No. 16-492

IN THE

Supreme Court of the United States

PEM ENTITIES, LLC,

Petitioner,

v.

ERIC M. LEVIN, *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iii
STATEMENT OF THE CASE	1
A. Recharacterization of Debts to Equity in Bankruptcy	1
B. Counterstatement of the Facts	1
Background	2
The Settlement Agreement with Paragon and the Formation of PEM	3
REASONS FOR DENYING THE WRIT	5
I. THERE IS NOT A WELL-DEVELOPED CIRCUIT SPLIT – WHILE RECHARACTERIZATION IS RECOGNIZED BY ALL THE CIRCUITS THAT HAVE ADDRESSED IT, THE RULES FOR ANALYSIS ARE STILL EVOLVING	6
A. The Majority Rule	6
B. Recent decisions from lower courts in the Second and Seventh Circuits are tending toward the majority approach	10
C. The Fitness Holdings cases added little clarity to how a court creates a “state law rule.”	11
D. It is too soon for the Court to consider this issue	12
CONCLUSION	13

TABLE OF CONTENTS—Continued

APPENDIX Page

APPENDIX: JUDGMENT: Wake County Superior Court, State of North Carolina (December 5, 2016).. 1a

TABLE OF AUTHORITIES

CASES Page(s)

Arizona v. Evans,
514 U.S. 1 (1995)....................................... 12, 13

Bayer Corp. v. MascoTech, Inc. (*In re AutoStyle Plastics, Inc.*),
269 F.3d 726 (6th Cir. 2001)....................*passim*

Butner v. United States,
440 U.S. 48 (1979)..................................... 9, 12

Fairchild Dornier GMBH v. Official Committee of Unsecured Creditors (*In re Dornier Aviation*)
453 F.3d 225 (4th Cir. 2006)..................... 1, 7

In re: Aéropostale, Inc.,
555 B.R. 369 (Bankr. S.D.N.Y. 2016)....... 11

In re Alternate Fuels, Inc.,
789 F.3d 1139 (10th Cir. 2015)................. 8

In re Cold Harbor Associates, L.P.,
204 B.R. 904 (Bankr. E.D. Va. 1997) 6

In re Emerald Casino, Inc.,
2015 WL 1843271
(N.D. Ill. Apr. 21, 2015) 10

In re Eternal Enterprise, Inc.,
557 B.R. 277 (Bankr. D. Conn. 2016)....... 10

In re Fitness Holdings Int'l, Inc.,
714 F.3d 1141 (9th Cir. 2013)........... 1, 6, 11, 12

In re Fitness Holdings Int'l, Inc.,
660 F. App'x 546 (9th Cir. 2016) 12

TABLE OF AUTHORITIES—Continued

Page(s)

In re Hedged-Investments Assocs. Inc.,
380 F.3d 1292 (10th Cir. 2004)................. 1, 8, 9

In re Lothian Oil, Inc.,
650 F.3d 539 (5th Cir. 2011)............ 1, 9, 11, 12

In re Sabine Oil & Gas Corp.,
547 B.R. 503 (Bankr. S.D.N.Y. 2016)....... 11

In re SubMicron Sys.,
432 F.3d 448 (3d Cir. 2006) 1, 7

McCray v. N.Y.,
461 U.S. 961 (1983)................................... 12

Pepper v. Litton,
308 U.S. 295 (1939)................................... 1

Roth Steel Tube Co. v. Comm'r,
800 F.2d 625 (6th Cir. 1986)..................... 6

STATUTES

11 U.S.C. § 101(31)....................................... 3

11 U.S.C. § 105(a) 7, 8, 9, 12

11 U.S.C. § 502.. 12

11 U.S.C. § 502(b) 9

STATEMENT OF THE CASE

A. Recharacterization of Debts to Equity in Bankruptcy

A bankruptcy court's equitable powers have long included the ability to look beyond form to substance. *See Pepper v. Litton*, 308 U.S. 295, 305 (1939). The Third, Fourth, Fifth, Sixth, Ninth and Tenth Circuits all recognize that a bankruptcy court has the ability to recharacterize debts as equity. *See In re Fitness Holdings Int'l, Inc.,* 714 F.3d 1141 (9th Cir. 2013) (Fitness Holdings I); *In re Lothian Oil, Inc.*, 650 F.3d 539 (5th Cir. 2011); *In re SubMicron Sys*., 432 F.3d 448 (3d Cir. 2006); *In re Dornier Aviation*, 453 F.3d 225 (4th Cir. 2006); *In re Hedged-Investments Assocs. Inc*., 380 F.3d 1292 (10th Cir. 2004); *In re AutoStyle Plastics, Inc*., 269 F.3d 726 (6th Cir. 2001).

