

I. INTRODUCTION

1. USTC is a member-owned cooperative of roughly 700 tobacco farmers who have organized to grow, market and sell flue-cured tobacco products. A grassroots organization, USTC is run directly by its members, many of whom are fifth generation farmers.

2. From May 2011 through March 2013, ATF informants Jason Carpenter and Christopher Small engineered a scheme to steal approximately \$24 million from USTC's farmers. They did so by leveraging their employment with ATF to (1) sell USTC an ATF-front operation as though it was a standard commercial tobacco business and (2) deprive USTC of millions of dollars through self-dealing sales of contraband Carpenter and Small received from ATF.

3. Carpenter's and Small's scheme depended on—and could not have been possible without—the negligence, complicity, and assistance of their ATF superiors, particularly their principal handler, retired Special Agent (“SA”) Thomas Lesnak. At every step along the way, SA Lesnak and others within the ATF knew or should have known of Carpenter's and Small's theft from American farmers—and at best, did nothing to stop it, and at worst, facilitated it.

4. The scheme worked like this: In May 2011, Carpenter and Small—with the help of USFC's former Executive Vice President, E. Stephen Daniel (“Daniel”)—angled for USTC to purchase the assets of two tobacco distribution businesses based in Bristol, Virginia: Big South Wholesale, LLC (“BSW”) and Big South Wholesale of Virginia, LLC (“BSW-Va.”). In reality, the two businesses were an ATF front and, unbeknownst to USTC's Board of Directors (“Board”), Carpenter and Small generated a substantial amount of BSW / BSW-Va.'s revenue from undercover ATF transactions.

5. Kept in the dark about the true nature of the companies it was buying, USTC's Board executed an asset purchase agreement (“APA”) on May 1, 2011 and paid Carpenter and Small approximately \$8.7 million for the assets. As part of this agreement, USTC offered

Carpenter and Small positions with USTC's newly-created subsidiary Big South Distribution ("BSD"). In these new roles, Carpenter and Small oversaw BSD's day-to-day operations, and controlled the tobacco products BSD purchased for wholesale. The day after the APA closed, Carpenter and Small paid a \$69,000 under-the-table kickback to Daniel—USTC's lead negotiator during what the USTC Board believed was an arms-length deal. This payment and the corrupted deal process were known to (and encouraged by) SA Lesnak, but were never disclosed to USTC's Board.

6. Following the APA, Carpenter and Small continued to unlawfully deprive USTC of millions of dollars by selling to BSD untaxed, contraband cigarettes provided by ATF. Carpenter and Small pocketed roughly \$12 million in ill-gotten gains from these self-dealing sales—which continued until March 2013, when USTC's Chief Financial Officer ("CFO") discovered and put an end to the misconduct.

7. Rather than rein in its informants' illegal conduct, ATF encouraged it. ATF superiors permitted Carpenter and Small to obtain contraband cigarettes, mark them up, and resell them for a profit—all while carefully concealing ATF's involvement. SA Lesnak even set the price Carpenter and Small charged for cigarettes they sold from Big Sky to BSD, despite the fact that ATF had no legal authority to direct Carpenter's and Small's sales to a non-target such as BSD.

8. As the *New York Times* reported in a series of articles published in 2017, ATF had a financial interest in its informants' scheme. Ex. C (Matt Apuzzo, *'I Smell Cash': How the A.T.F. Spent Millions Unchecked*, N.Y. Times (Sept. 8, 2017), <https://nyti.ms/2xhriuM>; Matt Apuzzo, *A.T.F. Memo Indicates Agents' Off-the-Books Account Was Against the Rules*, N.Y. Times (June 23, 2017), <https://nyti.ms/2t18Mnv>; Matt Apuzzo, *Secret A.T.F. Account Paid for \$21,000 Nascar*

Suite and Las Vegas Trip, N.Y. Times (Apr. 11, 2017), <https://nyti.ms/2p0hn8k>; Matt Apuzzo, *A.T.F. Filled Secret Bank Account With Millions From Shadowy Cigarette Sales*, N.Y. Times (Feb. 22, 2017), <https://nyti.ms/2lu9Ev1>).¹ The money Carpenter and Small stole from USTC’s farmers was deposited into an unauthorized, off-the-books ATF slush fund that—in addition to enriching Carpenter and Small—illegally bankrolled ATF operations. This slush fund took the form of a private bank account controlled by Carpenter and Small, which they named the “Big Sky International Management Account” (“management account”). Devised by SA Lesnak to circumvent limits on ATF’s lawful ability to augment its budget, the management account enabled ATF agents to tap a near-bottomless source of funding for ATF operations, all outside the reach of Congress and federal oversight and in clear violation of federal appropriations laws.

9. Freed from the strict audit trail that legitimate ATF spending requires, SA Lesnak and others at the ATF used the ill-gotten funds in the management account to splurge on cars, travel, electronics, and entertainment with no discernible law enforcement purpose. SA Lesnak, in particular, steered hundreds of thousands of dollars from the management account to things like his church and his children’s school. He even had his and other agents’ ATF credit cards paid from the account. All told, the account—flush with money stolen from USTC’s farmers—financed expenditures such as:

- \$50,000 prepayment for American Express credit cards in the names of ATF agents SA Lesnak and SA Daniel Whittemore;
- \$37,000 donation to the public high school that SA Lesnak’s child attended;

¹ SA Lesnak also benefitted from his relationship with Carpenter and Small on a personal level: after SA Lesnak retired from ATF in late 2012, Carpenter and Small arranged a six-figure position for him with USFC—a position Lesnak retained until Carpenter’s and Small’s self-dealing scheme was uncovered in spring 2013.

- A suite used by ATF agents at the Bristol Motor Speedway, where ATF agents racked up a \$21,000 bill;
- The living expenses of a cooperating defendant in a wholly unrelated matter while that individual was incarcerated; and
- Travel to Las Vegas and a suite at the Mirage Hotel for several ATF agents, Carpenter, Small, and others, including an individual under indictment at the time.

10. The ATF now admits it had no legal authority for the management account, or for SA Lesnak's conduct. Indeed, ATF's use of the management account and proceeds of Carpenter's and Small's theft violated federal law and ATF policies that (1) prohibit private funding to finance operations and (2) place strict limitations on sales of contraband and compensation for informants.

11. ATF agents were aware of the impropriety of this scheme. Accordingly, they carefully distanced themselves from the Big Sky account. Although ATF Headquarters purportedly knew of its existence, ATF never explicitly authorized the account, or implemented written protocols or guidelines for its use. No government official had access to the account itself, and SA Lesnak did not even know where it was located. It was Carpenter and Small, and their assistant Wendi Davis, who controlled its use on a day-to-day basis. Notwithstanding that the account purportedly contained funds subject to forfeiture as proceeds of unlawful activities, ATF never audited or reconciled the account. *See* Ex. D (Stipulation and Order of Voluntary Dismissal, *New York Times et al. v. Bureau of Alcohol, Tobacco, Firearms, and Explosives*, No. 17 Civ 2144 (SJN) (S.D.N.Y. June 8, 2018) (ECF No. 35)).

12. ATF's failure to implement adequate controls over the management account enabled SA Lesnak (and others) to misuse its funds. Moreover, SA Lesnak's failure to properly supervise Carpenter and Small gift-wrapped the perfect opportunity for them to steal from USTC's

farmers. Over a two-year period, SA Lesnak and others were content to let Carpenter and Small fleece USTC's farmers of millions of dollars as long as the ATF could continue to tap the management account for its off-the-book activities.

