

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

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| IN RE: | § | |
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| MEDICAL SELECT MANAGEMENT, | § | CASE NO. 401-45298-BJH-11 |
| | § | |
| Debtor. | § | |
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| BANK OF AMERICA, N.A. | § | |
| | § | |
| Plaintiff, | § | ADV. PRO. 401-4100-BJH |
| - against - | § | |
| | § | |
| PACIFICARE OF TEXAS, INC. and MEDICAL SELECT MANAGEMENT, | § | |
| | § | |
| Defendants. | § | |
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| PACIFICARE OF TEXAS, INC., | § | |
| | § | |
| Counter-Plaintiff, | § | |
| - against - | § | |
| | § | |
| BANK OF AMERICA, N.A., BANK OF AMERICA CORPORATION, and BANC OF AMERICA INVESTMENT SERVICES, INC., | § | |
| | § | |
| Counter-Defendants. | § | |
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FINDINGS OF FACT AND CONCLUSIONS OF LAW

Having considered the documentary evidence and testimony presented at trial, the Court enters the following findings of fact and conclusions of law:

JUDICIAL NOTICE

1. The Court takes judicial notice of the fact that Medical Select Management, Inc. (“MSM”) filed

its voluntary petition under Chapter 11 of the Bankruptcy Code on July 24, 2001 (the “Petition Date”).

2. The Court takes judicial notice of the fact that MSM ceased business operations after the Petition Date.

FINDINGS OF FACT

Background Matters.

1. Prior to the Petition Date, MSM operated as an independent physician association (“IPA”). Specifically, MSM contracted with several thousand doctors in Tarrant County, Texas, to build a network of physicians who would then offer their services at negotiated rates to health care service plans (*i.e.*, HMOs and PPOs (“payors”)) for their plan enrollees. (TR Vol. 1 at 77:6-15 (Lovelady); Ct.’s Mem. Op. 2/11/03, p. 2).
2. PacifiCare of Texas, Inc. (“PacifiCare”) is a health insurance company that sells HMO and PPO benefit plans to employers and employer groups. (TR Vol. 1 at 77:3-7 (Lovelady)).
3. MSM contracted with two primary payors - Aetna U.S. Healthcare, Inc. (“Aetna”) and PacifiCare, each of whom provided about 50% of MSM’s business annually. (TR Vol. 2 at 247:7-20 (Curtin)).

The Capitation Agreement and the Security Reserve Requirement.

4. As of November 1999, MSM and PacifiCare entered into a Medical Group/IPA Services Agreement (the “Capitation Agreement”). (Pre-Trial Order at p. 8, ¶ 2; PacifiCare Exhibit 1; TR Vol. 1 at 80:6-25 (Lovelady)). Pursuant to the Capitation Agreement, MSM was obligated to pay claims for specified medical charges and services rendered for PacifiCare enrollees that were

assigned to MSM, along with associated administrative expenses. In return, PacifiCare paid MSM a monthly “capitation” fee. (PacifiCare Exhibit 1; TR Vol. 1 at 81:1-82:14 (Lovelady)). If claims and/or expenses exceeded the capitation payment, then MSM was responsible for any excess amounts due. (TR Vol. 1 at 82:15-20 (Lovelady)). Through this arrangement, PacifiCare was able to “capitate” its risk on payment of medical claims, meaning that it was able to protect itself from the risk that claims would exceed its capitation payments. (TR Vol. 1 at 77:18-78:8 (Lovelady)).

5. In connection with its business relationship with MSM, PacifiCare did not want to be exposed to the possibility of paying claims twice (*i.e.*, paying “once” by making a capitation payment and then paying a “second” time if MSM failed to pay the enrollees’ claims when due). (TR Vol. 4 at 286:11-17, 287:19-288:13 (Comrie)). Accordingly, as a contracting requirement of PacifiCare, MSM agreed to establish a “Security Reserve” for PacifiCare’s benefit under the Capitation Agreement. (PacifiCare Exhibit 1 at § 2.8.2; TR Vol. 1 at 82:25-84:7 (Lovelady); TR Vol. 2 at 113:19-24 (Forman)). Section 2.8.2 of the Capitation Agreement set out numerous requirements for the Security Reserve including:

- (1) its funding by MSM in the amount of approximately 2.5 months of the monthly capitation payment made by PacifiCare to MSM. (PacifiCare Exhibit 1 at § 2.8.2(c));
- (2) the establishment by MSM of a bank account at a financial institution approved by PacifiCare (the “Reserve Bank Account”) in which PacifiCare would have a security interest pursuant to an account control agreement to be executed by

PacifiCare, the financial institution, and MSM. (PacifiCare Exhibit 1 at § 2.8.2(e); TR Vol. 1 at 85:5-19 (Lovelady));

- (3) an agreement that MSM could not withdraw the funds from the Reserve Bank Account “without written authorization delivered to the applicable bank from PacifiCare’s designated officer on PacifiCare letterhead.” (PacifiCare Exhibit 1 at § 2.8.2(f)); and
- (4) the ability for MSM to self-direct the investments in the Reserve Bank Account. (*Id.*).

6. As originally executed, the Capitation Agreement required that a portion of the Security Reserve be funded with a letter of credit and be fully secured by the Reserve Bank Account. (PacifiCare Exhibit 1 at § 2.8.2(a),(e)). The Capitation Agreement also permitted MSM to satisfy all or a portion of the Security Reserve by obtaining insolvency insurance. (PacifiCare Exhibit 1 at § 2.8.2(d)).

7. PacifiCare’s Network Management group was responsible for insuring that the Security Reserve was established as called for in the Capitation Agreement. (TR Vol. 2 at 70:5-8 Forman)). The Network Management group included the Director of Network Management in the Dallas-Fort Worth market John Lovelady (“Lovelady”) and Network Manager Fowad Choudhry (“Choudhry”), a former PacifiCare employee who, at the time, was assigned oversight and management of PacifiCare’s relationship with MSM. (TR Vol. 1 at 71:24-75:11, 180:23-181:3 (Lovelady); TR Vol. 4 at 548:5-14, 583:14-21 (Choudhry)). However, no letter of credit was ever provided, (TR Vol. 1 at 166:20-167:12 (Lovelady); TR Vol. 2 at 69:18-70:8 (Forman); TR

Vol. 4 at 356:9-21 (Comrie)), and the Capitation Agreement was later amended to delete this requirement. (PacifiCare Exhibit 130).

8. As relevant here, MSM maintained certain investment accounts at Bank of America Investment Services, Inc. (“BAISI”). (TR Vol. 1 at 233:24-235:1 (Frost)). On November 8, 1999, shortly after MSM and PacifiCare entered into the Capitation Agreement, MSM’s Chief Financial Officer Fred Miller (“Miller”) opened an account at BAISI (#W41-016900) (the “BAISI Account”). (BAISI Exhibit 9; TR Vol.1 at 255:19-256:1 (Frost)). The Brokerage Account Application for the BAISI Account was filled out in the name of “Medical Select Management” and was signed by Miller and Marsha Byers (“Byers”), as those authorized to act on behalf of MSM. (BAISI Exhibit 9; TR Vol. 1 at 274:17-275:19 (Frost); TR Vol. 2 at 199:19-25 (Ricks); TR Vol. 4 at 500:14-21 (Kiolbassa)). The first deposit into the BAISI Account occurred on January 18, 2000, when \$100 cash was transferred to it from another MSM account at BAISI (# W41-694851). (BAISI Exhibit 10 at 1-2).
9. As of February 1, 2000, PacifiCare and MSM entered into a Security Agreement pursuant to which MSM gave PacifiCare a security interest in the BAISI Account. (BAISI Exhibit 5). While the Security Agreement referenced the BAISI Account, BAISI was not a party to the agreement. (*Id.*). The Security Agreement provided that PacifiCare could invade the BAISI Account “only for the purposes of payment of [MSM’s] medical claims and incentive program settlement obligations pursuant to the [Capitation Agreement].” (BAISI Exhibit 5 at 2, ¶ 7).
10. Under the terms of the Capitation Agreement, PacifiCare was entitled “to apply the Security Reserve to satisfy [MSM’s] financial obligations under this Agreement” if, as occurred here, MSM

became insolvent or ceased doing business. (PacifiCare Exhibit 1 at § 2.8.2(g)).

The Reserve Bank Account And The Account Control Agreement.

11. When the BAISI Account was opened, Miller intended that it would serve as the Reserve Bank Account under the Capitation Agreement. (TR Vol. 1 at 236:4-19, 245:2-25, 255:15-18 (Frost); 87:14-88:2 (Lovelady)). In fact, Miller named the BAISI Account the “Security Reserve” account. (PacifiCare Exhibit 6; TR Vol. 1 at 245:2-5 (Frost)). BAISI was aware that Miller intended the BAISI Account to be the PacifiCare Reserve Bank Account. (TR Vol. 1 at 236:4-19, 245:2-25, 255:15-18 (Frost)).
12. Other than the future plan to try to enter into an account control agreement with PacifiCare, Miller did not inform BAISI of any restrictions on, or any restricted purpose for, the BAISI Account. (TR Vol. 1 at 278:3-279:7 (Frost); TR Vol. 2 at 200:1-13 (Ricks); TR Vol. 4 at 517:20-518:12 (Kiolbassa)).
13. In January 2000, Miller began negotiations with PacifiCare’s Lovelady and with BAISI’s Vice President Kenneth Frost (“Frost”), the BAISI broker assigned to MSM’s account, over the terms of a possible account control agreement to be entered into by those parties. (TR Vol. 1 at 247:12-250:10 (Frost); 91:3-92:6 (Lovelady)). At that time, Miller, Lovelady, and Frost understood that the purpose of the BAISI Account was to serve as the “Reserve Bank Account.” (TR Vol. 1 at 255:15-18 (Frost); 98:18-99:24 (Lovelady)). From his conversations with Miller at that time, Frost understood that no significant funds would be moved into the BAISI Account until an account control agreement was executed among the parties. (TR Vol. 1 at 257:13-17, 258:25-259:22, 260:18-261:1 (Frost)).

14. MSM provided BAISI with a draft of a proposed account control agreement in January 2000. (TR Vol. 1 at 247:12-248:7; PacifiCare Exhibit 2). Frost and David Mitchell (“Mitchell”), BAISI’s assistant general counsel, worked with MSM to revise the proposed account control agreement so that it was acceptable to both BAISI and MSM. (TR Vol. 1 at 261:2-263:23, 264:3-25 (Frost)). Throughout their negotiations, BAISI understood that Miller was communicating with PacifiCare regarding the terms of the proposed account control agreement. (TR Vol. 1 at 261:21-263:23 (Frost)). BAISI felt it was most appropriate for it to deal with PacifiCare through its customer, MSM. (TR Vol. 2 at 178:25-179:24, 216:7-217:4 (Ricks); TR Vol. 4 at 522:12-24, 530:11-18 (Kiolbassa); TR Vol. 5 at 627:1-628:2 (Harris)).
15. After BAISI’s legal department approved the form of the proposed account control agreement, Frost executed three copies of the agreement, indicating BAISI’s acceptance of its terms. (Pre-Trial Order at p. 9, ¶ 4; TR Vol. 1 at 264:14-265:3, 267:3-11 (Frost)). BAISI has stipulated that Frost was authorized to execute the proposed account control agreement on its behalf. (Pre-Trial Order at p. 9, ¶ 5). Based upon his communications with Miller, Frost believed that the proposed account control agreement was acceptable to MSM when he executed the agreement on BAISI’s behalf. (TR Vol. 1 at 264:3-25 (Frost)). Frost then forwarded the three executed copies to Miller for signature by MSM. (Pre-Trial Order at p. 9, ¶ 6; TR Vol. 1 at 267:3-11 (Frost)). Frost did not keep a copy of the signed account control agreement in the outgoing correspondence file at the branch office, although he was required by BAISI policy to do so. (TR Vol. 1 at 269:2-11 (Frost); TR Vol. 4 at 532:2-10, 533:1-16 (Kiolbassa); TR Vol. 5 at 629:14-630:13 (Harris)).
16. When he forwarded the three executed copies of the proposed account control agreement to

Miller, Frost expected Miller to sign it on behalf of MSM and forward it to PacifiCare for review and, if acceptable, signature. (TR Vol. 1 at 264:3-266:10 (Frost)). Although Frost expected to learn if PacifiCare had signed the agreement from Miller, he also expected to receive a fully executed copy of the agreement back from MSM and PacifiCare. (*Id.*).

