February 2015

California Bar Examination

Performance Test A
INSTRUCTIONS AND FILE

IN RE VIRTA AND BURNSEN

IN RE VIRTA AND BURNSEN

INSTRUCTIONS

1. This performance test is designed to evaluate your ability to handle a select number of legal authorities in the context of a factual problem involving a client.
2. The problem is set in the fictional State of Columbia, one of the United States.
3. You will have two sets of materials with which to work: a File and a Library.
4. The File contains factual materials about your case. The first document is a memorandum containing the instructions for the tasks you are to complete.
5. The Library contains the legal authorities needed to complete the tasks. The case reports may be real, modified, or written solely for the purpose of this performance test. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read each thoroughly, as if it were new to you. You should assume that cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page citations.
6. You should concentrate on the materials provided, but you should also bring to bear on the problem your general knowledge of the law. What you have learned in law school and elsewhere provides the general background for analyzing the problem; the File and Library provide the specific materials with which you must work.
7. Although there are no restrictions on how you apportion your time, you should probably allocate at least 90 minutes to reading and organizing before you begin preparing your response.
8. Your response will be graded on its compliance with instructions and on its content, thoroughness, and organization.

CLARK, MACHADO & SAMUELIAN

Attorneys at Law

MEMORANDUM

TO: Applicant

FROM: Dario Machado, Managing Partner

SUBJECT: Richard Burnsen and B-G Investors

DATE: February 24, 2015

I met with Chris Conner on short notice. Conner is a junior partner in our firm, specializing in transactional law. He is in the middle of closing a stock purchase deal for our clients, Richard Burnsen and Burnsen-Goldman Investors ("B-G"), and must decide immediately whether to close the deal and transfer the stock certificates. The seller is trying to revoke, and his counsel insists that Conner has become the escrow holder of the transaction. His counsel also says that if Conner does not return the stock certificates, they would sue Conner and our firm.

We have two interrelated problems: Are there any ethical or fiduciary issues raised by Conner's actions, and what does Conner do now? Please draft an objective memorandum analyzing these two problems, organized in two parts, specifically addressing the issues listed below.

Part I - Ethical / Fiduciary Issues.

A. Did Conner become an escrow holder for all the parties?

B. If Conner acted as an escrow holder, was it proper for him to be an attorney for one party and an escrow holder for all parties?

C. If Conner acted in this dual capacity, does it restrict his ability both to advise his clients and to follow their instructions?

D. If Conner is an escrow holder, what are his duties to the opposing party?

Part II - <u>Options</u>.

Listed below are the options that I want to consider at this moment. Analyze the consequences and legal exposure of Conner and the firm resulting from each option. Finally, recommend which option best serves our firm's interests.

1. Complete the purchase and forward stock certificates for transfer.
2. File an interpleader action against our clients and the seller.
3. Do nothing immediately and retain possession of the stock certificates, until seller sues or parties work out a settlement.

At this point consider only the potential liability of Conner and our firm. Someone else in the firm will focus on our clients' risks.

TRANSCRIPT

Dario Machado Meeting with Christopher Conner

February 24, 2015

MACHADO: Okay, Chris, let me turn on the tape recorder. From what you've already told me it's obvious that one of our associates is going to have to look into this matter immediately and will need to know what's happened.

CONNER: Let me give you the deal in a nutshell. As I told you, our firm represents Richard Burnsen, founder, CEO, and majority shareowner of BTI. That's Burnsen Technologies, Inc. BTI develops and markets bio-compact discs for clinical diagnostics. It began as a small company operated out of Burnsen's house, but grew much larger, now has 60 employees, and occupies a large suite in New Bennett, Columbia.

Jordan Virta helped start BTI and had been the chief scientist and a vice president. At the start of the year, Virta and Burnsen had a falling out, and Virta resigned. At the time Virta held 2,000,000 shares of BTI stock that he had received in exchange for the assignment of all of his patents and inventions. But, even though he quit, Virta was still subject to a consulting agreement that gave BTI the rights to his future inventions for 2 years after he left BTI. Virta needed cash and to get back to work. Virta began discussing a sale of his stock to Burnsen.

MACHADO: So what was the deal?

CONNER: At the beginning of this year, Burnsen proposed to buy 2,000,000 of Virta's shares for $1.50 per share. Virta would receive $500,000 on signing the stock purchase agreement, and Burnsen would execute a promissory note payable to Virta over the next 2 years, secured by the shares. Burnsen thought it was a good deal, since last year, some other investors had paid as much as $5.00 per share of BTI stock.

MACHADO: Why the low price?

CONNER: Because Burnsen offered, as part of the transaction, to cancel the consulting agreement that was hindering Virta's ability to work elsewhere. The deal was delayed because Burnsen couldn't come up with the down payment. But then Burnsen brought in another investor, Gerald Goldman, to help buy the Virta stock. We formed a company called Burnsen-Goldman Investors -- B-G, for short. Then on behalf of B-G, I negotiated a stock purchase agreement and a promissory note with Virta's attorney, Steven Dunn.