13. Indeed, the Fourth Circuit has placed responsibility for the management account—and the consequences of its use—squarely on ATF. In doing so, the Court found that Carpenter's and Small's conduct was undertaken “with the knowledge, direction and supervision of the ATF and their primary ATF handler” and occurred within the scope of Carpenter's and Small's employment as ATF informants. Op. at 38, *U.S. Tobacco Coop. Inc., et al. v. Big South Wholesale of Virginia, LLC, et al.*, No. 17-2070 (4th Cir. Aug. 3, 2018) (“Fourth Cir. Op.”).²

14. For years, ATF fought USTC to keep its behavior a secret. USTC's CFO discovered Carpenter's and Small's self-dealing sales in March 2013, and the cooperative hired external counsel to conduct an investigation into the scheme.

15. The findings of the investigation led USTC to file suit against Carpenter and Small in July 2013, a case that remains pending in this Court. *U.S. Tobacco Coop. Inc., et al. vs. Big South Wholesale of Virginia, LLC, et al.*, Civil Action No. 5:13-cv-00527-BO (asserting claims for RICO, civil conspiracy, fraud, breach of contract and other assorted claims). During the course of USTC's efforts to uncover the informants' scheme, however, ATF and its counsel deliberately concealed ATF's illegitimate use of the Big Sky management account as an unauthorized slush fund designed to circumvent federal law, as well as ATF's true role in perpetrating Carpenter's and Small's theft of millions of dollars from USTC's farmers.

² In this decision, the Fourth Circuit vacated the district court's reconsideration of a prior grant of Carpenter's and Small's petition to substitute the United States as a defendant for Plaintiffs' North Carolina RICO, breach of contract, and civil conspiracy claims initially brought against Carpenter and Small.

16. It was not until March 22, 2016, when USTC deposed SA Lesnak in the *U.S. Tobacco Coop. Inc., et al. vs. Big South Wholesale of Virginia, LLC, et al.*, litigation, that USTC learned, among other things, that ATF's negligent supervision of Carpenter and Small, negligent use of the management account, and conversion of BSD's funds caused USTC's farmers' injuries. USTC thereafter timely asserted its claims.

17. For these reasons, as set forth and detailed below, the United States is liable for damages under the Federal Tort Claims Act, 28 U.S.C. § 1346(b), for negligent supervision, conversion, and negligence under North Carolina law. It is time for ATF to acknowledge its illegal conduct and to compensate USTC's farmers for the harm its agents caused.

II. JURISDICTION AND VENUE

18. Plaintiffs file this action against the United States under 28 U.S.C. §§ 1346(b), 2671-2680 for money damages.

19. This Court has subject matter jurisdiction over this action pursuant to 28 U.S.C. § 1331 and the U.S. Constitution because the case arises under federal law, specifically the FTCA.

20. This action is timely pursuant to 28 U.S.C. § 2401(b) in that it was presented to the appropriate federal agency within two years of accrual, and this action was filed within six months of receipt of the certified letter sent by the federal agency denying this claim. In the alternative, the claim is timely under the doctrine of equitable tolling.

21. Venue is proper under 28 U.S.C. § 1402(b) because a substantial part of the acts or omissions giving rise to the claims occurred in the Eastern District of North Carolina. 28 U.S.C. § 1402. Additionally, venue is proper under 28 U.S.C. § 1402(b) because it is USTC's principal place of business.

III. THE PARTIES

22. Plaintiffs are three affiliated tobacco businesses: U.S. Tobacco Cooperative, Inc., U.S. Flue-Cured Tobacco Growers, Inc., and Big South Distribution, LLC.

23. Plaintiff USTC is a member-owned agricultural marketing cooperative based in Raleigh, North Carolina that produces and sells flue-cured tobacco products from tobacco grown by its roughly 700 farmer members. USTC and its subsidiaries sell USTC tobacco to other cigarette manufacturers, and also manufacture and sell their own consumer brands such as Ace, Checkers, and Wildhorse.

24. Plaintiff USFC is a wholly-owned subsidiary of USTC that manufactures cigarettes and other tobacco products, primarily using tobacco grown by USTC farmers. USFC maintains its corporate headquarters in Timberlake, North Carolina.

25. Plaintiff BSD is a limited liability company organized under the laws of North Carolina, that maintains places of business in Bristol, Virginia and Raleigh, North Carolina. In March 2011, USTC formed BSD for the purpose of acquiring the assets of BSW and BSW-Va., and to serve as a wholesale distributor of tobacco products.

26. Defendant United States of America is sued under the Federal Tort Claims Act, 28 U.S.C. § 1346, for the tortious acts of its employees, as defined in 28 U.S.C. § 2671.

IV. ATF STOOD WATCH WHILE CARPENTER AND SMALL FRAUDULENTLY INDUCED USTC TO BUY A GOVERNMENT FRONT

27. USTC became entangled with Carpenter, Small and the ATF in late 2010. At that time, Carpenter and Small (egged on by SA Lesnak) were looking to sell the assets of the companies through which they did business—Big South Wholesale, LLC (“BSW”) and Big South Wholesale of Virginia, LLC (“BSW-Va.).

28. Daniel, then Vice President of USFC, learned that Carpenter and Small were looking to sell, and began to lobby the USTC Board to acquire the companies. Daniel, Carpenter and Small thereafter negotiated—purportedly at arm’s length—USTC’s purchase of BSW and BSW-Va.’s assets, ultimately executing an Asset Purchase Agreement (“APA”) on May 1, 2011. Pursuant to the APA, USTC paid Carpenter and Small approximately \$8.7 million for the purchase of the assets. Throughout negotiations—and unbeknownst to USTC—Carpenter and Small paid Daniel secret kickbacks of \$2,000 per month.

a. *Carpenter and Small Inflated BSW’s and BSW-Va.’s Assets to the USTC Board with the ATF’s Knowledge*

29. Carpenter and Small concealed other material facts from USTC at the time of the asset purchase. In particular, they failed to disclose to the complete USTC Board that Carpenter was a confidential informant for the ATF, and Small was a cooperating witness.³ In that capacity, Carpenter and Small used their wholesale tobacco business to develop relationships with ATF targets and potential targets in ongoing ATF investigations into trafficking of untaxed and contraband tobacco products.

30. Carpenter and Small were *de facto* federal employees of the ATF pursuant to the Westfall Act. *See* 28 U.S.C. § 2679(b); Fourth Circuit Op. at 38.

31. ATF agents frequently deploy informants to buy and sell tobacco on the black market, as part of ATF undercover operations to infiltrate and disrupt cigarette smuggling rings. Given the nature of this work, ATF requires its informants to abide by certain standards of conduct. Among other things, informants may not lie or mislead the ATF, broker unauthorized side deals,

³ For purposes of this case, there is no practical difference between a confidential informant and cooperating witness. For ease of reference, both Carpenter and Small are herein referred to as ATF informants.

or engage in illegal activity not specifically authorized by ATF. As SA Lesnak has previously acknowledged, a breach of any of these standards would render an informant unfit, or incompetent, for his job.

32. Carpenter's relationship with the ATF began in or around November 2006. Small began working for the ATF a few years later. At the time he became an informant, Carpenter ran a small-time tobacco wholesale business in Alabama and Tennessee. Everything about that business suggested its limited scope: Carpenter stored inventory in a small storage shed and made deliveries to customers in a van. He did not run a warehouse.