17. Under its terms, the account control agreement could be executed in counterparts. (PacifiCare Exhibit 6). Upon receipt of the account control agreement from Frost, Miller signed the agreement on MSM's behalf and forwarded it to Lovelady at PacifiCare for review and, if acceptable, signature. (TR Vol. 1 at 104:21-105:18, 106:5-14 (Lovelady)). By virtue of their signatures on the proposed account control agreement, Lovelady understood that BAISI and MSM had each agreed to its terms. (TR Vol. 1 at 105:19-106:4 (Lovelady)). After reviewing the document, Lovelady told Miller that he thought the proposed account control agreement was acceptable to PacifiCare and that they had a "deal." (TR Vol. 1 at 101:6-8, 105:4-7, 106:2-4 (Lovelady)).
18. Lovelady then submitted the proposed account control agreement to Dan Comrie ("Comrie"), PacifiCare's Chief Financial Officer, for his signature. (TR Vol. 1 at 106:5-14 (Lovelady)). After Comrie signed the account control agreement on PacifiCare's behalf, Lovelady caused a fully executed copy of the account control agreement to be returned to Miller at MSM. (PacifiCare Exhibit 11; TR Vol. 1 at 106:15-22, 109:8-110:20 (Lovelady)).
19. Lovelady also instructed a PacifiCare administrative assistant in its San Antonio office, Alana Baron ("Baron"), to mail an executed original of the account control agreement to BAISI. (TR Vol. 1 at 158:10-21 (Lovelady); TR Vol. 4 at 590:10-591:1 (Baron)). Lovelady did not instruct Baron to send both originals to Miller at MSM. (TR Vol. 1 at 158:19-21 (Lovelady)). Lovelady knew

it was only BAISI that could place restrictions on the BAISI Account once the parties reached an agreement on the terms of an account control agreement. (TR Vol.1 at 160:8-161:13 (Lovelady)). Thus, Lovelady knew that BAISI needed to be told of PacifiCare's acceptance so that the restrictions could be placed on the BAISI Account.

20. Lovelady did not remember giving Baron any particular instructions regarding the method of delivery she should use, nor did he follow up with her to make sure she followed his instructions. (TR Vol. 1 at 158:10-15, 22-159:5 (Lovelady)).
21. Baron had no recollection of being instructed by Lovelady to mail the account control agreement to BAISI. (TR Vol. 4 at 592:4-7 (Baron)). Nor did she specifically recall actually mailing or otherwise causing the agreement to be delivered to BAISI. (TR Vol. 4 at 592:8-593:7 (Baron)). In fact, Baron did not recall having ever seen the account control agreement prior to her deposition being taken in connection with this action. (TR Vol. 4 at 591:11-18 (Baron)). Baron did testify, however, that if she had mailed the agreement at Lovelady's request, and no specific instruction about where to mail it had been given to her by Lovelady, she would have mailed it to the address identified in the notice section of the agreement. (TR Vol. 4 at 597:18-23, 598:19-599:10, 600:11-20 (Baron)).
22. If she followed that practice here, she would have mailed a fully executed copy of the account control agreement to BAISI's office in Charlotte, North Carolina. However, no copy of the executed agreement was received in BAISI's Charlotte office. (TR Vol. 5 at 619:25-625:12 (Harris)).
23. Although PacifiCare Exhibit 11 establishes that the signed account control agreement was actually

delivered by PacifiCare to MSM, PacifiCare was unable to locate any similar document – *i.e.*, a Federal Express slip, a certified mail card, a fax confirmation slip, a cover letter, or a note, to indicate actual delivery to BAISI. (TR Vol. 1 at 159:20-24 (Lovelady)).

24. During this time, PacifiCare was extremely busy. PacifiCare was closing a deal to acquire Harris Methodist Hospital (“Harris Methodist”), which was roughly ten times its size. (TR Vol. 1 at 161:14-25 (Lovelady); TR Vol. 2 at 67:17-19 (Forman); TR Vol. 4 at 350:23-351:16 (Comrie)). As part of the Harris Methodist acquisition, Lovelady personally had to complete various healthcare and independent physician association contracts. (TR Vol. 1 at 162:4-7 (Lovelady)). PacifiCare was adding doctors and members to the program during February, March, April, and May of 2000. (TR Vol. 1 at 162:4-12 (Lovelady)). Lovelady’s then-boss, John Wagner, left PacifiCare about the time of the Harris Methodist acquisition. (TR Vol. 1 at 161:19-22 (Lovelady)). PacifiCare was also involved in acquisitions of Wellmed and Baptist Health Systems during this time frame. (TR Vol. 4 at 594:17-595:13 (Baron)). As testified to by Baron, it was a very busy time at PacifiCare. (TR Vol. 4 at 595:1-13 (Baron)).
25. After he received the fully executed copy of the account control agreement back from PacifiCare, Miller led PacifiCare to believe that the account control agreement was in place and effective. (Ct.’s Mem. Op. 2/11/03, p. 5).
26. However, Miller told BAISI that PacifiCare had refused to sign the proposed account control agreement. (*Id.* at p. 4.) Specifically, Miller told Frost that PacifiCare was not comfortable with the collateral agreement and would feel more comfortable with a letter of credit arrangement. (TR Vol. 1 at 281:11-24 (Frost)). Moreover, prior to a fully executed copy of the account control

agreement being produced in connection with this action, Frost had no idea that Miller had signed the agreement on MSM's behalf. (TR Vol. 1 at 281:18-283:9 (Frost)).

27. BAISI never received a signed copy of the proposed account control agreement from either MSM or PacifiCare. (TR Vol. 1 at 282:14-283:21 (Frost); TR Vol. 2 at 197:20-198:9, 223:1-4 (Ricks); TR Vol. 4 at 526:14-19 (Kiolbassa); TR Vol. 5 at 619:25-625:12 (Harris)).
28. Paragraph 6(h) of the proposed account control agreement provides that “[t]he prevailing party in the prosecution or defense of any action arising out of this Account Agreement, including any action for declaratory relief, shall be reimbursed by the party whose course of action necessitated such prosecution or defense for all costs and expenses, including reasonable attorneys’ fees expended or incurred by the prevailing party in connection therewith” (PacifiCare Exhibit 6 at ¶ 6(h)).

The BAISI Account Is Funded

29. The value of assets held in the BAISI Account over time was as follows:

| <u>Date</u> | <u>Amount</u> | <u>Description of Transaction</u> |
|-------------------|---------------|---|
| January 18, 2000 | \$100.00 | First deposit: cash transfer from MSM Account # W41-694851 |
| January 19, 2000 | \$100.00 | Funds transferred to bank account |
| February 9, 2000 | \$100.00 | Intra-Bank Credit |
| February 10, 2000 | \$100.00 | Purchase of Nations Cash Reserves Daily |
| February 11, 2000 | \$0.00 | All assets in account liquidated |
| February 29, 2000 | \$0.00 | Balance in Account |
| March 2000 | \$0.04 | Dividend paid (earned in February 2000 from Nations Cash Reserves Daily) |
| April 2000 | \$0.04 | Balance in Account |
| May 2000 | \$0.04 | Balance in Account |
| June 2000 | \$0.04 | Balance in Account |
| July 2000 | \$0.04 | Balance in Account |

| <u>Date</u> | <u>Amount</u> | <u>Description of Transaction</u> |
|--------------------|----------------|--|
| August, 2000 | | Multiple transfers of securities from MSM's BAISI Account # W41-7841681 |
| August 31, 2000 | \$4,988,825.73 | Balance in Account |
| September 30, 2000 | \$4,979,279.92 | Balance in Account |
| October 31, 2000 | \$4,936,924.64 | Balance in Account |
| November 30, 2000 | \$4,923,244.77 | Balance in Account |
| December 31, 2000 | \$1,148,759.24 | Balance as of December 31, 2000 after several investments were liquidated by MSM, with proceeds transferred to Bank of America, N.A. ("BOA") Account # 004771354379 |
| January 31, 2001 | \$29.25 | Balance as of January 31, 2001 after additional liquidation and transfer by MSM |
| February 1, 2001 | 0.00 | Balance as of February 1, 2001. Account was closed by MSM and remaining funds wire transferred to a MSM account with BOA. |

(BAISI Exhibit 10 (description of transaction not in exhibit)).

30. The Capitation Agreement called for the funding of the Security Reserve through the provision of a \$1.0 million letter of credit and the funding of additional sums due (per a formulaic calculation) over the first six months following the “Commencement Date” of the agreement in equal monthly installments. (PacifiCare Exhibit 1 at §§ 2.8.2(a), 2.8.2(c); TR Vol. 4 at 354:19-356:16 (Comrie)). As found previously, the Security Reserve was not funded in accordance with the Capitation Agreement. (TR Vol. 1 at 168:18-170:20 (Frost); TR Vol. 4 at 295:18-296:25, 355:3-23 (Comrie)). PacifiCare gave MSM additional time to fund the Security Reserve because MSM needed that additional time for its membership to stabilize. (TR Vol. 1 at 113:15-114:18 (Lovely); TR Vol. 4 at 298:1-10 (Comrie)). This concession by PacifiCare was not normally granted. (TR Vol. 4 at 355:3-23, 357:1-3 (Comrie)).
31. Nevertheless, PacifiCare did not give up its right to insist upon the funding of the Security Reserve. In July 2000, PacifiCare told MSM that it was time to fund the Security Reserve. (TR Vol. 1 at 114:10-21 (Lovely)).
32. Frost left BAISI on June 30, 2000, to accept a position with Legg Mason Wood Walker, Inc. (“Legg Mason”), another brokerage company. (TR Vol. 1 at 273:16-20 (Frost); TR Vol. 4 at 514:17-21 (Kiolbassa)). Consequently, in July of 2000, Jeff Ricks (“Ricks”), an investment consultant with BAISI with over 10 years of experience, was asked to assume management of BAISI’s relationship with MSM. (TR Vol. 2 at 195:14-20, 196:25-197:7 (Ricks); TR Vol. 4 at 514:22-516:12 (Kiolbassa)).
33. Ricks reviewed BAISI’s files with respect to MSM’s accounts, including the BAISI Account. (TR

Vol. 2 at 197:20-23 (Ricks); TR Vol. 5 at 622:15-625:12 (Harris)). BAISI's files did not include an account control agreement. (TR Vol. 2 at 197:20-198:9 (Ricks)). Moreover, BAISI's files did not show that PacifiCare held a security interest in the BAISI Account or that there were any restrictions with respect to the BAISI Account. (TR Vol. 2 at 200:1-5 (Ricks); TR Vol. 3 at 222:22-223:4 (Hunter); TR Vol. 4 at 514:25-516:16, 517:20-518:12 (Kiolbassa)).

34. When he left, Frost attempted to take MSM's business with him to Legg Mason. (TR Vol. 2 at 200:14-16 (Ricks)). In July 2000, MSM transferred certain assets from BAISI to Legg Mason via an ACAT transfer. (TR Vol. 2 at 200:14-202:3 (Ricks); TR Vol. 4 at 514:22-516:10 (Kiolbassa)). Ultimately, Miller decided to keep MSM's investment accounts at BAISI, and Miller directed Frost to return \$4.8 million of investments to BAISI. (*Id.*). MSM could not return the assets to the same account at BAISI from which they had been transferred because that account had been closed automatically after the ACAT transfer. (*Id.*). So, Miller contacted a sales assistant at BAISI, David Hunter ("Hunter"), to get information about the MSM accounts still available at BAISI and to decide how to divide the returning funds among the available accounts. (TR Vol. 3 at 228:24-231:12 (Hunter)). Hunter took notes as he discussed the available accounts with Miller and wrote down what Miller said about the various accounts. (*Id.* at 229:7-230:17; PacifiCare Exhibit 120).
35. Accordingly, in early August 2000, some of the assets from Legg Mason were transferred back to BAISI to various MSM accounts, including, ultimately, the BAISI Account. (TR Vol. 2 at 202:19-203:16 (Ricks)). Thus, under pressure from PacifiCare, MSM funded the BAISI Account in the amount of approximately \$4.8 million with assets being returned from Legg Mason.

(PacifiCare Exhibits 22, 25 and 26; TR Vol. 1 at 114:6-115:8, 118:9-120:7, 125:9-11 (Lovelady)).

