NO. COA14-564

NORTH CAROLINA COURT OF APPEALS

Filed: 31 December 2014

DAVID BOTTOM and KRYSTAL DAWN SANCHEZ BOTTOM,

Plaintiffs,

v. Buncombe County
No. 11 CVS 824

JAMES W. BAILEY, JR., 1031 EXCHANGE SERVICES, LLC, HOMETRUST BANK, a federally chartered mutual savings bank, and MORGAN STANLEY SMITH BARNEY,

Defendants.

Appeal by plaintiff from order entered 7 February 2014 by Judge Alan Z. Thornburg in Buncombe County Superior Court. Heard in the Court of Appeals 20 October 2014.

Fisher Stark Cash, P.A., by W. Perry Fisher, II, Brad A. Stark and Colin A. McCormick, for plaintiff-appellants.

Moore & Van Allen PLLC, by Mark A. Nebrig and M. Cabell Clay, and Greenberg Traurig, P.A., by Bradford D. Kaufman (pro hac vice) and Joseph C. Coates, III (pro hac vice), for defendant-appellee Morgan Stanley Smith Barney.

STEELMAN, Judge.

Where plaintiffs' complaint, viewed as admitted, failed to state a claim against defendant upon which relief may be granted, the trial court did not err in granting defendant's

motion to dismiss pursuant to Rule 12(b)(6) of the North Carolina Rules of Civil Procedure, with prejudice.

I. Factual and Procedural History

David Bottom and Krystal Bottom (plaintiffs) owned real property in Buncombe County. On 11 November 2010, plaintiffs contracted with 1031 Exchange Services, LLC (1031) to provide intermediary services for a tax-deferred exchange pursuant to 26 U.S.C. § 1031. On 19 November 2010, plaintiffs sold the property, and the proceeds from the sale, $224,529.75, were deposited by 1031 into a fiduciary account at HomeTrust Bank (HomeTrust). Without plaintiffs' knowledge or permission, HomeTrust automatically transferred approximately $204,529.75 of the deposited funds into a separate sweep account in the name of 1031 at HomeTrust. HomeTrust comingled these monies with other accounts of James W. Bailey (Bailey), sole owner and manager of 1031, and various entities controlled by him. Funds in this separate account were then transferred back and forth between HomeTrust and Morgan Stanley Smith Barney (Morgan Stanley).

On 1 February 2011, Bailey was indicted in federal court for engaging in a 10-year check-kiting scheme involving the transfer of funds between HomeTrust and Morgan Stanley. Pursuant to this scheme, which involved more than $13,000,000,

Bailey would write and deposit checks issued from accounts at HomeTrust into Morgan Stanley accounts, and vice versa, even though the accounts lacked sufficient funds to cover the transfers.

Morgan Stanley's parent company made numerous inquiries to its Asheville office over the 10-year period. Morgan Stanley generated one or more reports indicating suspicious or wrongful activities involving Bailey's Morgan Stanley accounts. On one or more occasions, representatives of Morgan Stanley questioned Bailey regarding his account activities. Morgan Stanley did not file Suspicious Activity Reports (SARs) with federal law enforcement or the Department of the Treasury as to Bailey's activities.

On 30 November 2010, Bailey, on behalf of 1031, attempted to deposit three non-certified checks drawn upon a HomeTrust account with Morgan Stanley in the total amount of $4,800,000. Plaintiffs' funds were a portion of the funds used to cover the $4,800,000. Morgan Stanley requested that the checks be certified. Bailey subsequently obtained three certified checks from HomeTrust in the amount of $4,800,000, and deposited them with Morgan Stanley.

On 13 December 2010, HomeTrust informed 1031 that there were insufficient funds to cover the 30 November 2010 certified checks. A hold was subsequently placed on 1031's account. On 26 December 2010, plaintiffs received notice that 1031's account had been frozen; the next day, plaintiffs went to HomeTrust seeking the return of their funds. HomeTrust declined to disburse plaintiff's funds.

On 9 February 2011, the federal government executed a seizure warrant upon HomeTrust for all of 1031's accounts, including the sweep account. This warrant was served on 16 February 2011. On 22 August 2011, HomeTrust sent 10 checks to the United States government totaling $44,231.58, from various accounts controlled by Bailey and his controlled entities. None of those funds came from the sweep account.

