

SAFEGUARDING EXCHANGE PROCEEDS: "IMPLICATIONS OF THE LANDAMERICA 1031 EXCHANGE BANKRUPTCY"



Compliments of

In November of 2008, LandAmerica 1031 Exchange Services, Inc. ("LES") filed for bankruptcy protection in the United States Bankruptcy Court for the Eastern District of Virginia. LES was a qualified intermediary that facilitated tax deferred exchanges under Internal Revenue Code §1031. When it ceased operations, it was holding illiquid auction rate securities and was unable to advance funds to close replacement property acquisitions for its exchange customers.

On April 15, 2009, the Court ruled on a motion for summary judgment in a representative case filed by an LES exchange customer, Millard Refrigerated Services, Inc. ("Millard"). By its action, Millard sought to recover its exchange funds on the basis that LES held the funds in trust for Millard under the terms of the exchange agreement executed by the parties. Following a detailed review of the exchange agreement, the Court concluded that Millard's exchange funds were not held in trust and were included in LES's bankruptcy estate subject to the general claims of all LES creditors. In reaching its decision, the Court applied Virginia law, which requires an "affirmative intention" to create an express trust through express language or other circumstances evidencing with reasonable certainty that a trust was intended. Since the exchange funds were held in an LES bank account under LES's exclusive control, the funds were presumed to be property of the LES bankruptcy estate under applicable bankruptcy law. To rebut this presumption, Millard was required to prove that it retained some right to the exchange funds as an interest in property recognized under Virginia law. Millard argued that since LES was holding the funds solely to facilitate Millard's 1031 exchange, Millard never parted with its equitable interest in the funds.

The Court noted that there was no express language creating a trust such as "trust," "trustee," or "beneficiary" in the exchange agreement. That, coupled with other disclaimers in the exchange agreement pursuant to which Millard agreed that LES would have "sole and exclusive possession, dominion, control and use of all Exchange Funds" and that Millard had "no right, title or interest in or to the Exchange Funds," supported the view that no trust was intended. While the court could have found that there was a "resulting trust" (an indirect trust arising from the parties' intent or from the nature of the transaction even in the absence of an express declaration of trust), the Court concluded that Millard and LES, as sophisticated parties involved in a complex transaction, would have created a trust if they had intended to do so.

Asset Preservation, Inc. ("API") offers multiple investment options to suit each customer's needs, including the use of security arrangements (called "safe harbors") available under Treasury Reg. 1.10131(k)-1(g), such as a qualified escrow arrangement ("QEA"). If an exchanger desires to establish a QEA with an outside escrow holder, API will make appropriate arrangements and the client will execute a separate qualified escrow agreement in addition to API's standard exchange agreement. In a QEA, funds will be held by the escrow agent under the terms of the qualified escrow agreement. Furthermore, as seen in the LES bankruptcy, state law determines whether or not a separate escrow or trust has been created to exclude the exchanger's funds from a possible bankruptcy estate. Unlike Virginia law, which was applied in the LES case, California has enacted a law regulating qualified intermediaries that specifically states that exchange funds "shall not be subject to execution or attachment on any claim against the exchange facilitator." API's headquarters are located in California and California law governs API's exchange agreements. Had the LES Court decided the case under California law, the result would be different. Additionally, API has revised its exchange agreements to make absolutely clear that the exchange funds belong to the exchange client, not the intermediary, during the exchange. The absence of any such acknowledgement and the inclusion of language to the contrary in the LES case was a significant factor in the LES Court's decision.

API is a member of the Stewart family of companies under the umbrella of Stewart Information Services Corporation ("SISCO"), a NYSE publicly traded company. Upon request of an API exchange customer, SISCO will issue a Letter of Assurance ("LOA") under which SISCO assures the customer of API's faithful performance of its obligations under its exchange agreements. The coverage provided by the LOA is not limited to a specific dollar amount like a fidelity bond or Errors & Omissions coverage. We are proud of our more than 20 year history of service and we will continue to strive to make your exchange experience safe, secure and reliable.



A National IRC §1031 "Qualified Intermediary"

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