33. Starting in 2006, however, Carpenter's relationship with the ATF transformed his business. Once ATF began using Carpenter's and Small's business as a government front, the wholesaler grew exponentially and soon thereafter, Carpenter and Small formed BSW and BSW-Va. to support ATF operations. Around that time, Carpenter and Small acquired a warehouse in Bristol, Virginia (at SA Lesnak's behest) to accommodate BSW's and BSW-Va.'s growth. The Bristol warehouse became the headquarters of both Carpenter's and Small's limited legitimate business, and ATF's undercover operations involving Carpenter and Small.

34. Carpenter's and Small's relationship with ATF made the expansion of BSW / BSW-Va. possible, and it was BSW / BSW-Va.'s growth that brought the business to the attention of USTC and its subsidiary USFC. From 2006 to 2010, USFC increasingly partnered with BSW and BSW-Va. to distribute USFC products. During this time, Daniel also provided limited assistance to SA Lesnak for ATF operations, and learned of Carpenter's and Small's role as ATF confidential informants.

35. These developments set the stage for the APA. During APA negotiations in late 2010 and early 2011, however, Carpenter and Small affirmatively hid from USTC's farmer-led

Board the extent to which BSW's and BSW-Va.'s business derived from ATF transactions. Specifically, Carpenter and Small presented USTC's and USFC's Board of Directors with, in Carpenter's words, a "bogus" profit and loss statement. That statement reflected profits derived both from BSW / BSW-Va.'s commercial business activities and from Carpenter's and Small's undercover activities, even though (as Carpenter has since acknowledged) the latter profit stream was not what USTC was purchasing.

36. SA Lesnak knew that ATF assets dramatically inflated the balance sheet Carpenter and Small presented to the cooperative during APA due diligence. For one thing, SA Lesnak dictated the purchase price for ATF's share of the BSW / BSW-Va. assets. Moreover, SA Lesnak openly recognized that BSW / BSW-Va. was unprofitable absent ATF support. Indeed, he acknowledged to Carpenter in late 2010 that BSW and BSW-Va. had been "operating with play money" (e.g. proceeds from ATF activity) for the previous three years, and urged Carpenter and Small to work on making their business profitable absent ATF involvement in the future.

37. SA Lesnak also knew that Carpenter and Small failed to disclose to the Board the degree to which BSW / BSW-Va.'s profits derived from ATF—and that this omission deceived the farmers about the true value of what they were purchasing. Despite this, ATF did nothing to stop the APA transaction or dispel the misconceptions of the Board. Instead, SA Lesnak supported the APA, encouraged it to go forward, and later bragged that he orchestrated the entire thing.

38. In particular, prior to the APA, SA Lesnak took affirmative steps to reassure USTC's Chairman of the Board, Albert Johnson, that Carpenter's and Small's work as informants—and USTC's execution of the APA—would not harm the cooperative and USFC after the APA. In doing so, SA Lesnak knew or should have known that ATF's disclosures to the cooperative regarding Carpenter's and Small's relationship with ATF—and further explanations

to the farmers about the impact of Carpenter's and Small's relationship with ATF on USTC's future well-being—were necessary to protect USTC from harm. Upon information and belief, USTC relied upon SA Lesnak's assurances in entering into the APA and retaining Carpenter and Small thereafter. SA Lesnak's assurances to some USTC representatives thus left USTC in a worse position than if SA Lesnak had not affirmatively involved himself in the APA process at all.

a. *Carpenter and Small Concealed From USTC Their Intended Use of Big Sky Following the APA and ATF Did Not Stop Them*

39. Carpenter's and Small's deception of USTC's Board did not stop there. The informants also concealed from USTC their intent to maintain a separate tobacco business after selling BSW's and BSW-Va.'s assets to the cooperative. Although an ATF agent, Daniel Whittemore, disclosed to a small number of hand-picked representatives of USTC in a March 2011 meeting that Carpenter and Small were ATF informants, he told those USTC representatives that Carpenter's and Small's relationship with ATF was "winding down." At no time did anyone at ATF suggest to USTC's farmers that after the sale, once Carpenter and Small were working for BSD, they would continue operating a side business called Big Sky International ("Big Sky") and would sell tobacco products to ATF targets and non-targets alike in direct competition with BSD. Nor did SA Whittemore inform USTC's representatives that Carpenter and Small, despite taking on a fiduciary duty to USTC, would sell tobacco products from Big Sky to BSD in blatantly self-dealing sales, and reap profits from these sales. SA Whittemore knew or should have known that disclosing Carpenter's and Small's true relationship with ATF to the cooperative was necessary to protect the cooperative from harm. USTC relied upon SA Whittemore's representations in entering into the APA and retaining Carpenter and Small to run BSD.

40. The ATF, through SA Lesnak, Carpenter, and Small, knew all along about Carpenter's and Small's plan to sell contraband cigarettes from Big Sky to BSD following the

APA. In fact, prior to the APA, SA Lesnak notified Carpenter and Small that ATF intended for its undercover activities to remain with the informants' side business following the transaction. SA Lesnak also knew or had reason to know that Carpenter and Small concealed this plan from USTC's Board.

41. Daniel also knew about Carpenter's and Small's scheme. To ensure his continued complicity, Carpenter and Small secretly paid Daniel over \$69,000 as an illicit kickback the day after the APA closed. After years of litigation and ATF obfuscation, the ATF was finally forced to concede that this payment had no legitimate law enforcement purpose.

42. SA Lesnak knew about this payment to Daniel. SA Lesnak further knew or had reason to know that Daniel was paid for his role in the fraudulent inducement of the APA and his complicity in Carpenter's and Small's self-dealing scheme. Despite this, SA Lesnak and others at ATF looked the other way.

43. On May 1, 2011, the parties entered into the APA. As part of the APA, USFC created a new subsidiary, BSD, which acquired the assets of BSW and BSW-Va. USTC then made Daniel president of BSD, hired Small as BSD's executive director, and hired Carpenter as a BSD consultant. Small's and Carpenter's respective employment and consulting agreements with Plaintiffs contained non-compete covenants, which forbade them from competing with BSD in the wholesale acquisition and distribution of tobacco products in North Carolina, Virginia, Tennessee, South Carolina, and Georgia. Under those covenants, Carpenter and Small could not invest in, own, control, advise, manage, solicit business for or perform work for companies that competed with BSD in the designated states. USTC agreed to pay Carpenter and Small annual salaries of over \$100,000 each plus a percentage of BSD's profits.

44. SA Lesnak and other ATF superiors knew that Carpenter and Small agreed to non-compete provisions with Plaintiffs pursuant to the APA. SA Lesnak and others at the ATF also knew or had reason to know that Carpenter's and Small's operation of Big Sky violated those non-compete clauses.

45. Despite knowing of Carpenter's and Small's misdeeds in the lead-up to the APA, ATF continued to employ them as informants, and provide them with contraband cigarettes to resell at a profit.

V. ATF PERMITS CARPENTER AND SMALL TO STEAL MILLIONS OF DOLLARS FROM USTC THROUGH SELF-DEALING TRANSACTIONS

46. Following the APA, Carpenter and Small renamed BSW-Va. "Big Sky" to keep its uninterrupted operations secret from USTC, and continued to acquire and distribute tobacco products wholesale through Big Sky. But unlike before, Carpenter and Small could now play both sides of any transaction by virtue of controlling both buyer and seller—causing Big Sky to sell tobacco products to BSD and causing BSD in turn to buy those same products.

47. The first series of Carpenter's and Small's self-dealing transactions from Big Sky to BSD involved sales of Brand-B cigarettes. Brand-B cigarettes are a brand of South American cigarettes produced by Target B, a company owned by businessman Target A.⁴ At the time, Target A was the subject of a U.S. law enforcement investigation. Target B's American affiliate leased space in BSD's Virginia warehouse to store imported Brand-B cigarettes.