MACHADO: Did the stock purchase agreement include canceling the old consulting agreement that had granted BTI control of Virta's future inventions?

CONNER: Oh, yeah. That was a critical part, along with the terms of transfer of the shares themselves. Virta insisted on payment first.

MACHADO: What were those terms?

CONNER: That the deal would only close after the purchase agreement and promissory note were signed and after Virta acknowledged receipt of the down payment of $500,000. After the deal closed, then Virta's signed share certificates would go to BTI's transfer agent to be reissued in B-G's name. The shares would then go into an escrow account at Columbia State Bank and Trust Company, as security for the note, and thereafter be distributed by the Trust Company to B-G only as it paid for the shares according to the payment schedule.

MACHADO: Is this in writing?

CONNER: The escrow at the trust company? Yeah, Columbia State Bank and Trust Company's instructions were that it would hold all the shares, and release them to B-G as they made the down payment and the 5 payments of $500,000 provided under the note.

MACHADO: Who has the share certificates now?

CONNER: I do.

MACHADO: How did that come about?

CONNER: A few days ago, on February 16th, Dunn and I finished drafting the documents, but it turned out that Dunn was leaving for a couple of weeks on vacation and wouldn't be available for an office closing. Instead, we agreed to do

it by mail. Exchange the signed documents, make the down payment, and then transfer shares to escrow.

MACHADO: Was this an oral agreement between you and Dunn or in writing?

CONNER: Both. We said that I'd hold the documents until everyone signed and Virta had confirmed he had the down payment. I think that's what our letters say too.

MACHADO: Let me get this straight. You were to hold the share certificates until the deal closes?

CONNER: Right.

MACHADO: Did Dunn do his part, get Virta to sign the stock purchase agreement and stock certificates?

CONNER: Yeah. I got all that on February 17th, hand-delivered, along with Dunn's letter. That's when the trouble started. I gave the agreement and promissory note to Burnsen for him and Goldman to sign. At first, I didn't hear anything, but on the 18th and 19th of February I start getting calls from Virta asking why the deposit hadn't been made into his account, and demanding that the deal close on February 18th as agreed. I started leaving messages for Burnsen to call me. On February 20th Burnsen called me and said that he and Goldman wanted me to move the closing back to February 23rd, and that they wanted to move back the payment schedule on the promissory note. Since Dunn was unavailable, Burnsen and Goldman were dealing directly with Virta.

MACHADO: What happened?

CONNER: Both Burnsen and Goldman talked to Virta, quite a few times, in the next couple of days. Virta was adamant that he wanted the down payment and for the deal to close immediately. Even though they had missed the original closing date, Virta was still expecting the deal to close; at least that's what they told me.

MACHADO: Did Virta agree to revise the payment schedule?

CONNER: Burnsen and Goldman weren't clear on that. Sometimes they'd report that he agreed or, at least, he didn't disagree to change the payment

schedule. They did say he objected that the new schedule would put 4 rather than 3 payments in a single year, and make the tax bite too much.

MACHADO: So, the payment terms were critical to Virta?

CONNER: That's what he said to them. I think he has always doubted Burnsen's and Goldman's ability to come up with the down payment and make the payments. Frankly, it was a fair concern. Burnsen and Goldman were betting that BTI's growth would spin off enough for them to pay off Virta.

MACHADO: What did you think?

CONNER: You know, I really don't know. We don't ask clients for financial statements. Burnsen totally believed in his company. And Goldman? For all I know, he refinanced his house to come up with the down payment for Virta.

MACHADO: Very well. With what they told you, what did you do?

CONNER: I told them that I'd write up an amended promissory note and that they should come in and sign it, as well as the stock purchase agreement that they still hadn't signed. But, before they did, Burnsen called me at home, on the night of February 22nd, and read me a notice of revocation of the offer that Virta had faxed him that evening. We scheduled a conference call including Goldman for 10:00 p.m. that night.

MACHADO: What happened on the conference call?

CONNER: Goldman and Burnsen wanted to go ahead with the purchase, at least on their terms. Goldman agreed to deposit the $500,000, if it could close the deal on their terms.

MACHADO: What did you advise?

CONNER: That we probably did not have a defensible basis to go ahead and close. I told them that I'd make the best arguments I could, but that they shouldn't expect a miracle.

MACHADO: Were there colorable arguments?

CONNER: Some. The closing date was never ironclad. Even Virta demanded we close after the date had passed. We had an argument that the payment schedule had been amended orally. Also, the agreement didn't have a time-is-

of-the-essence clause, and we could argue that the new payment schedule wasn't a substantive change.

