

UNITED STATES DISTRICT COURT OF THE VIRGIN ISLANDS

DIVISION OF ST. THOMAS AND ST. JOHN

VIRGIN ISLANDS PUBLIC FINANCE
AUTHORITY, and THE GOVERNMENT OF
THE UNITED STATES VIRGIN ISLANDS,

Plaintiffs,

v.

BUCHANAN INGERSOLL & ROONEY PC,
BANK OF AMERICA CORPORATION,
BANC OF AMERICA SECURITIES, LLC,
MERRILL LYNCH, DOES 1-10, and XYZ
CORPORATIONS 1-10,

Defendants.

Civil Action No. 14-cv-83

JURY TRIAL DEMANDED

COMPLAINT

Plaintiffs Virgin Islands Public Finance Authority (“PFA”) and the Government of the U.S. Virgin Islands (“GVI”) (collectively “Plaintiffs”), file this Complaint against Defendants Buchanan, Ingersoll & Rooney PC (“Buchanan”), Bank of America Corporation, Banc of America Securities LLC, Merrill Lynch (collectively “BoA”) and XYZ Corporations 1-10 (“XYZ”) (collectively “Defendants”) and allege as follows:

NATURE OF THIS ACTION

1. This is an action for malpractice, negligence, breach of fiduciary duty, and breach of contract seeking compensatory and punitive damages against Defendant Buchanan, the PFA’s nationally recognized bond counsel at the time the actions described herein took place, and Defendant BoA, Plaintiffs’ financial advisor, arising out of the claim by the United States Internal Revenue Service (“IRS”) that \$219,490,000 of tax exempt municipal bonds issued in

2006 by the PFA (“Series 2006 Bonds”), for the benefit of the GVI, did not qualify for tax exempt status.

2. As a result of a random examination conducted by the IRS in 2012, the IRS ultimately determined that Plaintiffs had over-issued \$80 million worth of those bonds in violation of the Internal Revenue Code of 1986, as amended, including all rules and regulations promulgated thereunder, (the “Tax Code”) and ultimately demanded a \$13.6 million payment to settle those violations.

3. All of these damages resulted from the failure of Defendant Buchanan and Defendant BoA to properly advise Plaintiffs concerning the Series 2006 Bond issue and the events which led up to that bond issue. In particular, Defendants were negligent and failed to exercise the requisite standard of skill in the performance of their duties by, among other things, advising Plaintiffs that the Series 2006 Bonds would qualify for tax-exempt status because the Virgin Islands had established the requisite finding of a cash flow deficit when in fact no cash flow deficit existed under the Tax Code and under the applicable provisions of the bond indentures at issue.

4. Defendants’ advice directly resulted in Plaintiffs incurring substantial damages including the \$13.6 million payment to the IRS and all attendant costs relating thereto. Had Defendants correctly advised Plaintiffs, these damages would not have occurred.

PARTIES

Plaintiffs

5. Plaintiff PFA is a public corporation and autonomous government instrumentality created by the U.S. Virgin Islands Legislature in 1988. The PFA acts through its Board of

Directors (the “Board”), whose principal responsibilities include the securing of financing for the GVI through the issuance of bonds, and the management of bond proceeds.

6. Plaintiff GVI is an unincorporated United States territory organized under the Revised Organic Act of 1954. It is also a body politic with the right to sue and to be sued pursuant § 2(b) of the Revised Organic Act of 1954, as amended. The executive power of the GVI is vested in the Governor as the Chief Executive Officer of the GVI and the legislative power of the GVI is vested in a unicameral Legislature comprised of fifteen senators.

Defendants

7. Defendant Buchanan, Ingersoll & Rooney PC is a nationwide professional corporation with its headquarters in Pittsburgh, Pennsylvania.

8. Defendant Bank of America is a multinational banking and financial services corporation incorporated in Delaware and headquartered in Charlotte, North Carolina.

9. Defendant Banc of America Securities LLC was a wholly owned subsidiary of Bank of America headquartered in San Francisco, CA which merged with Merrill Lynch in 2008.

10. Merrill Lynch is the wealth management division of Bank of America headquartered in New York City.

11. Defendants Does 1-10 are employees of Defendants whose true names have not yet been determined. Plaintiffs will amend this Complaint to sue such parties by their actual names at such time as Plaintiffs become aware of them.

12. Plaintiffs are unaware of the true names of the defendants sued herein under the fictitious names XYZ Corporations 1-10 (“XYZ”), and will amend this Complaint to sue such parties by their actual names at such time as Plaintiffs become aware of them.

JURISDICTION AND VENUE

13. Jurisdiction, venue and/or choice of law are governed by certain contractual agreements between the parties which require that in the event of a dispute, venue shall be in a court of competent jurisdiction in the U.S. Virgin Islands, applying Virgin Islands law.

14. This Court is vested with subject matter jurisdiction over Plaintiffs' claims under 28 U.S.C. § 1332.

15. This Court has personal jurisdiction over Defendants because they conducted substantial business in this District, and/or engaged in a substantial portion of the challenged conduct in this District.