⁴ Although USTC does not believe that such a step is required, in an overabundance of caution, the text of this Complaint uses pseudonyms for certain entities and people relevant to this case, pursuant to the parties' historical practice in the *U.S. Tobacco Coop. Inc., et al. vs. Big South Wholesale of Virginia, LLC, et al.*, litigation. Despite this, all relevant names are now publicly available and appear numerous places in the unsealed record of the related litigation. *See, e.g.*, Ex. C.

48. Carpenter and Small purchased the Brand-B cigarettes through Doe-Company—an “expendable front” company established by ATF. The purchases were made ostensibly to smuggle Brand-B cigarettes into foreign countries, thereby ingratiating Doe-Company with Target A. To complete that ruse, after Doe-Company purchased the cigarettes, Carpenter and Small sent decoy containers to the purported overseas destinations.

49. In reality, the Brand-B cigarettes never left Carpenter’s and Small’s possession. Once the diversion was complete, they would mark up and sell the Brand-B cigarettes from Big Sky to BSD, yielding themselves over 200% in profits. Carpenter and Small sold the Brand-B cigarettes to BSD because there was no customer demand for them elsewhere—a fact SA Lesnak has acknowledged. Conveniently, Carpenter and Small could ensure that BSD would buy the cigarettes because they were on both sides of the deal.

50. BSD did not want Brand-B cigarettes and would never have purchased them absent Carpenter’s and Small’s misconduct. BSD lost money on virtually all of Carpenter’s and Small’s dealings at the company, including BSD’s purchases of Brand-B cigarettes. Not only was there no customer demand for Brand-B cigarettes, but purchasing that quantity of any third-party brand was contrary to USTC’s business model. Sixty percent of USTC’s business involved selling their own cigarettes, made with their farmers’ own, domestically produced tobacco. Yet by the time Carpenter’s and Small’s self-dealing was uncovered, BSD’s inventory was overwhelmingly third-party products. It was this incongruity that brought Carpenter’s and Small’s self-dealing to light.

51. Dozens of similar transactions occurred on a regular basis between May 2011 and March 2013, in which a total of over \$24 million of tobacco products were sold from Big Sky to BSD. As the records of the Big Sky management account reveal, the proceeds of each one of these discrete transactions are identifiable.

52. In addition to Carpenter's and Small's theft from BSD through the sales of Brand-B cigarettes, many of the Brand-B cigarettes became worthless because of Carpenter's, Small's and SA Lesnak's negligence in properly maintaining them as inventory. In particular, once they became BSD's property, many of the Brand-B cigarettes degraded, rotted, and became bug-infested and were treated as worthless by Carpenter, Small and SA Lesnak. As a result of this physical damage to its property, BSD was forced to write-off over a million dollars in lost inventory.

53. The ATF was responsible for this property damage. Upon information and belief, during the relevant period, ATF agents (including but not limited to SA Lesnak) actively monitored the conditions of the Bristol warehouse and the tobacco products stored therein, and others at the warehouse came to expect this would be done competently. ATF knew or should have known that its oversight of the Bristol warehouse and inventory was necessary to protect BSD's property from harm. ATF's negligence in doing so put BSD in a worse position than if ATF had never involved itself in the Bristol warehouse's operations in the first place.

54. Moreover, ATF was aware of and complicit in Carpenter's and Small's self-dealing scheme. ATF permitted Carpenter and Small to obtain contraband Brand-B cigarettes, mark them up, and resell them for a profit in violation of ATF regulations and federal law. ATF also knew that Carpenter and Small resold this contraband *specifically to BSD*, where the informants controlled procurement. After the APA, ATF continued to conduct operations from the Bristol warehouse, and SA Lesnak and other ATF officials were present at that facility nearly every day where they witnessed the scheme unfold. As SA Lesnak has testified, not only was he aware of Carpenter's and Small's self-dealing from Big Sky to BSD, he wholeheartedly endorsed the scheme as a convenient way to take advantage of a captive buyer for otherwise unsellable goods.

55. Despite lacking the authority to do so, SA Lesnak even set some of the terms of these sales from Big Sky to BSD, including the price Carpenter and Small charged BSD for the Brand-B cigarettes in many of these transactions at issue. Upon information and belief, SA Lesnak and other ATF agents knew or had reason to know that competent oversight of Carpenter's and Small's sales from Big Sky as informants was necessary to protect USFC's farmers from harm.

56. SA Lesnak and ATF superiors knew that Carpenter's and Small's sales of Brand-B cigarettes to BSD violated the law and ATF policy. First, BSD was not the target of any criminal investigation during the relevant time period. Moreover, the Brand-B cigarettes that Carpenter and Small marked-up and sold to BSD were untaxed, contraband cigarettes that should have been impounded or destroyed. The ATF knew full-well it had no legal authority to sell this contraband to a non-target company for resale, or to permit Carpenter and Small to sell this contraband to another non-target for a profit, and pocket the proceeds.

57. Despite this, ATF continued to provide Carpenter and Small with contraband, and encouraged their theft from American farmers.

58. Carpenter's and Small's self-dealing was not limited to the Brand-B cigarettes. They also operated an even more brazen shell game whereby they purchased USFC products and then re-sold those same products back to BSD at a much higher price. The purely paper transaction netted Carpenter and Small a personal profit of over \$600,000 in a matter of days.

59. First, Carpenter and Small caused USFC to sell Wildhorse cigarettes to Doe-Company for \$3 a carton—or \$134,280 in total. Five days later, Carpenter instructed BSD bookkeeper Wendi Davis to draft an invoice from Big Sky to BSD for \$747,492 for the very same Wildhorse cigarettes, and then write and deposit a check to Big Sky from BSD for the same. The next day, a BSD check for \$747,492 was deposited into Big Sky's bank account. And the day

after that, Big Sky wired \$134,280 to Doe-Company—the exact amount Doe-Company owed to USFC. Ultimately, this scheme caused USTC’s farmers to buy back their own cigarettes at a 450% markup.

60. Once again, Carpenter and Small were able to perpetrate this scheme because they were on all sides of the transaction—they caused USFC to sell the cigarettes to Big Sky via Doe-Company; they sold the same cigarettes from Big Sky back to BSD; and they caused BSD to agree to the purchase. No product actually moved anywhere. All that was necessary for Carpenter and Small to fleece the farmers of over \$600,000 was an email to their bookkeeper.

61. The sale and re-purchase of these Wildhorse cigarettes did not involve any ATF targets or investigations. As a result, there was no law enforcement justification for the Wildhorse transaction. Carpenter and Small were stealing from BSD’s till through a fake transaction. Celebrating their self-dealing in an e-mail, Carpenter urged Small “Let’s get paid!!!!” Had ATF not turned a blind eye to Carpenter’s and Small’s get-rich scheme, they would never have been able to steal from BSD.

62. In furtherance of their scheme and to ensure it would remain concealed, Carpenter and Small made seven kickback payments totaling more than \$470,000 to Steve Daniel, their supervisor, who was aware of the informants’ misconduct at the time. Most of these payments were made by cashier’s check, and six of the seven payments were made to Universal Services First Consulting, a shell company owned by Daniel. Daniel never disclosed these payments to USTC’s Board.

63. SA Lesnak encouraged these payments to Daniel, even as he knew or had reason to know their improper purpose.

VI. CARPENTER AND SMALL HOUSED THEIR ILL-GOTTEN GAINS IN AN ILLEGAL ATF SLUSH FUND

64. The proceeds of Carpenter's and Small's self-dealing sales to BSD flowed through a private bank account owned and controlled by the two informants, called the Big Sky International management account. The informants used this account to enrich themselves and reward their friends.