MACHADO: So, you didn't think it should be a deal breaker?

CONNER: Perhaps not. Burnsen and Goldman believed that if we put the $500,000 down payment in Virta's hands, he'd see that they were going ahead, and he could be persuaded to accept the amended payment schedule. And if we closed, then the onus would be on Virta to challenge the executed deal. A little pressure like that might do it. Besides, by that point, Burnsen and Goldman had decided that the original payment schedule was unrealistic, and they couldn't have met it.

MACHADO: Did you think pushing the revised deal was a risk?

CONNER: No, just the usual give-and-take that goes on to finish the last details of a deal. Nothing more than aggressive representation of a client, I'd call it. An unrealistic payment schedule wasn't in Virta's interest either.

MACHADO: Well, okay. Is that what was agreed on the conference call?

CONNER: Yeah. Next morning, Goldman deposited the $500,000 into Virta's account. Here's the deposit slip he brought us, February 23rd at 9:52 a.m., and we faxed it to Virta and Dunn immediately. Do you want the deposit slip?

MACHADO: No, just keep it in the file. What happened next?

CONNER: I drafted a new promissory note, with the payment schedule Burnsen and Goldman wanted. They came in and signed the stock purchase agreement that Virta had already signed and I'd been holding, and they also signed the new promissory note.

MACHADO: The new payment schedule was not set forth in the stock purchase agreement?

CONNER: No. The payment schedule was only in the promissory note, and the stock purchase agreement provided that payments were to be made as provided in the promissory note. So we could use and sign the agreement that Virta had already signed. Then, that same afternoon, yesterday, I delivered a letter to Virta and Dunn confirming that the deal was ready to close and I was going to transmit the documents.

MACHADO: Why to Virta?

CONNER: Everybody had agreed that all parties should be copied on documents where appropriate. But this morning I received a call from another lawyer in Dunn's firm, a Russell Taylor, threatening to sue me if I transfer the shares.

MACHADO: Have you sent the shares for transfer?

CONNER: No, I haven't. I still have the share certificates, right here in the file.

MACHADO: Did you tell that to Taylor?

CONNER: Yes, but I certainly led him to believe that I was going ahead to close, you know, as my clients wanted, to pressure and to shift the burden to Virta.

MACHADO: Would it now be a problem if you had to back off, should we decide it's necessary?

CONNER: Probably embarrassing, but overall, not that bad.

MACHADO: Okay. What did you say to him?

CONNER: First, to chill, relax. Transferring the stock certificates wasn't a big deal, nor an irrevocable step. I reminded him that Virta had a specific remedy under the Commercial Code. Section 8403 permits suits to stop the transfer agent from registering the change of ownership. I urged him, instead of that, though, to work positively and finish the deal. The original deal was still on the table. Virta had a half a million dollars in his hands. A little more taxes next year isn't anything compared to that and absolutely trivial compared to Virta's ability to get back to work. I even suggested that they should calculate the additional tax burden of the amended payment schedule and make a counteroffer, adding it to the selling price. It couldn't be more than a few pennies per share.

MACHADO: Did it persuade him?

CONNER: No. Taylor said that I'm responsible as the escrow agent, and that the deal had been revoked. The shares must be returned or they would hold us responsible for the full, present value of the shares.

MACHADO: Sounds like he's claiming that would make the firm liable for money that our clients may not have?

CONNER: Exactly. That's what made me stop and realize I needed to discuss our options with a senior member of the firm.

MACHADO: What about returning the certificates?

CONNER: That's the bind. My clients don't want me to return the shares. They were explicit on that. They want to complete the purchase and believe that transferring the shares to BTI for reissuance in their name helps them. My duty to my clients comes first, even if Taylor claims I'm an escrow agent.

MACHADO: Was that claim a surprise?

CONNER: Yeah. I don't see how they can claim that I became their escrow agent. I didn't volunteer to be their agent. I didn't do anything unusual for a transactional attorney. We do that all the time, hold the documents until everyone signs and the money is deposited, then distribute as everyone agreed. It's like an escrow, I guess, but it doesn't trump my duty of loyalty to my client. They seem to be saying that it's improper to be both a lawyer for a party and act as the escrow, if that's what I was. If so, the option of having to withdraw as counsel would be hard to accept.

MACHADO: If you're deemed to be an escrow agent, another option would be that you could interplead both sides of the dispute and deposit the share certificates in court, right?

CONNER: Sue my own clients? It is not in my clients' best interests for me to sue them and force them to hire another lawyer to defend themselves against me. How can that be consistent with my duty of loyalty to my clients?

MACHADO: Granted, that seems antithetical to everything we believe and do as lawyers.