B. Counterstatement of the Facts

Although Petitioner PEM Entities, LLC ("PEM") was formed by an insider of Debtor Province Grande Olde Liberty, LLC ("PGOL" or "Debtor") for the supposed "acquisition" of a $6.45 million bank note to Paragon Commercial Bank ("Paragon"), this deal was in fact a transparent effort by insiders to strip equity from the Debtor and prevent payment to the Plaintiff/Appellees, who are creditors of the Debtor and have been awarded a constructive trust over the Debtor's property. Three quarters of the purchase price of the Paragon note was funded by loans that were paid for and secured by the Debtor's property. The entire transaction was negotiated as part of a "Settlement Agreement" between the Debtor and Paragon that PEM was not even a party to. As a result of this transaction, insiders asserted a $7 million lien on everything that the Debtor owns, using the lien as

justification to drain any funds received by the Debtor. Plaintiff/Appellees asked the bankruptcy court to recognize PEM's contribution for what it is—an equity infusion that allowed the Debtor to satisfy the Debtor's debt to Paragon—and recharacterize the contribution as equity and not debt. The court agreed and entered summary judgment in Plaintiff/Appellees' favor recharacterizing PEM's asserted debt as equity in the Debtor.

Background

Plaintiff/Appellees Eric M. Levin ("Mr. Levin") and Howard Shareff ("Dr. Shareff") collectively invested one million dollars in Lakebound Fixed Return Fund LLC ("Lakebound"), an entity designed as a high-yield, fixed-return vehicle that was supposed to invest in multiple real estate projects and offer a fixed return to its investors. App. 2a. In a jury trial in the North Carolina Business Court, it was determined that Howard Jacobson purchased the Debtor's land with funds converted from Lakebound and the jury imposed a constructive trust against the Debtor's assets as a result of this misappropriation. Response App. 2a-3a. The trial court entered its final judgment, which set out the scope of that constructive trust, and the final judgment is on appeal to the North Carolina Supreme Court. *Id.* at 9a-10a.

The Debtor used $188,000.00 of Lakebound's funds (misappropriated by Howard Jacobson) to close purchase of the land that constitutes nearly all of its estate. *Id.* at 2a; App. at 20a. The Debtor does not deny that it used Lakebound's funds to close the deal, but contends that Lakebound voluntarily lent it these funds, even though such a loan would have violated

the terms of the Lakebound Operating Agreement and there is no documentation to support this contention. App. at 20a. That $188,000.00 is significant because it was the cash that was used to purchase the land that is now the Debtor's principal asset, and the Debtor would not own that land absent the conversion of the Plaintiff/Appellees' funds. Paragon Commercial Bank loaned the Debtor the rest of the purchase price in the approximate amount of $6.4 million secured by a deed of trust (the "Paragon Debt"). *Id.* It is the settlement of the Paragon Debt in a transaction involving Defendant/Appellant PEM that serves as the basis for Plaintiff/Appellees' claims in this action.

The Settlement Agreement with Paragon and the Formation of PEM

In late 2011, Paragon commenced a foreclosure action against the Debtor based on the Paragon Debt. *Id.* On or about March 2, 2012, PGOL, Howard Jacobson, PGOL's manager, Richard Wolf ("Wolf"), CILPS, and Paragon entered into a settlement agreement resolving both the Paragon Debt and a loan from Paragon to CILPS that secured other portions of the Olde Liberty Club land (the "Settlement Agreement"). *Id.*

PEM Entities, LLC is a Delaware limited liability company that was formed in December 2011 by Stanley Jacobson, who is Howard Jacobson's father and also a member of the Debtor. *Id.* Stanley Jacobson and PEM are insiders of the Debtor as that term is defined in 11 U.S.C. § 101(31). *Id.* Stanley Jacobson was the sole member of PEM at the time of execution of the settlement agreement. *Id.* PEM's current owners are Stanley Jacobson, Robert B. Conaty, and an entity owned by trusts established by Stanley Jacobson for the benefit of his grandchildren. *Id.* at 3a.

PEM is not a party to the Settlement Agreement and did not sign it. *Id.* Nonetheless, under the Settlement Agreement, PEM agreed to purchase the Paragon Debt, which was in the principal amount of approximately $6,465,000 for the severely discounted purchase amount of $1,242,000. *Id.* The settlement of claims between the Debtor and Paragon is in fact contingent on the acts of PEM, this supposed third-party actor.

Paragon's representatives negotiated this purchase solely with Howard Jacobson and Wolf and never negotiated with (or even met) any other representatives of PEM. *Id.* at 3a-4a.