36. At the time of its funding, MSM and PacifiCare understood that the funds deposited in the BAISI Account constituted the Security Reserve. (TR Vol. 4 at 298:17-299:17, 303:12-23 (Comrie); PacifiCare Exhibits 26, 28 and 31).
37. Ricks did not communicate with Frost about the funding of the BAISI Account. (TR Vol. 2 at 136:12-137:5 (Ricks)).
38. At about the time the BAISI Account was funded, and in response to a PacifiCare request to MSM, Miller asked Hunter to send information regarding the holdings in the BAISI Account to Lovelady, who in turn forwarded the information to PacifiCare's Regional Controller, Susan Forman ("Forman"). (PacifiCare Exhibit 25; TR Vol. 1 at 125:16-126:16 (Lovelady)). Lovelady conceded at trial that if an account control agreement had been in effect at that time, PacifiCare would not have had to go through Miller to obtain the account information; it could have requested it directly from BAISI. (TR Vol. 1 at 176:7-177:12 (Lovelady); PacifiCare Exhibit 6 at ¶¶ 2, 5(b)).
39. As BAISI's customer, MSM could instruct BAISI to send copies of account statements to third parties and BAISI would comply with such instructions. (TR Vol. 3 at 220:6-221:12 (Hunter)). BAISI did not inquire about the purpose of sending copies. (*Id.*; TR Vol. 2 at 206:22-207:15 (Ricks)).
40. Forman testified that after reviewing the account information forwarded to her by Lovelady, she had questions about the information. (TR Vol. 2 at 24:1-27:10 (Forman)). As a result, she

testified that she had a telephone conversation with Hunter on August 4, 2000 to confirm the amount of funds held in the BAISI Account and that the funds were protected by the account control agreement. (*Id.* at 24:1-26:19). Forman further testified that Lovelady participated in this call. (*Id.* at 24:15-18). PacifiCare introduced Forman's notes of this call, which reflect her belief that Hunter told her that the BAISI Account was protected by the account control agreement. (PacifiCare Exhibit 25; TR Vol. 2 at 24:1-30:15 (Forman)). However, neither Hunter nor Lovelady¹ recall the telephone conversation. (TR Vol. 1 at 174:4-23 (Lovelady); TR Vol. 3 at 223:5-23 (Hunter)). Forman knew nothing about Hunter or his job responsibilities at BAISI when she spoke with him. (TR Vol. 2 at 86:19-22 (Forman)). She called him because he was the person who sent the fax of the account information Lovelady had forwarded to her. (*Id.*).

41. Although he does not recall the conversation at all, Hunter testified that even if he spoke to Forman, he would not have told her that the assets in the BAISI Account were protected in accordance with any account control agreement because the information to which he had access showed no restrictions on the BAISI Account. (TR Vol. 3 at 224:7-225:3 (Hunter)). This testimony was credible and is consistent with this Court's finding that BAISI's files did not show any restrictions or liens on the BAISI Account (*see* finding 33, *supra*). After considering the record as a whole, the Court finds that Hunter did not assure Forman that the assets in the BAISI Account were protected by the account control agreement.

42. Under the terms of the proposed account control agreement, MSM could not transfer the principal

¹ Initially, Lovelady testified that he "vaguely" recalled being on a conference call; yet later admitted having no recollection of the substance of the call. (TR Vol. 1 at 174:4-23 (Lovelady)).

amount of the funds in the BAISI Account without PacifiCare's written consent. (PacifiCare Exhibit 6 at ¶3(b)). Moreover, if the account control agreement was in effect, BAISI had agreed to "comply with all entitlement orders originated by PacifiCare with respect to the Customer Account, and all other requests or instructions from PacifiCare regarding disposition and/or delivery of the Collateral." (PacifiCare Exhibit 6 at ¶2).

43. Although Comrie reviewed some MSM account statements from time to time, he could not identify which statements he had reviewed. (TR Vol. 4 at 303:18-304:5, 305:16-306:16 (Comrie)). Although it remained his ultimate responsibility, Comrie delegated the task of monitoring MSM's account statements to Forman. (TR Vol. 2 at 93:17-94:9 (Forman); TR Vol. 4 at 304:6-12, 306:17-23 (Comrie)).
44. From the time Ricks assumed responsibility for the MSM accounts until at least late January 2001, Ricks had no communications with anyone from PacifiCare. (TR Vol. 2 at 206:13-21; 215:2-216:9 (Ricks)). All transactions made by Ricks in the MSM accounts were done at the instruction of Miller, one of the authorized persons on the accounts, and never at the instruction of PacifiCare. (*Id.*).
45. On or about December 6, 2000, MSM instructed BAISI to liquidate the investment assets held in the BAISI Account and to move the resulting funds to an account at BOA. (PacifiCare Exhibit 49; TR Vol. 2 at 208:6-209:19 (Ricks); BAISI Exhibit 34). Over the next several weeks, approximately \$4.8 million was moved from the BAISI Account to an account at BOA from which funds were used to purchase certificates of deposit ("CDs") (PacifiCare Exhibits 100 and 137), some of which were then pledged to BOA to secure a revolving line of credit. (PacifiCare Exhibits

58, 59 and 60).

46. PacifiCare did not formally consent in writing and on PacifiCare letterhead to this transfer from BAISI to BOA as was required by the Capitation Agreement (and the account control agreement if it was in effect). (TR. Vol. 1 at 139:12-14, 145:11-20, 146:7-147:8 (Lovelady); TR Vol. 2 at 32:20-33:7 (Forman); TR Vol. 4 at 319:9-13, 321:8-13 (Comrie); TR Vol. 4 at 579:21-580:15 (Choudhry)).

The Capitation Agreement Is Amended

47. PacifiCare and MSM began negotiations over amendments to the Capitation Agreement in the summer of 2000. Although effective as of November 2000, PacifiCare actually signed the document amending the Capitation Agreement on December 6, 2000. (PacifiCare Exhibit 130). Pursuant to the amendment, the parties deleted any reference to a secured letter of credit. (*Id.* at Recital B). But, the amendment continued PacifiCare's security interest in, and restrictions regarding, the Reserve Bank Account. (*Id.* at ¶ 1). Under the terms of the amended Capitation Agreement, and to insure that the Reserve Bank Account was properly funded, PacifiCare was entitled to withhold a portion of MSM's capitation payment and deposit it directly into the Reserve Bank Account. (*Id.* at ¶ 7). Also, under the terms of the amended Capitation Agreement, PacifiCare was entitled to draw amounts from the Reserve Bank Account "equal to actual claims and capitation paid or to be paid on behalf of [MSM] and incentive program settlement amounts due PacifiCare under this Agreement." (*Id.* at ¶ 1).

MSM's Relationship with BOA.

48. Previously, in July 2000, MSM met with employees of BOA, including Derek Williams, Nathan

McClellan, John Curtin, and Mark Tranchina. (TR Vol. 3 at 239:1-14 (McClellan); TR Vol. 2 at 245:9-25 (Curtin)). The BOA employees were put in touch with MSM through BOA's "premier banking" group which learned, through internal channels at BOA, that investment opportunities existed with MSM's assets at BAISI, an affiliate of BOA. (TR Vol. 3 at 237:7-238:12, 239:10-240:2 (McClellan)). BOA had access to MSM's account information at BAISI, and BOA and BAISI were free to share MSM's confidential account information under applicable customer agreements and Bank of America policies. (BAISI Exhibit 9 at ¶ 7(b); PacifiCare Exhibit 3 at § 2.1.1) .

49. At the initial meeting between BOA and MSM which was, in effect, a "sales call" by BOA, Miller explained MSM's business to BOA. Miller explained that MSM's two major sources of business were its agreements with Aetna and PacifiCare. (TR Vol. 2 at 247:7-248:1 (Curtin); TR Vol. 3 at 240:8-241:2 (McClellan)).
50. At this meeting, Miller discussed the possibility of entering into a letter of credit transaction in order to satisfy MSM's security reserve requirement with Aetna. (TR Vol. 2 at 248:14-249:17 (Curtin); TR Vol. 3 at 241:10-242:13 (McClellan)). Miller indicated that he would be interested in pursuing a similar arrangement on behalf of PacifiCare after BOA and MSM consummated the Aetna letter of credit transaction. (TR Vol. 3 at 242:14-18 (McClellan)). In discussing the possible credit relationship between BOA and MSM, BOA made it clear that BOA would only lend to MSM on a cash secured basis. (TR Vol. 2 at 268:14-269:3 (Curtin); TR Vol. 3 at 241:23-242:7, 259:10-13 (McClellan)).
51. Thus, Miller opened two new accounts at BOA: account # 873437 (the "PacifiCare Account") and

account # 873438 (the “Aetna Account”). (PacifiCare Exhibit 18). Subsequently, Miller placed approximately \$6.7 million in the Aetna Account to serve as collateral for the letters of credit that MSM obtained on behalf of Aetna. (PacifiCare Exhibit 80). MSM reflected this \$6.7 million as a “restricted asset as to use” under the “Aetna Commercial HMO” column on its monthly balance sheets. (PacifiCare Exhibit 56).

52. In connection with his due diligence for the underwriting of the Aetna letter of credit transaction, which he performed in July and August 2000, BOA’s credit underwriter John Curtin (“Curtin”) obtained a copy of the Capitation Agreement and contact information for PacifiCare. (TR Vol. 2 at 250:8-251:8 (Curtin); PacifiCare Exhibits 1, 127, and 128). Curtin received a copy of the amendment to the Capitation Agreement in February 2001. (TR Vol. 2 at 293:21-295:2 (Curtin)).
53. In addition, in connection with the Aetna letter of credit transaction, BOA obtained an opinion letter from MSM’s counsel to the effect that MSM could enter into the letter of credit agreement without violating the terms of specified MSM contracts, including the Capitation Agreement and the similar capitation agreement with Aetna. (PacifiCare Exhibit 150). After Curtin completed his due diligence for the Aetna letter of credit transaction in August through September 2000, it appears that he performed very little additional due diligence in connection with any other credit facility subsequently established by MSM at BOA. (TR Vol. 2 at 255:9-256:4, 272:4-9 (Curtin)).
54. In the Fall of 2000, MSM began to incur substantial overdrafts in its main account at BOA. (TR Vol. 2 at 267:6-268:13 (Curtin); TR Vol. 3 at 246:10-16, 247:4-22 (McClellan); PacifiCare Exhibits 45, 46, 51, and 100). As of November 1, 2000, MSM was overdrawn by

approximately \$3.3 million. (PacifiCare Exhibit 45). During December 2000, MSM's overdrafts exceeded \$5 million. (PacifiCare Exhibit 100). The extent of MSM's overdrafts, and BOA's unsecured credit exposure to MSM as a result of the overdrafts, was of concern to BOA. (PacifiCare Exhibit 51; TR Vol. 3 at 249:21-250:5, 259:14-21 (McClellan)). At that time, BOA understood the cause of the overdrafts to be timing differences between MSM's receipt of capitation payments and when it paid out monies to doctor providers. (TR Vol. 3 at 14:21-15:1 (Curtin)).

55. BOA told MSM that it needed to come up with a solution for the continuing overdraft problem. (TR Vol.2 at 267:19-268:6 (Curtin)). One potential solution for resolving the overdraft problem was for MSM to deposit additional funds into the overdrawn account. (TR Vol. 2 at 268:2-4, TR Vol. 3 at 17:18-19:16 (Curtin)). Another solution was to de-link MSM's zero balance accounts ("ZBAs") from its main operating account (the "Demand Deposit Account") so that checks could be returned unpaid. (TR Vol. 3 at 15:6-16:4, 19:7-10 (Curtin)).
56. MSM did not want this to occur because if its bank accounts were "de-linked," its outstanding checks would not likely clear its bank accounts, thereby disrupting its business relationships with doctors and plan enrollees. To avoid the de-linking of its bank accounts, MSM and BOA began discussing a possible secured line of credit being extended to MSM by BOA. (PacifiCare Exhibit 52). An agreement on the terms of such a secured revolving line of credit was reached, and MSM began making the necessary arrangements to move the funds (approximately \$4.8 million) held in the BAISI Account to BOA to collateralize that revolving line of credit. (*Id.*) In this way, BOA hoped to turn MSM's unsecured debt (*i.e.*, the overdrafts) into a debt fully secured by cash

collateral, as the parties understood that MSM would repay the overdrafts through advances on the secured line of credit. (TR Vol. 2 at 271:25-272:3 (Curtin)).