On 16 July 2013, plaintiffs filed an amended complaint against Bailey, 1031, Hometrust, and Morgan Stanley. The amended complaint alleged breach of contract, negligence, negligent misrepresentation, and breach of fiduciary duty by Bailey and 1031; breach of implied contract, negligence, breach of fiduciary duty, violation of N.C. Gen. Stat. § 32-9, conversion, violation of 31 U.S.C. § 5311 *et seq.*, and aiding and abetting a breach of fiduciary duty by HomeTrust; and

negligence, violation of N.C. Gen. Stat. § 32-9, violation of 31 § U.S.C. 5311 *et seq.*, and aiding and abetting a breach of fiduciary duty by Morgan Stanley. The complaint also alleged unfair and deceptive practices and civil conspiracy, and sought equitable tracing or constructive trust, and an equitable lien, against all defendants.

On 17 September 2013, Morgan Stanley moved to dismiss plaintiffs' complaint against it, pursuant to Rule 12(b)(6) of the North Carolina Rules of Civil Procedure, on the grounds that plaintiffs were not customers of Morgan Stanley, that Morgan Stanley owed no duty to plaintiffs, fiduciary or otherwise, and that therefore plaintiffs "fail to allege the ultimate facts necessary to establish the essential elements of their claims[.]" On 7 February 2014, the trial court granted Morgan Stanley's motion to dismiss plaintiffs' complaint, with prejudice.

Plaintiffs appeal.

II. Standard of Review

"The motion to dismiss under N.C. R. Civ. P. 12(b)(6) tests the legal sufficiency of the complaint. In ruling on the motion the allegations of the complaint must be viewed as admitted, and on that basis the court must determine as a matter of law

whether the allegations state a claim for which relief may be granted." *Stanback v. Stanback*, 297 N.C. 181, 185, 254 S.E.2d 611, 615 (1979) (citations omitted).

"This Court must conduct a *de novo* review of the pleadings to determine their legal sufficiency and to determine whether the trial court's ruling on the motion to dismiss was correct." *Leary v. N.C. Forest Prods., Inc.*, 157 N.C. App. 396, 400, 580 S.E.2d 1, 4, *aff'd per curiam*, 357 N.C. 567, 597 S.E.2d 673 (2003).

"[T]o prevent a Rule 12(b)(6) dismissal, a party must . . . state enough to satisfy the substantive elements of at least some legally recognized claim. Additionally, we are not required . . . to accept as true allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." *Strickland v. Hedrick*, 194 N.C. App. 1, 20, 669 S.E.2d 61, 73 (2008) (citations and quotations omitted).

III. Analysis

Although plaintiffs make ten different arguments, they all concern a single issue: that the trial court erred in granting Morgan Stanley's motion to dismiss. We disagree.

Plaintiffs' complaint alleged that Morgan Stanley was negligent, that it violated N.C. Gen. Stat. § 32-9 and 31 U.S.C.

§ 5311, and that it aided and abetted Bailey and 1031 in their breach of fiduciary duty. Plaintiffs also alleged civil conspiracy and unfair and deceptive practices.

A. Negligence

"To state a claim for common law negligence, a plaintiff must allege: (1) a legal duty; (2) a breach thereof; and (3) injury proximately caused by the breach." *Fussell v. N.C. Farm Bureau Mut. Ins. Co.*, 364 N.C. 222, 226, 695 S.E.2d 437, 440 (2010). "The sine qua non of a negligence claim is a legal duty owed by defendant to the plaintiff." *Sterner v. Penn*, 159 N.C. App. 626, 629, 583 S.E.2d 670, 673 (2003). Plaintiffs contend that, despite not being customers of Morgan Stanley, they were owed a duty by Morgan Stanley.

