the fees were paid from bank accounts of corporations created or preserved as part of the fraudulent scheme, and therefore,

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according to Sidley, the claims belong to the corporations. This argument cannot withstand analysis.

Sidley simply ignores the case law holding that the claim for fees belongs to the defrauded taxpayer, not to the subchapter S corporations used as part of the scheme. It further ignores the fact that the Defendants engineered the strategy and controlled all the steps in implementation of the scheme, including how their fees were paid. The fact that the Defendants caused Gainor to pay them his money through a third party does not change the fact that it was Gainor's money, and he is the one who is entitled to get it back. It also ignores the fact that the IRS determined the transactions were a sham, contrived and fraudulent, totally lacking any legitimate economic substance. Sham transactions do not provide Sidley a shield from liability. The IRS saw through the transparent technical formalities of the transactions to the economic realities. The law deals in economic reality. And the economic reality is that Gainor paid Defendants' fees. Finally, Sidley ignores the well-settled exception to the rule it cites, that where the wrongdoer owes a duty directly to the Plaintiff, the Plaintiff may maintain a direct action against the wrongdoer (whether or not the wrongdoer also breaches a duty to the corporation of which the Plaintiff is a shareholder).

The tenor of Sidley's motion is likewise inaccurate. Sidley begins with an effort to shift the blame for its nationwide illegal fraud onto the individual taxpayer victims, who, instead of receiving appropriate advice, paid millions in fees for a strategy that embroiled them in the largest tax fraud investigation in the history of our country. Sidley's position in this motion is belied by its own Press Release (*Candelora Dec. Ex. 1*). In May of 2007, Sidley announced:

> Ruble was involved in, and issued opinions for, transactions for certain high net worth individuals. Ruble's conduct in those transactions defrauded the U.S. Treasury of taxes owed by those taxpayers. Ruble became involved in these transactions in 1999 while a partner at Brown & Wood. He authored opinions on

> a number of different tax shelter transactions, including Bond Linked Issue Premium Structure (BLIPS), Foreign Leveraged Investment Program ("FLIP"), Offshore Portfolio Investment Strategy ("OPIS"), Short Option Strategy ("SOS"), and Custom Adjustable Rate Debt Structure ("CARDS").
>
> ***
>
> Sidley has made this voluntary statement and has paid today a civil penalty to the IRS to resolve and conclude the civil tax shelter registration penalty examination of the firm by the IRS.

Further, in a Press Release issued the same day (*Candelora Dec. Ex. 2*), the assistant United States Attorney who was investigating Sidley, said:

> · Sidley has acknowledged, through a public statement of responsibility (copy attached), that its role with respect to certain tax shelter transactions wrongly and fraudulently deprived the U.S. Treasury of significant revenues.
>
> · Sidley has entered into a Closing Agreement with the IRS pursuant to which Sidley has paid a $39.4 million civil penalty to the IRS to resolve the IRS's tax shelter promoter penalty audit of Sidley.

It was Sidley partner (and co-Defendant) R.J. Ruble, who was indicted for tax fraud; not Gainor. It was Sidley who paid the government over $39,000,000 to close the investigation against it; not Gainor. The same actions of Ruble/Sidley that defrauded the United States government out of its taxes, defrauded Plaintiffs out of over $2 million in fees paid to Defendants. Plaintiffs paid the government the $17 million in taxes that the government lost as a result of the scheme. Sidley must pay Plaintiffs the fees Plaintiffs paid for the scheme.[1]

This effort by Sidley to avoid the consequences of its illegal actions demonstrates that the acts of its dismissed former partner Ruble are not those of a rogue "lone wolf", but rather are emblematic of the firm's managing structure. The fabric of the firm is the same now as it was when it knowingly issued hundreds of fraudulent opinion letters.