57. As found previously, on December 6, 2000, MSM authorized the liquidation of investments held in the BAISI Account and the transfer of the resulting funds into the Demand Deposit Account at BOA. (PacifiCare Exhibit 49). From December 12, 2000, to February 1, 2001, the securities in the BAISI Account were liquidated, and the resulting funds were transferred into the Demand Deposit Account at BOA. (TR Vol. 2 at 208:6-209:19 (Ricks); PacifiCare Exhibit 100). In accordance with Miller's instructions, BOA used funds from the Demand Deposit Account to purchase CDs, which were then held in the PacifiCare Account at BOA. (TR Vol. 2 at 208:6-209:19 (Ricks); 278:19-279:3 (Curtin); TR Vol. 3 at 255:9-20 (McClellan); PacifiCare Exhibits 52, 60, 100 and 137). Of the approximately \$5 million in CDs purchased, \$3 million worth were pledged to BOA to secure the revolving line of credit. (TR Vol. 2 at 273:21-274:2 (Curtin); PacifiCare Exhibits 58, 59 and 60).
58. Curtin engaged in little further due diligence with regard to the establishment of MSM's revolving line of credit at BOA. (TR Vol. 2 at 255:9-256:4, 272:4-9 (Curtin)). Curtin made no effort to determine the source of the \$4.8 million in cash being transferred to BOA, (TR Vol. 2 at 258:2-259:17 (Curtin)), or to contact his colleagues at BAISI to determine if there were any restrictions on the funds being transferred from the BAISI Account, (TR Vol. 2 at 279:4-24 (Curtin)). Curtin made no such effort even though he knew that MSM was required to maintain a Reserve Bank Account for PacifiCare under the terms of the Capitation Agreement. (PacifiCare Exhibit 1; TR Vol. 2 at 250:8-251:8 (Curtin)). Finally, Curtin did not obtain a new opinion letter from MSM's

counsel that entering into the financing did not violate the terms of any of MSM's contracts.

59. Instead of undertaking further due diligence, Curtin relied on Miller's "representation and warranty" in the loan agreement that the funds were unencumbered and could be pledged to BOA to secure the revolving line of credit. (TR Vol. 2 at 273:25-275:24 (Curtin); TR Vol. 3 at 25:18-26:9 (Curtin); BOA Exhibit 11 at pp. 8-11). Curtin felt justified in doing little further due diligence in connection with BOA's secured line of credit because the funds to be used to secure the line were already on deposit at BOA in the Demand Deposit Account, and were not pledged previously or otherwise subject to any restrictions as held in that account. (TR Vol. 2 at 258:18-259:21, TR Vol. 3 at 25:11-17 (Curtin)).
60. On the day the revolving line of credit transaction closed, December 28, 2000, Curtin received a copy of MSM's September 30, 2000 financial statement, which BOA required MSM to provide in connection with the closing of the secured revolving line of credit. (TR Vol. 2 at 274:9-275:24 (Curtin); PacifiCare Exhibit 56). That financial statement showed \$4,979,210 of assets (identified in the PacifiCare Commercial HMO column of MSM's balance sheet) which were described as "Restricted Assets as to Use." (PacifiCare Exhibit 56). Moreover, the financial statement defined "assets limited as to use" as "[a]ssets deposited with trustee under terms of letter of credit agreements and assets set aside by the Board of Trustees for insolvency protection." (*Id.*). The \$4,979,210 of assets reflected on MSM's September 30, 2000 balance sheet are the same assets held in the BAISI Account as of September 30, 2000. (PacifiCare Exhibits 56 and 134). The value of the mutual fund investments in the BAISI Account as of that date was \$4,979,209.56. (PacifiCare Exhibit 134).

61. While Curtin got the September 30, 2000 financial statement on the day the revolving line of credit was established, he undertook only a “cursory” review of it before closing the deal. (TR Vol. 2 at 275:21-24 (Curtin)).
62. A careful review of MSM’s September 30, 2000 balance sheet would have raised questions about whether MSM had unrestricted funds available to secure a \$3 million revolving line of credit as of September 30, 2000. (PacifiCare Exhibit 56; TR Vol. 3 at 254:5-24 (McClellan)). But, about two months later, MSM pledged \$3 million of the CDs purchased with funds from the Demand Deposit Account as collateral for the BOA revolving line of credit. (TR Vol. 3 at 254:25-255:20 (McClellan)).
63. At trial, PacifiCare introduced expert testimony from its banking expert Chip Morrow (“Morrow”) to attempt to show that BOA knew, or should have known, that the funds in the BAISI Account were pledged to PacifiCare. (TR Vol. 3 at 68:23-71:13 (Morrow)). Morrow was qualified to offer expert testimony regarding what Curtin knew or had reason to know from his underwriting of the MSM-BOA credit relationship. In short, Morrow testified that according to industry standards in August of 2000 and Bank of America’s own manual, BOA knew or should have known of PacifiCare’s security interest in the BAISI Account by no later than September 2000 as a result of PacifiCare’s security reserve requirements in the Capitation Agreement. (TR Vol. 3 at 80:7-16, 82:20-25 (Morrow)).
64. In so testifying, Morrow analyzed BOA’s underwriting of the credit relationship and compared it to the underwriting principles set out in BOA’s June 2000 commercial bank lending manual. (TR Vol. 3 at 89:23-104:10 (Morrow); PacifiCare Exhibit 146). Morrow opined that BOA should

have known of PacifiCare's security reserve requirement as early as August 2000 from BOA's underwriting of the Aetna transaction, as well as BOA's analysis of MSM's business relationships with Aetna and PacifiCare. (TR Vol. 3 at 102:18-106:13 (Morrow)). Morrow also testified that an analysis and comparison of MSM's financial statements would have shown that MSM had a negative net worth at the time that BOA entered into the secured credit transaction. (TR Vol. 3 at 115:25-120:20 (Morrow)). Finally, Morrow testified that the September 30, 2000 financial statement should have alerted BOA to the existence of the security reserve requirement and PacifiCare's interest in the funds held in the BAISI Account. (TR Vol. 3 at 120:21-123:5, 126:5-25 (Morrow)).

Advances on the Secured Line of Credit.

65. Once the line of credit was extended by BOA, it was immediately exhausted. In other words, MSM had already incurred over \$3 million in overdrafts when the line of credit was initially extended at the end of December 2000, and all advances on the secured line of credit were immediately used to pay off \$3 million of the then outstanding overdrafts. (TR Vol. 3 at 260:11-262:12 (McClellan)).

PacifiCare's Knowledge of the Transfers of Funds from BAISI to BOA.

66. While PacifiCare contends that it did not know about, or consent to the transfer of funds from the BAISI Account to BOA, (TR Vol. 1 at 139:12-14, 145:11-20, 146:7-147:8 (Lovelady); TR Vol. 2 at 32:20-33:7 (Forman)), the testimony of its witnesses in that regard is ultimately unpersuasive. What is clear from the entire record is that PacifiCare's *financial managers* were unaware of the transfer of funds from the BAISI Account to BOA when they initially occurred, (TR Vol. 2 at

32:20-33:7 (Forman)), and did not become aware of those transfers until around January 26, 2001. (TR Vol. 2 at 33:8-35:13 (Forman)). However, the record is equally clear that PacifiCare's *network managers* were aware of MSM's desire to move its investment relationship to BOA during the summer of 2000 and of MSM's specific intention to liquidate the assets and move the resulting funds in the BAISI Account to BOA by late November/early December 2000. (BAISI Exhibit 31; TR Vol.1 at 178:23-179:5 (Lovelady)).

67. Specifically, by July 2000, MSM and PacifiCare had begun negotiations to amend the Capitation Agreement and to enter into a new account control agreement (BAISI Exhibit 13) for the purpose of moving the assets from the BAISI Account to a replacement account at BOA. (TR Vol. 4 at 550:21-557:9, 567:14-22 (Choudhry)). On July 24, 2000, Choudhry faxed a document to Miller attaching drafts of proposed amendments to those MSM/PacifiCare agreements. (*Id.* at 550:21-551:7). Choudhry was the lead drafter of the new BOA account control agreement on behalf of PacifiCare. (TR Vol. 1 at 181:7-23 (Lovelady)).
68. In November 2000, PacifiCare and MSM continued to exchange drafts of an account control agreement for the BOA account. (TR Vol. 1 at 178:8-180:22 (Lovelady); TR Vol. 4 at 551:17-554:2 (Choudhry)). Continuing that month and into December 2000, Lovelady, Choudhry, and Miller discussed the timing for (i) moving assets in the BAISI Account over to BOA, and (ii) executing the replacement agreements that Choudhry had been working on. (TR Vol. 1 at 128:6-131:16, 136:8-16, 138:9-20, 180:19-181:3 (Lovelady); TR Vol. 4 at 551:17-554:2, 555:22-557:9, 558:18-560:13 (Choudhry); BAISI Exhibit 26, 27, 30, and 32). In fact, in December 2000, Lovelady informed Choudhry that he wanted an aggressive schedule in place to finalize the

new security agreement and the new account control agreement. (TR Vol. 1 at 180:19-181:3 (Lovelady)).

69. On November 28, 2000, Miller sent Lovelady an email (with a copy to Choudhry) with the latest draft of the proposed BOA account control agreement attached, and requested that Lovelady review it because he “would like to move monies this week” to BOA. (BAISI Exhibit 30). Miller placed an indication on this email stating that it was of “high importance.” (*Id.*). Miller also sent Lovelady direct wiring instructions for deposit into the new reserve bank account at BOA. (TR Vol. 4 at 555:22-556:7 (Choudhry); BAISI Exhibit 27). The account number at BOA was the same account number in the new account control agreement. (TR Vol. 4 at 555:22-556:12 (Choudhry)).
70. On December 1, 2000, Choudhry sent a further revised BOA account control agreement to Miller by attachment to an email, also copying Lovelady on the email. (BAISI Exhibit 32). In this email, Choudhry stated that everything “looks fine.” (*Id.*). A reasonable inference from BAISI Exhibit 32 is that Choudhry consented to the transfer of the funds from BAISI to BOA on PacifiCare’s behalf at this point. While PacifiCare offered testimony that Choudhry did not have authority to consent on PacifiCare’s behalf, (TR Vol. 1 at 140:6-142:12 (Lovelady)), and that those PacifiCare officers with such authority had not consented, (TR Vol. 1 at 139:12-14, 142:13-146:14 (Lovelady)), it is not clear that MSM knew of any restrictions on Choudhry’s authority to consent to the transfer of funds from BAISI to BOA. In fact, Lovelady admitted that Choudhry was authorized to communicate with MSM regarding the contract matters that were the subject of Choudhry’s December 1, 2000 email. (TR Vol. 1 at 206:23-207:08 (Lovelady)). In any event,

at a minimum, Choudhry acquiesced in the transfer when it occurred. Neither Choudhry nor anyone else at PacifiCare took any steps to try to enforce the account control agreement PacifiCare believed to be in effect with BAISI after the assets were transferred to BOA. (TR Vol. 4 at 565:12-566:13 (Choudhry)).

71. On January 4, 2001, PacifiCare consulted with outside counsel regarding the replacement agreements. (TR Vol. 4 at 555:1-14 (Choudhry)). On January 5, 2001, with the liquidation of assets and transfer of funds from BAISI to BOA in progress, Lovelady sent Miller original replacement documents and asked Miller to sign and return them. (BAISI Exhibit 40; TR Vol. 1 at 182:1-11 (Lovelady)). The new agreements were satisfactory to Lovelady at this time. (TR Vol. 1 at 182:9-11 (Lovelady)).
72. Lovelady and Choudhry had not kept the financial group (specifically Comrie and Forman) updated regarding their negotiations with MSM, the multiple new agreements which were in process, or the anticipated transfer of funds from BAISI to BOA. (TR Vol. 2 at 40:3-21 (Forman); TR Vol. 4 at 366:16-368:6 (Comrie)). But, by no later than January 26, 2001, Forman and Comrie learned of the transfer of funds from BAISI to BOA. (TR Vol. 2 at 35:7-22 (Forman); TR Vol. 4 at 360:23-361:2 (Comrie)). Forman called BAISI's offices on January 26, 2001 and spoke to someone there who gave her no meaningful information because she was not BAISI's customer. (TR Vol. 2 at 34:19-38:1, 73:17-23 (Forman)). In that call Forman asked why funds were moved out of the BAISI Account without PacifiCare's consent and, when the person on the call refused to respond, she asked that someone return her call. (TR Vol. 2 at 36:6-38:1, 73:17-74:1 (Forman)). No one from BAISI returned her call, even though BAISI's internal

documents show that certain BAISI employees were expressing concern internally that the funds transferred from the BAISI Account had been subject to some sort of a restrictive agreement. (PacifiCare Exhibits 36, 119, and 120; TR Vol. 2 at 37:25-38:17 (Forman); TR Vol. 2 at 186:3-20 (Ricks)). However, Ricks contacted Miller and advised him of Forman's call. According to Rick's notes, Miller responded that "he would take care of it" and Ricks did not need to return Forman's call. (PacifiCare Exhibit 119). No one from BAISI contacted BOA to inform it that PacifiCare was claiming an interest in the funds transferred to BOA.

