American Arbitration Association

Commercial Arbitration Tribunal

Mark H. Chandler and
Janet M. Chandler
Claimants

VS

Case #74 115 Y 00812 10 HIIB

Asset Preservation, Inc.
Respondent

FINAL AWARD

I , THE UNDERSIGNED ARBITRATOR, having been designated in accordance with the arbitration agreement entered into by the above-named parties and dated April 03, 2006, and having been duly sworn, and having duly heard the proofs and allegations of the Parties, and having previously rendered an Interim Award dated January 5, 2012 do hereby, AWARD, as follows:

I am the duly appointed and sworn Arbitrator in this dispute pursuant to the arbitration agreement among the above-named parties contained in a written agreement dated April 3, 2006. This claim was heard through four very full days commencing December 6, 2011, continuing through December 8, 2011 and December 16, 2011, in Sacramento, California. Mark H. Chandler and Janet M. Chandler, Claimants (hereafter referred to as "Claimants" or the "Chandlers") were represented by Peter E. Von Elten and Jack S. Johal of CVM Law Group, LLP. Respondent, Asset Preservation Inc., a corporation, (hereafter referred to as "API" or "Respondent") was represented by Dennis J. Kelly and Patrick K. Suter of Dillingham & Murphy, LLP. By agreement of the parties a Certified Shorthand Reporter attended the hearing. Both parties presented extensive expert witness testimony regarding the technicalities of Section 1031 tax deferred exchanges and concerning the standard of practice of Qualified Intermediaries in forward deferred Section 1031 exchanges. Both parties submitted argumentative briefs.

Narrative Summary of Evidence.

The Chandlers owned residential rental real property which they wished to sell (the "relinquished property"), and to reinvest the relinquished property sale proceeds and accumulated interest in the amount of $215,658.81. They also desired to defer recognition of taxable gain on the sale of their relinquished property per Internal Revenue Code Section 1031 ("Section 1031") and pertinent U.S. Treasury Regulations which deal with tax deferred exchanges of like-kind

property ("Regulations"). The Chandlers had made previous real estate and business investments and each had many years of experience in business and commercial affairs.

API is an established and experienced company specialized in providing services to exchangers of real property as a Qualified Intermediary, as defined by the Regulations.

The Chandlers entered into a contract to sell the relinquished property to Sharyl Tozel. Prior to the closing of the sale of their relinquished property the Chandlers entered into an "Exchange Agreement" with API dated April 3, 2006. The Chandlers read the Exchange Agreement before signing it and consulted their accountant about it. The Exchange Agreement made liberal reference to Section 1031 and the Regulations and recited that API was to acquire as yet unidentified replacement property pursuant to the Exchange Agreement and "pursuant to the terms of Section 1031 of the Internal Revenue Code, as amended". Pursuant to the Exchange Agreement, and in accordance with the requirements of Section 1031 and the Regulations, the Chandlers assigned their rights as seller of the relinquished property to API. They also agreed to later assign rights to purchase replacement property pursuant to a future Agreement of Purchase and Sale not then in existence because the Chandlers had not yet identified any replacement property. The Exchange Agreement also contained a number of important contractual provisions setting forth the scope of and limitations upon the relationship of the parties and upon the respective contractual duties and obligations of API and the Chandlers.[1] The Exchange Agreement also contained two separate provisions (Sections VH and VI) for recovery of reasonable attorneys' fees and costs arising out of or relating to any controversy or claim between the parties. Pursuant to the Exchange Agreement API was paid $700 for services as Qualified Intermediary.

The Exchange Agreement's dispute resolution clause requires any controversy or claim arising out of or relating to it or the transactions contemplated by it or the relationship between the Chandlers and API, regardless of the basis of the claim, to be determined by arbitration administered by the American Arbitration Association.

The Chandlers decided to reinvest all the relinquished property sale proceeds plus an additional sum of $189,467.79 in replacement property for a total investment in replacement property of approximately $405,000.

On June 14, 2006, (within the time required by the Regulations) Claimants' selected and identified real property in Sacramento County owned by Blackstone Partners Development 1, LLC as the replacement property. During June 2006 the Chandlers learned the replacement property was owned by Blackstone Partners Development 1, LLC and made a cursory inspection of it. The Chandlers later executed a purchase contract titled "Agreement of Purchase and Sale of Undivided Interest in Land" for the identified replacement property dated August 1, 2006. Attached to the August 1, 2006, replacement property purchase contract was a preliminary title report disclosing that, notwithstanding their replacement property purchase contract was with Bradshaw Partners 1, LP, ("Bradshaw Partners") the replacement property was still owned by

[1] Such provisions of the Exchange Agreement included, among others: Chandler's express assumption of tax risk associated with the Section 1031 exchange; Chandlers' indemnification of API for expenses connected with the relinquished property transaction; and Chandlers' release of API from any claims resulting from conduct of any person other than API.