In *Sterner*, we addressed the issue of "whether a securities broker/dealer has a legal duty to 'supervise' and 'monitor' the investments ordered by its customer on behalf of that customer's client." *Id.* In that case, the plaintiff, Sterner, brought an action against brokerage firms. Sterner, who was not a customer of the defendants, entrusted her money to Penn, a person who was a customer of defendants; Penn invested and subsequently lost her money. Sterner brought suit against defendants, alleging that they were negligent in failing to oversee the investments

made by Penn, who was their customer. The trial court granted the defendants' motion to dismiss. On appeal this Court held, after extensive analysis, that defendants were not investment advisors to Penn, nor to Sterner, that defendants had no duty to supervise and monitor Penn's actions to protect Sterner, and that Sterner's claim for negligence failed because defendants owed no duty to Sterner. *Id.* at 631, 583 S.E.2d at 674.

In reaching our decision in *Sterner*, we relied upon *Eisenberg v. Wachovia Bank*, 301 F.3d 220 (4th Cir. 2002). *Eisenberg* was a North Carolina case in which the plaintiff was "the victim of a fraudulent investment scheme" perpetrated by a person named Reid. *Id.* at 222. At Reid's direction, plaintiff transferred $1,000,000 into Reid's account at Wachovia Bank in North Carolina. Reid took the money, and plaintiff brought action against Wachovia, alleging negligence, specifically contending that Wachovia breached its duty in permitting Reid to open a fraudulent account and failing to discover Reid's improper use of the account. The federal district court granted Wachovia's motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. On appeal, the United States Court of Appeals for the Fourth Circuit held that:

> We consider whether a bank owes a duty of care to a noncustomer who is defrauded by

> the bank's customer through use of its services. We cannot find an applicable precedent from a North Carolina court and look to case law from other jurisdictions. We conclude that the North Carolina Supreme Court, if it were to decide this issue, would hold that Wachovia did not owe Eisenberg a duty of care under the facts presented.
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> Whether Wachovia owes a duty of care to Eisenberg depends on the relationship between them. *See* W. Page Keeton et al., *Prosser and Keeton on Torts* § 53 at 356 (5th ed. 1984) ("It is better to reserve 'duty' for the problem of the relation between individuals which imposes upon one a legal obligation for the benefit of the other ...."); *cf. Newton v. New Hanover Co. Bd. of Educ.*, 342 N.C. 554, 467 S.E.2d 58, 63 (1996) (holding nature and scope of duty owed by owner of land depends upon status of injured person as invitee, licensee or trespasser). Eisenberg had no direct relationship with Wachovia. He was not a Wachovia bank customer and, so far as the allegations indicate, has never conducted business with Wachovia. Eisenberg instead transacted with Reid, a Wachovia bank customer.

Id. at 225. The Court noted that a bank has no duty to anyone but its own customers, and that despite the fact that a bank account may have been used in the course of perpetrating a fraud, the bank's only duty was to its customers, not to those with whom its customers had dealings. *Id.* at 225-26. The Fourth Circuit Court of Appeals concluded that since there was no relationship between Wachovia and plaintiff, that Wachovia

did not owe plaintiff a duty of care, and that plaintiff's claim was properly dismissed. *Id.* at 227.

In the instant case, we hold the precedent of *Eisenberg* and *Sterner* to be both controlling and persuasive. Morgan Stanley had no relationship with plaintiffs, and therefore owed them no duty. The trial court did not err in dismissing plaintiffs' claim of negligence with respect to Morgan Stanley.

This argument is without merit.

B. N.C. Gen. Stat. § 32-9

N.C. Gen. Stat. § 32-9 provides that:

> If a check is drawn upon the account of his principal in a bank by a fiduciary who is empowered to draw checks upon his principal's account, the bank is authorized to pay such check without being liable to the principal, unless the bank pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in drawing such check, or with knowledge of such facts that its action in paying the check amounts to bad faith. If, however, such a check is payable to the drawee bank and is delivered to it in payment of or as security for a personal debt of the fiduciary to it, the bank is liable to the principal if the fiduciary in fact commits a breach of his obligation as fiduciary in drawing or delivering the check.

N.C. Gen. Stat. § 32-9 (2013).