CONNER: Seems to me that I don't have a choice but to follow my clients' instructions, and send the certificates to the BTI transfer agent. True, the transfer agent will change ownership to B-G, but really B-G only gets the shares they've paid for with the $500,000 down payment, and the remainder goes to the Trust Company and is held and released only as B-G makes future payments. Virta's not harmed by the closing and the transfer. Besides, as I told Taylor, Section 8403 is the functional equivalent of an interpleader. The results of a suit

under Section 8403 and an interpleader are the same. The stock remains in Virta's name and under the control of a judge pending resolution of the dispute. Either way, Virta doesn't get and can't sell the stock until it's decided. The only difference is that Virta files the lawsuit instead of us.

MACHADO: Perhaps. I think the question is, which is the right course of action? Leave me the key documents and we'll get together shortly.

CONNER: Thanks. See you soon.

CLARK, MACHADO & SAMUELIAN

Attorneys at Law

Parkside, Columbia

February 16, 2015

HAND-DELIVERED

Steven J. Dunn
Dunn and Jaime
12 Main Street, Suite 100
Riverton, Columbia

Dear Steve:

Enclosed are the stock purchase agreement and promissory note that we have finished drafting. Since you will be on vacation after tomorrow, I propose that we have the documents executed by our respective clients, and close by mail. The following steps should permit us to close on February 18, 2015.

First, all parties will execute the documents and return all signed copies to me so that I have them on Wednesday, February 18, 2015. I shall then distribute those copies to the appropriate parties on that day. Steve, if you send me the stock certificates representing all of the pledged shares, with stock powers duly executed by Dr. Virta, I undertake to hold them until I have the agreement, together with the promissory note, executed by B-G Investors, at which time I shall send the promissory note to you and the share certificates to BTI for transfer and reissuance in B-G's name and delivery to Columbia State Bank and Trust Company.

I envy your Florida vacation during our annual monsoon season.

Sincerely,

/s/ Chris Conner
Christopher C. Conner

cc: Richard Burnsen
Gerald Goldman
Dr. Jordan Virta

DUNN and JAIME

Attorneys at Law

Riverton, Columbia

February 17, 2015

Christopher C. Conner
Clark, Machado & Samuelian
605 First Street, Suite 810
Parkside, Columbia

Dear Chris:

This will confirm that we have completed the documents to close the sale to B-G Investors of 2 million of Dr. Jordan Virta's shares on February 18, 2015. I have enclosed the following documents, all duly executed and signed by Dr. Virta:

1. A stock purchase agreement.
2. A promissory note.
3. The original stock certificates with executed stock assignments for 2,000,000 shares in Burnsen Technologies, Inc. (BTI).

These documents are all delivered to you to be held by you until both of the following conditions are satisfied:

(a) You have signed copies of all of the above-referenced documents and are authorized to deliver to me the originals of all such documents; and

(b) Dr. Virta has confirmed that the $500,000 has been deposited into his bank account.

Upon satisfaction of these conditions, the sale shall close, and only on satisfaction of these conditions are you authorized to send the share certificates to BTI for reissuance in B-G's name. Either you or BTI then is authorized to transfer the shares to Columbia State Bank and Trust Company, pursuant to the formal escrow instructions on file with the Trust Company.

Sincerely,

/s/ Steven J. Dunn
Steven J. Dunn

cc: Dr. Jordan Virta
Richard Burnsen and Gerald Goldman

FAX

Dr. Jordan Virta

TO: Richard Burnsen and Gerald Goldman, B-G Investors
SUBJECT: Revocation of Offer to Sell Stock
DATE: February 22, 2015

Dear Richard and Gerald:

I am out of patience. You are out of time.

We had agreed that this transaction would close on February 18, 2015. On that date you and your counsel had all of the documents, and all of the documents had been signed by me and approved by your counsel.

I have been calling my bank several times a day to learn if the down payment has been deposited as promised. It is now 4 days later, and no deposit. I don't know if you ever signed the agreement or the promissory note. I have never received signed copies of the documents.

Instead, each of you has been asking for an extension of the date of closing to February 23, 2015, and for a new, unacceptable payment schedule.

Each of these is a material breach of the agreement, if you ever signed it.

Effective this moment, I do hereby withdraw my offer to sell my shares in BTI.

I hereby demand that you and all agents and counsel acting on your behalf immediately return to me my stock certificates and all documents delivered by me.

Very truly yours,

/s/ Jordan Virta
Jordan Virta, Ph.D.

cc: Steven J. Dunn
Christopher C. Conner

CLARK, MACHADO & SAMUELIAN

Attorneys at Law

Parkside, Columbia

February 23, 2015

HAND-DELIVERED

Steven J. Dunn
Dunn and Jaime
12 Main Street, Suite 100
Riverton, Columbia

Dear Steven:

It is my understanding that, in separate conversations with Messrs. Burnsen and Goldman, Dr. Virta has urged that the transaction close immediately and agreed to accept these deliveries today.