This $1,242,000 purchase was funded by two deeds of trust pledged by the Debtor against its land for the benefit of PEM. The first deed of trust (the "Paragon-PEM Deed of Trust") in the amount of $292,000 secures a zero-percent loan from Paragon to PEM that was used to finance PEM's discounted purchase of the Paragon Debt. *Id.* at 21a.

The Debtor also entered into a second deed of trust, pledging additional property to secure a second loan for funds that PEM used to purchase the Paragon Debt. This deed of trust states that PEM is indebted to Joseph Deglomini ("Deglomini") and Joseph Simone ("Simone") in the amount of $650,000.00 (the "Deglomini-Simone Deed of Trust"). *Id.* This $650,000.00 was integral to financing PEM's discounted purchase of the Paragon Debt. *Id.* Deglomini and Simone required a pledge of the Debtor's land and subordination of the lien associated with the Paragon Debt that PEM was acquiring as a condition to making the loan. *Id.*

PEM's claim was scheduled as a secured claim in the amount of seven million dollars in the Debtor's schedules. *Id.* PEM maintained no ledger, nor did it keep any other documentation that applied this payment to the amount Debtor owed on the Paragon Debt. *Id. at 27a.* The Debtor has used PEM's purported security interest as justification to funnel all equity in the Debtor to this insider and alter ego of the Debtor, and away from the Debtor's legitimate creditors, including Plaintiffs.

REASONS FOR DENYING THE WRIT

Petitioner asks this Court to potentially upend the established bankruptcy doctrine of recharacterization because of what it claims is uncertainty arising from a circuit split between two warring "rules of decision." The Court should deny this Petition because there is no real circuit split, nor are there two competing rules of decision. Rather, on the one side there is an established majority rule developed over decades under which Bankruptcy Courts use a well-defined set of factors to determine whether a particular transaction is debt or equity and where that claim sits in bankruptcy's priority scheme. On the other is a single decision that is an outlier; a case decided by the Ninth Circuit that proposes a poorly-defined alternative to the majority rule.

For the reasons set out in more detail below, the Court's review of this issue now through a grant of certiorari is unwarranted.

I. THERE IS NOT A WELL-DEVELOPED CIRCUIT SPLIT – WHILE RECHARACTERIZATION IS RECOGNIZED BY ALL THE CIRCUITS THAT HAVE ADDRESSED IT, THE RULES FOR ANALYSIS ARE STILL EVOLVING.

A. The Majority Rule

Under the doctrine of recharacterization, a court "is not required to accept the label of 'debt' or 'equity' placed by the debtor upon a particular transaction, but must inquire into the actual nature of a transaction to determine how best to characterize it." *In re Cold Harbor Associates, L.P.*, 204 B.R. 904, 915 (Bankr. E.D. Va. 1997). "In determining from the evidence available to it that a transaction called a loan by the debtor is actually more properly called a contribution to equity," the court "may recharacterize the alleged loan to reflect the true nature of the transaction." *Id.* As the Ninth Circuit noted in *Fitness Holdings I*, there is "broad agreement that the Code authorizes courts to recharacterize claims." *In re Fitness Holdings Int'l, Inc.,* 714 F.3d 1141, 1148 (9th Cir. 2013) (*Fitness Holdings I*).

The Third, Fourth, Fifth, Sixth, and Tenth Circuits all use variations of the same test as the analytical framework to conduct the recharacterization analysis. In *Roth Steel Tube Co. v. Comm'r*, 800 F.2d 625 (6th Cir. 1986), the Court of Appeals for the Sixth Circuit set out 11 factors to determine whether an investment was debt or equity in the context of assessing income tax liability. *Id*. at 630. In *Bayer Corp. v. MascoTech, Inc. (In re AutoStyle Plastics, Inc.*), 269 F.3d 726 (6th Cir. 2001), the Sixth Circuit extended the use of those factors to the recharacterization context. Those factors are:

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

269 F.3d at 749–50.

The Fourth Circuit in *Fairchild Dornier GMBH v. Official Committee of Unsecured Creditors (In re Dornier Aviation)*, 452 F.3d 225, 231 (4th Cir. 2006) adopted the *AutoStyle* factors, reasoning that section 105(a) affords bankruptcy courts broad powers to facilitate priorities under the Bankruptcy Code and to do so a bankruptcy court should be able to determine whether a given claim is debt or equity.

The Third Circuit agreed with the *AutoStyle* court that bankruptcy courts have the inherent power to recharacterize debt as equity in *In re SubMicron Systems Corporation, et al.*, 432 F.3d 448 (3d Cir. 2006). The Third Circuit's approach was more flexible than the 11 *AutoStyle* factors, and focused on the intent of the parties. The court recognized that use of multi-factor tests "devolve to an overarching inquiry: the characterization as debt or equity is a court's attempt

to discern whether the parties called an instrument one thing when in fact they intended it as something else." 432 F.3d 448 at 456.