[1] Plaintiffs also seek additional damages, including the fees paid to the lawyers and accountants that Plaintiffs hired to help them deal with the IRS. However, Sidley's motion does not challenge these additional damages. For the full extent of Plaintiffs' damages, please see Exhibit D to the Declaration of Gabriel Sanchez, filed by Sidley on July 26, 2007, which is Plaintiffs' Damages Summary.

II. STATEMENT OF FACTS

Plaintiffs largely agree with Sidley's Statement of Undisputed Facts. Plaintiffs do take issue with statement number 3, however, which suggests that Gainor approached Andersen about the strategy. The cited references do not support this assertion. To the contrary, in his affidavit filed simultaneously herewith, Mr. Gainor, having had his recollection refreshed by a letter from Phillip Miles of Andersen (attached to the affidavit as Exhibit A), states that Andersen approached him with the proposal. *Gainor Aff. ¶ 6.*

Similarly, Sidley's Statement of the Facts suggests that Mark Gainor did not contract with Merrill Lynch in his individual capacity. This is incorrect. *See* letter from Erin Frederick dated August 20, 1999 signed by Mark Gainor on August 30, 1999 (*Candelora Dec. Ex 11*).

The pertinent background facts are:

1. Prior to 1998, Plaintiff Mark Gainor was the president and principal shareholder of Gainor Medical USA, a family medical supply business. *Gainor Aff. ¶ 2.*

2. In 1998, Gainor began discussing selling the medical business to Matria Healthcare. *Gainor Aff. ¶ 3.*

3. For several years prior to 1999, Arthur Andersen had been Gainor's personal accountants and the corporation's accountants. *Gainor Aff. ¶ 4.*

4. Arthur Andersen was involved in the sale of Gainor's business to Matria Healthcare, and in the course of that transaction, Phillip Miles of Andersen advised Gainor that Arthur Andersen might be able to find a way to reduce Gainor's tax liability from the transaction. *Gainor Aff. ¶ 5.*

5. Thereafter, in the Spring of 1999, there was a series of emails among Andersen and others, including R. J. Ruble, a partner in the tax department of Defendant Sidley's

predecessor firm, Brown & Wood regarding a possible tax loss transaction. *Candelora Dec. Composite Ex. 10.*

6. In July of 1999, Brown & Wood opened a file naming Andersen as the client for "structuring tax advantaged transactions." (*MacKinnon depo., Ex. 5 and p. 84, Candelora Dec. Exs. 12 and 14).*

7. On August 5, 1999, Ruble sent Marx of Andersen a sample opinion letter that described a situation and contained an analysis strikingly similar to the opinion letters ultimately issued to Gainor. (*MacKinnon depo., Ex. 2 and pp. 56 & 94-95*; *Candelora Dec. Exs. 6 and 14).*

8. Andersen passed the tax shelter strategy on to Gainor. Andersen repeatedly emphasized the fact that Gainor would get an opinion letter from Brown & Wood, Defendant Sidley's predecessor, a prestigious Wall Street law firm, verifying that the tax deductions to be claimed from implementation of the strategy would more likely than not be upheld in an IRS audit. Gainor was also advised that Merrill Lynch would assist in effectuating the program. *Gainor Aff.* ¶ *8.*

9. Gainor was furnished a "Transaction Summary" (*Gainor Aff.* ¶ *9 and Exhibit B*) detailing pre and post strategy taxes, reflecting that implementation of the strategy would reduce Gainor's personal taxes from $37.1 million to $19.7 million, a savings of over $17 million in taxes. It also reflected fees of approximately 2.1 million to Brown & Wood, Andersen, Merrill Lynch, and Transtar, an entity of Defendant Klopfenstein.

