The Philadelphia Inquirer

March 11, 2001 www.philly.com

After $1.7 million landed in the wrong account, CoreStates insisted it could seize the money.

It was A VERY COSTLY MOVE

By L. Stuart Ditzen

Glenda Klein felt sure she had straightened out the problem.

Money owed to her company was being sent to the wrong place, and Klein was having to chase around to get it back. It was irksome.

But this was the mortgage business, where money bounces around like a puck in a hockey game. A small company originates a mortgage. A middleman puts up cash for the loan. A big bank lends money to the middleman. An investment company buys the mortgage. Somehow, everybody eventually gets paid back.

But it isn't surprising that money sometimes misses its target in the whirl of wire transfers that fly around behind the scenes when Joe Public signs papers to buy a house.

This was the problem Glenda Klein was having in the fall of 1997.

Her company, Pioneer Commercial Funding Corp., of New York City, was a middleman in the mortgage business.

Money owed to Pioneer from a series of mortgage transactions was being sent mistakenly to an account at CoreStates Bank in Philadelphia.

The account belonged to a King of Prussia firm, American Financial Mortgage Corp., that did business with Pioneer.

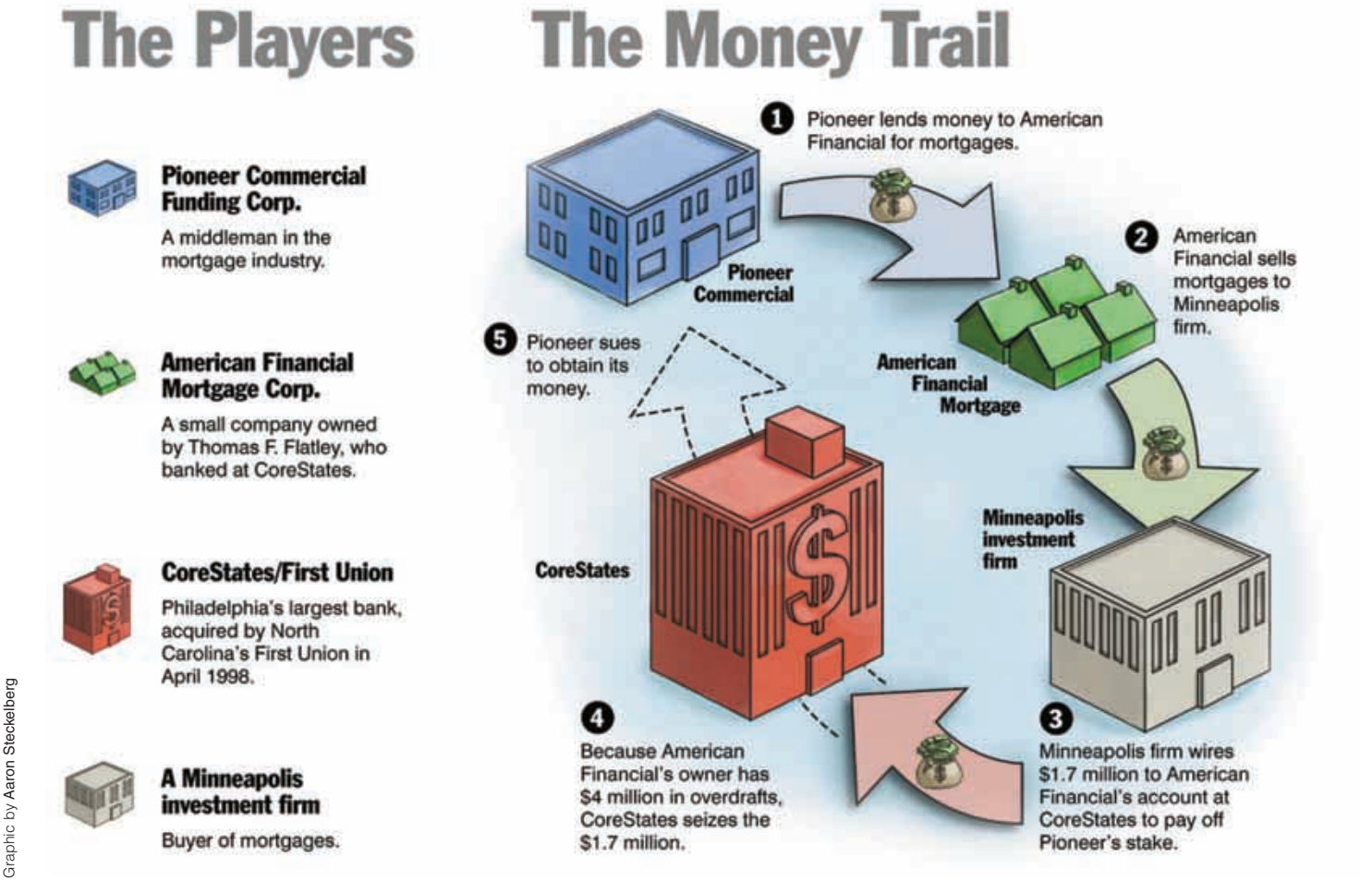
Klein, the chief financial officer at Pioneer, already had straightened out one set of misrouted transactions at CoreStates. She thought she had corrected the problem.