16. Venue is proper in this District under 28 U.S.C. § 1391 and 15 U.S.C. § 22.

17. The amount in controversy in this case is approximately \$14 million.

ALLEGATIONS

The GVI Created The PFA To Promote Its Financial Interests

18. In 1988, the United States Virgin Islands ("USVI") Legislature created the PFA under the Government Capital Improvement Act of 1988 "to promote and sustain economic and social development in the U.S. Virgin Islands." The Legislature incorporated the PFA as an autonomous, government instrumentality for the purposes of aiding the GVI in the performance of its fiscal duties and in effectively carrying out its governmental responsibility of raising capital for essential public projects.

19. During the relevant time period, the PFA was governed by a five member Board of Directors. The Governor of the Virgin Islands serves as Chairman; the Commissioner of Finance of the GVI serves as the Executive Director; the Director of the Office of Management and Budget of the GVI serves as the Secretary; and two private sector members (presently four

by subsequent amendment) are appointed by the Governor, with the advice and consent of the Legislature.

20. In addition, the Board of Directors appoints a Director of Finance and Administration, who is responsible for day-to-day administration and operation. Even though the PFA is part of the GVI, it is a separate entity and does not share Virgin Islands government offices. The PFA's annual budget is derived from a combination of interest earned on funds derived from the issuance of bonds, administrative fees, and certain matching fund revenues.

21. During the relevant time period, none of the members of the PFA Board were attorneys and none of them had the specialized training in the law that pertains to tax-exempt bond financing. Accordingly, the Board and the GVI relied upon the advice of the skilled advisors that the PFA retained, such as their bond counsel and their financial advisor, when determining how to size and structure such bond issues and whether they complied with applicable laws and regulations, including the Tax Code.

22. Moreover, because of its relatively limited staff, resources, and training, during the relevant time period, the Board also relied on Defendant BoA, its financial advisor, for advice about cash and asset management, preparation of financial and accounting reports, investment portfolio management, and the structuring and issuance of tax-exempt bonds.

The PFA And GVI Hired BoA To Serve As Its Financial Advisor

23. On or about February 18, 2002, the PFA, on behalf of and for the benefit of the GVI, hired BoA pursuant to a Financial Advisor Agreement to provide financial advice to the PFA and the GVI and to help manage the Territory's finances. Specifically, BoA was engaged "to assist in efforts to develop a series of detailed revenue enhancement and expenditure

reduction initiatives.” BoA assigned Margaret Guarino and Larry Soule, specialists in municipal finance, to provide the required services.

24. In furtherance of this role, the PFA and the GVI regularly provided BoA with financial data to be compiled and used in reports for the purpose of providing guidance to the PFA and the GVI on spending and investment issues, as well as structuring bond transactions.

25. At all times throughout the course of their relationship, BoA maintained a fiduciary relationship with the PFA and the GVI. Indeed, BoA had both a contractual duty as well as a duty arising from its advisory relationship with both the PFA and the GVI to act in a fiduciary capacity in providing financial services to Plaintiffs.

26. Accordingly, the law required BoA to act, at all times, in the best interest of the PFA and the GVI. In addition, as financial advisor and fiduciary, BoA had to adhere to a duty of loyalty and care, which included the performance of requisite diligence in furtherance of the investment and financial advice administered to the PFA and the GVI.

27. BoA solicited the PFA’s and the GVI’s business and represented itself as an expert in municipal finance and in financial issues encountered by entities such as the GVI.

28. The Financial Advisory Agreement specifically acknowledged that BoA had been selected by the PFA and the GVI as its financial advisor “because the personnel assigned to PFA’s account are knowledgeable about PFA and USVI and are familiar with the Government’s problems and the opportunities.”

29. The Financial Advisory Agreement also provided that BoA would offer services to the PFA and the GVI “in connection with the issuance of debt, the upgrading of the Government’s analytical and debt management capabilities and matters related thereto.” BoA was thus directly responsible for advising the PFA and the GVI on matters related to managing

the GVI's debt which included assisting bond counsel and directly assisting with bond transactions and bond redemptions, analysis of GVI projects to which bond proceeds would be applied, as well as other financial matters that affected the operations of the GVI.

30. The Financial Advisory Agreement further outlined the specific services to be provided by BoA to the PFA and the GVI including but not limited to responding to the Department Of Interior ("DOI") in connection with the Memorandum Of Understanding ("MOU")¹, providing recommendations on bond financings, and monitoring the financial condition of the GVI.

31. By contract, BoA also agreed that its services would be provided with "the degree of skill and care that is customarily demanded of professional financial consultants using practices and standards that assured that all such work is correct and appropriate for the purposes intended." In other words, BoA acknowledged it was a fiduciary to the PFA and the GVI, and agreed to be bound by the requisite duty of care and skill of a fiduciary.

32. Accordingly, BoA knew that the GVI was a beneficiary of all the activities of the PFA and the services provided by BoA.

33. In exchange for these services, BoA was to be paid \$750,000 per year, in addition to fees earned on bond transactions.

34. The initial term of the BoA Agreement was renewed by the PFA, maintaining the same terms in force until January 15, 2007.

¹ Pursuant to the MOU with the DOI, the GVI was required to make its best efforts to reduce its deficit, which included: (a) Preparation of a five-year financial recovery plan; (b) Fiscal year 2000 budget mandating substantial reductions in departmental budgets and overall general fund fiscal year 2000 expenditures not to exceed \$432.1 million; (c) Absent extraordinary circumstances, to maintain balanced budgets after fiscal year 2003 with any generated surpluses applied to the reduction of the accumulated deficit and unfunded obligations; and, (d) Efforts to reduce the outstanding debt of the Government.