10. Gainor authorized Defendants to proceed with implementing the proposed tax planning strategy. *Gainor Aff.* ¶ *10.*

11. Thereafter, Defendants orchestrated a series of complex transactions involving numerous entities, loans, transfers of interests and shifts of money. Gainor did not understand or direct the mechanics or details of the transactions. He merely did what his advisors, the Defendants, told him to do. Defendants caused the transactions involved in the strategy to be

implemented. They told Gainor what he needed to do to realize the personal tax savings they had promised, and they prepared the documents and told Gainor to sign them. Gainor trusted them to be giving him sound advice, and did what they told him to do. *Gainor Aff.* ¶ *11.*

12. As part of the process, at the direction of Defendants, Gainor placed at least $4.5 million of his own money into the bank account of one of the entities, in addition to transferring all his interests in the various entities according to the directions of Defendants. *Gainor Aff.* ¶ *12.*

13. While the transactions were being implemented, Gainor was furnished a draft "more likely than not" opinion letter from Brown & Wood. *Gainor Aff.* ¶ *13.*

14. In December of 1999, before implementation of the strategy was completed, the Internal Revenue Service issued Notice 99-59 (*Candelora Dec. Ex. 13*), which ruled that losses resulting from transactions such as the ones contemplated by the strategy would not be considered tax deductible because the transactions lacked economic substance; the strategy was simply a fraudulent tax scheme.

15. Although aware of this IRS ruling (indeed, it is referenced in the final opinion letters, *Candelora Dec. Exs. 8 and 9*), Sidley nonetheless allowed Plaintiffs, who were not aware of it, to complete the transactions.

16. After the transactions were implemented, Brown & Wood delivered the promised final "more likely than not" opinion letters. The opinion letters (*Candelora Dec. Exs. 8 and 9*) were addressed to Gainor, personally, as well as to the corporations and were sent to Gainor at his home address in Florida. *Gainor Aff.* ¶ *14.*

17. Andersen prepared the tax returns that claimed the deductions supposedly resulting from the transactions involved in implementing the strategy. Gainor and his wife signed the returns. *Gainor Aff.* ¶ *15.*

18. Defendants Sidley Austin, Arthur Andersen, and Merrill Lynch charged Gainor over two million one hundred thousand dollars in legal, accounting, and professional fees (Sidley Separate Statement of Facts Nos. 22, 23 & 24), to implement the transactions that Sidley, through its predecessor Brown & Wood, opined were legitimate means to reduce Gainor's capital gains tax liability and would more likely than not survive IRS scrutiny. *Gainor Aff. ¶ 16.*

19. The IRS rejected the deductions claimed as a result of implementation of the strategy, and as a result, Gainor personally paid the IRS $17 million dollars in taxes and interest after the advice for which Gainor had paid Defendants over two million dollars proved to be false and fraudulent.[2] *Gainor Aff. ¶ 17.*

20. Although the IRS refused to allow Gainor to deduct the losses purportedly caused by implementation of the strategy, the IRS did permit Gainor to personally deduct the fees paid to Andersen, Sidley and Merrill Lynch on his amended return. *Gainor Aff. ¶ 18.*

21. Defendant Mark Klopfenstein controlled TranStar, (n/k/a Palladium, Inc.) the purchaser in the transactions, and his participation in the scheme caused Gainor additional damage in excess of $1.1 million. *Gainor Aff. ¶ 19.*

22. But for Defendants' actions, Gainor would not have agreed to sell Bryan Medical and Lucor to TranStar for the price paid. The result of following Defendants' advice was an additional loss of over $1.1 million, which was Defendant Klopfenstein's fee for doing the transactions. *Gainor Aff. ¶ 20.*

23. Defendants' fees were paid with funds to which Gainor would have been entitled if they had not been used to pay to the Defendants as fees.[3] *Gainor Aff. ¶ 21.*

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[2] In addition to the fees Gainor paid Defendants, Mark Gainor also paid hundreds of thousands of dollars to the lawyers and accountants that he hired to help him deal with the IRS. These fees are also sought as damages in this case. However, Sidley's motion does not challenge Gainor's right to recover these fees as damages (assuming Gainor prevails on liability). For the full extent of Plaintiffs' damages, please see Exhibit D to the Declaration of Gabriel Sanchez, filed by Sidley on July 26, 2007, which is Plaintiffs' Damages Summary.