Blackstone Partners Development 1, LLC. The Chandlers each initialed the preliminary title report exhibit attached to the August 1, 2006, replacement property purchase agreement.

The replacement property was brought to the Chandlers' attention by their broker, a person with whom they had prior business experience and from whom they took advice about their investment in the replacement property. API had no role in the Chandlers' selection of their broker or their choice of the replacement property nor in the preparation or approval of either of the purchase and sale agreements between the Chandlers and Tozel (regarding the relinquished property) or between the Chandlers and Bradshaw Partners 1 LP (regarding the replacement property).

On August 10, 2006, the Chandlers wired $189,467.79, in supplemental funds needed to close the purchase of the replacement property, to the account of Financial Title Company, the replacement property escrow. Those wiring instructions included reference to Financial Title Company's replacement property purchase escrow account and the replacement property purchase escrow number.

The following day, August 11, 2006, API sent the Chandlers a letter enclosing forms of assignment of the replacement property purchase agreement, notice of assignment, draft closing instructions and request for funds - all for Chandlers' review. That letter also advised the Chandlers "Your execution of these documents is our authorization to transfer funds for the closing upon the request of Erika at Financial Title." That same day API sent Financial Title Company written instructions to transfer title to the replacement property directly from Blackstone Partners Development 1, LLC, (the then record owner of the replacement property) or its assigns, to the Chandlers at the replacement property escrow closing.

A week later, on August 17, 2006, the Chandlers executed both (i) an assignment of that replacement property purchase agreement to API as Qualified Intermediary and (ii) a notice of that assignment naming "Blackstone Partners Development 1, LLC, and/or assigns" as seller. As of this time Blackstone Partners Development 1, LLC was still the record title owner of the replacement property. Notice of the assignment of the replacement property purchase agreement from the Chandlers to API was given to "Blackstone Partners Development 1, LLC, and/or assigns". It is unclear that such notice was given directly to Bradshaw Partners 1, LP, the entity with which Chandlers had contracted to buy the replacement property.

On the same day, August 17, 2006, the Chandlers instructed API to withdraw the full balance of funds held for them by API as Qualified Intermediary, including accrued interest, and wire those funds to the same replacement property escrow account and referencing the same escrow number as the Chandlers' had specified when previously wiring their separate $189,467.79 supplemental purchase funds. As instructed by the Chandlers API promptly wired the full balance of Chandler's relinquished property proceeds held by API ($215,658.81, including interest) to Financial Title Company, as escrow for the replacement property purchase.

On August 18, 2006, the replacement property escrow, Financial Title Company, (i) canceled the Chandlers' replacement property escrow without the authority or approval of, and without notice to the Chandlers or API, and (ii) improperly disbursed the Chandlers' $405,000 to Chandlers'

broker and/ or other third parties whose identities were not established by the evidence at the hearing.

API was not an escrow or closing agent of the Chandlers. The Chandlers received multiple reminders of the limited and special role of API under the April 3, 2006, Exchange Agreement. From the beginning of their relationship the Chandlers knew that API could not and would not provide legal or tax advice to them; and were advised to consult their own legal or tax advisor concerning the exchange transaction. Not later than October 19, 2006, the Chandlers knew or should have known that API regarded the April 3, 2006, Exchange Agreement and its contractual role as Chandlers' Qualified Intermediary concluded. No later than June 2006 the Chandlers knew the record owner of the replacement property was Blackstone Partners Development 1 LLC and that Bradshaw Partners 1, LP was not the owner.

The Chandlers maintained a course of telephone and email communication with their broker beginning no later than May 2006 and continuing for more than three years, through at least late 2009, in which their broker discussed difficulties with the financing and development of the replacement property. The Chandlers testified they first realized they might have no record interest at all in the replacement property during June or July 2009. Their broker continued thereafter to reassure the Chandlers everything was "OK" and that the Chandlers were "on the title". The Chandlers waited until January 2010 before contacting API and requesting a copy of their 2006 exchange transaction file from API. As of the time of the evidentiary hearing, the Chandlers had never received statements for, and had not paid any, real estate taxes, maintenance expenses or insurance premiums respecting the replacement property.