65. Specifically, the year they entered into the APA, Carpenter and Small pocketed \$2,151,826 and \$2,083,031, respectively, from Big Sky. The next year Carpenter took home \$3,857,439 and Small took home \$3,674,356. And the year after that, they each took home over \$300,000 before their scheme was uncovered in early March. All told, the pair netted over \$12 million in two years from their self-dealing. And they openly celebrated that fact, with Carpenter reacting to their sales with: "Ka-Ching!" and Small responding: "I smell cash??"

66. As records from the Big Sky management account demonstrate, Carpenter and Small also used money stolen from USTC's farmers to pay:

- \$37,000 to Small's son's high school;
- \$32,000 to Sullins Academy;
- \$5,000 to Small's son's Cub Scout troop; and
- \$37,000 to Divine Care Ministries.

67. In addition to funding their pet projects, Carpenter and Small used the management account as an illegal off-the-books slush fund to "backstop" ATF activities and agents—purchasing vehicles for use in law enforcement, prepaying ATF agents' credit cards, and the like. Indeed, SA Lesnak, Carpenter and Small have all testified under oath that at least one purpose of the Big Sky-BSD transactions was to finance ATF operations through the Big Sky management account.

68. In supplementing its budget with money Carpenter and Small “earned” from Big Sky’s sales to BSD, ATF violated its own regulations and federal law. The ATF is bound by strict rules on how it may finance its operations and spend its funds: The agency may spend only sums appropriated by Congress, and it may not accept private funding to supplement its Congressionally-appropriated budget. *See* 31 U.S.C. §§ 1341-42.

69. Congress permits only limited exceptions to this prohibition. *See* 28 U.S.C. § 533. Through a process known as “churning,” ATF may recycle the profits generated from an undercover operation against a specific target for use in that same investigation against that same target. Proceeds generated from churning operations must be deposited in a government-controlled account subject to regular audits. *See* Consolidated Appropriations Act, 2005, Pub. L. No. 108-447, § 116, 118 Stat. 2809, 2870 (2004); Dep’t of Justice & Related Agencies Appropriations Act, 1993, Pub. L. No. 102-395, § 102(b)(3), 106 Stat. 1828, 1839-41 (1992).

70. Apart from churning, ATF may not use private funds to augment its annual budget. Moreover, the “churning” exception is narrow, and multiple ATF rules and policies have reinforced its limitations. In 2009, for example, the ATF Chief Counsel issued an opinion, of which there is no written record, stating that no funds other than churning proceeds may be deposited into a churning bank account.

71. Additionally, on April 25, 2011, the ATF issued a Memorandum (“2011 ATF Memorandum”) that articulated the agency’s enhanced policies and procedures for churning investigations. The 2011 ATF Memorandum responded to prior lapses in the agency’s churning procedures, and sought to ensure that ATF investigations did not exceed the limited churning authority granted by Congress going forward. ATF knew that the 2009 and 2011 policies were

necessary to better regulate ATF's sales of contraband and prevent future abuses of ATF's churning authority that could, among other things, harm third parties like USTC.⁵

72. To this end, the 2011 ATF Memorandum clarified that a churning transaction is limited to the completed sale, or trade, of tobacco products to a *suspect/defendant*, and that cigarettes purchased with churned funds cannot be transferred, loaned, sold, or fronted to another Federal, state or local investigation. The 2011 ATF Memorandum further warned ATF employees not to use churning funds in a way that would create the appearance that ATF was augmenting its annual appropriations.

73. As the 2011 ATF Memorandum demonstrated, in the context of an ongoing churning operation, ATF is not permitted to use sales (1) to a different target or (2) related to a separate investigation to finance its investigations. Nor may ATF agents finance an investigation through sales to a complete non-target, like BSD. ATF has admitted that sales of tobacco products to *complete* non-targets—that is, private businesses that were never suspected of becoming targets and were never implicated in ATF sales—are not permitted by law or ATF policy.

74. ATF rules further prohibit ATF agents from compensating confidential informants absent proper documentation and approval.

75. SA Lesnak and other ATF superiors were well-aware of the 2009 and 2011 ATF policies and their implications for ATF churning operations. To circumvent these rules, SA Lesnak, with the knowledge of his ATF superiors in the Washington Field Division and ATF headquarters, began to use privately-held management accounts to store funds that could not be deposited into a churning account. The Big Sky management account—which housed and

⁵ The ATF issued this memorandum only after the Office of the Inspector General of the Department of Justice (“OIG”) commenced a two-year audit of the ATF’s churning operations. The OIG’s report was highly critical of the ATF’s oversight of churning operations.

segregated the proceeds of Big Sky's sales of contraband cigarettes to BSD⁶—was one such account.

76. Because they were privately-held, management accounts enabled SA Lesnak and other ATF supervisors to tap into an unlimited source of funding for operations while evading the strict financial controls which accompany government spending. Emboldened by this lack of oversight, SA Lesnak and others at the ATF used the ill-gotten funds in the management account to pay for travel, electronics, entertainment, and personal perks for SA Lesnak. The numerous improper uses of funds from the management account include, but are not limited to:

- \$50,000 prepayment for American Express cards in the names of ATF agents SA Lesnak and SA Whittemore;
- \$37,000 donation to the public high school that SA Lesnak's child attended;
- A suite used by ATF agents at the Bristol Motor Speedway;
- The living expenses of a cooperating defendant in a wholly unrelated matter while that individual was incarcerated; and
- Travel to Las Vegas and a suite at the Mirage Hotel for several ATF agents, Carpenter, Small and others, including an individual under indictment at the time.

77. The ATF has admitted it had no legal justification for the Big Sky management account, or for SA Lesnak's use of its funds—much of which served no operational purpose and fell well outside of the law permitting the use of churning funds. In fact, the 2011 ATF Memorandum demonstrates that *ATF itself* understands that ATF's use of the management account (and the proceeds of the Big Sky-BSD transactions) to finance ATF operations violated federal

⁶ Upon information and belief, Carpenter and Small took steps to identify the discrete funds in the management account that resulted from the Big Sky to BSD sales.

anti-augmentation law and fell far outside of the ATF's authority. Tellingly, although ATF Headquarters knew of the management account's existence, ATF never issued explicit written authorization for the account (or any other management account), and never implemented any written protocol or guidelines dictating how management accounts should be operated or reconciled.

78. Despite this and the government's attempt to avoid responsibility for the account (including in a May 2016 letter from the government's counsel to USTC counsel), the Fourth Circuit held that ATF was responsible for the management account and the consequences of its use. In its August 3, 2018 decision, the Court held that Carpenter's and Small's use of the management account was with the knowledge, direction and supervision of the ATF and their primary ATF handler. Fourth Cir. Op. at 38.

79. The ATF's supervision of the management account and its informants' use of it was negligent at best. No government official had access to the account itself—SA Lesnak claims not to even know where it was located. Carpenter, Small and their assistant Wendi Davis were the ones who most frequently controlled the account and its use. Although SA Lesnak purportedly “suggested” ways in which Carpenter and Small should conduct spending from the account, he relied on Carpenter and Small to provide him with information about the account, and to execute his “suggestions.” In reality, ATF did not monitor the account and had no internal controls in place over it.

80. Nor did the ATF ever reconcile the account. Indeed, ATF did nothing to account for or document the \$12 million that Carpenter and Small skimmed off the top of the management account, which Carpenter and Small now characterize as compensation for their work as informants.