[3] Prior to implementation of the strategy, none of Gainor's companies had any unpaid creditors. Thus, there were no corporate creditors with any superior rights to the value of the companies. *Gainor Aff. ¶ 21.*

24. The reason Defendants' fees were paid the way they were is because that is what Defendants told Gainor to do. If Defendants had told Gainor to pay the fees of Andersen, Sidley Austin, Merrill Lynch and Mr. Klopfenstein directly from his personal funds, Gainor would have done so; just like he injected $4.5 million of his personal funds, more than enough to pay all Defendants' fees, into one of the corporate bank accounts when Defendants told him to. *Gainor Aff.* ¶ *22.* The fact that Mark Gainor did things the way Defendants told him to do them does not change the fact that Mark Gainor's money was used to pay Defendants' fees.

III. LEGAL AUTHORITIES

Sidley's attempt to cram the complex transactions and relationships involved in this case into a two-page argument results in an overly broad interpretation of a general rule that exalts form over substance. Sidley states that the "precise mechanics" of the transactions at issue in this case are "not material." *See* Sidley's Partial MSJ at p.3, n.4. Yet Sidley then proceeds to rely on those "precise mechanics," which it engineered, in order to exonerate itself from liability. Plaintiffs do not dispute that technically, in form, it was Gainor's S corporations that wrote the fee checks to Defendants. However, as the IRS recognized, Defendants' plan created an appearance that departed from reality. Courts regularly reject placing form over substance in such circumstances, and this Court should do so as well.

A. The general rule and its exceptions

Sidley's sole argument is that a corporation and its owner are separate entities and therefore the owner cannot pursue, in his individual capacity, claims belonging to the corporation. *See* Sidley's Partial MSJ at p. 7. This general rule, however, does not apply in this case for at least three distinct reasons. First, particularly in the tax shelter context, courts look to

the economic reality of the transactions, not their form. The economic reality is that Mark Gainor's money was used to pay Defendants' fees. Therefore, Mark Gainor is entitled to sue to get it back. Secondly, Defendants owed duties directly to Plaintiffs, independent of any duties they may have owed the corporations. As the direct, intended, (and in fact *only*) beneficiaries of Defendants' advice, Plaintiffs can sue for the damages they incurred as the result of that advice. Finally, Plaintiffs are not pursuing the corporations' claims. They are pursing claims for damage they personally suffered as a result of Defendants' faulty and fraudulent tax shelter scheme. Where a plaintiff's injury is direct, the fact that the corporation may also have been injured and could assert its own claims does not preclude the plaintiff from asserting his claim directly.

B. Courts Look To Economic Reality

Particularly in tax shelter cases, courts regularly reject arguments like the one Sidley advances here. In such cases the courts see through the technicalities of complicated transactions, looking instead to their substance and who ultimately was injured. For instance, in *Shalam v. KPMG LLP*, 2006 WL 2589917 (N.Y. Sup. Sept. 8, 2006, *aff'd*, 41 A.D.3d 200 (N.Y.A.D. 1 Dept. 2007), a recent tax shelter case that also involved Sidley Austin, one of the defendants was a bank that challenged the individual plaintiff's standing to pursue claims against it because the plaintiff was not technically a party to any of the bank's contracts. The bank had set up "Congo Ventures" as the investment vehicle through which the plaintiff's tax shelter investments would be funneled. As part of the scheme, the bank loaned money to Congo Ventures. The bank argued that since the plaintiff was not a party to the Congo Ventures loan agreements, he had no standing to sue the bank. The court disagreed, finding the plaintiff had the right to pursue non-contract claims.

The court began its analysis by noting the general rule that shareholders do not have standing to sue for injuries to the corporation itself. *Id.* at *4. They can, however, "assert claims based upon breach of a duty owed directly to them, independent of any duty owed to the corporation . . . ." *Id.* (internal citations omitted).