73. Other than her initial call on January 26, 2001, Forman made no further effort to contact BAISI to discuss the transfer of funds from BAISI to BOA. (TR Vol. 2 at 73:17-74:1 Forman)). Forman then learned from Lovelady that PacifiCare had been working with MSM on replacement agreements for a new security reserve account at BOA. (TR Vol. 2 at 40:17-21 (Forman)).
74. Prior to January 26, 2001, and certainly by no later than January 24, 2001, several other people at PacifiCare were aware that the assets in the BAISI Account had been liquidated and the resulting funds transferred to BOA as anticipated by Lovelady and Choudhry. (TR Vol. 1 at 183:9-17 (Lovelady); BAISI Exhibits 44 and 45). This information was officially communicated to others in PacifiCare. PacifiCare acknowledged the movement of the funds by internal memorandum dated January 24, 2001. (BAISI Exhibit 44). In one memorandum, Choudhry told his colleagues that "[t]hese agreements replace previous versions of both the Account Control and Security Agreements" (BAISI Exhibit 45).
75. With knowledge that the funds had already been transferred from BAISI to BOA, two departments within PacifiCare recommended signing the new agreements. (BAISI Exhibits 44 and

- 45). Of course, all PacifiCare employees involved in the MSM relationship – including Comrie, Forman, Lovelady, and Choudhry, intended that PacifiCare have a security interest in the Reserve Bank Account at BOA pursuant to the new account control agreement such that PacifiCare’s interest in the funds transferred from BAISI and all future monies deposited into the Security Reserve in accordance with the terms of the amended Capitation Agreement would be properly perfected.
76. With knowledge that Miller had transferred funds from the BAISI Account in violation of PacifiCare’s view of the requirements of both the Capitation Agreement and the account control agreement, PacifiCare voluntarily entered into a new account control agreement with MSM. (TR Vol. 4 at 553:9-557:9 (Choudhry); TR Vol. 4 at 362:6-363:3 (Comrie)). Even though Comrie testified that he did not trust Miller from that point forward, he made a business decision to keep doing business with MSM. (TR Vol. 4 at 362:6-363:3 (Comrie)).
77. During the negotiations surrounding the drafting and execution of the new account control agreement and related security agreement, PacifiCare had no direct communications with either BOA or Bank of America Corporation (“Corporation”), the Bank of America entity who, as drafted, was to be a signatory to the account control agreement. Instead, PacifiCare chose to use MSM as its intermediary.
78. At no time did PacifiCare ever demand, either through Forman or otherwise, that the wire transfers from BAISI to BOA be reversed, that the original account control agreement be enforced, or that BAISI take any action whatsoever to remedy PacifiCare’s perceived breach of the account control agreement by BAISI. (TR Vol. 1 at 177:20-178:3, 183:14-184:19, 188:11-22 (Lovelady); TR

Vol. 2 at 77:5-78:7, 99:5-15 (Forman); TR Vol. 2 at 222:19-25, 224:23-225:1 (Ricks); TR Vol. 4 at 360:8-362:18 (Comrie); TR Vol. 4 at 565:12-566:13 (Choudhry)).

79. Even Forman, who on January 31, 2001 had sent an email instructing her staff not to transfer any funds into the PacifiCare Account at BOA until the previous account control agreement issues were resolved, (BAISI Exhibit 53), thereafter permitted PacifiCare funds to be transferred into the PacifiCare Account at BOA. (TR Vol. 2 at 100:21-101:10 (Forman)).
80. From February to June 2001, PacifiCare deposited approximately \$2.4 million in the PacifiCare Account at BOA based on its belief that the funds were protected. (TR Vol. 2 at 58:21-59:17 (Forman); PacifiCare Exhibits 78A-E). PacifiCare deposited these funds pursuant to its amended Capitation Agreement with MSM, which provided that PacifiCare would fund MSM's security reserves directly by allocating a portion of PacifiCare's capitation payment to the Reserve Bank Account – now, the PacifiCare Account at BOA. (PacifiCare Exhibit 130). In doing so, PacifiCare believed that the additional funds were protected by the new account control agreement among PacifiCare, MSM, and Corporation. (TR Vol. 1 at 153:22-154:24 (Lovely); TR Vol. 2 at 54:7-24, 59:12-17, 64:25-66:3 (Forman)).
81. PacifiCare received bank statements from BOA which indicated that the funds in the PacifiCare Account at BOA were “pledged hold as collateral” (TR Vol. 2 at 64:25-65:16 (Forman); PacifiCare Exhibit 137). While these bank statements showed the funds to be “pledged,” that notation referred to the pledge to BOA, not PacifiCare.
82. During this same time period, MSM continued to incur substantial overdrafts at BOA – *ie.*, the \$3 million line of credit was fully advanced and MSM was overdrawn on its main operating account.

(TR Vol. 3 at 256:18-259:24 (McClellan)). In some instances, MSM's overdrafts exceeded the line of credit by \$2.6 to \$4.2 million. (PacifiCare Exhibits 100 and 140). Given MSM's obvious financial problems, and once again trying to secure an unsecured loan it did not want to make, BOA and MSM continued to discuss options for resolving the ongoing overdraft problem. One solution was to increase the line of credit. (TR Vol. 3 at 256:18-259:24 (McClellan)).

The Increased Line of Credit.

83. On May 29, 2001, MSM and BOA agreed to increase the secured line of credit to \$7 million. (PacifiCare Exhibit 91). BOA took an additional \$4 million in CDs held in the PacifiCare Account at BOA as collateral. (PacifiCare Exhibits 149 and 163). Given MSM's increasing financial problems and the limited sources of revenue to MSM, this additional collateral presumably included the remainder of funds previously transferred from the BAISI Account and \$2 million of funds deposited by PacifiCare from February to June 2001 as additional security reserves under the amended Capitation Agreement. (PacifiCare Exhibits 78A-E and 100).
84. BOA did no further due diligence of any significance in connection with increasing the line of credit. (TR Vol. 2 at 255:9-256:4, 272:4-9 (Curtin)). As before, the line of credit was immediately exhausted due to MSM's outstanding overdrafts. (PacifiCare Exhibit 140; TR Vol. 3 at 260:11-263:10 (McClellan)).

The Last Shoe Drops.

85. The parties' competing claims to the collateral held in the PacifiCare Account at BOA were not discovered until after the increased line of credit was fully advanced.
86. On July 13, 2001, BOA filed a declaratory judgment action in the United States District Court for

the Northern District of Texas seeking a determination that BOA held a valid, enforceable security interest with respect to the PacifiCare Account; that PacifiCare had no valid security interest in the account or no rights in the account superior to BOA's rights; and that BOA was not obligated to honor PacifiCare's demand to receive payment of all of the assets held in the account.

87. On July 24, 2001, MSM filed its voluntary petition under Chapter 11 of the Bankruptcy Code.
88. On August 15, 2001, BOA's declaratory judgment action was "removed" to this Court, and was assigned the above adversary number.
89. PacifiCare learned that the funds held in the PacifiCare Account at BOA were pledged to BOA when BOA filed this action against PacifiCare.
90. In response, PacifiCare filed multiple counterclaims against BOA and BAISI.² During discovery in connection with this action, a mistake by PacifiCare and certain fraudulent conduct by Miller at MSM was uncovered as explained below.
91. In the late January/early February 2001 time frame, PacifiCare's primary concern had been to finalize the BOA account control agreement and the other related documents that had been under discussion with MSM for some time in order to attempt to protect its interest in the funds now held at BOA. (TR Vol. 1 at 148:8-149:11, 155:21-156:11 (Lovelady)). While PacifiCare thought it had entered into a new account control agreement covering the PacifiCare Account at BOA, PacifiCare came to realize that it had signed an account control agreement with the wrong Bank of America entity. As executed by PacifiCare, that new account control agreement purported to

² Although denominated by PacifiCare as "counterclaims" in its answer, PacifiCare's claims against BAISI are technically third party claims, as BAISI was not a party to the complaint as filed.

be among PacifiCare, MSM, and Corporation, the parent holding company of BOA which maintains no depository accounts. Moreover, PacifiCare discovered that Miller forged the signature of a fictional employee of Corporation, Paul Kaatz, to the new account control agreement. So, not only had PacifiCare signed an agreement with the wrong Bank of America entity, that entity, Corporation, had not really signed the agreement.

92. In addition, to assuage PacifiCare's concerns about protecting the already transferred funds, Miller forged a letter purporting to be from Mark Tranchina at BOA that assured PacifiCare that the funds held in the PacifiCare Account at BOA were protected in favor of PacifiCare. (TR Vol. 2 at 48:10-52:1 (Forman); PacifiCare Exhibit 79). Someone also orchestrated a conference call between Forman and someone purporting to be a representative of BOA (whose name Forman did not get), in which the purported BOA representative assured Forman that the funds on deposit at BOA were now protected in PacifiCare's favor. (TR Vol. 2 at 41:20-48:15 (Forman)).
93. From this, PacifiCare believed that funds held in the PacifiCare Account at BOA were subject to its security interest through the newly executed account control agreement. As a result, PacifiCare authorized the release of capitation payments that had been withheld to further fund the security reserve requirements of the amended Capitation Agreement. (TR Vol. 1 at 153:22-154:24 (Lovelady); TR Vol. 2 at 54:7-24, 59:12-17 (Forman); PacifiCare Exhibits 78A-E).
94. If PacifiCare had known of Miller's and/or MSM's fraudulent activities in forging documents and signatures, and in orchestrating fake calls, Comrie, Lovelady, and Forman each testified that PacifiCare would have undertaken additional steps, or they would have recommended a different course of action, to protect PacifiCare's rights under the amended Capitation Agreement. (TR

Vol. 1 at 156:8-22 (Lovely); TR Vol. 2 at 62:17-23, 65:17-66:3 (Forman); TR Vol. 4 at 328:12-329:4 (Comrie)).

95. After a partial summary judgment in favor of BOA and BAISI, only two claims remained: (i) PacifiCare's breach of contract claim against BAISI (for an alleged breach of the original account control agreement), and (ii) PacifiCare's tortious interference with contract claim against BOA (for alleged interference with the Capitation Agreement's requirements that MSM maintain a Reserve Bank Account for PacifiCare's benefit).
96. To the extent that any of these findings of fact constitute conclusions of law, the Court adopts them as conclusions of law.

CONCLUSIONS OF LAW

1. The Court has jurisdiction over the adversary proceeding in accordance with 28 U.S.C. §§ 1334 and 157.

PacifiCare's Breach of Contract Claim Against BAISI.

2. To form a binding agreement, Texas contract law requires: (i) an offer, (ii) acceptance of that offer, (iii) a meeting of the minds, (iv) communication that each party consents to the terms, and (v) execution and delivery of the contract with the intent that it be mutual and binding. *See Interfederal Capital, Inc. v. Flagstar Bank, FSB*, 2001 WL 1645480 at *4 (N.D. Tex. Dec. 19, 2001)(citing *Komet v. Graves*, 40 S.W.3d 596, 600 (Tex. App – San Antonio 2001, no writ)). To satisfy the delivery requirement, there must be an expression of intent to accept the offer communicated or delivered to the offeror or someone authorized by the offeror to accept on its behalf. *See Jatoi v. Park Ctr., Inc.* 616 S.W.2d 399, 400 (Tex. Civ. App. – Fort Worth 1981,

writ ref'd n.r.e.); *Lee v. Stroman*, 470 S.W.2d 783, 785 (Tex. Civ. App. – Dallas 1971, writ ref'd n.r.e.); *see also* § 68 *Restatement (Second) of Contracts* (1981).