But in mid-November 1997 it happened again. Three electronic wire transfers totaling $1,779,519 landed in American Financial's account. The money was en route to Pioneer from a Minneapolis investment firm as payment for a bundle of mortgages it was purchasing.

L. Stuart Ditzen last wrote for the magazine about bone-screw litigation.

How this story was put together

This story is drawn from court documents - transcripts, trial exhibits, legal pleadings - and from interviews. Officials at First Union Bank declined to comment while the case is on appeal. Walter Weir Jr. said that he was not authorized by the bank to speak about the case. Thomas F. Flatley's lawyers said they had advised him to make no comment.



Graphic by Aaron Steckelberg

Klein was annoyed. As she put it when testifying in court later, "I went a little crazy."

Once again, she set about trying to get the money rerouted to Pioneer.

But this time, to Klein's amazement, CoreStates refused to give back the money.

American Financial's account had been frozen.

CoreStates refused to say why.

No amount of protest by Klein, or the president of her company, or Pioneer's lawyer, or executives at American Financial, or that company's lawyer, made any difference.

CoreStates held tight to the money. Weeks went by. And months. And years. CoreStates and its successor, First Union Bank, never released the $1.7 million. The bank did not explain its action until much later, and then only in response to stern court orders.

Pioneer filed suit in April 1998 to get its $1.7 million.

By the time the case went to trial last summer, Pioneer had gone out of business — ruined, its lawyer said, by the repercussions of CoreStates' action.

A jury sitting for two months in Philadelphia Common Pleas Court learned why the bank had seized the $1.7 million, and it didn't like what it heard.

The verdict stunned everyone — especially First Union Bank and its lawyers.

The jury ordered the bank to pay Pioneer $352.7 million. That included the largest punitive damage award against a bank in Pennsylvania history.

On Nov. 6, 1997, a ripple of alarm spread through executive offices at CoreStates Bank. Bank officials discovered on that day that more than $4 million in overdrafts had just been written in the corporate accounts of a King of Prussia businessman named Thomas F. Flatley.

Fearing that the bank was the victim of a huge check-kiting operation, CoreStates executives froze all of Flatley's business accounts.

Kiting is a form of fraud that generally involves churning deposits and withdrawals through accounts in multiple banks. The object is to siphon out money in a game of timing. The kiter writes a check from an empty account in one bank, deposits that check in another bank, and then makes a fast withdrawal from the second bank before the bad check bounces.

Flatley and his lawyers have emphatically denied — then and now — any check-kiting. Though CoreStates referred its suspicions to federal authorities for investigation, no action against Flatley has resulted.

The odd thing about it, in view of the facts, is this: CoreStates knew perfectly well that Flatley's firms were writing overdrafts.

In fact, the bank — by written agreement — had permitted the overdrafts.

Flatley had what was called a "cash management" arrangement with CoreStates. The bank routinely covered overdrafts from his companies with a credit line. CoreStates had been paid several hundred thousand dollars in interest on the loans.

When the overdrafts exceeded $4 million, though, bank officials decided it was not a matter of tight cash flow, but a check-kiting operation.

Flatley's companies included commercial real estate enterprises, resorts in Florida and Arizona, and a mortgage company — American Financial Mortgage Corp. — all of which were abruptly caught in the freeze.

No money could be withdrawn from the accounts. CoreStates seized all money on deposit, no matter where it came from, and used it to cover the $4 million in overdrafts.

Gene D. Cohen is inclined to say what he thinks — probably more bluntly than the typical judge.