The *Shalam* court continued: "[w]here there is an actionable wrong that arises out of a breach of duty independent of the contract, it may be asserted by the party actually incurring the injury or damages, provided the injury is a natural consequence of the alleged wrongful act . . ." *Id.* The *Shalam* court explained that this distinction has been applied in tax shelter cases:

> Thus, in a number of tax shelter cases, courts considering the issue have held that causes of action for fraud in the inducement, conspiracy, negligent misrepresentation and the like, belong to the taxpayer who undertook the investment, incurred the loss, and suffered the actual damage. . . . Analogy in such instances may be made to cases granting standing to a third-party beneficiary . . . or the owner of a corporate nominee . . . .

Id. The court concluded that the *Shalam* plaintiff had standing to sue for fraud and conspiracy:

> In this case, plaintiff, who it is alleged was induced to enter into the BLIPS transaction, who paid the $3.5 million fee, claimed the loss that was passed through Congo Ventures, and paid the tax deficiency, penalties, interest and additional attorney and accounting fees associated with the disallowance of the deduction, is the real party in interest. With respect to the fraud and conspiracy claims, therefore, plaintiff has a right to maintain the action in his own name, and need not join the sub-chapter S corporation.

Id.[4] *Shalam* was recently affirmed on appeal. 41 A.D.3d 200 (N.Y.A.D. 1 Dept. 2007).

[4] Sidley may try to distinguish *Shalam* on the basis that the individual plaintiff there paid a $3.5 million dollar fee and not Congo Ventures. That distinction is not material here. The *Shalam* plaintiff's payment of the transaction fee was simply the product of how the particular tax shelter transactions were structured in that case. Here the shelters were structured differently and payment of the transaction fees by the S corporations was done on Defendants' advice. Moreover, the money to pay those fees came from Gainor. He caused the fees to be paid to accomplish the transactions that Defendants recommended in order to realize personal tax savings.

Similarly, in this instance Plaintiffs are the only parties who were injured by Defendants' actions. Defendants' advice was specifically designed to benefit not the corporations, but Gainor by the reduction in his capital gains taxes. Nor was it the corporations who were injured by the payment of transactional costs to Defendants. Instead, it was Gainor who paid for that faulty and fraudulent advice, through the pass-through corporations, and who was then injured when that advice failed. Plaintiffs also had to pay the IRS $17 million in taxes and interest, thereby eliminating any benefit that the $2.1 million in transactional costs were paid to secure. Moreover, Plaintiffs were the ones required to pay additional legal and accounting professionals to clean up the mess Defendants created. Lastly, but for Defendants' actions, Gainor would not have agreed to sell to TranStar for the price paid, resulting in a further $1.1 million loss.

Courts have refused to favor form over substance in other similar contexts. In *Far West Federal Bank, S.B. v. Office of Thrift Supervision-Director*, 119 F.3d 1358 (9th Cir. 1997), for example, investors had standing to sue for FDIC's breach of an agreement even though they were not parties to it. The court rejected FDIC's argument to contrary which ignored the substance of the agreement and who was really injured. As the court explained, the FDIC's argument:

> ignores the nature and circumstances of the entire agreement among the Investors, Far West, FHLBB and FHLB-Seattle. At the time of the Conversion Agreement, FHLBB . . . made promises to entice the Investors to recapitalize Far West . . . those promises unquestionably injured the Investors, who were induced by the FHLBB's promises to pour $26.6 million into a failing thrift. Under the Restatement, a third party who is an intended beneficiary of a contract may sue to enforce the contract or to obtain an appropriate remedy for breach . . . To deny the Investors an opportunity to recover for FHLBB's breach simply because Far West and not the Investors signed one of the documents evidencing those promises would place the form of the agreement over its substance. We decline to take such a formalistic and narrow view of the parties' agreement.

Id. at 1363-64.