81. The negligent acts and omissions of SA Lesnak and other ATF supervisors were the proximate cause of USTC's injuries.

82. These failures to adequately monitor and control the management account and Big Sky's sales to BSD enabled SA Lesnak (and others) to misuse the account's funds to the detriment of USTC's farmer members. Moreover, SA Lesnak's failure to properly supervise Carpenter and Small, in purpose and effect, facilitated the informants' scheme to unlawfully deprive USTC's farmers of the money that rightfully belonged to them.

VII. ATF FIGHTS FOR YEARS TO KEEP ITS WRONGDOING SECRET

83. In March 2013, a whistleblower alerted USFC's CFO, Stuart Thompson, to Carpenter's and Small's self-dealing sales from Big Sky to BSD. Shortly thereafter, USTC hired outside counsel to conduct an internal investigation into the misconduct. USTC then sued Carpenter and Small in July 2013, a case that remains pending in this Court. *See U.S. Tobacco Coop. Inc., et al.*, Civil Action No. 5:13-cv-00527-BO.⁷ Although prior to suit USTC requested that Carpenter and Small return the funds belonging to BSD that they unlawfully acquired, neither Carpenter nor Small have done so.

84. Although USTC discovered Carpenter's and Small's scheme in spring of 2013, the cooperative did not learn that ATF was responsible for this misconduct (and its farmers' ensuing harm)—or learn that ATF itself converted BSD's funds—until years later. Specifically, it was not until March 22, 2016, when USTC deposed SA Lesnak in the *USTC et al. v. BSW et al* litigation,

⁷ Plaintiffs' second amended complaint in that matter includes eighteen claims for relief, including claims under federal RICO and North Carolina RICO, as well as claims for fraud, fraud-in-the-inducement, violation of the North Carolina Unfair and Deceptive Practices Act, breach of fiduciary duty, constructive fraud, breach of contract, tortious interference, misappropriation, and unfair enrichment. It also asserts claims against Daniel, and USTC's former Chairman, Albert Johnson.

that USTC learned that, among other things, ATF's negligent supervision of Carpenter and Small, negligent handling of the management account, and conversion of BSD's property caused its injuries. Plaintiffs thereafter timely asserted their claims.

85. In the intervening years, ATF and its lawyers went to great lengths to conceal ATF's true role in—and ultimate responsibility for—Carpenter's and Small's illegal conduct. In the spring and summer of 2013, pursuant to the cooperative's ongoing investigation of Carpenter's and Small's self-dealing, USTC's outside counsel pursued several interviews with SA Lesnak and other ATF representatives in an attempt to discover what connection—if any—existed between Carpenter's and Small's role as ATF informants and their unlawful sales from Big Sky to BSD. During these communications, no one from ATF disclosed ATF's illegitimate use of the Big Sky management account as an unauthorized slush fund to circumvent federal law, or ATF's true role in perpetrating Carpenter's and Small's theft of millions of dollars from USTC's farmers. Nor did ATF inform USTC that SA Lesnak not only encouraged, but even set the price for, Big Sky's sales of contraband to BSD. ATF further hid from USTC that it permitted its informants to enrich themselves at the expense of the farmers from the proceeds of these illegal sales to the tune of \$12 million over two years. Indeed, ATF deliberately concealed this essential information.

86. As a result of ATF's inaccurate and/or incomplete disclosures, USTC was unable to learn that ATF caused its injuries at that time.

87. ATF also stonewalled USTC's attempts to gather more information. During the cooperative's 2013 investigation into Carpenter's and Small's scheme, ATF offered to provide USTC's counsel with certain information regarding Carpenter's and Small's activities on the condition that counsel not share this information with USTC. USTC's counsel refused this offer because it would have put him in an untenable ethical position and would have led him to violate

his duties of loyalty and candor to USTC. ATF's improper demand obstructed USTC's ability to discover ATF's role in Carpenter's and Small's misconduct.

88. After USTC filed suit against Carpenter and Small in July 2013, the ATF further frustrated USTC's discovery efforts by instructing Carpenter and Small not to disclose during discovery any details of their involvement with federal law enforcement. When USTC was forced to litigate this issue, the United States intervened as a third party in order to block USTC's efforts to obtain discovery on its claims, and succeeded in getting discovery stayed for 12 months. After that delay, ATF agreed to produce relevant discovery; however, despite promising USTC that it was actively reviewing six bankers' boxes and a flash drive of potentially responsive documents, *the United States never produced a single document in that case.*

89. Similarly, on May 17, 2016, the United States precluded its Federal Rule of Civil Procedure 30(b)(6) deponent for ATF from answering a series of critical questions relating to the management account. In particular, the United States ordered the ATF witness not to answer *over twenty* questions about the management account and ATF's involvement in Carpenter's and Small's illegal scheme, including questions relating to: ATF's involvement in setting the prices for sales that funded the management account; ATF's involvement in Carpenter's and Small's sales of Brand-B cigarettes to BSD; and ATF's reconciliation of the Big Sky management account. USTC was able to obtain information from that witness only during a Court-ordered evidentiary hearing several months later.

90. ATF compounded these refusals to disclose relevant information by strategically deploying a series of contradictory positions on the critical questions of whether (1) ATF approved Carpenter's and Small's use of the management account and (2) ATF reconciled that account. As

the United States well-knew, ATF's seesawing on these topics further stymied USTC's efforts to uncover the cause of its injuries.

91. For example, in response to the farmers' repeated efforts to ascertain whether ATF authorized the management account, and if so, to understand the legal basis for such an authorization:

- ATF claimed, on May 17, 2016, that the management account did not require ATF authorization and that, rather than authorize the account, ATF only had an “understanding” about it;
- ATF then took the opposite position three months later on August 24, 2016, and represented that ATF headquarters *had* approved the use of the Big Sky International management account;
- ATF hedged its August 24 admission less than four weeks later, conceding that the ATF had no written record that the agency had authorized the management account, but contending that the management account was the result of “verbal directives” from the ATF Chief Counsel in 2009.

92. USTC did not learn about this 2009 opinion by the ATF Chief Counsel—which revealed that ATF devised the management account as an unlawful end-run around the churning rules—until September 2016. Similarly, USTC was not able to obtain the 2011 ATF Memorandum that further revealed the extent of ATF's misconduct until at least 2016—despite years of trying to get this information in discovery from ATF.

93. The ATF also hindered USTC's attempts to discover whether the ATF reconciled the management account by taking a series of inconsistent positions on that critical topic:

- On May 10, 2016, counsel for the United States represented that ATF did not reconcile the management account;
- On May 17, 2017, counsel for the United States refused to identify any ATF employee engaged in the reconciliation of the Big Sky management account, and further refused to permit the ATF's Rule 30(b)(6) witness, SSA Ryan Kaye, to identify whether ATF generated any documents relating to any reconciliation of the management account;
- On August 24, 2014, SSA Kaye testified to the Court that ATF in fact *did reconcile* the account;
- On June 8, 2018, the United States revealed that ATF generated no records related to any audits or reconciliation of the management account.

94. Nor did ATF's efforts to conceal the government's liability stop there. The ATF and its lawyers fought tooth and nail to keep all records of the case under seal for years. And ATF even refused to acknowledge that Carpenter and Small were federal employees, opposing the informants' substitution petition before the Court in *U.S. Tobacco Coop. Inc., et al.*, Civil Action No. 5:13-cv-00527-BO.