On May 31, he did not mince words. The unusual case of Pioneer Commercial Funding v. First Union Bank was coming up for trial before him in Common Pleas Court. Cohen had reviewed the facts and he told lawyers for First Union: "These things look bad."

In essence, Pioneer was accusing the bank of stealing $1.7 million.

The bank's lawyers did not seem to heed the judge's pretrial warning: "These things look bad."

Cohen could not possibly have foreseen all the surprises — or the huge verdict — that lay ahead. But he saw, in broad strokes, the picture that would emerge, and he issued a clear warning to the bank. He repeated it several times.

"It looks bad on the surface."

First Union and its lawyers did not seem to pick up on the judge's point.

And despite the jury verdict, the bank and its lawyers still insist that the $1.7 million seizure was justified under the law.

But First Union lost that argument before Cohen in December, when the judge issued a post-trial opinion stating, in loose translation, that the facts not only had looked bad, they were bad. Cohen left the verdict intact, except for one thing: He reduced the punitive damages to $40.5 million from $337.5 million. That number, he said, was more in the "realm of reason."

Walter Weir Jr. is a pugnacious and self-confident man reputed to be the best banking lawyer in Philadelphia. Weir & Partners is the firm big banks often turn to in times of trouble. And it was to the 53-year-old Weir that CoreStates turned in 1997 as bank executives stared at a $4 million hole that they suspected was the result of a scam.

Weir's job was to get back the money.

He was determined to succeed.

And he was willing to play rough.

First, Weir told CoreStates it had a legal right to seize the $1.7 million in American Financial's frozen account that was being claimed by Pioneer. That knocked down the $4 million overdraft debt almost by half.

The bank has never disputed that the $1.7 million, under normal circumstances, would have been forwarded immediately by American Financial to Pioneer.

But in Weir's legal analysis, based on his examination of documents in the mortgage lending chain, the $1.7 million belonged to American Financial — at least momentarily — when it landed in the CoreStates account. Despite a chorus of voices saying the money belonged to Pioneer, Weir was cocksure of his position: It was American Financial's money.

The bank seized the money. But it did not tell Pioneer why.

"We knew nothing of the check-kiting that was going on," Albert Nissim, Pioneer's president, would testify at the trial. ". . . We had very little information except that they took the money without any justification."

Tom Flatley and his lawyer, David R. Moffitt, tried to persuade CoreStates — and Weir — to release the $1.7 million to Pioneer.

Weir rejected that. And he used a big stick on Flatley to get back the rest of the money.

It was such a big stick that the judge would later observe that Flatley had repaid the bank "at the point of a gun."

On March 18, 1998, Weir sent a curt letter to Moffitt, saying that he intended to file a federal racketeering lawsuit against Flatley and his companies, accusing them of check-kiting. He wasn't bluffing. A draft copy was enclosed.

That rang the bell for Flatley. As a businessman, the last thing he wanted was to be publicly called a check-kiter. Flatley responded immediately. He signed a 20-page "workout" agreement pledging to repay CoreStates the balance of his overdraft debt. He sold one of his companies to do it. And he made several major concessions to the bank.

One was to consent to the bank's seizure of the $1.7 million.

Another was to agree that if Pioneer sued CoreStates, Flatley would pay the bank's legal fees as well as any ultimate judgment against the bank. Theoretically, that puts Flatley on the hook for all the money assessed against the bank. It is questionable, however, whether the bank can pass off the punitive damages.

Maurice R. Mitts is a cheerful and energetic man who looks younger than his 40 years and relishes his work in the law.

Mitts, a member of the Center City firm of Frey Petrakis Deeb & Blum, picked up the Pioneer Commercial Funding case in 1998 on a referral.

He proved to be the nemesis of Walter Weir and First Union Bank.

For two years, Mitts engaged Weir in an acrimonious battle to extract documents from CoreStates, and later First Union, that would shed light on what the bank had done and why.

Weir resisted tenaciously.

Mitts obtained court orders in July 1999, November 1999, and February, March and May of last year. And still, Weir and the bank held back information about the $1.7 million seizure.

That blatantly recalcitrant conduct was unusual for a big corporation, and Cohen became suspicious. Smart, brusque and self-assured, the 58-year-old judge condemned the bank and its lawyers at one point during the pretrial wrangling for "obfuscation, delay, tough tactics, maybe even sharp practice." That last term was an uppercut — sharp practice is lawyerspeak for unscrupulousness.