3. Manual delivery is not required, however, if the offer is silent as to the method of acceptance and the parties demonstrate that they intended for the contract to become effective. *See Awad Tex. Enters., Inc. v. Homart Dev. Co.*, 589 S.W.2d 817, 819-820 (Tex. Civ. App. – Dallas 1979, no writ); *Orgain v. Butler*, 478 S.W.2d 610, 614 (Tex. App.– Austin 1972, no writ). Texas law provides that once an offer has been made, the other party may manifest acceptance by written or spoken words, by actions, or even by the failure to act. *Hollywood Fantasy Corp. v. Gabor*, 151 F.3d 203, 210 (5th Cir. 1998) (citing *Fujimoto v. Rio Grande Pickle Co.*, 414 F.2d 648, 652 (5th Cir. 1969)).
4. Under Texas law, an acceptance by any medium reasonable under the circumstances is effective on dispatch, absent a contrary indication in the offer. *See Cantu v. Cent. Educ. Agency*, 884 S.W.2d 565, 567 (Tex. App. – Austin 1994, no writ) (citing *Restatement (Second) of Contracts* §§ 63(a) and 65). In this regard, the Restatement (Second) of Contracts provides that an acceptance made in the manner and by a medium invited by an offer is operative and completes the manifestation of mutual assent as soon as it is put out of the offeree's possession, without regard to whether it ever reaches the offeror. *See* § 63(a) *Restatement (Second) of Contracts* (1981). Further, the Restatement of Contracts provides that a medium of acceptance is reasonable if it is the one used by the offeror or one customary in similar transactions at the time and place the offer is received. *See* § 65 *Restatement (Second) of Contracts* (1981). Finally, the law provides that a written acceptance is received when it comes into the possession of the person addressed, or of

some person authorized by him to receive it for him, or when it is deposited in some place which he has authorized. See § 68 *Restatement (Second) of Contracts* (1981).

5. Based on the evidence presented at trial, the Court concludes that no valid and binding account control agreement was entered into among MSM, BAISI and PacifiCare because BAISI never learned of either PacifiCare's or MSM's acceptance of the account control agreement. The Court's analysis is set forth below.
6. The record is clear; BAISI never received a signed original of the proposed account control agreement back from either MSM or PacifiCare. Thus, in an attempt to satisfy the delivery requirement here, PacifiCare first contends that Miller was BAISI's agent – at least for purposes of receiving notice of acceptance of the proposed account control agreement from PacifiCare. Whenever an issue as to the existence of an alleged agency relationship is raised, the party who relies on its existence has the burden of proof. *Verna Drilling Co. v. Parks-Davis Auctioneers, Inc.*, 659 S.W.2d 877, 881 (Tex. App.—El Paso 1983, writ ref'd n.r.e.) (citing *Boucher v. City Paint & Supply, Inc.*, 398 S.W.2d 352 (Tex. Civ. App.—Tyler 1966, no writ)); *Hanson Southwest Corp. v. Dal-Mac Constr. Co.*, 554 S.W.2d 712, 719 (Tex. App.—Dallas 1977, writ ref'd n.r.e.). Actions of an agent are not presumed to be within the scope of his or her authority. *In re Westec Corp.*, 434 F.2d 195, 200 (5th Cir. 1970). The party dealing with the purported agent has a duty to ascertain both the fact of the agency relationship and the extent of the agent's authority. *Suarez v. Jordan*, 35 S.W.3d 268, 273 (Tex. App.—Houston [14th Dist.] 2000, no pet.).
7. On this record, PacifiCare has not met its burden of proving that Miller was BAISI's agent and that

it knew Miller was BAISI's agent at the time it accepted the proposed account control agreement. Absent from PacifiCare's case is a showing that PacifiCare investigated and determined that Miller was BAISI's agent at that, or any other, time. Under Texas law, "[o]nly the conduct of a principal [BAISI] may be considered; representations made by the agent [Miller] of his authority have no effect." *Suarez*, 35 S.W.3d 268 at 173. There is no evidence that PacifiCare ever communicated with BAISI regarding Miller's purported authority to act on BAISI's behalf.

8. While BAISI preferred to work through its customer, MSM, during the negotiation of the proposed account control agreement, and Frost expected to learn from Miller whether PacifiCare had accepted the agreement in the first instance, he also expected to get a fully executed copy of the agreement back from both PacifiCare and MSM. (TR Vol. 1 at 264:3-266:10 (Frost)). In short, Miller was not BAISI's agent and BAISI did not hold Miller out to PacifiCare as its agent for purposes of receiving notice of PacifiCare's acceptance of the proposed account control agreement.
9. Moreover, Lovelady did not believe that Miller was BAISI's agent for purposes of receiving notice of PacifiCare's acceptance when the proposed account control agreement was signed. If Lovelady had thought Miller was BAISI's authorized agent for that purpose when the agreement was signed, Lovelady would have instructed Baron to mail both originals back to MSM – one original for MSM and one original for BAISI. But, Lovelady did not do that. Rather, he instructed Baron to return an original signed document to BAISI directly.
10. The combination of this testimony from BAISI and PacifiCare makes it clear that BAISI had not held Miller out to PacifiCare as its agent, nor did PacifiCare believe Miller to be BAISI's agent.

Rather, Miller was a principal of another party, MSM, to the proposed tri-party agreement. Until all three parties accepted the proposed agreement and delivered notice of its acceptance to the other two parties to that agreement (or their authorized agents), no binding agreement was formed. Because BAISI never received a signed copy of the proposed account control agreement back from either MSM or PacifiCare, no binding agreement was formed.

11. PacifiCare next contends that by telling Miller that PacifiCare accepted the proposed account control agreement, PacifiCare communicated its acceptance of the agreement in the same manner as BAISI communicated its offer – *i.e.*, through Miller, and that this was reasonable under the circumstances and effective acceptance in accordance with § 65, *Restatement (Second) of Contracts* (1981). The Court cannot agree. BAISI’s offer to PacifiCare was communicated not by Miller, but through a written offer – *i.e.*, the proposed account control agreement. BAISI signed the proposed agreement, thereby indicating that the terms set forth in that proposed agreement were acceptable to it. While Miller forwarded the proposed agreement on to PacifiCare, Miller did not communicate the terms of BAISI’s offer to PacifiCare; it was unnecessary for him to do so as the proposed agreement spoke for itself.
12. Moreover, PacifiCare contends that under the law, it is irrelevant whether Miller ever informed BAISI that PacifiCare accepted the proposed account control agreement, as acceptance made in the manner and by a medium invited by an offer is operative and completes the manifestation of mutual assent as soon as put out of the offeree’s possession, without regard to whether it ever reaches the offeror in accordance with §§ 63(a) and 68, *Restatement (Second) of Contracts* (1981). Again, the Court cannot agree. In making this argument, PacifiCare overlooks the

significance of the tri-party nature of the proposed account control agreement. In effect, by signing the proposed account control agreement and forwarding it to Miller, who in turn would forward it to PacifiCare, BAISI made an offer to both MSM and PacifiCare of terms for an account control agreement that it would find acceptable. While PacifiCare arguably accepted the proposed account control agreement in the same manner – *i.e.*, by signing the agreement and forwarding it to Miller, who in turn was to forward it to BAISI, MSM never communicated its actual acceptance of the proposed account control agreement to BAISI. While BAISI thought the terms of the proposed account control agreement would be acceptable to MSM when it signed the agreement and forwarded it to Miller, BAISI never received a signed agreement back from either PacifiCare or MSM. In fact, the evidence is uncontroverted that Miller advised BAISI that PacifiCare refused to sign the proposed agreement because it preferred a more “secure” letter of credit arrangement. Moreover, MSM never gave notice of its acceptance of the proposed account control agreement to BAISI either. Thus, even if PacifiCare accepted the proposed account control agreement in the same manner as BAISI invited by its offer as PacifiCare contends, MSM did not. And until BAISI was advised that all three parties had agreed to its terms, there was no effective account control agreement among the parties. In short, BAISI had no way of knowing that PacifiCare and MSM had both agreed to the terms of the proposed account control agreement and intended to be bound by it.

13. The cases PacifiCare relies upon to support a contrary conclusion here are not persuasive. In those cases (most of which are lease cases), the courts do not allow one party’s failure to formally deliver a signed contract to the other to prevent enforcement of its terms against the other. But,

of significance, in those cases both parties to the contract were actually aware through their acts that the lease was in effect and were accepting the benefits of the contract – *i.e.*, the tenant was actually occupying the premises and paying rent and the landlord knew of the occupancy – either directly or through a property manager or broker whose job it was to lease the property. Here, BAISI simply had no way of knowing that PacifiCare believed the proposed account control agreement to be in effect among the three parties – unless the Court finds PacifiCare’s final arguments to be persuasive, to which we now turn.

14. PacifiCare contends that MSM and PacifiCare communicated PacifiCare’s acceptance of the proposed agreement to BAISI in August 2000, when (i) MSM funded the BAISI Account, and/or (ii) Forman spoke with Hunter to confirm that the funds in the BAISI Account were subject to the account control agreement. For the reasons explained below, neither act will suffice here for notice of acceptance to BAISI.
15. PacifiCare first argues that the deposit of significant funds into the BAISI Account constituted acceptance of the proposed account control agreement by MSM and PacifiCare. Of course, PacifiCare did not deposit the funds into the BAISI Account, MSM did. To reach the conclusion PacifiCare advances, the Court would have to overlook this distinction, which it is unwilling to do. Moreover, these monies were not new monies to a BAISI account. The assets had been at BAISI before and were simply returned to BAISI when Miller elected to keep his investment relationship at BAISI instead of with Frost who had taken a job at Legg Mason.
16. There are other flaws in PacifiCare’s contention as well, which is largely premised upon the fact that Frost “understood” from Miller when the BAISI Account was initially opened that no

significant funds would be deposited into the BAISI Account until an account control agreement was in place. From the fact that significant funds were then deposited into the BAISI Account, PacifiCare concludes that BAISI must have known of MSM's and PacifiCare's acceptance of the proposed account control agreement. In this context, the Court cannot agree for at least two reasons. First, Frost was no longer at BAISI when the funds were deposited. So, any informal "understanding" he may have had was no longer of any legal consequence. Second, there is simply no legal significance to the deposit of funds into the BAISI Account. MSM was free to deposit funds into its accounts at any time.

17. The Court will not require BAISI to read PacifiCare's mind from afar. If PacifiCare wanted BAISI to be on notice of its acceptance of the proposed account control agreement, it could have delivered a signed copy of that agreement to BAISI directly. Moreover, a PacifiCare representative could have simply called Frost when the agreement was first signed by PacifiCare to advise him that the proposed agreement was acceptable to PacifiCare. PacifiCare was the party with a significant financial interest in insuring that the agreement's protections were in place. BAISI had little to gain from entering into the agreement, other than a satisfied customer. In fact, by proposing to restrict the account, BAISI only subjected itself to potential claims (like these) for breach of contract.
18. This leads us of course to PacifiCare's final contention – *i.e.*, that Forman's call to Hunter on August 4, 2000 should constitute notice to BAISI of PacifiCare's acceptance of the proposed account control agreement. Again, the Court cannot agree. First, the Court finds it odd that Lovelady does not remember the call – at all. This is a call of some significance to PacifiCare, as

it had finally gotten MSM to fund the Security Reserve required by the Capitation Agreement. Thus, protecting the funds finally on deposit should have been of paramount concern to both Lovelady, who was responsible for this business deal and the account's funding, and Forman, who was the day-to-day financial officer monitoring the relationship. The Court finds it quite troubling that Lovelady has no recollection of the call, or the substance of what was discussed, particularly given the legal significance PacifiCare wants this Court to place on the content of the call.

19. On this record, the Court cannot conclude that Forman's call with Hunter constituted notice to BAISI of PacifiCare's acceptance of the proposed account control agreement. The Court did not find Forman to be a particularly compelling witness. While the Court is not suggesting that it believes Forman "doctored" her notes of the call (as BAISI contends), the Court is unwilling to conclude that a conversation with Hunter put BAISI on notice of PacifiCare's acceptance of the proposed account control agreement for at least two further reasons. First, Forman had no idea who Hunter was. She made no inquiry of his position with BAISI. She called him because he was the person who sent the fax of the account statement for the BAISI Account. (TR Vol. 2 at 86:19-22 (Forman)). If she had inquired as to his position at BAISI, she would have discovered that he was a recent college graduate employed at BAISI for a short time as a sales assistant without authority to speak to substantive issues affecting BAISI customers. Second, Hunter (who does not recall the phone conversation with Forman at all) credibly denied assuring Forman that PacifiCare's interest in the assets in the BAISI Account was protected by any account control agreement because the information available to him from the operations systems showed no such restrictions on the BAISI Account.

20. For all of these reasons, the Court concludes that no binding account control agreement was in effect among the parties. As a result, the Court need not address the remaining elements of PacifiCare's breach of contract claim or BAISI's affirmative defenses of waiver, ratification, and estoppel to that claim. However, the Court will address BAISI's claim for attorneys' fees below.