> No mechanistic scorecard suffices. And none should, for Kabuki outcomes elude difficult fact patterns. While some cases are easy (*e.g.,* a document titled a "Note" calling for payments of sums certain at fixed intervals with market-rate interest and these obligations are secured and are partly performed, versus a document issued as a certificate indicating a proportional interest in the enterprise to which the certificate relates), others are hard (such as a "Note" with conventional repayment terms yet reflecting an amount proportional to prior equity interests and whose payment terms are ignored). Which course a court discerns is typically a commonsense conclusion that the party infusing funds does so as a banker (the party expects to be repaid with interest no matter the borrower's fortunes; therefore, the funds are debt) or as an investor (the funds infused are repaid based on the borrower's fortunes; hence, they are equity). Form is no doubt a factor, but in the end it is no more than an indicator of what the parties actually intended and acted on.

Id.

The Tenth Circuit in *In re Alternate Fuels, Inc.,* 789 F.3d 1139, 1146-47 (10th Cir. 2015) held that "the authority to recharacterize putative debt as equity arises from a court's general equitable powers under 11 U.S.C. § 105(a)." *See also In re Hedged–Investments,* 380 F.3d 1292, 1298 (10th Cir. 2004) (also adopting the

Sixth Circuit's recharacterization analysis in *AutoStyle,* including its reliance on § 105(a)). "Recharacterization under § 105(a) is essential to a court's ability to properly implement the priority scheme of the Bankruptcy Code." *Id.* at 1146.

> When a court recharacterizes putative debt as equity, it effectively ignores the label attached to the transaction at issue and instead recognizes its true substance. The funds advanced are no longer considered a loan which must be repaid in bankruptcy proceedings as corporate debt, but are instead treated as a capital contribution. The practical effect of recharacterizing a putative debt claim as an equity interest is subordination, since a corporation repays capital contributions only if and when it has satisfied all other obligations. In this way, recharacterization ensures that controlling equity owners of a troubled corporation do not jump the line of the bankruptcy process and thwart the company's outside creditors' and investors' priority rights.

Id. at 1147 (citations omitted).

The Fifth Circuit adopted the *AutoStyle* factors in *In re Lothian Oil, Inc.*, 650 F.3d 539, 544 (2011). Unlike the other courts that have addressed this issue, the Fifth Circuit took a cautious view of the application of section 105(a) to the issue of recharacterization. *Id.* at 543. Instead, the Fifth Circuit found that recharacterization was an appropriate power of the bankruptcy court under section 502(b) and this Court's decision in *Butner v. United States*, 440 U.S. 48, 54 (1979). It also recognized that Texas courts look to the *AutoStyle* factors when distinguishing debt from equity. *Lothian Oil,* 650 F.3d at 544. The court did *not* adopt a *per se*

state rule, noting that "[o]ther courts that have permitted recharacterization have also borrowed tests from federal tax cases." *Id.*

B. Recent decisions from lower courts in the Second and Seventh Circuits are tending toward the majority approach.

Although the Seventh Circuit and Second Circuit have not directly addressed bankruptcy courts' power to recharacterize debt, recent cases from lower courts in those circuits that have looked at the issue have tended to recognize the majority position. In *In re Emerald Casino, Inc.*, 2015 WL 1843271 (N.D. Ill. Apr. 21, 2015), the Northern District of Illinois noted: "Though the Seventh Circuit has not explicitly adopted the majority approach, this court finds the reasoning supporting that approach persuasive." *Id.* at 10. The court also noted: "Though the court finds the reasoning of the majority approach more persuasive, it appears that there is little practical difference between the majority and minority approaches in this case." *Id.* Like the law of Texas in *Lothian Oil*, the law of Illinois uses the *AutoStyle* factors to analyze recharacterization of debt as equity, making the analysis under a "state" rule identical to that under a "federal" rule.

Likewise, in *In re Eternal Enterprise, Inc.,* 557 B.R. 277, 286 (Bankr. D. Conn. 2016), the Bankruptcy Court for the District of Connecticut cited the principal cases supporting the majority view:

> Although it is not expressly provided for in the Bankruptcy Code, and the issue has not been addressed by the Second Circuit Court of Appeals, the overwhelming majority of courts to have considered the issue have concluded that bankruptcy courts, as courts of equity, are empowered to recharacterize a

> purported loan as an equity contribution when the true nature of the underlying transaction or transactions which form the basis for the purported claimant's rights against the bankruptcy estate is, in substance, a capital contribution.