One of the key documents Weir refused to turn over to Mitts was the workout agreement Flatley had signed to settle with the bank.

Under court order, Weir and an associate, Robert D. Sayre, finally produced the agreement early last year, about three

months before the trial. But the 20-page document consisted of 16 blank pages, with sections of the four other pages blanked out. Sayre said the blanked-out material was irrelevant.

Mitts was outraged. He took the sheaf of blank pages to Cohen.

The judge, too, was outraged. On March 15, Cohen ordered the complete, unaltered document produced within 24 hours, and he levied a $5,000 sanction on Sayre for withholding it.

Remarkably, Cohen also suggested a hypothetical as he talked to the bank's lawyers. He speculated that CoreStates might have "conspired" to steal Pioneer's money. And the bank might be trying to cover up details of the suspected check-kiting because it had been "complicit" in allowing Flatley's huge corporate overdrafts to occur. Later on, the bank cited those remarks as evidence of bias.

As the trial approached, almost 2½ years after the $1.7 million was seized, Walter Weir had to step aside as lawyer for the bank. His involvement in the case had become so encompassing that he would have to testify as a witness.

To replace him, First Union hired two prestigious lawyers — Michael M. Baylson, a former U.S. attorney, and Nolan N. Atkinson Jr., a confidante to former Mayor Wilson W. Goode.

Mitts presented Baylson and Atkinson with a new claim. This was no longer a case for $1.7 million; Mitts demanded $72 million for lost business. Pioneer had ceased operations. Mitts contended the company had gone into a death spiral as a consequence of CoreStates' seizure of the money.

Baylson protested to Cohen: "These are astronomical figures!" First Union and its lawyers had viewed the case as no more than a business-to-business tiff involving a couple of million dollars. Apparently they never anticipated that Pioneer might raise the stakes.

Tom Flatley, like Weir, also would be a witness.

American Financial was a codefendant in Pioneer's lawsuit. Regardless of what CoreStates had done, Flatley's mortgage company still owed Pioneer $1.7 million.

David Moffitt did not want his client depicted as a check-kiter. He asked the judge to bar any mention of check-kiting from the trial, saying the allegation was "unsubstantiated."

Once more, Cohen did not mince words: "Mr. Moffitt, what is an overdraft? Do you think it was an innocent overdraft of $4 million? Are we supposed to act as if we were born yesterday? Do you think I fell off a Christmas tree? . . . You know, there is no way to sugarcoat or marshmallow your client's involvement in this matter."

The trial began on June 5 in a huge courtroom on the sixth floor of City Hall. And there was plenty of talk about check-kiting.

In the opening days, Mitts presented a series of witnesses from Pioneer and American Financial who testified that the $1.7 million belonged to Pioneer and had gone to American Financial in error.

Glenda Klein flew in from Australia, where she was working for another mortgage company. On the witness stand, she said she couldn't believe it when CoreStates refused to return the money. In more than a dozen years in the business, she said, "I had never experienced a bank taking funds that didn't belong to it."

Photography by Michael Bryant

Plaintiff's lawyer Maurice R. Mitts is surrounded by a portion of the documents in the case.

Howard J. Seidman, who ran American Financial for Flatley, testified that he made many calls to CoreStates in futile efforts to get the money released.

Pioneer's lawyer, Robert Izmirian, testified that he couldn't get any information from Walter Weir — he couldn't even get his phone calls returned.

After a few days, Cohen suggested to Baylson and Atkinson — out of the jury's hearing — that it might be a good idea for the bank to settle the case.

"Are the parties negotiating at all?" he asked.

The answer was: very little.

On June 20, Weir took the stand. Almost boastfully, he defended his advice to the bank to seize the $1.7 million.

"I told them they had a right to keep the money," he testified, ". . . and I stand by that today and don't feel that I have to come in here to the court and apologize for what I did."

Aggressive by nature, Weir seemed to want to duke it out with Mitts. Mitts had depicted him as the architect of a theft and a cover-up, and Weir was angry. He was frustrated at being sidelined as the trial lawyer. And he was bitter about the judge's harsh criticisms.

Mitts needled and tweaked him, and Weir did not react well.

Pulling out a letter David Moffitt had written, stating that the $1.7 million belonged to Pioneer, Mitts asked:

"What did you understand this to mean when you got the letter?"