**Acting On The Advice Of Fiduciaries, The PFA Issued
Series 1999A Bonds For Capital Improvements**

35. In 1999, Charles Wesley Turnbull became the Governor of the Virgin Islands, succeeding Roy Lester Schneider. At the time, the GVI was in the midst of a financial downturn, struggling with severe fiscal deficits and a limited ability to obtain financing for capital improvements and government operating expenses. Governor Turnbull, as Governor, also became Chairman of the PFA, and immediately assembled a fiscal deficit reduction team to meet with BoA to mobilize a strategy to turn around the USVI's economy and its financial condition.

36. The fiscal deficit reduction team began meeting with BoA to develop initiatives to reduce the Territory's general fund unreserved fiscal deficit of \$345 million (as of September 30, 1999).

37. Among the decisions made by the PFA, under the advice and guidance of BoA, was to undertake a substantial long-term capital bond issuance to reduce the deficit and bring some economic stability to the GVI.

38. The PFA hired the law firm of Harris Beach to serve as bond counsel to the PFA and the GVI. William O'Connor, who later joined Buchanan as a partner, was the engagement partner and lead bond counsel for Harris Beach. The GVI hired no other bond counsel to represent it in connection with any of the PFA bond offerings thus it was abundantly clear that the GVI was a beneficiary of all the activities of the PFA and the services provided by Harris Beach.

39. Bond counsel are both legal counsel and fiduciaries to bond issuers whose primary role is to provide and prepare documents needed for an issuance of bonds, advise the issuer on Federal tax issues pertaining to bond issuances, monitor and review compliance with prior bond issuances in appropriate circumstances, and provide an objective, competent opinion

on the validity of the bonds and the tax treatment of the interest paid to bond holders. In addition to this role, bond counsel also coordinates with the financial advisor and the underwriter, supervises the bond proceedings up to and including the closing, prepares the bond transcript², and participates in the sizing and structuring of the bond issue, among other things.³

40. On November 16, 1999, the PFA and the GVI, under the advice of bond counsel, Harris Beach, issued \$299,880,000 of tax-exempt revenue bonds (the “Series 1999A Bonds”) to finance the then-existing working capital cash deficit of the GVI. Pursuant to the bond documents and consistent with IRS rulings, the PFA covenanted and agreed under the First Supplemental to the Indenture of Trust, dated November 1, 1999 (“First Supplemental Indenture”) that it would cause the GVI, within 90 days of October 1 of each year from 2005 to 2009, to apply any “Surplus Available Revenues” equal to the “Cumulative Available Revenues” as of such October 1, to purchase and retire Series 1999A Bonds at purchase prices up to the tender price. Thus, the maximum price that the PFA could offer for the bonds was limited to the value of the bonds assuming that they had been fully defeased and were called on October 1, 2010, the first date that the bonds could be redeemed by bond holders.

41. The First Supplemental Indenture defined “ Surplus Available Revenues” as the “available amounts” within the meaning of Treasury Regulation 1.148-6(d)(3)(iii), and included:

[A]ll amounts available to the Government for expenditure for payment of working capital expenditures purposes include cash, investments, and other amounts held in accounts, or otherwise by the issuer or a related party, that may be used for working capital expenditures, of the type being financed by an issue, if those amounts may be used for working capital expenditures without legislative or judicial action and without a legislative, judicial or contractual requirement that

² A bond transcript is a compendium of all the executed documents used to create a bond offering which is indexed and bound. The bond transcript is compiled and prepared by bond counsel and distributed to all the parties to the closing of the bonds.

³ See generally The Function and Professional Responsibilities of Bond Counsel, National Association of Bond Lawyers, 2011, http://www.nabl.org/uploads/cms/documents/nabl_function_and_professional_responsibilities_of_bond_counsel.pdf.

those amounts be reimbursed. Surplus Available Revenues shall not include (a) sale proceeds of the Series 1999A Bonds, and (b) an amount equal to 5% of the expenditures paid by the Government from current revenues for the prior fiscal year of the Government.

42. Additionally, on November 1, 1999, the PFA entered into a loan agreement (the “1999 Loan Agreement”) with the GVI under which the PFA loaned the proceeds of the issuance to the GVI with a corresponding promise to pay principal and interest when due in amounts sufficient to pay all amounts due and to satisfy all obligations under the Series 1999A Bonds and the First Supplemental Indenture. Pursuant to the 1999 Loan Agreement, the GVI covenanted to the PFA and the bond holders that in the event that the GVI had any Cumulative Available Revenues, that an amount equal to the Cumulative Available Revenues would be used to purchase Series 1999A Bonds.

43. Thus, in three separate agreements (First Supplemental Indenture, Loan Agreement and the MOU) , the GVI and the PFA covenanted to pay off the Series 1999A Bonds in the event that the GVI experienced a surplus, as defined by those documents and in accordance with applicable law.

44. Shortly after the issuance of the bonds, the GVI created an Economic Recovery Task Force which, in April 2000, presented a five year Operating and Strategic Financial Plan containing over 200 recommendations for reducing the general fund deficit.