As of the time of the evidentiary hearing, the Chandlers had not received any interest in the replacement property or any other substitute replacement property or return of any portion of their $405,000. In addition, the Chandlers have not yet received what they regard as a proper escrow closing statement from Financial Title Company and not yet reported or paid state or federal income tax on the gain recognized on the sale of their relinquished property.

The replacement property the Chandlers intended to acquire was a small fractional tenancy- in-common interest in unimproved land. Also, the Chandlers planned to hold the property for up to two years after which time their understanding with Bradshaw Partners and their broker was that they would resell it to Bradshaw Partners or again exchange their interest for yet other investment real estate. There were other details of the Chandlers' understanding with Bradshaw Partners concerning the replacement property investment which, had the replacement property acquisition closed as intended by the Chandlers, might have been in conflict with the requirements of Section 1031 if closely considered.

Whether the Chandlers' intended transaction would have met the requirement of Section 1031 if it had closed as intended by them or whether, regardless of compliance with Section 1031, the transaction would have escaped the critical attention of the Internal Revenue Service or the California Franchise Tax Board, is highly speculative. The same may be said about the completeness or adequacy of the identification of the replacement property provided by the Chandlers (street address and assessor's parcel number but no legal description and without mention of it being only a small tenancy-in-common interest). For reasons that will be evident below, resolution of this dispute doesn't require determination whether the transaction intended

by the Chandlers would have or should have provided them deferral of taxable gain on the sale of their relinquished property had it closed as the Chandlers intended.

There was no timely purchase of replacement property. The Chandlers did not defer tax on their $215,658 of gain in the sale of the relinquished property. The Chandlers' $405,000 is gone and their prospects of recovering it from the persons who took it from them are at best uncertain.

Chandlers' Claims.

Claimants advance seven legal theories in support of their monetary claim against API. In addition Claimants seek punitive damages. Briefly summarized, Claimants argue API is liable in damages for:

a. Breach of the April 3, 2006, Exchange Agreement
b. Breach of Duty of Good Faith and Fair Dealing owed Claimants.
c. Breach of Fiduciary Duty owed Claimants.
d. Intentional Misrepresentation.
e. Negligent Misrepresentation.
f. Fraudulent Concealment.
g. Negligence Per Se.

Claimants' monetary claims, as specified in their testimony, are:

a. Principal	$405,126.30
b. Respondent's Expert Witness fee	1,925.00
c. Claimants' Expert Witness fee	3,627.50
d, Claimants' Attorneys' fees	179,092.72
e. Federal Income Tax on sale of relinquished property	24,400.00
f. State Income Tax on sale of relinquished property	15,684.00
g. Interest on Principal at 10% from 8/18/06 to 12/17/11	216,000.00
h. Plus unspecified punitive damages.	

Discussion

There is no material dispute between the parties that API performed its obligations to Claimants in accord with Section 1031 and the Regulations respecting Claimants' sale of their relinquished property. Claimants' place blame for the failure of their replacement purchase escrow with Bradshaw Partners upon API and seek to recoup all their claimed loss from API. The notions Claimants advance - to the effect that API undertook or was required to oversee Claimants' reinvestment in the replacement property, to conduct due diligence upon Bradshaw Partners or the replacement property, to conduct a post-closing audit of the replacement property closing escrow including obtaining a copy a recorded deed to the Chandlers or that API's duty to them was fiduciary in all aspects- are not warranted by the Exchange Agreement, Section 1031, the Regulations or any special relationship between Claimants and API. The evidence does not establish fraud, or misrepresentation by API to Claimants, or with regard to Section 1031 requirements or the replacement property.

The Chandlers include the $189,467 they sent directly to Financial Title Company, the repurchase property escrow, in their claim against API. At no time did API have possession or control of those funds nor is there creditable evidence that the Chandlers' were somehow under the hand of API when they wired that sum to the Financial Title Company escrow.

Claimants cite specific language of the Exchange Agreement (i.e., Section IV B which states "API agrees to acquire the Replacement Property from seller and to immediately transfer such property to Exchanger. API will transfer the Replacement Property to Exchanger under the terms and conditions of the Replacement Property Purchase Agreement and this Exchange Agreement.") However Claimants completely discount several other provisions of the Exchange Agreement which provide definition of the meaning of "acquisition" in this context and for direct deeding (See e.g., Section IV C) not to mention provisions of the Regulations which expressly sanction this approach by Qualified Intermediaries in Section 1031 exchanges. Indeed, both expert witnesses in this case testified that such direct deeding is the usual practice in Section 1031 exchanges.