It is my further understanding that the two conditions to close and release the stock certificates set forth in your letter of February 17, 2015 have been fully satisfied, to wit: (a) I have copies of the Stock Purchase Agreement, signed by all the parties, and of the Promissory Note, dated February 23, 2015, signed by Messrs. Burnsen and Goldman, the parties to be bound; and (b) I have a deposit slip confirming that $500,000 has been deposited into Dr. Virta's bank account.

Thus, we have completed the sale of Dr. Virta's shares in Burnsen Technologies, Inc. (BTI), and the transaction is now ready to close. Accordingly, I will send Dr. Virta's stock certificates that we received from you to BTI's transfer agent for transfer of ownership of the shares on BTI's books to B-G Investors, issuance of the appropriate renamed share certificates and transfer to Columbia State Bank and Trust Company.

Please find enclosed your copy of the fully executed Stock Purchase Agreement and the amended Promissory Note, signed by Messrs. Burnsen and Goldman.

Sincerely,

/s/ Chris Conner
Christopher C. Conner

cc: Jordan Virta, with all copies, and also hand-delivered this date

DUNN and JAIME

Attorneys at Law

Riverton, Columbia

February 24, 2015

VIA FAX

Christopher C. Conner
Clark, Machado & Samuelian
605 First Street, Suite 810
Parkside, Columbia

Dear Mr. Conner:

On behalf of our client, Dr. Jordan Virta, I hereby demand that you stop all efforts purporting to close the transaction for the disposition of Dr. Virta's shares in BTI.

There never was a signed agreement. Your clients never accepted the agreement that Dr. Virta signed; it did not close on February 18, 2015, as had been agreed, and your clients never performed the conditions. It never took effect.

Any action on your part to divest Dr. Virta of his stock is a conversion and a breach of your fiduciary duty as the escrow agent of the parties. The only course of action that will avoid liability is to return Dr. Virta's share certificates immediately.

We are astonished that any attempt would be made to exercise dominion and control over Dr. Virta's stock certificates in light of his revocation of the stock purchase offer and cancellation of the transaction. Please take notice that, if you do not immediately return Mr. Virta's stock certificates and related documents,

you and your law firm will face significant personal liability for the tort of conversion, having exercised dominion and control over the stock certificates.

Today Dr. Virta received notice from his bank that $500,000 was deposited in his account on February 23, 2015. As soon as he is notified that the funds are at his disposal, Dr. Virta will return the entire $500,000 by immediate wire transfer to Messrs. Burnsen and Goldman.

Sincerely,

/s/ J. Russell Taylor
J. Russell Taylor

February 2015

California Bar Examination

Performance Test A
LIBRARY

IN RE VIRTA AND BURNSEN

LIBRARY

SELECTED PROVISIONS OF COLUMBIA CODE OF CIVIL PROCEDURE, COLUMBIA COMMERCIAL CODE, AND COLUMBIA PROFESSIONAL CODE

Columbia Code of Civil Procedure

Section 386. Interpleader

Any person, firm, corporation, association or other entity against whom double or multiple claims are made, or may be made, by two or more persons which are such that they may give rise to double or multiple liability, may bring an action against the claimants to compel them to interplead and litigate their several claims. When the person, firm, corporation, association or other entity against whom such claims are made, or may be made, is a defendant in an action brought upon one or more of such claims, it may file a cross-complaint in interpleader.

Columbia Commercial Code

Section 8403.

(a) A person who is a registered owner of corporate shares may serve a written demand that the issuer of corporate shares not register an improper or unauthorized transfer of the shares.

(b) The issuer of the corporate shares may withhold registration of the transfer for a period of time, not to exceed 30 days, in order to provide the person who initiated the demand an opportunity to obtain legal process.

(c) A person who is the registered owner of corporate shares may seek an appropriate order, injunction, or other process from a court of competent jurisdiction enjoining the issuer of the corporate shares from registering an improper or unauthorized transfer of the shares.

Columbia Professional Code

Section 17002.

(a) It shall be unlawful for any person to engage in business as an escrow agent within this state except by means of a corporation duly organized for that purpose and licensed by the Commissioner of Corporations as an escrow agent.

(b) It shall not be unlawful for any person to engage in the business of an escrow agent, without authorization or license by the Commissioner of Corporations, if the person is:

(1) Doing business under any law of this state or the United States relating to banks, trust companies, building and loan or savings and loan associations, or insurance companies.

(2) Licensed to practice law in Columbia who has a bona fide client relationship with a principal in a real estate or personal property transaction and who is not actively engaged in the business of an escrow agent.

(3) Licensed by the Real Estate Commissioner while performing acts in the course of or incidental to a real estate transaction in which the broker is an agent or a party to the transaction and in which the broker is performing an act for which a real estate license is required.

Section 17003.