The PFA Hired Buchanan as Bond Counsel

45. In May 2000, the PFA, on behalf of and for the benefit of the GVI, hired new bond counsel when William O’Connor, the principal partner with whom the PFA had a relationship at Harris Beach, joined Buchanan as a partner. The GVI hired no other bond counsel to represent it in connection with any of the PFA bond offerings, thus, the GVI was clearly a beneficiary of all the activities of the PFA and the services provided by Buchanan.

46. Under its Contract for Bond Counsel Services with the PFA, Buchanan was to provide the PFA and the GVI with “legal, consulting, and other professional services related to (1) financing and refinancing public debt through structured bond transactions or other forms of bond financing, (2) economic recovery and (3) legislation and other matters raised from time to time by PFA or the Governor or his advisors.”

47. The agreement carried an initial one-year term, and in each subsequent year through 2007, either a new agreement with the same terms was signed or the agreement’s terms were extended by resolution of the Board.

48. The agreement contained an indemnification provision, which reads:

[Buchanan] agrees to indemnify, defend and hold harmless PFA from and against any and all loss, damages, liability, claims demands, detriments, costs, charges and expenses (including attorney’s fees) and causes of action of whatsoever character which PFA may incur, sustain or be subjected to, as a direct result of the [Buchanan’s] negligence in the performance of services under this Contract.

49. Accordingly, Buchanan contractually agreed to indemnify the PFA for all costs and expenses, and causes of action “of whatsoever character” incurred as a result of Buchanan’s negligence.

Bond Underwriter UBS Approached The PFA About Issuing More Working Capital Bonds

50. From 2000 to 2005, the financial condition of the GVI improved as a result of significant budget cuts, the long-term working capital provided from the issuance of the Series 1999A Bonds, and the implementation of the Operating and Strategic Financial Plan.

51. During this time period, the GVI and the PFA worked with BoA in an effort to reduce the significant 1999 deficit. In furtherance of this goal, the GVI and the PFA routinely provided BoA with its financial information in order to allow BoA to analyze the GVI’s available cash and assets, and to advise the GVI.

52. Even though BoA advised the PFA and GVI regarding the determination of whether the GVI was in a deficit financial position, BoA was responsible for, but never prepared, a cash flow analysis required as of October 1, 2005 that would have enabled the PFA and the GVI to determine if the GVI had Cumulative Available Revenues to purchase and retire Series 1999A Bonds.

53. As a result of BoA's failure to provide such cash flow analysis to the PFA and the GVI, none of the Series 1999A Bonds were defeased during that time period as the PFA. The GVI believed there were no Cumulative Available Revenues to be applied to reduce the principal amount of such bonds as required under the Tax Code, in reliance on other BoA reports that the GVI was in a cash deficit position.

54. In 2005, with the economy improving but still struggling in the U.S. Virgin Islands, bond underwriter UBS Securities LLC ("UBS") made an unsolicited proposal to the PFA Board of Directors to sell additional bonds.

55. Over the next several months, UBS made several proposals to the PFA and the GVI regarding the issuance of additional bonds. Many of these proposals included the participation of representatives of BoA, as the financial advisor, and bond counsel, Buchanan.

56. The new bond issue was fully endorsed by BoA and Buchanan. Indeed, both attended numerous board meetings and meetings with the GVI financial team that worked on the bond issue.

57. Several meetings were held and presentations made to the PFA board. For example, on July 6, 2006, Margaret Angel of Defendant Buchanan and Larry Soule of Defendant BoA both encouraged the PFA Board to seek Legislative approval for a new bond issue. The proposal included an advance refunding of the outstanding Series 1999A Bonds, and the

termination of an outstanding Swap Option Agreement, entered into in 2002, which would require a termination payment of \$26,910,000.

PFA Issued The Series 2006 Bonds And Redeemed All Outstanding Series 1999A Bonds Upon The Advice Of Buchanan And BoA

58. Defendants advised Plaintiffs that because the GVI was in a cash deficit position, the PFA, on behalf of the GVI, could issue tax-exempt working capital bonds and thereby raise substantial funds. Defendants further advised that under the 1999A Bond indenture, \$175,125,168.43 would have to be applied to the outstanding Series 1999A Bonds which, in essence, would be replaced with the 2006 Bonds.

59. In or about August 2006, under the advice and guidance of BoA and Buchanan, the PFA Board approved the issuance of Series 2006 tax-exempt, revenue bonds in the amount of \$219,490,000. As bond counsel, Buchanan began drafting and assembling the required documentation for the issuance with the assistance of BoA. Buchanan also began assembling the bond transcript.

60. Critical to Plaintiffs' issuance of the 2006 Bond Issue was Buchanan's opinion as bond counsel that it qualified for tax exempt status under the Tax Code and applicable IRS rules and regulations because the bond issue was required to finance a working capital cash deficit that the GVI was continuing to experience. Accordingly, on September 28, 2006, Buchanan issued such a bond opinion ("Buchanan Bond Opinion") to the PFA and the GVI. In the Buchanan Bond Opinion, Buchanan set out its objective opinion for the validity of a Series 2006 bond issue, and certified the accuracy of the bond documents and the issuance's compliance with applicable laws and that under the Tax Code, interest on the Bonds was not includable in gross income for federal income tax purposes.