Id.; see also In re Sabine Oil & Gas Corp., 547 B.R. 503, 566 (Bankr. S.D.N.Y. 2016) ("In determining whether an investment that purports to be debt should be recharacterized as equity, courts in this district balance the factors laid out by the Court of Appeals for the Sixth Circuit in [*AutoStyle*]."); *In re: Aéropostale, Inc.,* 555 B.R. 369, 420 (Bankr. S.D.N.Y. 2016) ("In determining whether to recharacterize the [debt] as equity, the Court considers the factors set out in [*AutoStyle*] along with the facts and circumstances surrounding the transaction.").

C. The Fitness Holdings cases added little clarity to how a court creates a "state law rule."

There is little guidance as to how a bankruptcy court would even go about implementing a "state law rule" that varies from the factors established by the majority rule.[1] This is not the time to grant certiorari. The Ninth Circuit in *Fitness Holdings I* joined every other circuit that has considered the issue in recognizing that bankruptcy courts have the authority to recharacterize claims in bankruptcy proceedings. *Fitness Holdings I,* 714 F.3d 1141, 1148 (9th Cir. 2013). The *Fitness Holdings I* case, however, went

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[1] While the Fifth Circuit did look to state law when analyzing recharacterization in *In re Lotian Oil* it only looked to state law for guidance, and ended up adopting the same 11 factors that the majority view uses.

further. Like *Lothian Oil*, *Fitness Holdings I* held that the court's recharacterization power did not come from section 105(a) but rather from this Court's *Butner* decision and 11 U.S.C. § 502. It did not offer guidance on what a "state law rule" would look like, but instead sent the case back to the district court to enter a decision consistent with its holding. In *Fitness Holdings II*, the Ninth Circuit looked to contract law to determine whether the notes at issue in that case were contracts that created a right to payment. *In re Fitness Holdings Int'l, Inc.,* 660 F. App'x 546, 547 (9th Cir. 2016) (rehearing denied) (*Fitness Holdings II*). The court's brief, unpublished opinion offers little guidance to other courts that might seek a state-based alternative to the *AutoStyle* factors.

The time for filing of a petition for a writ of certiorari in *Fitness Holdings II* has not yet run. *Fitness Holdings II* is the only circuit case that has even considered what a state-based rule would look like when the state has not adopted the *AutoStyle* factors. Because that case directly addresses the issue of a proposed "state law rule," *Fitness Holdings II* or another case that applied a "state court rule" would offer a more appropriate vehicle for this Court to consider this unformed doctrine.

D. It is too soon for the Court to consider this issue.

But the bottom line is this—it is just too soon for the Supreme Court to consider this issue. As Justice Stevens noted: "it is a sound exercise of discretion for the Court to allow the various States to serve as laboratories in which the issue receives further study before it is addressed by this Court." *McCray v. N.Y.*, 461 U.S. 961, 963 (1983); *see also Arizona v. Evans*, 514 U.S. 1, 24 (1995) ("We have in many instances

recognized that when frontier legal problems are presented, periods of 'percolation' in, and diverse opinions from, state and federal appellate courts may yield a better informed and more enduring final pronouncement by this Court."). The well-established majority rule based on *AutoStyle* developed in circuit courts over the better part of a decade. The Ninth Circuit (and possibly the Fifth) offer the alternative of a "state-based" rule, but no court has yet articulated what a state-based rule would look like when it is not derived from the *AutoStyle* factors. Discarding an established rule that most Bankruptcy Courts use when analyzing recharacterization of debt and replacing it with 50 as-yet-undefined standards would introduce chaos and uncertainty into lending markets. Even if the Court found the alternative of state-law based rules of analysis appealing, lower courts have not had time to determine what that that alternative would look like. This Court should allow this nascent circuit split to develop before it considers granting certiorari.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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February 28, 2017

APPENDIX

APPENDIX

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION

STATE OF NORTH CAROLINA
WAKE COUNTY

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10 CVS 12062

ERIC LEVIN and HOWARD SHAREFF, derivatively in the right of LAKEBOUND FIXED RETURN FUND, LLC,

Plaintiffs,

v.

HOWARD A. JACOBSON and PROVINCE GRANDE OLDE LIBERTY LLC,

Defendants.

FINAL JUDGMENT

1. THIS MATTER was called for trial before a jury during an August 31, 2016 civil session of the Wake County Superior Court.

Parry Tyndall White, by James C. White and Michelle M. Walker, for Plaintiffs Eric Levin and Howard Shareff, individually and derivatively in the right of Lakebound Fixed Return Fund, LLC.

Robinson Elliott and Smith, by William C. Robinson, for Defendant Province Grande Olde Liberty LLC.

Howard A. Jacobson, Pro se.