"Escrow" means any transaction in which one person, for the purpose of effecting the sale, transfer, encumbering, or leasing of real or personal property to another person, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by that third person until the happening of a specified event or the performance of a prescribed condition, when it is then to be delivered by that third person to a grantee, grantor, promisee, promisor, obligee, obligor, bailee, bailor, or any agent or employee of any of the latter.

WASMAN v. SEIDEN

Columbia Court of Appeal (1998)

Does an attorney have a duty to safeguard property entrusted to him during settlement negotiations by an adverse party? Yes.

Plaintiff Kenneth Wasman sued his ex-wife and others for torts allegedly arising out of a marital dissolution gone awry. One of the named defendants was an attorney who arranged the property settlement on behalf of the wife. As to the causes of action against this attorney, the trial court sustained a general demurrer without leave to amend. Wasman appeals from the ensuing judgment of dismissal. We reverse.

Wasman alleged, and we assume for purposes of review, the following facts. Kenneth and Barbara Wasman married in 1992, and separated in 1995. In 1996, Barbara hired attorney Charles Schwenck to dissolve the marriage. The parties agreed to bifurcate the proceedings, with an immediate dissolution of the marriage contingent on acceptance of a proposed division of marital property, to be "formalized" later. The terms of the property division included Kenneth's conveyance to Barbara of his community interest in a Newport Beach residence in exchange for $70,000 in cash or a promissory note in that amount secured by a grant deed on the property.

In October 1996, Barbara, now married to Schwenck, retained new counsel, Peter Seiden, to complete the marital property settlement. After counsel conferred many times by phone, Kenneth's attorney Jeffrey Hartman sent a letter to Seiden enclosing a final draft of the settlement agreement and a grant deed conveying the Newport Beach property to Barbara. Kenneth had executed both documents. The letter stated that Seiden was "authorized to record the deed only upon obtaining" for Kenneth the $70,000 in cash or the promissory note.

Hartman received no response to his letter. Over the next few months he telephoned Seiden several times to ask the status of the settlement agreement. Hartman subsequently learned that Barbara, without handing over the cash or promissory note, had obtained the grant deed from Seiden and recorded it.

Kenneth Wasman sued Peter Seiden for legal malpractice. Seiden's general demurrer to the complaint was sustained.

The central issue in this appeal is whether Seiden had a legal duty to safeguard the executed grant deed until Barbara satisfied the condition of its delivery. Wasman argues Seiden owed him a professional duty to guard the deed until the stated condition for recordation was met; he contends breach of that duty was legal malpractice. But the law of professional negligence does not supply the foundation necessary for the duty Wasman asserts here.

We have rejected the theory that attorneys owe a duty of care to adverse third parties in litigation. Only in the limited circumstances when third parties are the intended beneficiaries of an attorney's services are they entitled to bring actions for professional negligence. Wasman's attempt to bring himself within this exception by arguing he was an intended beneficiary of the marital settlement is patently absurd: The agreement resulted from arm's-length negotiations between counsel acting to protect their respective clients' interests.

Although Seiden owed Wasman no professional duty, his acceptance of Wasman's deed would give rise to a duty of care. The wellspring of this duty is the fiduciary role of an escrow holder. An escrow is created when, for the purpose of facilitating a transaction, property is delivered to an escrow holder to be held until the conditions specified in agreed-upon instructions are fulfilled, when the property is to be delivered to another according to the instructions. See Professional Code, Section 17003.

The threshold issue in this appeal, then, is whether the complaint sufficiently alleges the elements of an escrow.

Wasman variously alleges in the complaint that Seiden "undertook to exercise reasonable care to protect Plaintiff's Deed" and "voluntarily accepted the trust and confidence reposed in him with regard to Plaintiff's Grant Deed." Significantly, there is no allegation of an express undertaking by Seiden or of agreed-upon instructions; rather, Wasman infers acceptance of the entrustment from the attorney's failure to reject or otherwise respond to the deed's delivery.

We find this a permissible inference. According to allegations in the complaint, the parties had successfully concluded settlement discussions. The final agreement

had been reduced to writing and executed by Wasman; the document lacked only Barbara's signature. The remaining acts required by the agreement were Wasman's conveying his interest in the Newport Beach property to Barbara, and her transferring to him a note or cash in the amount of $70,000. Given this state of affairs, Wasman's delivery of the grant deed to Seiden along with the executed settlement agreement can only be seen as a good faith attempt to facilitate settlement. The act appears foolish only when viewed against a backdrop of unethical and unprofessional practices by some attorneys.

Wasman and his attorney Hartman reasonably relied on Seiden because of his professional status and role as attorney for Barbara. If Seiden did not want to be responsible for the deed, he should have promptly returned it to Wasman. We hold a trier of fact could find any failure to do so was an acceptance of Wasman's entrustment and of its conditions. Thus, the allegations of acceptance are legally sufficient.