61. In support of the Buchanan Bond Opinion, Buchanan stated that it examined and relied upon the record of proceedings of the PFA and the GVI in connection with the authorization and issuance of the Series 2006 Bonds and made such investigation of law and further review, inquiry or examination as deemed necessary or desirable in rendering their opinion. In addition, Buchanan also indicated that it rendered its opinion assuming the accuracy of certain factual certifications made by the PFA and GVI in the Tax Certificate and Agreement (“2006 Tax Certificate”).

62. The 2006 Tax Certificate is an agreement prepared by Buchanan which contains representations made by the PFA and the GVI with respect to the use and investment of the proceeds of the bonds and setting forth the cash position of the PFA and the GVI. It also contained representations that the PFA and the GVI were in compliance at the time with all documents and covenants that govern all prior bond issuances and the Tax Code. The PFA and the GVI relied on Buchanan and BoA to establish compliance and advise them whether the representations they were asked to make were true and correct.

63. The Series 2006 Bonds were issued on September 28, 2006. The AAA-rated Series 2006 Bonds had maturities between 2007 to 2029 and bore interest rates between 3.50% and 5%.

64. The proceeds for the bond issue were applied as follows:

- i. \$175,125,168.43 to the 100% refunding of the Series 1999A Bonds;
- ii. \$26,910,000 to terminating the Swap Option Agreement;
- iii. \$14,000,000 to Series 2006 capital projects;
- iv. \$2,863,300 into the Debt Service Reserve Account;
- v. \$2,911,000 into the New Payments Reserve Account; and,

vi. \$9,252,425.49 to the costs of issuing the Series 2006 Bonds.

65. Accordingly, the Series 1999A Bonds, as of the Series 2006 Bond issuance, were no longer “outstanding” because 100% had been defeased, and would be fully redeemed on their first call date in 2010.

66. The PFA paid Buchanan over \$335,000 for services rendered in connection with the Series 2006 Bond issuance, including the issuance of the Buchanan Bond Opinion.

**IRS Performed A Random Examination Of The Series 2006 Bond Issuance
And Discovered A Missing Document**

67. On March 1, 2012, the PFA received notice from the IRS that it would be conducting an examination of the Series 2006 Bond issue (“IRS Notice”). The IRS Notice was accompanied by an initial Form 4564 Information Document Request (“IDR No. 01”) which requested an extensive amount of documentation in connection with the issuance, including all documents contained in the 2006 Bond Transcript, all PFA meeting minutes concerning the bonds, the Tax Certificate and Agreement, and other documents related to the refunding of the Series 1999A Bonds. The IRS indicated that it sought these documents in order for the IRS to determine whether the PFA had complied with Sections 103 and 141-150 of the Tax Code.

68. The PFA engaged Hawkins Delafield & Wood LLP (“Hawkins”) as counsel to represent the PFA in connection with the examination. A highly regarded New York City based law firm with extensive experience in tax and bond issues, Hawkins has been bond counsel to the PFA since 2007.

69. Hawkins immediately contacted Buchanan who, as bond counsel for the 2006 bond issue, had created and maintained all of the documentation related to the issuance. Hawkins responded to the IRS document request, providing substantially all of the materials requested by the IRS.

70. On April 20, 2012, the IRS followed up with a second Information Document Request (“IDR No. 02”). This time, the IRS requested Exhibit I which is referenced in the Tax Certificate and Agreement that was included in the bond transcript. Exhibit I was the “Cumulative Cash Flow Analysis” which was omitted from the bond transcript prepared by Buchanan.

71. The “Cumulative Cash Flow Analysis,” sought by the IRS was a report which calculated the projected Accumulated General Fund Surplus for the GVI over the next five years. The report was required to be part of the bond documents as it provided a critical analysis of available surplus cash for the GVI and was relied upon in the Tax Certificate and Agreement and was integral to properly structuring the size of the working capital component of the bond issue and its use of proceeds and assuring compliance with all prior bond issues and the Tax Code. Instead of providing the required Cumulative Cash Flow Analysis, Buchanan included a blank sheet of paper which read: **“Cumulative Cash Flow Analysis: Document Not Reproduced Herein.”**

72. Hawkins requested the missing document from Buchanan, along with other follow up documentation requested in the second IDR No. 02. Buchanan provided various documents from their files in response. Included in that response was a document which Margaret Angel of Buchanan represented to be the Cumulative Cash Flow Analysis which was omitted from the bond transcripts.

73. As indicated at the bottom of that document, Defendant BoA created the Cumulative Cash Flow Analysis, in its capacity as fiduciary for the PFA and the GVI, on August 15, 2006, over a month before the 2006 Bond Issue.

**The Missing Cumulative Cash Flow Analysis Showed that BoA Projected
A Surplus in Fiscal Year 2006**

74. On May 17, 2012, after reviewing the various documents that had been produced by Hawkins and Buchanan, the IRS sent its third Information and Document Request to the PFA which included a letter to Hawkins (“IDR No. 03”). In that letter, the IRS indicated that it had reviewed the relevant financial statements of the GVI from 1999 through 2008, and that those financial statements showed a cash surplus in years 2003 through 2006, rather than a cash deficit. The IRS also noted that under the 1999 Bond Indenture documents the GVI was required to review its financial situation on an annual basis and to redeem the Series 1999A Bonds if it had a cash surplus. Accordingly, the IRS asked Hawkins to confirm whether the GVI had made any tender offer on the Series 1999A Bonds.