Bledsoe, Judge.

2. During the pretrial conference, counsel for Plaintiffs Eric Levin and Howard Shareff, derivatively in the right of Lakebound Fixed Return Fund, LLC ("Lakebound") (collectively, "Lakebound") informed the Court that Plaintiffs were (i) voluntarily dismissing all claims by former Plaintiff Shareff & Associates, DDS PA and (ii) voluntarily dismissing Plaintiffs' claim for conversion of $100,000 of Lakebound's funds allegedly used to purchase an interest in former Defendant CILPS Acquisition LLC ("CILPS"), which had the effect of voluntarily dismissing the only claim against former Defendant CILPS. Plaintiffs presented to the jury their derivative claim on behalf of Lakebound for conversion of $188,000 against Defendant Howard A. Jacobson ("Jacobson") and sought the imposition of a constructive trust over land held by Defendant Province Grande Olde Liberty, LLC ("PGOL"), which PGOL had purchased, in part, with the $188,000 allegedly converted by Jacobson.

3. Following the conclusion of the presentation of evidence and the arguments of counsel, the following questions were submitted to the jury and answered as indicated:

(1) Did defendant Howard Jacobson convert $188,000 of Lakebound's funds by transferring $188,000 of Lakebound's funds to Province Grande Olde Liberty, LLC?

______X______ Yes   ____________ No

If you answer this issue YES, please proceed to Issue #2.

If you answer this issue NO, you shall not answer Issue #2.

(2) Is the land purchased by Province Grande Olde Liberty, LLC with $188,000 of Lakebound's funds subject to a constructive trust in favor of Lakebound?

____X____ Yes __________ No

4. On September 7, 2016, the jury returned its unanimous verdict in favor of Plaintiffs on both issues.

5. At the pretrial conference in this matter and at Defendants' request, the Court bifurcated Plaintiffs' claim for punitive damages, which was then to be tried to the same jury only in the event the jury returned a verdict for Plaintiffs on their conversion claim against Jacobson. On September 8, 2016, however, Plaintiffs informed the Court that they were abandoning their request for punitive damages.

6. In light of the jury's verdict in favor of Plaintiffs' constructive trust remedy over the land purchased by PGOL, the Court received supplemental briefing from the parties and held a hearing on October 28, 2016 to determine the terms of the constructive trust.

7. Therefore, the Court further FINDS and CONCLUDES as follows:

FINDINGS OF FACT AND CONCLUSIONS OF LAW

8. Plaintiffs seek a constructive trust over an undivided 79.4% interest in the land purchased by PGOL at the Olde Liberty Golf and Country Club (the "PGOL Land"), on the theory that Lakebound's converted funds accounted for 79.4% of the cash paid at closing by PGOL. In opposition, PGOL advances a number of arguments against the imposition of a constructive trust on the PGOL Land. In addition,

PGOL argues that a constructive trust over the PGOL Land should not exceed a 2.83% interest, which represents the proportion of the converted funds to the total purchase price of the PGOL Land, inclusive of debt.

9. The North Carolina Supreme Court has defined a constructive trust as "a duty, or relationship, imposed by courts of equity to prevent the unjust enrichment of the holder of title or, of an interest in, property which such holder acquired through . . . circumstance[s] making it inequitable to retain it against the claim of the beneficiary of the constructive trust." *Variety Wholesalers, Inc. v. Salem Logistics Traffic Servs., LLC*, 365 N.C. 520, 530, 723 S.E.2d 744, 751 (2012) (quoting *Wilson v. Crab Orchard Dev. Co.*, 276 N.C. 198, 211, 171 S.E.2d 873, 882 (1970)). "The constructive trust plaintiff wins an *in personam* order that requires the defendant to transfer specific property in some form to the plaintiff." *Roper v. Edwards*, 323 N.C. 461, 464, 373 S.E.2d 423, 425 (1988) (citation omitted). "Trial courts have broad discretion to fashion equitable remedies to protect innocent parties when injustice would otherwise result." *Kinlaw v. Harris*, 364 N.C. 528, 532, 702 S.E.2d 294, 297 (2010).

10. As an initial matter, the Court notes that PGOL's arguments against the imposition of a constructive trust on the PGOL Land ignore the jury's verdict and are more properly brought in a motion for judgment notwithstanding the verdict. As such, the Court finds those arguments irrelevant in preparing this judgment.

11. The evidence shows that the total purchase price of the PGOL Land was $6,620,000.00. (Trial Exhibit 83.) At closing, PGOL paid $236,761.56 in cash and financed the remainder of the purchase price with

a loan in the amount of $6,465,000.00 from Paragon Commercial Bank ("Paragon"). (Trial Exhibit 83.) The jury found that $188,000 of the cash paid by PGOL at closing were funds converted by Jacobson from Lakebound. (*See also* Trial Exhibit 82.)