In the instant case, plaintiffs alleged that Morgan Stanley had actual knowledge of either 1031's breach of fiduciary duty or Bailey's misconduct. However, N.C. Gen. Stat. § 32-9 does not address the factual situation recited in plaintiffs' complaint. The language of the statute, on its face, applies to the fiduciary's fraudulent mishandling of the principal's account. In the instant case, the Morgan Stanley account was not in the names of plaintiffs. While the complaint is unclear, it seems to suggest that the account or accounts with Morgan Stanley were in Bailey's name. The language of N.C. Gen. Stat. § 32-9 is clear: it applies when the fiduciary makes fraudulent withdrawals *on the account of his principal*, of which the bank should be aware. Because the complaint does not allege that the account with Morgan Stanley was in the name of plaintiffs, no claim arises under that statute. The trial court did not err in dismissing plaintiff's claim against Morgan Stanley based upon a violation of N.C. Gen. Stat. § 32-9.

This argument is without merit.

C. 31 U.S.C. § 5311

31 U.S.C. § 5311 *et seq.*, known as the Bank Secrecy Act, are federal laws requiring "certain reports or records where they have a high degree of usefulness in criminal, tax, or

regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism." 31 U.S.C. § 5311 (2001). We note in passing that the instant action concerns none of these things; the action at issue is neither criminal nor regulatory, does not involve intelligence nor counterintelligence, and does not, based upon the allegations in plaintiff's complaint, concern international terrorism. The instant action is a civil claim, between private parties, for breach of contract, negligence, and other assorted civil wrongs. Although the question has not been addressed within our jurisdiction, other courts have held that the Bank Secrecy Act does not create a private cause of action. *See e.g. El Camino Res., LTD. V. Huntington Nat'l Bank*, 722 F. Supp. 2d 875, 923 (W.D. Mich. 2010) *aff'd,* 712 F.3d 917 (6th Cir. 2013) (holding that "it is now well settled that the anti-money-laundering obligations of banks, as established by the Bank Secrecy Act, obligate banks to report certain customer activity to the government but do not create a private cause of action permitting third parties to sue for violations of the statute"); *see also Alexander v. Sandoval*, 532 U.S. 275, 291, 121 S. Ct. 1511, 1522, 149 L. Ed. 2d 517, 531 (2001) (holding that

"[l]anguage in a regulation may invoke a private right of action that Congress through statutory text created, but it may not create a right that Congress has not").

In plaintiffs' amended complaint, they contend that the Bank Secrecy Act required HomeTrust and Morgan Stanley to "establish, implement, and maintain programs designed to detect and report suspicious activity indicative of financial crimes as further set forth herein." Rather than citing to the Bank Secrecy Act itself for a basis for this contention, however, plaintiffs cite to Title 12 of the Code of Federal Regulations, specifically a subsection concerning compliance with the Bank Secrecy Act. The regulation in question requires:

> (b) *Establishment of a BSA compliance program*—
>
> (1) *Program requirement.* Each bank shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and reporting requirements set forth in subchapter II of chapter 53 of title 31, United States Code and the implementing regulations issued by the Department of the Treasury at 31 CFR Chapter X. The compliance program must be written, approved by the bank's board of directors, and reflected in the minutes of the bank.
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> (2) *Customer identification program.* Each bank is subject to the requirements of 31 U.S.C. 5318(1) and the implementing

> regulations jointly promulgated by the OCC and the Department of the Treasury at 31 CFR 1020.220, which require a customer identification program to be implemented as part of the BSA compliance program required under this section.
>
> (c) *Contents of compliance program*. The compliance program shall, at a minimum:
>
> (1) Provide for a system of internal controls to assure ongoing compliance;
>
> (2) Provide for independent testing for compliance to be conducted by bank personnel or by an outside party;
>
> (3) Designate an individual or individuals responsible for coordinating and monitoring day-to-day compliance; and
>
> (4) Provide training for appropriate personnel.

12 C.F.R. § 21.21 (2014). Plaintiffs contend, without citing further legal basis, that this regulation required Morgan Stanley to "implement and maintain a program to detect known or suspected federal crimes[,]" and that Morgan Stanley's failure to file a SAR concerning Bailey or 1031 constituted a failure to "take appropriate actions to prevent [] Bailey's crimes." We are not persuaded.