75. Specifically, IDR No. 3 stated:

Attached is a summary of the Surplus Available Revenues detailing the available amounts for each year 1999 through 2008 with information that has been obtained from the audited financial statements of the blended component of the Virgin Islands Public Finance Authority and the Government of the United States Virgin Islands. Per Treas. Regs. 1.148-1(c)(4)(i)(A) replacement proceeds arise if the term of the bond is outstanding longer than necessary and there are available amounts during the time that it is outstanding longer than necessary. Treas. Regs. 1.148-1(c)(5)(i)(B) provides a safe harbor for working capital expenditures of two years. Beginning with fiscal year ending 9/30/2003 which is more than two years from the issue date, there are Surplus Available Revenues.

Explain whether you made a tender offer of outstanding bonds within 90 days of the end of each year that the fiscal year had Surplus Available Revenues or whether a tender offer was made within 90 days of 10/1/2005, of the Cumulative Available Revenues per Article 304 of the First Supplemental to the Indenture Trust dated 11/1/1999 and each October 1, thereafter. Your explanation should be supported with documentation that there has been a tender offer; there are no Surplus Available Revenues; or the Surplus Available Revenues have been yield restricted per Treas. Regs 1.148-10(b)(1)(i).

76. A chart attached by the IRS to IDR No. 3 detailed the Surplus Available Revenues using Unreserved General Fund Balances and showed that in 2003, 2004, 2005, and

2006, the PFA General Fund had Surplus Available Revenue, which totaled \$76,525,000 in 2006.

77. On June 21, 2012, Hawkins sent a letter to the IRS responding to IDR No. 3. In that letter, Hawkins acknowledged that no tender offers had been made and that the numbers contained in IDR No. 3 appeared to be accurate. However, Hawkins attempted to mitigate the damages caused by Defendants' conduct by arguing that there were other factors outside of the applicable regulations which should excuse Plaintiffs' actions.

**IRS Determined That The PFA Violated The Tax Code
And Over-Issued The Series 2006 Bonds**

78. On July 5, 2012, the IRS sent the conclusions of its random examination in a "Notice of Proposed Issues" memorandum which outlined its findings. In that memorandum, the IRS rejected Hawkins' arguments of mitigating factors and submitted its initial determination that the entire 2006 Bond Issue was disqualified from tax exempt treatment under applicable sections of the Tax Code and IRS regulations. This position, of course, directly contradicted the advice of Defendants Buchanan and BoA that the bonds qualified for tax exempt status.

79. Specifically, the IRS determined (1) that GVI had failed to comply with the Series 1999A bond indenture documents because it had failed to redeem or refund any of the Series 1999A Bonds prior to 2006 even though it had experienced a cash surplus in 2003, 2004, and 2005; and (2) that all of the bonds issued by the PFA on behalf of the GVI in 2006 were disqualified for tax exempt status because the GVI was ineligible to issue the Series 2006 refunding bonds under applicable Tax Code sections and regulations since it actually had a cash surplus at the relevant time rather than a cash deficit.

80. The Notice of Proposed Issues included the following explanation:

Interest on the \$219,490,000 Virgin Islands Public Finance Authority Revenue Bonds Series 2006 (Gross Receipts Tax Loan Note), the “Bonds,” is not excludable from gross income. Interest that is excludable from gross income is interest on State or local bonds that are not arbitrage bonds per § 103(b)(2) within the meaning of § 148. Treasury Regulations § 1.148-10(a)(1) states that bonds that use an abusive arbitrage device are arbitrage bonds and defines the overburdening of the tax-exempt market an abusive arbitrage device. The refunding of a portion of the Series 1999A is overburdening the tax-exempt market because there should have been a tender offer on the Series 1999A when there were surplus available revenues. The audited financial statements indicate that there were surplus available revenues at the end of each fiscal year September 30, 2003, 2004, 2005. Therefore, the surplus available revenues should have redeemed a portion of the 1999A series and the corresponding issuance of the refunding bonds would have been proportionately reduced and not overburdened the tax-exempt market. Because it could have been reasonably expected that as of the issue date the bonds would overburden the market, the provisions of § 1.148-10(b) apply to all of the gross proceeds of the issue.

81. The IRS further explained:

At the time of the issuance of the refunding bonds the Issuer **knew or should have known** that there were Surplus Available Revenues because the audited financial statements for the fiscal years ending 1999 through 2004 had already been released and as it relates to 2005 the MOU with the DOI states that within 120 days of the end of each fiscal year the annual financial reports will be prepared. Therefore, the Issuer had available or should have had available all information necessary to properly size the 2006 Bonds after the pro rate deduction under the provisions of the Series 1999A Trust Indenture. (emphasis added).

82. In summary, although Defendants Buchanan and BoA advised Plaintiffs that they qualified for tax exempt status and that Defendant Buchanan issued an approving bond opinion and tax opinion to that effect, the IRS was taking the position that none of the bonds issued in 2006 so qualified. In other words, Defendants’ advice was wrong and, as a result, interest earned on the Series 2006 Bonds issued by the PFA, on behalf of the GVI, was federally taxable. The IRS further took the position that the Plaintiffs and/or their advisors knew or should have known that the Series 2006 Bonds did not qualify for tax exempt status because the information in the relevant documents which included the Cumulative Cash Flow Analysis and the audited and

unaudited financial statements that were available at the time, showed a cash surplus, not a cash flow deficit.