The principle difference in the opinions of the expert witnesses was the extent the standard of practice of the "Qualified Intermediary industry" requires a Qualified Intermediary to investigate and construct a complete file of the replacement transaction, independent of the escrow involved, including verification of the recordation of and a copy of the recorded deed conveying the replacement property to the exchanger. Claimant's expert testified it was the industry's standard of practice to do so. Respondent's expert testified there was no such industry standard of practice and in any event Qualified Intermediaries do not routinely do so. Indeed, evidence was presented that Claimant's expert does not routinely do so when acting as a Qualified Intermediary.

The relationship between Mr. and Mrs. Chandler and Respondent API is grounded upon, and circumscribed by, the April 3, 2006, Exchange Agreement. The Exchange Agreement in turn is a creature of Section 1031 and its appurtenant Regulations. The Exchange Agreement makes repeated express reference to Section 1031 and to the Regulations. The required duties of a Section 1031 Qualified Intermediary are set forth in the Regulations. The Regulations define what a Qualified Intermediary is and what it must do on behalf of its client if the client's planned deferral of tax on the sale of its relinquished property is to be achieved.

The Regulations establish the role of the Qualified Intermediary as the custodian of the funds it receives on behalf of its clients seeking tax deferred exchanges. It imposes that role only with respect to the handling of its clients' funds. Even if a Qualified Intermediary's "custodian" role (as described in the Regulations) is interpreted as a "fiduciary" duty, API did not breach that duty. The custodianship ended when API disbursed the Chandlers' relinquished property proceeds to Financial Title Company as escrow at the written direction of the Chandlers. API's alleged "fiduciary duty" owed to the Chandlers' relates to safekeeping of the relinquished property sale proceeds and ended with API's transfer of Chandlers' funds to the escrow designated by the Chandlers as instructed by the Chandlers in the context of a replacement property purchase arranged by the Chandlers.

A Qualified Intermediary is not the agent, business manager or tax advisor of its clients. Only its clients have the authority and responsibility to arrange the sale of their relinquished property

and to timely select the replacement property and to close with the parties with whom it wishes to deal in obtaining that replacement property. API released the Chandlers' reinvestment funds only upon the express direction of the Chandlers and API delivered that money, exactly as instructed by the Chandlers, to Financial Title Company, then a licensed escrow company, into an escrow created by the Chandlers. The Chandlers' loss stems from the dishonesty or incompetence of that escrow and of Bradshaw Partners and possibly others not party to this arbitration.

As Claimants, Mr. and Mrs. Chandlers bear the burden of proving each of their claims. There is not sufficient evidence that Claimants' loss was caused by the conduct or breach of duty owed them by API. API's duty to them, whether grounded in contract, due care, or good faith was performed according to the Exchange Agreement, Section 1031, the Regulations and California Financial Code 51000 et seq. No conduct of API caused any of Claimants' claimed loss.

FINAL AWARD

I make the following Award in favor of Respondent Asset Preservation, Inc., a corporation, and against Claimants Mark H. Chandler and Janet M. Chandler as indicated below:

1. Claimants Mark H. Chandler and Janet M. Chandler take nothing from Respondent Asset Preservation, Inc. by their claims herein.

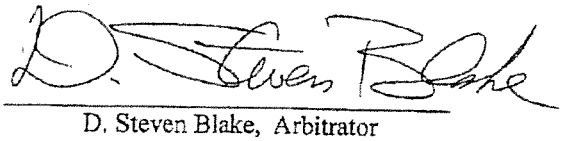
2. Respondent Asset Preservation, Inc. is the prevailing party in this matter.

3. Respondent is awarded its reasonable attorneys fees herein in the amount of $110,075.00 and the sum of $41,279.09 as costs of the arbitration.

4. The administrative filing and case service fees of the AAA, totaling $8,700.00, and the fees and expenses of the arbitrator, totaling $33,600.00, shall be borne as incurred.

This award is in full settlement of all claims submitted to this Arbitration. All claims not expressly granted herein are hereby, denied.

Dated: February 13, 2012.



D. Steven Blake, Arbitrator