The intent of the Bank Secrecy Act, as expressed therein, is to aid in "criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or

counterintelligence activities, including analysis, to protect against international terrorism." 31 U.S.C. § 5311. Plaintiffs impute an intent to this statute, and to 12 C.F.R. § 21.21, to protect third party non-customers of banks. Plaintiffs offer no legal authority for this assertion. We readily acknowledge that the purpose of the Bank Secrecy Act is to require banks to produce reports where they may be of value in federal criminal investigations. The instant case, however, is not a criminal investigation. Despite Bailey having been indicted in federal court, the instant case involves private state claims, not a federal criminal charge.

Even assuming *arguendo* that plaintiffs' allegations were sufficient on their face, the statutes upon which plaintiffs rely do not explicitly create a private cause of action. Absent such language, no private cause of action exists. We hold that plaintiffs' allegations are insufficient to support a claim. The trial court did not err in dismissing plaintiffs' claim of violation of 31 U.S.C. § 5311 *et seq.* with respect to Morgan Stanley.

This argument is without merit.

D. Aiding and Abetting a Breach of Fiduciary Duty

With respect to plaintiffs' claim of aiding and abetting a breach of fiduciary duty:

> The court finds that no such cause of action exists in North Carolina. It is undisputed that the Supreme Court of North Carolina has never recognized such a cause of action. The only North Carolina Court of Appeals decision recognizing such a claim, *Blow v. Shaughnessy,* 88 N.C. App. 484, 489, 364 S.E.2d 444, 447–48 (1988), involved allegations of securities fraud, and its underlying rationale was eliminated by the United States Supreme Court in *Central Bank of Denver v. First Interstate Bank of Denver,* 511 U.S. 164, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994).

Laws v. Priority Tr. Servs. of N.C., 610 F. Supp. 2d 528, 532 (W.D.N.C. 2009) *aff'd sub nom. Laws v. Priority Tr. Servs. of N. Carolina, LLC*, 375 F. App'x. 345 (4th Cir. 2010). We recognize that the United States Supreme Court, in *Cent. Bank of Denver*, abrogated the rationale of *Blow*, and that *Blow* is no longer valid precedent. *See e.g. Land v. Land*, ___ N.C. App. ___, 729 S.E.2d 731 (2012) (unpublished).

Plaintiffs nonetheless contend that case law exists in support of their claim. Plaintiffs cite to *Greensboro Rubber Stamp Co. v. Southeast Stamp & Sign, Inc.*, 212 N.C. App. 691, 718 S.E.2d 736 (2011) (unpublished) in support of this position. However, that case is not controlling precedent for two reasons: first, it is unpublished, and thus not binding upon this Court,

N.C. R. App. P. 30(e)(3); and second, it relies upon *Blow*, the operative holding of which was abrogated by the United States Supreme Court. Plaintiffs also cite to two cases from the North Carolina Business Court, and one case from the United States Bankruptcy Court for the Middle District of North Carolina, in support of this claim. The North Carolina Business Court "is a special Superior Court, the decisions of which have no precedential value in North Carolina." *Estate of Browne v. Thompson*, ___ N.C. App. ___, ___, 727 S.E.2d 573, 576 (2012) *disc. review denied,* 366 N.C. 426, 736 S.E.2d 495 (2013). Neither do the decisions of the United States Bankruptcy Court constitute precedent binding upon this Court. *In re Bass*, 217 N.C. App. 244, 254, 720 S.E.2d 18, 26 (2011) *rev'd on other grounds,* 366 N.C. 464, 738 S.E.2d 173 (2013).

While we need not address whether a claim for aiding and abetting a breach of fiduciary duty exists at law in North Carolina, we note that plaintiffs' amended complaint does not state such a claim with the required specificity. Plaintiffs allege that Morgan Stanley provided substantial assistance to Bailey's alleged breach of fiduciary duty "by, including but not limited to allowing [] Bailey and 1031 [] to engage in the acts and omissions set forth herein and by failing to recognize or

take action to end the [] scheme." The tort of aiding and abetting a breach of fiduciary duty, according to *Blow*, requires "(1) the existence of a securities law violation by the primary party; (2) knowledge of the violation on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in the achievement of the primary violation." *Blow*, 88 N.C. App. at 490, 364 S.E.2d at 447. Even assuming *arguendo* that this cause of action was still valid, plaintiffs only offer conclusory allegations, without more, that Morgan Stanley was aware of Bailey's fraudulent acts and rendered substantial assistance to Bailey. We hold that the trial court did not err in dismissing plaintiffs' claim of aiding and abetting a breach of fiduciary duty with respect to Morgan Stanley.