Hirsch v. Arthur Andersen & Co., 72 F.3d 1085 (2d Cir. 1995) is another case recognizing the real injured parties in fraudulent financial advice situations are the investors and not those involved in the scheme. *Hirsch* involved a bankruptcy trustee, standing in debtor's shoes, who wanted to pursue claims against various professionals that helped the debtor implement a Ponzi scheme. The court rejected the claims, reasoning the claims for damage from, for instance, misleading private placement memoranda, belonged to the defrauded investors and not the debtor who was engaged in the scheme. *Id.* at 1094.

O'Keefe v. Han, 2004 WL 327004 (Cal. App.4 Dist. 2004) arose in another context but similarly rejected the "hypertechnical" application of corporate/shareholder rules if they deny the wronged party a remedy. The defendant in this malicious prosecution case objected that the court could not consider as an element of damages attorneys fees that the solely-owned corporation paid on shareholder O'Keefe's behalf in defense of a prior action. In rejecting this argument the court explained:

> Under Han's theory, the corporation would not be a proper malicious prosecution plaintiff because it was not a defendant in the prior action, but O'Keefe himself incurred no damages because his subchapter S corporation, of which he was the sole shareholder, paid the attorney fees rather than O'Keefe individually. The ridiculousness of such a result is apparent, presenting a hypertechnical pitfall for the unwary who fail to pay legal expenses personally rather than through such corporations. Such a result serves no policy interest, unlike the general rule prohibiting the assignment of purely personal wrongs, and we decline to adopt it.

Id. at *3.

Defendants here are making a similar argument. They claim Gainor cannot sue for the transactional fees he ultimately paid and which led to Plaintiffs' additional injuries because the S corporations technically paid the fees. Even if the S corporations sued, however, presumably Defendants would then claim the corporations suffered no injury because in reality Gainor paid the fees. The Court should reject such an absurd result that exalts form over substance and

instead permit the party actually injured to sue for the damages actually incurred. *See also HC Consulting, Inc. v. Goodman*, 2006 WL 3165035 (E.D. Pa. 2006).

Finally, one of the primary rationales for application of the general corporate/shareholder rule Sidley advances is lacking in this case. "The reason for the rule requiring that damages generally be awarded to the corporation in suits brought by shareholders, even when the corporation is closely held, is to prevent impairment of the rights of the corporation's creditors whose claims may be superior to those of the innocent shareholder." *Venizelos v. Oceania Maritime Agency, Inc.*, 702 N.Y.S.2d 17, 18 (N.Y.A.D. 1 Dept. 2000). There are no corporate creditors with any superior rights to Gainor's in this instance.

C. Defendants breached duties they owed directly to Plaintiffs as the beneficiaries of their advice.

It is axiomatic that where a defendant owes a direct duty to the plaintiff, the plaintiff may sue the defendant for breach of that duty. The fact that the defendant may have also breached a duty it owed to a corporation of which the plaintiff is a shareholder, does not change this result. "'Where the wrongful acts are not only wrongs against the corporation but are also violations by the wrongdoer of a duty arising from contract or otherwise, and owing directly to the shareholders, individual shareholders can sue in their own right." *Harrington v. Batchelor*, 781 So. 2d 1133, 1135 (Fla. 3d DCA 2001) ("'[A] shareholder can sue for breach of [a] contract to which he is a party, even if he has not suffered an injury separate and distinct from that suffered by other shareholders."); *Vencor Hospitals v. Blue Cross Blue Shield of Rhode Island*, 169 F.3d 677, 680 (11th Cir. 1999) (party has cause of action as third-party beneficiary to contract if parties expressed an intent to primarily and directly benefit the third party).