83. Because the IRS determined that the issuance of Series 2006 Bonds did not comply with the Tax Code, and applicable IRS rules and regulations, the interest earned on the bonds was now federally taxable under the Tax Code. The PFA and the GVI, as the issuer and obligor respectively, were, therefore, liable for the amount of interest now taxable on the Series 2006 Bonds from inception.

84. In an attempt to mitigate these substantial damages, the PFA and its counsel Hawkins continued to negotiate with the IRS and eventually persuaded it to base the ultimate settlement payment on a conclusion that only \$80 million of the \$219,490,000 of the bond issue was not federally tax-exempt. The amount of \$80 million was based on the Surplus Available Revenue from 2005 and 2006 that should have been used to redeem the Series 1999A Bonds prior to the Series 2006 Bond issuance rather than being redeemed with proceeds of the Series 2006 Bonds. Put another way, the IRS concluded that Plaintiffs should not have issued \$80 million worth of bonds that were issued in 2006 to refund the Series 1999A Bonds and accordingly demanded a payment to compensate it for the lost taxes payable on the interest earned on the Series 2006 Bonds.

85. Although the tax liabilities were actually much higher and could have approached \$300 million for this over-issuance, in 2013, the PFA and the GVI settled with the IRS, resolving all issues raised during the examination without litigation, resulting in a payment to the IRS by the PFA and the GVI of \$13.6 million pursuant to a closing agreement with the IRS. In order to make this payment to the IRS, the PFA issued taxable bonds and loaned \$14 million to the GVI pursuant to a loan agreement.

**Buchanan And BoA Failed To Exercise Due Diligence In Determining
That The GVI Had A Surplus Rather Than A Deficit**

86. As the IRS concluded, BoA and Buchanan had the necessary information at the time of the Series 2006 Bond issue on September 28, 2006, to determine the proper size of the issuance in order to prevent overburdening the tax-exempt bond market in violation of § 103 of the Tax Code, Treasury Regulation § 1.148-10(a)(4), and Treasury Regulation § 1.148-10(b)(1)(i).

87. As bond counsel, Buchanan was required to act as a fiduciary to the PFA and the GVI, providing objective advice on the size and structure of the Series 2006 Bonds. In order to do this, Buchanan was required to review all relevant documentation, all prior agreements, all prior covenants for all prior outstanding bond issuances, and all applicable rules and regulations, to ensure the PFA's and GVI's compliance. Instead, Buchanan failed to recognize clear evidence in its possession that the GVI had experienced a cash surplus for the three years preceding the 2006 issue, and failed to properly recognize a projected cash surplus for 2006. In fact, the 2006 Tax Certificate, prepared by Buchanan on behalf of the PFA and the GVI, included representations that the GVI had no working capital surpluses and that calculations to that effect were attached to the bond transcript as Exhibit I to the Tax Certificate – a document which showed the opposite conclusion.

88. Similarly, as a financial advisor, BoA was required, throughout its representation of the PFA and the GVI, to act as a fiduciary, providing advice based on due diligence and adequate skill, observing the absolute highest duty of care. As part of its responsibilities, by contract and by law, BoA was required to provide financial advice on all matters related to debt management, including an ongoing obligation to maintain and accurately report the GVI's financial condition. Instead, BoA misapplied rudimentary

accounting principles to its revenue and surplus calculations, failed to recognize clear evidence, some of which it prepared, that GVI had cash surpluses for fiscal years 2003-2005 and a projected cash surplus for 2006, and misadvised the PFA and the GVI in sizing and structuring the Series 2006 Bond issuance.

89. As of this date, Defendants have not paid any portion of the damages suffered by Plaintiffs, and, accordingly, Plaintiffs have been required to engage counsel to seek such payments and indemnifications by way of this action. Plaintiffs have suffered substantial damages as a result of Defendants' conduct outlined herein including but not limited to the expense involved in connection with the IRS examination, the expense in connection with the \$13.6 million payment and the expense in investigating and pursuing recovery from the Defendants.

CAUSES OF ACTION

COUNT I (Legal Malpractice) (Against Buchanan)

90. Plaintiffs re-allege and incorporate herein all foregoing paragraphs of this Complaint as if set forth in full.

91. From 2000-2006, Buchanan represented the PFA and the GVI as bond counsel, creating an attorney-client relationship between Buchanan and the PFA and the GVI.

92. Among its responsibilities as bond counsel, Buchanan was required to advise the PFA on issues related to the issuance of bonds which included reviewing previous agreements and covenants that governed the PFA's bond issues, providing guidance to the PFA and GVI with respect to the structure and size of bond issues, and ensuring compliance with applicable laws, regulations, and agreements.

93. Buchanan did not competently advise the PFA and GVI on these issues when it failed to recognize that the PFA and the GVI had “Surplus Available Amounts” under the Tax Code, and as defined by the Series 1999A Bond documents.

94. As a direct and proximate result of Buchanan’s legal malpractice, the PFA and the GVI suffered damages resulting from the Series 2006 Bond issuance in the form of the \$13.6 million payment to the IRS and the substantial related costs and expenses.

COUNT II
(Negligence)
(Against All Defendants)

95. Plaintiffs re-allege and incorporate herein each and every foregoing paragraph of this Complaint as if set forth in full.