95. By fighting USTC's quest for information at every step of the way, ATF succeeded in hiding its true role in USTC's injuries for years after the cooperative first uncovered Carpenter's and Small's self-dealing. Because of ATF's concealment of the relevant information, USTC could not, and did not, learn the key facts establishing the ATF's tort liability until SA Lesnak's March 22, 2016 deposition—when the ATF's true involvement in the management account, Big Sky-BSD sales, and compensation of its informants came to light.

96. Thereafter, USTC timely filed an administrative complaint with the United States relating to the instant claims on October 30, 2017 and requested that the United States pay USTC for the money ATF improperly converted from BSD. On April 2, 2018, the United States denied USTC's request for relief.

VIII. FIRST CLAIM FOR RELIEF: TORT OF NEGLIGENT SUPERVISION UNDER NORTH CAROLINA LAW (FEDERAL TORTS CLAIM ACT)

97. Plaintiffs hereby incorporate the allegations in paragraphs 1 through 96 as if set forth fully herein.

98. From May 2011 until March 2013, Carpenter and Small perpetrated a scheme in which they obtained contraband cigarettes from the ATF, marked them up, and improperly sold them from Big Sky to BSD for a substantial profit. Because these sales were illegal and involved cigarettes that should have been impounded or destroyed, Carpenter's and Small's receipt and retention of BSD's funds in return for this contraband was improper.

99. Upon information and belief, SA Lesnak and others at ATF had full knowledge of Carpenter's and Small's self-dealing sales from Big Sky to BSD, which were possible only because SA Lesnak and other ATF agents permitted Carpenter and Small to acquire untaxed contraband cigarettes at extremely low prices and to resell those cigarettes to BSD. SA Lesnak and others at ATF did nothing to stop Carpenter's and Small's unauthorized dominion over the funds belonging to BSD—in fact, they continued to employ Carpenter and Small after knowing of their misconduct, and equip them with the contraband cigarettes that enabled them to carry out their scheme.

100. Defendant United States' conduct—as evidenced through the actions of SA Lesnak and other ATF supervisors—was negligent and wrongful within the meaning of 28 U.S.C. § 1346(b)(1) and would, if the United States were a private person, render Defendant liable to Plaintiffs under the laws of the State of North Carolina within the meaning of 28 U.S.C. § 1346

(b)(1). At all relevant times, SA Lesnak and other ATF supervisors were employees of the United States acting within the scope of their employment, pursuant to 28 U.S.C. § 1346(b).

101. At all relevant times, ATF employed Jason Carpenter and Christopher Small as ATF informants. Carpenter and Small engaged in conduct including but not limited to buying and selling of tobacco products and using the Big Sky International management account, which fell within the scope of their employment with ATF.

102. Defendant United States owed a duty to Plaintiffs to exercise due care in the retention and supervision of its employees Carpenter and Small. Plaintiffs' injuries arose from the nexus with Carpenter's and Small's employment by ATF.

103. Defendant United States breached its duty by failing to properly supervise Carpenter's and Small's conduct as ATF informants.

104. At least as of May 2, 2011, Carpenter and Small were incompetent or unfit to serve as ATF informants. Among other things, their conduct prior to that date violated ATF rules and policies regarding informants' standards of behavior. Carpenter and Small demonstrated their incompetence by engaging in conduct described herein, including but not limited to the following:

- a. Selling USTC an ATF-front with a balance sheet artificially inflated by ATF transactions;
- b. Paying improper kickback payments to Daniel the day after the execution of the APA;
- c. Other acts of negligence, carelessness, and/or misconduct that may materialize during the pendency of this action.

105. Following the close of the APA, from approximately May 4, 2011 through March 2013, Carpenter and Small deprived BSD of funds through a series of illegal self-dealing sales of

contraband from Big Sky to BSD. Carpenter's and Small's receipt of BSD's funds in exchange for cigarettes that should have been impounded or destroyed constituted an unauthorized assumption and exercise of ownership rights over property which undoubtedly and knowingly belonged to BSD.

106. Upon information and belief, Carpenter and Small segregated the funds they received from BSD by depositing them into the Big Sky management account. Upon information and belief, Carpenter and Small took steps to identify specific funds belonging to BSD after depositing the funds in the Big Sky management account.

107. Upon information and belief, following the discovery of Carpenter's and Small's self-dealing scheme in the spring of 2013, USTC made demand upon Carpenter and Small that they return BSD's funds, but Carpenter and Small refused to do so.

108. Carpenter's and Small's actions constitute a conversion of BSD's property.

109. Carpenter's and Small's conversion of BSD's property was to the exclusion of BSD, the rightful owner of that property, and prevented BSD from asserting its right of ownership and possession over its funds.

110. As a direct and proximate result of Carpenter's and Small's conversion, Plaintiffs have been damaged in the amount of at least \$24,038,831 or an amount to be otherwise determined at trial.

111. Carpenter's and Small's conversion was malicious, intentional, willful, and with a reckless and wanton disregard of Plaintiffs' rights.

112. Upon information and belief, Defendant United States had both actual and constructive knowledge of Carpenter's and Small's incompetence and unfitness to serve as ATF informants prior to Carpenter's and Small's self-dealing sales to BSD began after May 2, 2011.

Among other things, SA Lesnak and others at the ATF knew or had reason to know that Carpenter and Small overcharged USTC for the acquisition of BSW's and BSW-Va.'s assets, which were inflated with ATF-transactions at the time of the APA. SA Lesnak and others at the ATF also knew or had reason to know that Carpenter and Small paid an improper kickback payment to Daniel for his complicity in their scheme, on May 2, 2011.

113. Defendant and its employees, including SA Lesnak and other ATF supervisors, were careless and negligent by breaching the duty of care they owed to Plaintiffs to properly supervise Carpenter and Small, both generally and in the following specific respects:

- a. By continuing to employ Carpenter and Small as informants after learning of their behavior that violated ATF rules and the law;
- b. By permitting Carpenter and Small to acquire contraband and unlawfully convert BSD's funds;
- c. By failing to intervene to stop the misconduct, where adequate supervision of ATF informants would have prevented their conversion of BSD's property;
- d. Through other acts of negligence or carelessness that may materialize during the pendency of this action.

114. Defendant's negligent supervision of Carpenter and Small was a direct and proximate cause of Plaintiffs' injuries and damages.

115. Defendant's conduct in permitting Carpenter and Small to obtain contraband cigarettes and sell them on the open market violated ATF rules and policies on churning investigations and the use of informants. Defendant's conduct in using the proceeds of Carpenter's and Small's self-dealing to finance ATF operations violated federal anti-augmentation statutes and ATF rules and policies.

116. Under the Federal Tort Claims Act, defendant United States is liable for the above described actions.

IX. SECOND CLAIM FOR RELIEF: CONVERSION UNDER NORTH CAROLINA LAW (FEDERAL TORTS CLAIM ACT)

117. Plaintiffs hereby incorporate the allegations in paragraphs 1 through 116 as if set forth fully herein.

118. Defendant United States' conduct—as evidenced through the actions of SA Lesnak and other ATF agents—was wrongful within the meaning of 28 U.S.C. § 1346(b)(1) and would, if the United States were a private person, render Defendant liable to Plaintiffs under the laws of the State of North Carolina within the meaning of 28 U.S.C. § 1346 (b)(1). At all relevant times, SA Lesnak and other ATF agents were employees of the United States acting within the scope of their employment, pursuant to 28 U.S.C. § 1346(b).

119. From May 2011-March 2013, Carpenter and Small deprived BSD of funds through a series of illegal self-dealing sales of contraband from Big Sky to BSD. Carpenter's and Small's receipt of BSD's funds in exchange for contraband cigarettes that should have been impounded or destroyed constituted an unauthorized assumption and exercise of ownership rights over property which undoubtedly and knowingly belonged to BSD.