". . . I took this letter with a big grain of salt," Weir snapped. "And [I] decided I was going to investigate it before I did anything."

Later, pulling out the 20-page agreement with Flatley — the version with all the blank pages — Mitts compared it with the full-text document, with the droll observation that the two looked "markedly different."

"The only difference is the blank pages," Weir said.

"Yes, that's all. Just the words," Mitts goaded.

And what, Mitts asked, was Weir hoping to achieve in his investigation? "It wasn't to look and see if this money should go somewhere else. It was to look and see if you could find a way to take it. Isn't that right?"

"Well, Mr. Mitts," Weir said, "if you're asking me am I an advocate for my client, you bet I am. . . . Was I looking out after CoreStates' interest? Of course I was. Was I looking out after Pioneer's interest? No. I'm not Pioneer's lawyer."

Midway through the trial, Weir's associate, Robert Sayre, gave Mitts several hundred pages of new documents — papers that Cohen said should have been produced long before trial.

Then another surprise document surfaced right in the middle of a bank executive's testimony.

Cohen was fed up. All exchanges of documents in civil cases are supposed to take place before trial, not in the midst of it.

The judge stopped the trial and sent the eight-member jury home for the day. Then

In the end, the price tag for the bank could be 97% higher than when the case started.

he delivered a tongue-lashing to Baylson, Weir and Atkinson.

"I want you to understand something," he snapped. "The conduct of the defense has been something less than professional, something less than forthcoming, something less than we would have expected from Philadelphia lawyers of your reputation and character."

Weir had been getting more and more angry, and he abruptly exploded at the judge. "I told you . . . that it was going to take a lot of time to produce these documents. I know what it takes to produce these documents, and you are, with all due respect, dead wrong."

Dead wrong.

The words ignited Cohen.

"I'm going to tell you how dead wrong I am," he barked at Weir. "I don't want you in my courtroom anymore. . . . You're out of here. . . . I may be in error, I may be incorrect, but I'm never dead wrong, not from a lawyer. . . . On the record in open court you're going to tell me I'm dead wrong?"

Judge Gene D. Cohen frequently urged the bank to reach a negotiated settlement.

As fast as Weir had lost his temper, he now seemed to break down. He began to apologize. He said there was no excuse for his remark. He said he should be sanctioned. "I only ask you to please keep in mind that I have been kicked around in this case. . . . And to sit passively by while a lot of people throw around innuendo that I am unethical, that I have counseled my client to do criminal things. And I can only tell you that I'm just a little upset about it."

Cohen cooled down, but he warned Weir: "You had better toughen up. The circumstances of this case were such that I told you at one time what the appearance was. . . . You had better toughen up because it will get worse for you."

The next day, in what may have been the most surreal moment of the strange trial, Walter Weir came to court with a confession.

There were yet more documents that hadn't been turned over. Among them were several internal bank memos that nearly sent Mitts into orbit.

In one, a CoreStates executive named Don Mishler commented in puzzlement about the $1.7 million that had landed in American Financial's frozen account: "Go figure how the funds got here. . . ." That statement seemed to contradict dramatically the bank's position in court that there was no puzzle about it and that the money clearly belonged in the account.

In another memo, a bank executive recommended coming down hard on Flatley: "We should shoot and ask questions later."

On June 30, the eight jurors spent one hour in deliberations and concluded that Pioneer was the rightful owner of the $1.7 million. Thus, First Union was liable to Pioneer for that sum.

But that was only the first round.

This was a two-phase trial.

And the second round was a much more precarious one for the bank.

The jury would have the opportunity to add whatever amount it deemed appropriate to punish the bank.

At this stage, the judge wondered aloud whether the top brass at First Union were paying attention.

On July 5, Cohen told Baylson and Atkinson: "I'm going to order somebody from CoreStates Bank or First Union to be here for the rest of the trial." Cohen wanted an executive from Charlotte, N.C., First Union's home base, to come to court — and come with the power and inclination to settle the case.

No one from Charlotte came.

A few days later, Baylson told Cohen the bank was not willing to pay a big number to settle.

It was still worth only a couple of million dollars.

So the trial proceeded.

The jury heard from Albert Nissim, Pioneer's president, and Boaz Harel, an Israeli citizen who was Pioneer's chairman. In their telling, CoreStates had inflicted a fatal injury on their company.