12. Plaintiffs argue, and the Court agrees, that the constructive trust should be imposed over a percentage interest in the PGOL Land in order to capture any profits arising from the use of the converted funds. "[UInder application of the rule of trust pursuit, the trust follows and embraces not only the property or its proceeds or products, but ordinarily it also includes any profit or increase in the value of such proceeds or products over the original trust property." *Edgecombe Bank & Trust Co. v. Barrett*, 238 N.C. 579, 586, 78 S.E.2d 730, 736 (1953).

13. Plaintiffs argue that Lakebound should hold a 79.4% interest in the PGOL Land because Lakebound's $188,000 accounted for 79.4% of the $236,761.56 in cash paid at closing. No North Carolina court appears to have addressed the treatment of a loan on property when the property is subject to a constructive trust. Plaintiffs rely on non-binding authority to argue that its interest in the PGOL Land should be "determined by reference to the amount invested (in other words, the cash portion of the purchase price), disregarding the amount of the mortgage loan." Restatement (Third) of Unjust Enrichment and Restitution § 55 cmt. n (2011).

14. The cases cited by Plaintiffs, however, do not support their position. In *Kim v. Parcel K-Tudor Hall Farm LLC*, a case relied upon by Plaintiffs, the Fourth Circuit analyzed a constructive trust in which the trial court set the plaintiff's proportional interest based on the property's total purchase price, including

a purchase money note. 499 F. App'x 313, 319 (4th Cir. 2012) (reversing trial court on other grounds). On remand and after a bench trial, the trial court again calculated the amount of the constructive trust as plaintiff's proportion of the total purchase price of the property, inclusive of debt. *Kim v. Parcel K-Tudor Hall Farm, LLC*, No. MAB 09-CV-1572, 2014 U.S. Dist. LEXIS 163740, at *10 (D. Md. Nov. 20, 2014).

15. Plaintiffs also cite *Belcher v. Birmingham Trust Nat. Bank*, 348 F. Supp. 61, 84 (N.D. Ala. 1968), but that case does not provide that a constructive trust on real property should be measured by the amount of cash paid at closing. Instead, *Belcher* states that a constructive trust "may be measured by the amount of [converted funds] so used in relation to the total purchase price, provided there is no doubt as to the proportion of funds actually invested" *Id.* In this case, the evidence clearly shows that the purchase price included the $6,465,000 loan from Paragon.

16. In one case cited by Plaintiffs, a California court did award a constructive trust based on the proportion of the down payment without regard to the purchase money deed of trust on the property. *See Martin v. Kehl*, 145 Cal. App. 3d 228, 243–44, 193 Cal. Rptr. 312, 321 (Cal. App. 2d Dist. 1983). In that case, however, the court ignored the amount of the purchase money deed of trust because the dispute involved the parties' agreement to purchase the property together. *Id.* In contrast, here an act of conversion gave rise to the constructive trust. While Plaintiffs are entitled to a constructive trust to remedy that act of conversion, the Court cannot read the evidence as giving rise to some sort of failed joint venture by which Plaintiffs should be deemed to be a party to the Paragon loan with PGOL.

17. In the absence of a North Carolina case directly on point, Plaintiffs argue that North Carolina law nevertheless directs the Court to ignore the Paragon loan when shaping the constructive trust because in cases involving the intermingling of property, "the trust will be declared upon the entire fund[,] and the loss, if any must fall on the perpetrators of the wrong." *Peoples' Nat'l Bank v. Waggoner*, 185 N.C. 297, 297, 117 S.E. 6, 8 (1923). *Waggoner* dealt with the problem of property intermingled to such a degree that the interests of the legal title holders are no longer distinguishable from those of the equitable owners. *Id.* The Supreme Court's holding there, however, still acknowledged that separate or identifiable interests should be respected. In such scenarios, "the whole mixed fund or property becomes subject to the trust *except so far as the trustee may be able to distinguish or separate his own*[.]" *Id*. (emphasis added). In this case, the sources of the funds used to purchase the PGOL Land are readily distinguishable, and *Waggoner* counsels that those separate interests cannot be ignored.

18. Therefore, the Court concludes that it is not compelled by any North Carolina law nor persuaded by any other authority that equity demands the constructive trust be calculated as a percentage of the cash paid at closing by PGOL as urged by Plaintiffs. *See Kim*, 2014 U.S. Dist. LEXIS 163740, at *10 (calculating the constructive trust as the plaintiff's proportion of the total purchase price for a parcel of land); *Belcher*, 348 F. Supp. at 84 (holding that the constructive trust may be calculated by reference to the total purchase price of the property).