Having accepted the deed from Wasman, Seiden was bound to comply strictly with the escrow instructions. Specifically, he was obligated to prevent recordation of the deed until Barbara deposited into escrow the sum due to Wasman. Violation of an escrow instruction gives rise to an action for breach of contract; similarly, negligent performance by an escrow holder creates liability in tort for breach of duty.

Wasman forgoes the contract claim and alleges negligence in Seiden's handling of the deed. These allegations of negligence, however, are not the stuff of which legal malpractice claims are made. An attorney's failure to prevent a client's unauthorized seizure and recordation of a document held in escrow is not lawyering. But Wasman's erroneous labeling of his cause of action as one for professional negligence is of no consequence. To withstand a general demurrer, a complaint need only state some cause of action from which liability results.

Seiden’s liability is not founded upon professional negligence, but under the duty as a bailee to keep the property and not dispose of it without the authority of the depositor. Although not expressly pleaded, we believe the facts alleged are sufficient to state a cause of action for conversion. Conversion is the wrongful exercise of dominion over the property of another. The general rule is that the foundation for the action of conversion rests neither in the knowledge nor the intent of the defendant. It rests upon the unwarranted interference by defendant with the dominion over the property of the

plaintiff from which injury to the latter results. Therefore, good or bad faith, care or negligence, and knowledge or ignorance, are ordinarily immaterial.

The elements of a conversion claim are: (1) the plaintiff's ownership or right to possession of the property; (2) the defendant's conversion by a wrongful act or disposition of property rights; and (3) damages. As a general rule, the normal measure of damages for conversion is the value of the property at the time of the conversion and a fair compensation for the time and money properly expended in pursuit of the property (Civil Code, Section 3336).

The misdelivery of entrusted property of another constitutes a conversion of it even though he acted innocently and by mistake.

Seiden argues that saddling lawyers with the obligations of escrow holders will expose them to third party tort liability simply for helping clients conclude transactions and litigation. We do not intend to discourage attorneys from facilitating transactions or settlements. Indeed, it is both useful and commonplace to entrust attorneys with closing documents, settlement agreements, releases, funds and other items. However, we caution that an attorney cannot convert the escrowed property to his or her client's own use.

The court erred in sustaining the general demurrer to this cause of action.

The judgment is reversed.

DIAZ V. UNITED COLUMBIA BANK

Columbia Court of Appeal (1977)

Plaintiff and appellant Edelso Diaz executed a written agreement for the sale of his assets in the La Lechonera Restaurant to Antonio Gil. Diaz was a recent immigrant and could not read or write English and was ignorant of legal formalities. The agreement was prepared by a notary public and provided that the total purchase price was $19,000, payable by a promissory note payable by installments of $300. In furtherance of the sale, an escrow was opened by Antonio Gil at the United Columbia Bank ("Bank"). The escrow was processed on printed forms of the Bank signed by Edelso Diaz and by Antonio Gil. The original escrow instructions provided for a "note for $7,000 executed by Antonio Gil, in favor of Edelso Diaz, principal payable $200 or more per month and continuing until paid." Later, the escrow was supplemented by an additional instruction, also on a Bank form, as follows: "You are hereby instructed to reduce the principal amount of the note for $7,000 being delivered through escrow by an amount of $2,000, representing costs of repairs paid by Antonio Gil, by endorsement on back of note, payable in installments of $200 on the first day of each month."

Prior to close of escrow, the Bank received a letter from an attorney, Jorge Fernandez Isla, representing the seller, Edelso Diaz. The letter stated that:

> NOTICE is hereby given that the amount indicated in above-referred escrow of seven thousand dollars ($7,000) is in error. The escrow instructions should have read "Note for $19,000" and not $7,000.

The letter enclosed the original sale agreement showing the actual selling price of $19,000.

Thereafter, disregarding the attorney's letter, the Bank deducted $2,000 from the $7,000, and prepared the note for $5,000. Gil signed the note, and the Bank closed the escrow.

Plaintiff Edelso Diaz seeks compensatory and punitive damages from defendants Gil and Bank. A demurrer was sustained without leave to amend as to the causes of action directed against the Bank.

The gravamen of the action against the defendant Bank lies in the claim that the escrow was improperly closed after the Bank received the attorney's letter notifying it of a claim of error with respect to the consideration for the sale as recited in the escrow instructions.

It is elemental that the fiduciary duty of an escrow holder is to comply strictly with the instructions of its principals and to exercise reasonable skill and ordinary diligence with respect to the employment. If the escrow holder fails to follow his instructions, he may be liable for any loss occasioned thereby.

It is, however, also elemental that, where the written escrow instructions amount to an agreement made by two principals with their joint agent and signed by both, neither can unilaterally change the instructions.