Sidley's corporate representative, John MacKinnon, admitted at the Rule 30(b)(6) deposition of Sidley that Mark Gainor was a client of Sidley's (*MacKinnon depo at pp. 17-18*

and 339, Candelora Dec. Ex. 14).[5] As such, Sidley owed a fiduciary duty as well as a duty of due care directly to Gainor. *Resolution Trust Corp. v. Holland & Knight*, 832 F.Supp. 1528 (S.D. Fla. 1993). Gainor was directly injured by Sidley's faulty advice in an amount exceeding $2.1 million simply for the fees paid to Defendants. Sidley's argument that it cannot be sued by one who it admits to have been its client for breach of its duty to provide complete and competent advice and to deal with the client in an ethical and truthful manner, is clearly without merit. Sidley is liable to Plaintiffs for all resultant damages.

D. Plaintiffs are suing for their own direct injuries.

In this instance, as a factual matter, Plaintiffs sustained direct injuries. Although technically the S corporations engaged in the transactions at issue, the corporations were simply pass-through entities. Defendants told Gainor how to structure the transactions (and pay their fees) in order to realize the personal tax savings that the IRS later rejected. Defendants' fees were paid with funds to which Gainor was otherwise entitled as the sole owner of the corporations. It was Plaintiffs personally who later had to pay the IRS $17 million dollars in taxes and interest after the advice Gainor paid for proved false and fraudulent. Gainor also received less on the sale of the S corporations to TranStar based on Defendants' actions and advice.

The IRS recognized Gainor's direct interest in these legal, accounting, and financial fees when it permitted Gainor to personally deduct the transaction fees on his amended return. The IRS' determination confirms that in fact it was Gainor who ultimately incurred the transaction fees. The S corporations were nothing more than neutral vessels through which economic benefit or loss flowed. *See e.g., Gitlitz v. C.I.R.*, 531 U.S. 206, 214 n.6 (2001) ("The very

[5] In addition, Defendants' legal, tax and financial advice was expressly intended to benefit the Gainors personally by reducing the capital gains on which they would be taxed. In fact, Sidley's opinion letters were addressed directly to Gainor as well as to the corporations.

purpose of Subchapter S is to tax at the shareholder level, not the corporate level.") This is cemented by the fact that the purchase agreements (*Sanchez Dec, Exs. M & N*) required Mark Gainor personally to indemnify the purchaser from any tax liabilities that might arise.

"A stockholder may bring a suit in his own right to redress an injury sustained directly by him and which is separate and distinct from that sustained by other stockholders." *Wolfe v. American Sav. & Loan Assoc. of Fla.*, 539 So. 2d 606, 607 (Fla. 3d DCA 1989) (holders of preferred stock in S&L brought class action against S&L and officers and directors for damages allegedly caused by merger; properly maintained as individual or direct actions; action could not be brought on behalf of corporation as derivative action). As this Court has recently explained, direct actions permit shareholders to sue for their own distinct injuries:

> A direct or individual action is 'a suit by a stockholder to enforce a right existing in the stockholder. . . A direct action is thus, a limited exception to the rule regarding derivative suits, and allows a shareholder to sue on his or her own behalf if he or she (1) is not similarly situated to other shareholders; (2) suffers a distinct injury (i.e. special damages) from other shareholders; and (3) does not have the same opportunity to be made whole by a corporate recovery.

Falic v. Legg Mason Wood Walker, Inc., 347 F. Supp.2d 1260, 1270 (S.D. Fla. 2004).

Here Gainor not only suffered direct and distinct injuries by Defendants' actions and advice but he also has no opportunity to be made whole by any corporate recovery. Gainor's S corporations are now controlled by Klopfenstein. The corporations have not sued Defendants and have no incentive to sue them since Klopfenstein was a co-conspirator in Defendants' fraudulent activities.[6] Gainor clearly cannot benefit from a non-existent corporate recovery.