This argument is without merit.

E. Civil Conspiracy

In their amended complaint, plaintiffs contend that Morgan Stanley conspired with the other defendants to injure plaintiffs, or alternatively that defendants collectively aided and abetted one another.

"The elements of a civil conspiracy are: (1) an agreement between two or more individuals; (2) to do an unlawful act or to do a lawful act in an unlawful way; (3) resulting in injury to

plaintiff inflicted by one or more of the conspirators; and (4) pursuant to a common scheme." *Strickland v. Hedrick*, 194 N.C. App. 1, 19, 669 S.E.2d 61, 72 (2008) (quoting *Privette v. Univ. of North Carolina,* 96 N.C. App. 124, 139, 385 S.E.2d 185, 193 (1989)).

In the instant case, plaintiffs offer nothing but bare allegations of this misconduct. Specifically, plaintiffs allege:

> 176. Defendants combined to injure Plaintiffs without reasonable or lawful excuse and conspired, assisted and facilitated the fraudulent scheme upon Plaintiffs as set forth herein.
>
> 177. In the alternative, the Defendants aided and abetted one another in committing the acts and omissions set forth herein with reckless disregard for the rights of the Plaintiffs.
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> 178. As a direct and proximate result of this conspiracy or aiding and abetting, Plaintiffs have been damaged and will be damaged in the amount of $224,529.75, plus interest and all associated tax consequences for Plaintiffs' inability to complete their agreed upon 1031 exchange.

This sparsely worded claim attempts to allege the existence of a conspiracy, but fails to allege one of the vital elements of a conspiracy, an agreement between two or more individuals. The claim suggests that defendants – Bailey, 1031 and Morgan

Stanley – conspired, but fails to allege how this conspiracy came to be, or when, or where, or why. The complaint asserts mere conclusions concerning the elements of civil conspiracy, without offering a scintilla of factual allegation in support of the claim.

The alternative claim asserted in paragraph 177 is nothing more than a thinly disguised attempt to bring in through a back door the aiding and abetting claim previously rejected in section III D of this opinion. Alternatively, it is an attempt to assert a conspiracy without an agreement. Both of these theories fail.

We hold that the trial court did not err in dismissing plaintiffs' claim of civil conspiracy with respect to Morgan Stanley.

This argument is without merit.

F. Unfair and Deceptive Practices

In their amended complaint, plaintiffs contend that Morgan Stanley's "acts and omissions . . . were in or affecting commerce and constitute unfair and deceptive [] practices as prescribed by Chapter 75 of the North Carolina General Statutes." Plaintiffs' claims consist entirely of conclusory statements that Morgan Stanley "engaged in a conspiracy to

defraud Plaintiffs[,]" and that this alleged conspiracy "proximately caused actual injury and damages to Plaintiffs."

As we have already stated, the allegations contained in plaintiffs' complaint are insufficient to support a claim for conspiracy. Inasmuch as plaintiffs' claim for unfair and deceptive practices is predicated upon the existence of a conspiracy, we hold that the trial court did not err in dismissing that claim.

This argument is without merit.

IV. Conclusion

Plaintiffs' complaint, taken as true, failed to establish a duty incumbent upon Morgan Stanley, and therefore failed to establish a cause of action for negligence. The complaint failed to make sufficient allegations that any private civil actions arose under state or federal statute. The complaint failed to establish all of the elements of aiding and abetting a breach of fiduciary duty. The complaint failed to allege the existence of an agreement, and therefore failed to establish a claim for civil conspiracy. The complaint failed to allege unfair and deceptive practices arising from a conspiracy.

The trial court did not err in dismissing plaintiffs' complaint as to Morgan Stanley.

AFFIRMED.

Chief Judge McGEE and Judge HUNTER concur.