Pioneer had been growing rapidly. It had been funding 800 loans a month. It had been approaching $1 billion in gross business. It had been expanding its borrowing capacity.

After CoreStates seized the $1.7 million, the two men said, Pioneer's reputation was blackened. The money represented funds

that Pioneer needed to complete a series of mortgage transactions.

When Pioneer failed to promptly complete the transactions, its credit line gradually dried up. Its prospects for growth evaporated.

"It was devastating," Harel testified. ". . . We had a totally clean balance sheet and financial reports before that."

Baylson and Atkinson argued that Pioneer's failure had nothing to do with the $1.7 million seizure. Rather, there had been a downturn in the mortgage market. Pioneer had been vulnerable because it had expanded too quickly. And it was too heavily involved in the risky "sub-prime" mortgage market.

In his closing argument, Maurice Mitts unleashed a stream of rhetoric, suggesting that the bank had acted like "the Mafia" or "a pack of hoodlums."

"This is a greed machine," he declared, ". . . a vicious greed machine."

Mitts urged the jury to make the bank pay and pay big.

Nolan Atkinson asked the jury to be reasonable.

On July 26, after deliberating for all of one hour and 53 minutes, the jury reported to Cohen that it had reached a verdict.

As the jurors filed into the cavernous courtroom, Mitts and an associate, Christopher Day, sat side by side, each with a pad of paper.

As the verdict was read, each wrote down what he heard.

There were "consequential damages" of $13.5 million.

There was silence in the courtroom as the jury forewoman announced the punitive damages.

Mitts wrote down the number. He looked at Day's number. It was the same: $337.5 million.

For a moment or two, everyone was silent.

Then Cohen thanked the jurors and released them.

Baylson stepped over to Mitts and shook his hand.

The case, of course, was not over. Six weeks later, First Union filed a motion asking Cohen to throw out the verdict and grant a new trial.

The bank had brought in two more lawyers — two more marquee names — to join the battle.

One was Arlin M. Adams, a retired judge of the U.S. Court of Appeals for the Third Circuit. The other was Ralph G. Wellington, chairman of the law firm of Schnader Harrison Segal & Lewis.

Adams and Wellington submitted a long memorandum to Cohen arguing that the trial had been unfair.

The jury had been inflamed. Mitts improperly had tossed around all kinds of hot lingo. And the judge had been unfair. His remarks had been intemperate and his rulings prejudicial. Evidence that never should have been put before the jury had been allowed.

"Through the strident and at times irresponsible advocacy of Pioneer's counsel, and as a result of a series of rulings by the court, this became a case about conspiracies, check-kites, cover-ups and attorney misconduct . . . ," the bank's lawyers argued. "The result was a trial that was fundamentally unfair."

Cohen utterly rejected the bank's position. Except for the runaway punitive damages award, he said in an opinion issued on Dec. 4, the jury's verdict was justified.

As for Mitts' "neon-lit" language, it may have been extreme, but it was understandable, the judge wrote, in light of "constant cheating and provocations on the part of CoreStates and its lawyers."

Cohen set the final verdict against the bank — including compensatory, consequential and punitive damages — at $56 million.

First Union is appealing that ruling to the Pennsylvania Superior Court. Wellington and Adams are hoping to get the case back to square one. They want to start all over with a new trial — a quest that could go on for years in the appellate courts. If the bank loses, it is likely to face a judgment of $56 million, plus interest, on a case that, not so long ago, carried a price tag 97 percent smaller.

With its armada of lawyers, First Union surely has spent far more than $1.7 million in legal fees already.

Mitts, who is being paid on an hourly basis with no contingency fee, says that even Pioneer has run up a legal tab approaching $2 million.

The overarching question of why the bank didn't settle remains a puzzle. Walter Weir thought he gave the bank solid advice. All the lawyers who joined in the bank's defense hold to that position: Legally, they contend, the bank was within its rights in seizing the $1.7 million.

But the case ran away from them. It got bigger and bigger and worse and worse. And there was no stopping it. One defense lawyer observed, "It went to hell in a handbasket."

Maurice Mitts says his client is willing to call it quits for the $56 million.

But First Union still isn't willing to pay a big number.

Mitts isn't surprised.

" 'We know the law, we are the law, and too bad for you,' " Mitts said. "That's been their attitude all along." ●

L. Stuart Ditzen's e-mail address is sditzen@phillynews.com.