BAISI's Claim for Attorneys' Fees Against PacifiCare.

21. In its amended answer and counterclaim, BAISI asserts, in the alternative, an entitlement to recover its reasonable attorneys' fees if the Court concludes that there is a binding account control agreement in effect among the parties and BAISI is the prevailing party at trial. BAISI's amended answer and counterclaim does *not* assert a claim for attorneys' fees in the event the Court concludes that no binding account control agreement was in effect among the parties.

22. Nevertheless, BAISI now proposes a conclusion of law which is broader than the claim asserted previously. Specifically, BAISI now proposes that the Court conclude that BAISI is entitled to recover its reasonable attorneys' fees from PacifiCare because PacifiCare chose to pursue a breach of contract claim against BAISI based solely on the account control agreement and PacifiCare did not prevail at trial.

23. Since the Court concluded that there was no binding agreement in effect among the parties, BAISI is not entitled to recover its reasonable attorneys' fees as requested in its amended answer and counterclaim. Because BAISI's new theory of recovery was not pled prior to trial (in either its amended answer and counterclaim or the parties' joint pre-trial order), the Court concludes that BAISI waived this theory of recovery. *Elvis Presley Enter. Inc. v. Capece* 141 F.3d 188 (5th Cir. 1998) (issues not raised in pre-trial order are waived); *Triad Elec. & Controls, Inc. v.*

Power Sys. Eng'g, Inc., 117 F.3d 180 (5th Cir. 1997) (ruling on unplead issue is appropriate only where there is express consent or party impliedly consented to trial of that issue; consent not to be lightly inferred).

24. However, even if the Court were to consider this “new,” unpled theory of recovery on the merits, it fails as a matter of law. Pursuant to the “American Rule” governing the recovery of attorneys’ fees, “the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys’ fee from the loser. Generally, absent statute or *enforceable* contract, litigants must pay their own attorneys’ fees.” *Galveston County Nav. Dist. No. 1 v. Hopson Towing Co.*, 92 F.3d 353, 356 (5th Cir. 1996) (quoting *Alyeska Pipeline Serv. Co. v. Wilderness Society*, 421 U.S. 240, 255-57 (1975)) (emphasis supplied). Texas follows the American Rule. *Ashland Chem. Inc. v. Barco Inc.*, 123 F.3d 261 (5th Cir. 1997); *see, e.g. Knebel v. Capital Nat. Bank in Austin*, 518 S.W.2d 795 (Tex. 1975). Thus, under Texas law, a party may recover attorneys’ fees only if they are authorized by an enforceable contract or by statute. *Bank One Tex., N.A. v. Taylor*, 970 F.2d 16 (5th Cir. 1992) (citing *New Amsterdam Cas. Co. v. Tex. Indus. Inc.*, 414 S.W.2d 914 (Tex. 1967)); *Travelers Indem. Co. of Connecticut v. Mayfield*, 923 S.W.2d 590 (Tex. 1996).
25. Here, the Court has concluded that no binding account control agreement was in effect among the parties. As the contract was not in effect, paragraph 6(h) of that contract was also not effective. In short, BAISI cannot make a claim under an agreement which is not enforceable against the parties. *See Hill v. Heritage Res., Inc.*, 964 S.W.2d 89 (Tex. App. - El Paso, 1997) (finding there can be no recovery of attorneys’ fees based on a contract where Statute of Frauds bars its

enforcement); *David v. Richman*, 568 So.2d 922 (Fla. 1990) (finding that party may not recover attorneys' fees under contractual provision where contract was never validly formed); *Gibson v. Courtois*, 539 So.2d 459 (Fla. 1989) (rejecting the argument that a party who attempted to uphold the enforceability of a contract is estopped from claiming the attorney fee provision in that same contract is unenforceable, but holding that where contract never came into existence, attorneys' fees under the contract could not be recovered); *see also Richter, S.A. v. Bank of Am. Nat'l Trust and Sav. Ass'n*, 939 F.2d 1176 (5th Cir. 1991) (holding that attorneys' fees not recoverable under Texas statute providing for their recovery on claim for breach of contract where contract held to be unenforceable for indefiniteness).

26. Accordingly, BAISI is not entitled to a recovery of its attorneys' fees from PacifiCare.

PacifiCare's Tortious Interference Claim Against BOA.

27. To prevail on a claim for tortious interference, PacifiCare must prove that: (i) a contract subject to interference exists, (ii) the alleged act of interference was willful and intentional, (iii) the willful and intentional act proximately caused damage, and (iv) actual damage or loss occurred. *Personal Preference Video, Inc. v. Home Box Office, Inc.*, 986 F.2d 110, 111 (5th Cir. 1993) (citing *Victoria Bank & Trust Co. v. Brady*, 811 S.W.2d 931, 939 (Tex. 1991)); *Prudential Ins. Co. of Am. v. Fin. Review Serv.*, 29 S.W.3d 74, 77 (Tex. 2000), *ACS Investors, Inc. v. McLaughlin*, 943 S.W.2d 426, 430 (Tex. 1997).

28. On this record, it is clear that there was a contract subject to interference – *i.e.*, the Capitation Agreement and its amendment, which required the establishment of a Reserve Bank Account. (PacifiCare Exhibit 1 at § 2.8.2(e); PacifiCare Exhibit 130 at ¶ 1). Therefore, Pacificare met its

burden with regard to the first element of its tortious interference claim.

29. The Court turns next to the second element of a tortious interference claim – a willful and intentional act of inducing interference. Obviously, interference with a contract is tortious only if it is intentional. *Southwestern Bell Tel. Co. v. John Carlo Tex., Inc.*, 843 S.W.2d 470, 472 (Tex. 1992). Texas law does not require intent to injure. To be intentional, the actor must only desire to cause the consequences of his act or believe that the consequences are substantially certain to result from his action. *Wardlaw v. Inland Container Corp.*, 76 F.3d 1372, 1375-1376 (5th Cir. 1996) (citing *Southwestern*, 843 S.W.2d 470 at 472 (internal citations omitted)).
30. To satisfy the second element, PacifiCare must also establish that BOA knowingly induced MSM to breach its obligations to PacifiCare under the Capitation Agreement and its amendment. To do so, PacifiCare must establish that BOA took an active part in persuading MSM to breach it. *Davis v. Hyd Pro, Inc.*, 839 S.W.2d 137 (Tex. App. – Eastland 1992, writ denied). Further, under Texas law, intentional acts of interference include all invasions of contractual relations, including inducement or procurement of a contract breach, active efforts to persuade a party to a contract to breach it, and any other act that retards, makes more difficult or prevents performance. *John Paul Mitchell Sys. v. Randalls Food Mkts, Inc.*, 17 S.W.3d 721, 730-31 (Tex. App. – Austin 2000, pet. denied); *Tippett v. Hart*, 497 S.W.2d 606, 610 (Tex. App. – Amarillo 1973, writ ref'd n.r.e.).
31. There are two potential points of intentional interference with the Capitation Agreement: (i) when the approximately \$4.8 million was transferred from the BAISI Account to BOA in December 2000 in connection with the establishment of the secured line of credit, and (ii) when the secured

line of credit was increased in May 2001. The Court will analyze each potential point of intentional interference separately.

32. Turning first to the December 2000 time frame, and consistent with the legal meaning of intent (desire or substantial certainty), PacifiCare had to show that BOA either (i) had actual knowledge that MSM deposited funds in the BAISI Account pursuant to the “security reserve” provision of the Capitation Agreement or (ii) had facts from which a reasonable person would conclude that MSM deposited funds in the BAISI Account pursuant to the “security reserve” provision of the Capitation Agreement. *Exxon Corp. v. Allsup*, 808 S.W.2d 648, 656 (Tex. App. —Corpus Christi 1991, writ denied); *see also Steinmetz & Assoc., Inc. v. Crow*, 700 S.W.2d 276, 278 (Tex. App.—San Antonio 1985, writ ref’d n.r.e.); *Kelly v. Galveston County*, 520 S.W.2d 507, 513 (Tex. Civ. App.—Houston [14th Dist.] 1975, no writ); *Armendariz v. Mora*, 553 S.W.2d 400, 406 (Tex. Civ. App.—El Paso 1977, writ ref’d n.r.e.); *Tippet v. Hart*, 497 S.W.2d 606, 611 (Tex. Civ. App.—Amarillo 1973, writ ref’d n.r.e).
33. The reference to a "reasonable person" does not mean that BOA is charged with a legal duty to discover facts not in its possession—*i.e.*, facts that it "should have discovered" through investigation and due diligence, such as in a negligence case. Texas law has in mind situations where a person observes conduct or a set of facts that would not occur or exist in the absence of some contractual obligation. *See, e.g., Kelly*, 520 S.W.2d 507 at 513 (“It can be reasonably inferred from the undisputed fact that Kelly was administrator of the Galveston County Coordinated Community Clinics that he had some form of contractual arrangement.”); *see also Steinmetz & Assocs. v. Crow*, 700 S.W.2d 276, 280 (Tex. App. – San Antonio 1985, writ ref’d n.r.e.)(holding that “duty

of inquiry” in tortious interference context only extends to those matters that are fairly suggested by the facts really known – *i.e.*, can be reasonably inferred from those known facts). Under Texas law, a person has “notice” of a fact when he has actual knowledge of it, he has received a notice or notification of it or, from all facts known to him at the time, he has “reason to know” that it exists. Tex. Bus. & Comm. Code § 1.201(25).

34. There is no evidence that BOA had actual knowledge that the funds transferred to BOA in December 2000 had been deposited by MSM in the BAISI Account pursuant to the “security reserve” provision of the Capitation Agreement. Thus, applying the relevant legal standard here, PacifiCare had to show that BOA had facts from which a reasonable person would conclude, or facts from which it could be reasonably inferred, that the \$4.8 million held in the BAISI Account constituted the Security Reserve under the terms of the Capitation Agreement. For the following reasons, the Court concludes that the evidence PacifiCare presented is legally insufficient to establish a willful and intentional act of interference.
35. First, under the Capitation Agreement, MSM could satisfy its obligation to create the Security Reserve in more than one way. MSM could fund the Security Reserve with a letter of credit backed up by the Reserve Bank Account and additional cash deposits. (PacifiCare Exhibit 1 at §§ 2.8.2(a), 2.8.2(c)). Or, under Section 2.8.2(d) of the Capitation Agreement, MSM could obtain insolvency insurance to satisfy all or a portion of the security reserve requirement. (PacifiCare Exhibit 1). As Lovelady admitted, BOA did not know if MSM had satisfied the security reserve requirement by providing insolvency insurance or whether insolvency insurance was available to MSM, as PacifiCare did not inform BOA of either of these facts. (TR Vol. 1 at

221:6-222:17 (Lovelady)). Because BOA did not know whether insolvency insurance was in place, and that was an alternative available to MSM through which to satisfy the security reserve requirement, BOA was not in possession of sufficient facts from which it could be reasonably inferred that the \$4.8 million was the Security Reserve called for in the Capitation Agreement.

36. Second, as noted previously, Section 2.8.2(a) of the Capitation Agreement called for a letter of credit to be funded in the initial amount of \$1,000,000 and secured by cash collateral. (PacifiCare Exhibit 1). The schedule for funding additional “security reserve” amounts under Section 2.8.2(c) of the Capitation Agreement was conditioned upon and triggered by the “Commencement Date” of the Capitation Agreement. (PacifiCare Exhibit 1 at § 2.8.2(c)). Moreover, the amounts to be additionally funded were not specified, but had to be calculated. (*Id.*). Lovelady conceded that the “Commencement Date” was not apparent from the face of the Capitation Agreement and that no one at PacifiCare gave BOA the information it would need to determine the “Commencement Date.” (TR Vol. 1 at 218:13-216:17 (Lovelady)). Moreover, Lovelady admitted that no one at PacifiCare gave BOA the information it would need to make the required calculation for determining the amount to be additionally funded. (TR Vol. 1 at 218:14-220:10 (Lovelady)). As a result, armed only with a copy of the Capitation Agreement, BOA had no way of knowing or determining how much the Security Reserve should be. Thus, on this record, BOA did not have knowledge of facts from which it could be reasonably inferred that some portion, or all, of the approximately \$4.8 million was the Security Reserve called for in the Capitation Agreement.
37. Third, PacifiCare admitted that BOA could not have determined that PacifiCare claimed a security interest in the BAISI Account based upon a review of the Capitation Agreement. (TR Vol. 1 at

223:7-13 (Lovelady)).