96. Defendants, as fiduciaries, owed the highest duty of care to the PFA and the GVI in the provision of services related to the Series 1999A Bonds and the Series 2006 Bonds.

97. In addition to their fiduciary duties, Defendants had a contractual duty to adequately perform services for the PFA and the GVI regarding bonds.

98. In violation of these duties, Defendants failed to recognize that the PFA and the GVI had a working capital surplus, as defined in the Series 1999A Bond documents. Defendants knew or should have known that the GVI had “Surplus Available Amounts” under the Tax Code, and as defined by the Series 1999A Bond documents to redeem the Series 1999A Bonds prior to the Series 2006 Bond issuance because all of the documentation required to form that understanding was available prior to the Series 2006 Bond issuance.

99. As a direct and proximate result of Defendants’ negligence, the PFA and the GVI suffered damages in the form of the payment to the IRS and the substantial related costs and expenses.

COUNT III
(Breach of Fiduciary Duty)
(Against Buchanan)

100. Plaintiffs re-allege and incorporate herein each and every foregoing paragraph of this Complaint as if set forth in full.

101. As bond counsel, Buchanan owed a fiduciary duty to the PFA and the GVI.

102. Buchanan breached this fiduciary duty by failing to recognize that the PFA and the GVI had “Surplus Available Amounts” under the Tax Code, and as defined by the Series 1999A Bond documents. Buchanan knew or should have known that the GVI had “Surplus Available Amounts” under the Tax Code, and as defined by the Series 1999A Bond documents, to redeem the Series 1999A Bonds prior to the Series 2006 Bond issuance because all of the documentation required to form that understanding was available prior to the Series 2006 Bond issuance.

103. As a direct and proximate result of Buchanan’s breach of fiduciary duty, the PFA and the GVI suffered damages in the form of the payment to the IRS and the substantial related costs and expenses.

COUNT IV
(Breach of Fiduciary Duty)
(Against BoA)

104. Plaintiffs re-allege and incorporate herein each and every foregoing paragraph of this Complaint as if set forth in full.

105. As its financial advisor, BoA owed the PFA and the GVI a fiduciary duty.

106. BoA breached this fiduciary duty by failing to recognize that the PFA and the GVI had a working capital surplus, as defined in the Series 1999A Bond documents. BoA knew or should have known that the GVI had “Surplus Available Amounts” under the Tax Code, and as defined by the Series 1999A Bond documents, to redeem the Series 1999A Bonds prior to

Series 2006 Bond issuance because all of the documentation required to form that understanding was available prior to the Series 2006 Bond issuance.

107. As a direct and proximate result of BoA's breach of fiduciary duty, the PFA and the GVI suffered damages in the form of the payment to the IRS and the substantial related costs and expenses.

**COUNT V
(Breach of Contract)
(Against Buchanan)**

108. Plaintiffs re-allege and incorporate herein each and every foregoing paragraph of this Complaint as if set forth in full.

109. Buchanan's retainer agreement with the PFA included an indemnification provision which reads:

[Buchanan] agrees to indemnify, defend and hold harmless PFA from and against any and all loss, damages, liability, claims demands, detriments, costs, charges and expenses (including attorney's fees) and causes of action of whatsoever character which PFA may incur, sustain or be subjected to, as a direct result of the [Buchanan's] negligence in the performance of services under this Contract.

110. To date, Buchanan has not indemnified the PFA or the GVI for any of the loses, damages, liability, claims demands, detriments, costs, charges or expenses in connection with the IRS investigation and settlement.

111. As a direct and proximate result of Buchanan's breach of contract, the PFA and the GVI suffered damages in the form of the payment to the IRS and the substantial related costs and expenses.

**COUNT VI
(Breach of Contract)
(Against BoA)**

112. Plaintiffs re-allege and incorporate herein each and every foregoing paragraph of this Complaint as if set forth in full.

113. Under the Financial Advisory Agreement between the PFA, GVI and BoA, BoA agreed “to perform services to the degree of skill and care that is customarily demanded of professional financial consultants using practices and standards that assured that all such work is correct and appropriate for the purposes intended.”

114. BoA breached this provision by failing to recognize that the PFA and the GVI had a working capital surplus, as defined in the Series 1999A Bond documents. BoA knew or should have known that the GVI had “Surplus Available Amounts” under the Tax Code, and as defined by the Series 1999A Bond documents, to redeem the Series 1999A Bonds prior to the Series 2006 Bond issuance because all of the documentation required to form that understanding was available prior to the Series 2006 Bond issuance.

115. As a direct and proximate result of BoA’s breach of contract, the PFA and the GVI suffered damages in the form of the payment to the IRS and the substantial related costs and expenses.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs pray for judgment against Defendants jointly and severally as follows:

- A. That the Court declare, adjudge, and decree that Defendants have committed the violations of law, duties and agreements alleged herein;
- B. That the Court award compensatory damages in an amount to be proven at trial;
- C. That the Court award prejudgment interest according to statute;
- D. That the Court award punitive damages according to proof at trial;
- E. That the Court award Plaintiffs attorneys’ fees and costs of suit, and other such legal and equitable relief as the Court may deem Plaintiffs to be entitled to receive.

DEMAND FOR JURY TRIAL

Plaintiffs demand a trial by jury of all issues in this action triable by jury.

Respectfully submitted:

DATED: October 20, 2014

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DATED: October 20, 2014

Respectfully Submitted:

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