Even if the corporations did sue for recovery, Defendants presumably would defend on the ground that the corporations suffered no injury, for the very reasons discussed above. The

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[6] The corporations' lack of incentive to seek damages against Defendants is further evidenced by the indemnity claims Klopfenstein is pursuing in this litigation against Gainor. *See* Klopfenstein Counterclaim (Dkt. 63).

transactional fees the S corporations technically paid were actually absorbed by Gainor on the pass-through. He received less on the sale of his interest in the S corporations due to the transaction fees and Defendants' actions. Nor was it the S corporations that paid back taxes and interest to the IRS or the professional fees needed to defend Gainor against the IRS. Thus, Defendants would surely reason, the corporations were not really damaged by Defendants' advice. Under such reasoning, Defendants' orchestration of the corporate transactions permitted them to accept millions of dollars in fees, give faulty and fraudulent advice, but have no responsibility to anyone involved in the transactions. Not surprisingly, the law does not support such inequity. Instead it permits the Plaintiffs, the parties who were actually damaged by Defendants' actions, to sue for that damage.

E. A wrongdoer may not profit from his own wrongdoing

Sidley does not contend that the fees paid for implementation of the strategy cannot be recovered. Rather, Sidley asserts that the wrong person is attempting to recover them. This effort must fail. Defendants were the ones who designed the strategy and controlled its implementation. They determined and controlled what was done, by whom, and when. There is no dispute that Defendants' fees were paid with funds to which Gainor would have been entitled if they had not been used to pay to the Defendants as fees. To permit Defendant Sidley to escape liability because Defendants structured and implemented the strategy in a way that caused Gainor's money to be paid to them by someone else, would permit the wrongdoer to profit from his wrongdoing. The law does not allow this.

The applicable legal doctrine is called equitable estoppel. As stated by the Florida Supreme Court in *Major League Baseball v. Morsani*, 790 So. 2d 1071, 1076-77 (Fla. 2001):

> The doctrine of equitable estoppel has been a fundamental tenet of Anglo American jurisprudence for centuries:

* * *

> Equitable estoppel is based on principles of fair play and essential justice and arises when one party lulls another party into a disadvantageous legal position:
>
> * * *
>
> The doctrine of estoppel is applicable in all cases where one, by word, act or conduct, willfully caused another to believe in the existence of a certain state of things, and thereby induces him to act on this belief injuriously to himself, or to alter his own previous condition to his injury.
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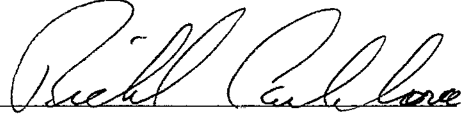
> * * *
>
> Equitable estoppel presupposes a legal shortcoming in a party's case that is directly attributable to the opposing party's misconduct. The doctrine bars the wrongdoer from asserting that shortcoming and profiting from his or her own misconduct. Equitable estoppel thus functions as a shield, not a sword, and operates against the wrongdoer, not the victim. This Court has applied the doctrine for more than a century and a half.

The facts of this case fall precisely within the *Morsani* rationale. The funds which wound up as fees in Defendants' coffers came ultimately from Gainor's pocket. The only reason that Gainor did not pay Defendants' fees directly is because Defendants, who had induced him to believe that they were the experts in this area, and who controlled all activities in implementation of the strategy, told him to do it another way. Thus, if there is a "legal shortcoming" in Plaintiffs' case, it is directly attributable to Defendants' misconduct. The doctrine of equitable estoppel therefore precludes Sidley from asserting that Gainor cannot recover because a corporate entity paid Gainor's money to Defendants.

CONCLUSION

Sidley's motion for partial summary judgment should be denied in its entirety. Alternatively, Plaintiffs request leave of Court to add the affected corporations as defendants or involuntary plaintiffs.



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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 23rd day of August, 2007, I electronically filed the foregoing document with the Clerk of the Court using CM/ECF. I also certify that the foregoing document is being served this day on all counsel of record or pro se parties identified on the attached Service List in the manner specified, either via transmission of Notices of Electronic Filing generated by CM/ECF or in some other authorized manner for those counsel or parties who are not authorized to receive electronically Notices of Electronic Filing.

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