38. Fourth, while the Capitation Agreement was amended in December 2000, BOA did not learn about the amendment until February 2001, well after the transfer of the approximately \$4.8 million from the BAISI Account to BOA. (TR Vol. 3 at 13:19-14:3 (Curtin)).
39. The most compelling piece of evidence PacifiCare offered at trial was the September 30, 2000 financial statement of MSM which BOA received on December 28, 2000, the day the line of credit was established. As found previously, that financial statement showed that MSM had approximately \$4.9 million of assets as of September 30, 2000 (identified in the PacifiCare Commercial HMO column of MSM's balance sheet) that were "restricted as to use" – *i.e.*, "[a]ssets deposited with trustee under terms of letter of credit agreements and assets set aside by the Board of Trustees for insolvency protection." (PacifiCare Exhibit 56; finding 60, *supra*). So, does this financial statement put BOA on notice of sufficient facts from which a reasonable person would conclude that the investments in the BAISI Account constituted the "Security Reserve" MSM was required to establish under the Capitation Agreement for PacifiCare's benefit when the line of credit was established and collateralized in December 2000?
40. As found previously, this financial statement raises questions about whether MSM had unrestricted funds available to secure a \$3 million line of credit at the end of September 2000. (*See* finding 62, *supra*). But, the line of credit was not established and collateralized at the end of September; that occurred some two months later. Given the alternative ways by which MSM could satisfy the Capitation Agreement's security reserve requirement, *see* conclusions 35 and 36, *supra*, the Court cannot conclude that the September 30 financial statement put BOA on notice of sufficient facts

from which it could be reasonably inferred that the assets in the BAISI Account in December 2000 represented the “Security Reserve” called for in the Capitation Agreement.³

41. In sum, while BOA knew about the existence of the BAISI Account, and it knew from the Capitation Agreement that some form of security was required, the Court is not persuaded that BOA had knowledge of facts from which it could be reasonably inferred that the assets in the BAISI Account represented the “Security Reserve” provided for in the Capitation Agreement when the line of credit was established in December 2000. Thus, PacifiCare failed to prove that BOA willfully and intentionally interfered with the Capitation Agreement at that time. The Court further concludes that BOA could not have interfered with the amendment to the Capitation Agreement when the line of credit was established in December 2000, since BOA did not know of its existence until February 2001, well after the transfer of the approximately \$4.8 million from the BAISI Account.

42. Turning next to May 2001 when the line of credit was increased and MSM pledged additional funds (which PacifiCare also claims were a portion of its Security Reserve) to BOA, there is no evidence that BOA had actual knowledge that the funds on deposit at BOA were deposited by MSM pursuant to the “security reserve” provision of the amended Capitation Agreement. Thus, applying the relevant legal standard here, PacifiCare had to show that BOA had facts from which a reasonable person would conclude, or facts from which it could be reasonably inferred, that the

³Of equal significance, however, is the fact that BOA did not engage in intentional conduct that induced MSM’s breach of the Capitation Agreement. (*See* conclusion 45, *infra*). By December 2000, MSM had already breached the Capitation Agreement. Absent evidence of intentional conduct that induced MSM’s breach of the Capitation Agreement, PacifiCare’s intentional interference claim also fails.

funds on deposit at BOA constituted the Security Reserve under the terms of the amended Capitation Agreement. For the following reasons, the Court concludes that the evidence PacifiCare presented is legally insufficient to establish a willful and intentional act of interference.

43. While BOA had a copy of the amended Capitation Agreement at this time, it also knew that the funds on deposit at BOA were not subject to any restrictions in favor of PacifiCare. Why? Because BOA knew it had not signed an account control agreement in PacifiCare's favor with respect to any of MSM's accounts at BOA. Nor had PacifiCare filed a financing statement with respect to the pledge to it of the account at BOA as provided in the amended security agreement. Thus, at most, BOA knew of the amended Capitation Agreement's requirement that MSM maintain a security reserve and establish a reserve bank account. But, it had no facts from which a reasonable person would have concluded that the funds pledged to it in May 2001 (which were on deposit in unrestricted accounts at BOA prior to the pledge) were supposed to be pledged to PacifiCare under the terms of the amended Capitation Agreement.
44. In sum, the Court cannot conclude that BOA had possession of facts from which a reasonable person would have concluded that the funds transferred to BOA from BAISI were pledged to PacifiCare under the Capitation Agreement. Moreover, on this record, the Court cannot conclude that BOA had possession of facts from which a reasonable person would have concluded that the funds on deposit at BOA in 2001 were pledged to PacifiCare under the amended Capitation Agreement. For this reason, PacifiCare's tortious interference claim fails as a matter of law. However, there are other problems with PacifiCare's tortious interference claim to which we will now turn.

45. To prevail, PacifiCare also had to prove that BOA engaged in intentional conduct that induced MSM to breach the Capitation Agreement. On this record, the Court cannot so conclude. By December 2000 when the line of credit was first established, MSM was already in breach of the Capitation Agreement. For whatever reason, Miller at MSM had decided to embark on a course of fraudulent conduct in connection with MSM's relationship with PacifiCare. The first fraudulent act of which the Court is aware occurred when Miller led PacifiCare to believe that the account control agreement was in place with respect to the BAISI Account; but he told BAISI that PacifiCare had refused to sign that agreement, preferring a more secure letter of credit arrangement. For the reasons discussed previously, the Court has concluded that there was no valid account control agreement in effect among PacifiCare, MSM, and BAISI. (*See* conclusions 5-20, *supra*). MSM's failure to enter into a binding account control agreement constituted a breach of the Capitation Agreement. (PacifiCare Exhibit 1 at § 2.8.2(e)). But, the fraud by MSM against PacifiCare continued. Miller: (i) forged a new account control agreement to allegedly protect funds deposited by PacifiCare at BOA under the amended Capitation Agreement, (ii) forged a letter purporting to be from a BOA employee to assure PacifiCare that the funds transferred from BAISI were subject to the protections of the new account control agreement while on deposit at BOA, and (iii) orchestrated a telephone call with someone purporting to be a BOA employee to give PacifiCare further assurances with regard to the transferred funds. There never was a valid account control agreement in place with respect to funds on deposit at BOA either. The fact that MSM failed to enter into a valid account control agreement with respect to funds on deposit at BOA was a breach of the amended Capitation Agreement. (PacifiCare Exhibit 130 at

¶1). The BOA conduct complained of here by PacifiCare occurred after MSM had first breached the Capitation Agreement and is simply not actionable as BOA did not induce MSM's breach of that agreement. *Davis v. Hyd Pro, Inc.*, 839 S.W.2d 137 (Tex. App. – Eastland 1992, writ denied).

46. Moreover, merely entering into a contract with a party with the knowledge of that party's contractual obligations to someone else is not the same as inducing a breach. *John Paul Mitchell Sys. v. Randall's Food Mkts.*, 17 S.W.3d 721, 731 (Tex. App.—Austin 2000, pet. denied). A defendant must do more than merely reap the advantages of a broken contract after the contracting party has already breached its contract of its own volition. *Arabesque Studios, Inc. v. Acad. of Fine Arts Int'l, Inc.*, 529 S.W.2d 564, 568 (Tex. Civ. App.—Dallas 1975, no writ). At best, the evidence showed that BOA benefited from MSM's fraudulent conduct which, in turn, resulted in MSM's breach of the Capitation Agreement (in either its original form or as amended). But, BOA did not induce the fraudulent conduct by MSM or the resulting breaches of the Capitation Agreement by MSM; thus, it cannot be held liable to PacifiCare for tortious interference.
47. Because PacifiCare failed to establish the second element of its tortious interference claim, the Court need not address the further elements of proximate cause and damages or BOA's affirmative defense of justification. But, because it is ultimately dispositive here, the Court will address the issue of relative fault under Texas state law and its legal effect on PacifiCare's tortious interference claim.
48. Even if the Court concluded that PacifiCare carried its burden of proof with respect to each element of a tortious interference claim, and the Court concluded that BOA was not justified in its

actions, PacifiCare is precluded from recovering damages here in accordance with Section 33.001 of the Texas Civil Practices and Remedies Code. Under that statute, PacifiCare cannot recover damages if its percentage of responsibility for the injuries it claims is greater than 50 percent.

49. On this record, PacifiCare must bear more than 50 percent of the responsibility for the injuries it claims. While none of the parties should be particularly proud of their institutional conduct here, PacifiCare could have protected itself by three simple, common sense acts – *i.e.*, by making two phone calls and sending one letter. By way of example (admittedly with the benefit of 20/20 hindsight), if Lovelady had called Frost to tell him that Comrie had signed the account control agreement for the BAISI Account, then notice of acceptance would have been proven, and the Court, in all likelihood, would have found a binding account control agreement to be in effect among the parties, thereby perfecting PacifiCare’s interest in the assets in the BAISI Account. Moreover, if Lovelady had sent a letter to Miller, with a copy to Ricks, advising that PacifiCare did not consent to the transfer of funds from BAISI to BOA, nor would it consent until the new account control agreement with BOA was in effect; it is unlikely that BAISI would have allowed funds to be transferred in violation of the account control agreement (of which it was aware from Lovelady’s earlier call). Finally, if Lovelady had called the fictional Paul Kaatz, who was to sign the new account control agreement on Corporation’s behalf, he would have discovered that there was no such person and, in all likelihood, the extent of Miller’s attempted fraud would have been discovered before any funds left their protected status at BAISI. Through these three simple acts, PacifiCare could have not only protected itself, but shifted the risk to BOA, who had, inexplicably, allowed a customer to overdraw its accounts by multiple millions of dollars. But, PacifiCare did

none of these things; and this suit resulted.

50. PacifiCare made other mistakes in its handling of its relationship with MSM, which further support the Court's conclusion that it bears more than 50 percent of the responsibility for the injuries it claims. First, PacifiCare failed to deliver an executed copy of the account control agreement for the BAISI Account to BAISI. Second, while Miller should not have moved funds to BOA without PacifiCare's written consent under the Capitation Agreement, PacifiCare failed to put Miller on notice that it did not consent to the transfer. Miller advised PacifiCare that he wanted to move the funds from BAISI to BOA "this week," (BAISI Exhibit 30), and no one at PacifiCare told him not to move the funds until the new account control agreement was in place. As found previously, Choudhry appeared to consent to the transfer on PacifiCare's behalf. Third, after learning that the funds had moved without a new account control agreement in place, PacifiCare did not demand a reversal of the transaction, or otherwise object in any meaningful way to either BAISI or BOA. Fourth, after learning that funds had moved without a new account control agreement in place, PacifiCare did not invoke any of the remedies available to it under the Capitation Agreement, one of which would have been to cease doing business with MSM. (PacifiCare Exhibit 1 at §§ 2.10 and 6.2.2(iv)). Moreover, PacifiCare did not invoke any other remedy available to it under applicable law and Section 6.7 of the Capitation Agreement. (PacifiCare Exhibit 1 at § 6.7). Fifth, PacifiCare entered into a new account control agreement with the wrong entity. After consulting with outside legal counsel, it signed a new agreement with a bank holding company that maintains no depository accounts. PacifiCare failed to protect itself by recognizing the entity discrepancy between its deposit of funds into an account at BOA and its new account control agreement

“allegedly” with Corporation. Sixth, PacifiCare failed to perfect its alleged security interest according to the pertinent provisions of the Texas Business & Commerce Code. Seventh, in securing the new account control agreement and related security agreement, PacifiCare had no direct communications with either BOA or Corporation. Instead, PacifiCare chose to use Miller as its intermediary for negotiating and securing the execution of these instruments on its behalf. PacifiCare offered no explanation for assuming the risk of entrusting Miller with the responsibility of protecting PacifiCare’s interests. This is particularly surprising given PacifiCare’s belief that Miller transferred funds in violation of the Capitation Agreement’s requirements, (TR Vol. 4 at 313:21-314:1 (Comrie)), as well as the lack of trust PacifiCare’s representatives had for Miller. (TR Vol. 4 at 362:6-363:3 (Comrie)).

51. On this record, PacifiCare clearly bears more than 50 percent of the responsibility for the injuries it claims. As a result, PacifiCare is precluded from recovering damages from BOA in accordance with Section 33.001 of the Texas Civil Practices and Remedies Code.
52. To the extent that any of these conclusions of law constitute findings of fact, the Court adopts them as findings of fact.

Signed: January 22, 2004.

Barbara J. Houser
United States Bankruptcy Judge