120. Upon information and belief, Carpenter and Small segregated the funds they received from BSD by depositing them into the Big Sky management account.

121. Upon information and belief, Carpenter and Small took steps to identify specific funds belonging to BSD after depositing the funds in the Big Sky management account.

122. The ATF and SA Lesnak subsequently took possession of BSD's funds which Carpenter and Small transferred from the management account to ATF. ATF and SA Lesnak and others at the ATF used those funds to backstop and further finance ongoing ATF activities.

123. Through their receipt of the proceeds of Carpenter's and Small's self-dealing transactions and subsequent use of those funds to finance ATF activities, ATF and SA Lesnak committed an unauthorized assumption and exercise of ownership rights over property which undoubtedly and knowingly belonged to BSD.

124. At SA Lesnak's request, Carpenter and Small also made transfers (of funds rightfully belonging to BSD) that directly benefitted SA Lesnak in the form of donations to his child's school. Additionally, the account funded the prepayment of \$50,000 worth of American Express cards in the names of SA Lesnak and SA Whittimore. USTC has made demand for the refund of BSD funds, but ATF has refused to do so.

125. Defendant's actions constitute a conversion of Plaintiffs' property.

126. Defendant's conversion of BSD's property is to the exclusion of BSD, the rightful owner of that property, and prevents BSD from asserting its right of ownership and possession over its funds.

127. As a direct and proximate result of Defendant's conversion, Plaintiffs have been damaged in the amount to be determined at trial.

128. Defendant's conversion was intentional, willful, and with a reckless and wanton disregard of Plaintiffs' rights.

129. Defendant's conduct in using the proceeds of Carpenter's and Small's self-dealing to finance ATF operations violated federal anti-augmentation statutes and ATF rules and policies.

130. Under the Federal Tort Claims Act, defendant United States is liable for the above described actions.

X. THIRD CLAIM FOR RELIEF: NEGLIGENCE UNDER NORTH CAROLINA LAW (FEDERAL TORT CLAIMS ACT)

131. Plaintiffs hereby incorporate the allegations in paragraphs 1 through 130 as if set forth fully herein.

132. Defendant United States' conduct—as evidenced through the actions of SA Lesnak and other ATF agents—was negligent and wrongful within the meaning of 28 U.S.C. § 1346(b)(1) and would, if the United States were a private person, render Defendant liable to Plaintiffs under the laws of the State of North Carolina within the meaning of 28 U.S.C. § 1346 (b)(1). At all relevant times, SA Lesnak and other ATF agents were employees of the United States acting within the scope of their employment, pursuant to 28 U.S.C. § 1346(b).

133. Defendant United States voluntarily assumed a duty to protect USTC, which it recognized as necessary for the protection of Plaintiffs' property. Defendant United States assumed this duty both generally and in the following regards:

- a. By disclosing a limited amount of information regarding Carpenter's and Small's relationship to ATF with a select group of USTC's representatives, who were considering whether to execute the APA with Carpenter and Small at that time;
- b. By reassuring USTC's representatives that ATF's relationship with Carpenter and Small would not harm the cooperative's farmers;
- c. By regulating Carpenter's and Small's sales from Big Sky to BSD by imposing certain conditions on the transactions, including but not limited to, price; and
- d. By taking steps to maintain the physical conditions of the Bristol warehouse and the inventory stored therein.

134. Defendant knew or had reason to know that USTC relied on the assurances of ATF agents, including SA Lesnak and SA Whittemore, in deciding to approve the APA and entrust the

daily operations of BSD (including but not limited to control over procurement) to Carpenter and Small. Defendant also knew or had reason to know that workers at the Bristol warehouse relied upon ATF's oversight of the warehouse and inventory.

135. USTC suffered harm as a result of reliance on ATF's conduct.

136. At all times, Defendant had a duty of reasonable care to USTC to institute, supervise, regulate, monitor and provide adequate mechanisms to safeguard USTC's interactions with Big Sky and Carpenter and Small. SA Lesnak and other ATF superiors recognized such mechanisms to be necessary for the protection of USTC and its property.

137. Defendant United States was careless and negligent by breaching the duty of care it assumed for the benefit of USTC, both generally and in the following respects:

- a. By permitting Big Sky to acquire contraband cigarettes without implementing or enforcing adequate controls on the subsequent use of that contraband;
- b. By encouraging Carpenter and Small to pay Daniel kickbacks for his complicity in their scheme against USTC, in violation of ATF rules;
- c. By failing to warn USTC that Carpenter and Small intended to continue their work as ATF informants for the foreseeable future following the APA; operate a side business called Big Sky; and sell contraband cigarettes from Big Sky to BSD;
- d. By permitting Carpenter and Small to obtain contraband cigarettes, mark them up, resell them for a profit to BSD;
- e. By permitting Carpenter and Small to deposit the proceeds of these self-dealing sales into a "management account" that they would use to enrich themselves in violation of ATF rules and federal law regarding compensation of informants;

- f. By using the management account to illegally fund ATF operations in violation of ATF rules regarding the use of churning funds and the prohibition on private funding of ATF operations;
- g. By failing to properly maintain the physical conditions of the Bristol warehouse and its inventory, leading to physical damage to inventory stored in that warehouse;
- h. By actively concealing relevant facts; and
- i. Through other acts of negligence or carelessness that may materialize during the pendency of this action.

138. Plaintiffs reasonably and justifiably relied upon the negligent conduct of the ATF to their detriment.

139. As a direct and proximate cause of Defendant's negligence, Plaintiffs have suffered physical harm to their property, in an amount to be determined at trial.

140. Defendant's conduct in using sales to a non-target and proceeds of Carpenter's and Small's self-dealing to finance ATF operations violated federal anti-augmentation statutes and ATF rules and policies.

141. Under the Federal Tort Claims Act, defendant United States is liable for the above described actions.

XI. REQUEST FOR RELIEF

142. WHEREFORE, Plaintiffs request that the Court grant it the following relief:

- 1. Compensatory damages in an amount to be proven at trial;
- 2. Reasonable attorneys' fees, costs, and experts' fees;
- 3. Post-judgment interest; and
- 4. Such other relief as the Court may deem just and proper.

Filed: October 1, 2018

OGLETREE, DEAKINS, NASH
SMOAK & STEWART, P.C.

/s/ Thomas A. Farr

Thomas A. Farr (N.C. Bar No. 10871)
Kimberly Joyce Lehman (N.C. Bar No. 43001)
4208 Six Forks Road, Suite 1100
Raleigh, NC 27609
Telephone: 919.787.9700
Facsimile: 919.783.9412
thomas.farr@ogletree.com
kim.lehman@ogletree.com

Amy M. Pocklington (Virginia Bar. No. 45233)
Tevis Marshall (Virginia Bar No. 68401)
Riverfront Plaza—West Tower
901 East Byrd Street, Suite 1300
Richmond, VA 23219
Telephone: 804.663.2330
Facsimile: 804.225.8641
amy.pocklington@ogletree.com
tevis.marshall@ogletree.com

Kathryn H. Ruemmler (D.C. Bar No. 461737)
Allen M. Gardner (D.C. Bar No. 456723)
Latham & Watkins LLP
555 11th St., NW, Suite 1000
Washington, DC 20004
Telephone: 202-637-2200
Facsimile: 202-637-2201
kathryn.ruemmler@lw.com
allen.gardner@lw.com

35799228.1