We therefore agree with defendant Bank that the escrow holder had no duty, contractual or otherwise, in the instant case to defer to plaintiff’s unilateral notice as to the sale price and modify the escrow instructions in accordance therewith.

The question, however, remains as to the effect, if any, to be accorded the attorney's letter. While ineffective as a unilateral attempt to modify the instructions, it clearly placed the escrow holder on notice of a possible error in the instructions with respect to a material matter involving the escrow itself. The agreement of sale provided for a price of $19,000. The letter from attorney Isla not only advises of the total sale price as reflected in the agreement of sale, but specifically points out that the note should be for that amount ($19,000) rather than for $7,000. The failure of defendant Bank to heed the notice of a possible error in the escrow instructions and to close in the face thereof might be found to be a failure to exercise reasonable skill and ordinary diligence in the conduct of the escrow, and thus support recovery on a tort theory.

When faced with competing demands, an escrow holder must either hold the property or interplead it. The Bank neither held the property that was the subject of the sale nor interpleaded it. Its remarkable choice was to close escrow.

Section 386 of the Code of Civil Procedure permits a party against whom multiple claims are made to bring an interpleader action compelling the claimants to litigate their opposing claims. In an interpleader action, the court initially determines the right of the plaintiff to interplead the funds; if that right is sustained, an interlocutory decree is entered which requires the defendants to interplead and litigate their claims to the

funds. Upon deposit of monies with the court, the plaintiff then may be discharged from liability and dismissed from the interpleader action. The effect of such an order is to preserve the fund, to discharge the stakeholder from further liability, and to keep the fund in the court's custody until the rights of the potential claimants of the monies can be adjudicated. By implementing an interpleader action and obtaining a discharge from further liability, the stakeholder avoids tort liability.

The Bank contends that it was not required to hold the property or interplead it, since neither party requested or sought those elections.

This argument presupposes two things. First, it assumes that there could have been no negotiated resolution of the matter, i.e., no new joint escrow instructions forthcoming, had the Bank simply not closed for a while to see how things played out. Second, it assumes that the litigation that ensued, once escrow had closed and Diaz was in the position of trying to undo it, was essentially the same as the litigation that would have ensued had an interpleader action been filed instead. We are not prepared to accept either assumption.

When the parties are still in escrow they tend to be predisposed to resolution. Once an escrow has been closed in such a manner as to make one party feel victimized and to force that party to hire a litigator to assert his or her rights, the chances of a speedy resolution diminish. There may even be a difference in the tenor of the litigation in that instance and in the instance in which a conflicted escrow holder has been the one to file an interpleader action.

Not surprisingly, the Bank cites no authority to the effect that closing an escrow is an acceptable alternative to holding the property or interpleading it. By definition, closing escrow, i.e., delivering property to parties on the completion of a transaction or the satisfaction of identified conditions, is not the same thing as filing an interpleader action, i.e., depositing property into the court until the rights thereto are resolved by judicial intervention. The former device harbors obvious dangers for an aggrieved party that the latter does not.

The Bank simply has not convinced us that putting the burden on a party to an escrow to commence immediate litigation following a premature closing is the same as the escrow holder's filing of an interpleader action before any closing takes place. In an interpleader action, the parties' rights remain protected while the court sorts things out.

By filing an interpleader action, the conflicted escrow holder may shield himself or herself from liability, and protect the interests of the parties to the escrow as well. Interpleader is a safe harbor for the conflicted stakeholder. An escrow holder who fails to implead acts at his or her own peril.

While the Bank had an option to hold up or interplead, it did not have a right to ignore these options and blindly close the escrow without making a reasonable effort to determine the correctness of the instructions prepared by it on behalf of these illiterate parties. We conclude that a reasonable construction of the escrow instructions required the Bank, upon receipt of the Isla letter, to at least hold up closure until the situation was clarified. The nature and extent of the duty, its breach if any, and the effect thereof, must be resolved in the instant case as questions of fact and not as questions of law on demurrer.

Finally, the Bank contends that the prayer for punitive damages is improper. Civil Code section 3294 provides for the recovery of punitive damages "where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice. . . ." We have held that something more than the mere commission of a tort is always required for punitive damages. There must be circumstances of aggravation or outrage, such as spite or "malice," or a fraudulent or evil motive on the part of the defendant, or such a conscious and deliberate disregard of the interests of others that his conduct may be called willful or wanton.

The complaint alleged that, knowing full well that there was a dispute as to the terms of the escrow, the Bank closed it anyway. The Bank did so in complete disregard of the written notice from Diaz's attorney. The Bank did so while owing a duty, as escrow holder, to Diaz. There is sufficient evidence for a reasonable trier of fact to conclude by clear and convincing proof that the Bank acted in such a conscious and deliberate disregard for the rights of Diaz that its conduct could be characterized as willful or wanton, giving rise to a punitive damages award.

The order of dismissal is reversed.