19. Instead, the Court concludes, after careful review of the evidence introduced at trial and in the exercise

of the Court's discretion, that equity will be served by calculating the constructive trust as a proportion of the total purchase price of the PGOL Land, inclusive of the Paragon loan. As stated above, the Court has not found any law compelling the Court to ignore the mortgage portion of the purchase price on the PGOL Land. Furthermore, Plaintiffs have not offered evidence—apart from the high value of the loan relative to the down payment, which the Court does not consider as determinative in and of itself—that PGOL acted wrongfully in obtaining the loan such that equity demands that the Court ignore the existence of that debt.

20. Plaintiffs argue that the subsequent settlement of the Paragon loan at a severe discount and the Bankruptcy Court's recharacterization of some of PGOL's debt as equity—*see In re Province Grande Olde Liberty, LLC*, 13-00122-8-RDD, 2014 Bankr. LEXIS 4922, at *22 (Bankr. E.D.N.C. Dec. 5, 2014), *aff'd*, No. 15-1669, 2016 U.S. App. LEXIS 14860 (4th Cir. Aug. 12, 2016)—reveals that the Paragon loan was a sweetheart deal for which PGOL will receive an undeserved windfall upon sale of the PGOL Land. The subsequent treatment of the Paragon loan, however, does not alter the Court's view of the equities at the moment the conversion occurred and the constructive trust arose. Apart from PGOL's use of the converted funds in purchasing the PGOL Land, the Court does not find sufficient evidence that the existence of the Paragon loan was inequitable to Lakebound. Furthermore, to the extent PGOL's subsequent debt negotiations eliminated most of the Paragon loan, that conduct indirectly benefitted Lakebound by preserving PGOL's ownership of the PGOL Land. Had Paragon foreclosed on the property, Lakebound likely would not have had

a constructive trust remedy available to it on the PGOL Land.

21. The Court therefore concludes that the constructive trust in the PGOL Land should be calculated as the percentage of the converted funds to the total purchase price, inclusive of debt. Based on the $6,620,000.00 purchase price, Lakebound's converted $188,000 comprises 2.83% of the total funds used to purchase the PGOL Land.

22. Finally, a primary purpose of North Carolina's election of remedies doctrine is "to prevent double redress for a single wrong." *Smith v. Oil Corp.*, 239 N.C. 360, 368, 79 S.E.2d 880, 885 (1954). To determine whether recovery is duplicitous, the Court should consider whether recoveries serve the same interests and are based on the same conduct. *United Labs, Inc. v. Kuykendall*, 335 N.C. 183, 193, 437 S.E.2d 374, 380 (1993). The evidence indicates that, although the conversion claim and the constructive trust remedy required different proof, Lakebound has suffered a single loss of $188,000 and can be made whole whether it recovers from Jacobson or PGOL. Therefore, the Court concludes that recovery of monetary damages for the conversion claim from Jacobson and under the constructive trust remedy from PGOL would constitute an impermissible double recovery. Thus, the Court concludes, in the exercise of its discretion, that Plaintiffs must elect between the money judgment against Jacobson and the constructive trust remedy against PGOL as Plaintiffs' sole remedy on behalf of Lakebound in this action.

23. WHEREFORE, the Court enters JUDGMENT as follows:

a. Plaintiffs, on behalf of Lakebound, shall have and recover from Jacobson the sum of $188,000.00, plus interest at the legal rate, from December 31, 2009 until paid.

b. PGOL holds a 2.83% interest in the PGOL Land it purchased on December 31, 2009 in a constructive trust for the benefit of Lakebound. Lakebound's beneficial interest in the PGOL Land is superior to PGOL's interest, and PGOL as trustee shall promptly execute a deed transferring the 2.83% interest in fee simple to Lakebound.

c. Plaintiffs, on behalf of Lakebound, shall only recover once for Lakebound's loss. Plaintiffs, on behalf of Lakebound, may recover either damages under the money judgment against Jacobson set forth in subparagraph (a) above or the constructive trust against PGOL set forth in subparagraph (b) above, but any recovery shall be non-cumulative, as Plaintiffs are not entitled to recover for Lakebound from both Jacobson and PGOL.

d. The Court defers consideration of (i) Plaintiffs' Motion for Attorney's Fees and Expenses and (ii) Plaintiffs' Motion to Appoint a Receiver for Lakebound Fixed Return Fund, LLC until the consideration of post-judgment motions, if any.

SO ORDERED, this the 5th day of December, 2016.

/s/ Louis A. Bledsoe, III
Louis A. Bledsoe, III
Special Superior Court Judge
for Complex Business Cases