No. 17-1210

IN THE

Supreme Court of the United States

LISA ANNE HENRY, ET AL.,

Petitioners,

v.

BRIAN WEISS, liquidation trustee of the Walldesign Liquidation Trust

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Section 550 of the Bankruptcy Code provides that a trustee "may recover" fraudulently transferred property from "the initial transferee." In this case, a corporate principal fraudulently transferred funds directly from the debtor corporation's account to the petitioners. Do the petitioners qualify as "initial transferee[s]" from whom the trustee may seek recovery under Section 550?

PARTIES TO THE PROCEEDING

The petitioners are Lisa Anne Henry, Donald F. Buresh, and Sharon J. Phillips. Each was an appellant in the Ninth Circuit. The respondent here is Brian Weiss, the liquidation trustee of the Walldesign Liquidating Trust, successor in interest to the Official Committee of Unsecured Creditors of Walldesign, Inc., which was the appellee below.

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INTRODUCTION

When a corporate principal causes a corporation to transfer funds directly to a third party, who is the "initial transferee" of those funds? The corporate principal who directs the transfer of the funds, or the third party who receives them? The Ninth Circuit held below that the third party is the initial transferee in these circumstances. The law is the same in every other circuit that has addressed the issue.

The petitioners ask this Court to resolve a lopsided split on the meaning of "transferee"—a term that the Eleventh Circuit has interpreted to bear a meaning that the Fourth, Fifth, Sixth, Seventh, Eighth, Ninth and Tenth Circuits have all rejected. But this case does not implicate that split: Every court of appeals to have addressed the issue, *including* the Eleventh Circuit, has held a third party who receives a direct transfer from a corporate debtor's account qualifies as an "initial transferee." Thus, all circuits agree that, whatever "transferee" means, it does not include corporate principals who never receive the funds they direct to third parties.

The Court should deny the petition for a writ of certiorari.

STATEMENT

1. Michael Bello is the former director, president, and sole shareholder of Walldesign, Inc.—the debtor in this bankruptcy case. In 2002, he opened a Walldesign bank account at Preferred Bank. Then, between 2007 and 2012, Bello "channeled nearly $8 million of Walldesign funds" into the Pre-

ferred Account, and used those funds "to support his own lavish lifestyle." Pet. App. 5a.

Bello opened the Preferred Account using Walldesign's information: Its "Federal Tax I.D. Number"; its articles of incorporation; "a Statement by Domestic Stock Corporation"; a "Unanimous Consent of Shareholder of Walldesign to Corporate Action"; and "a signature card" that authorized him to act as Walldesign's agent. Pet. App. 4a. But he "did not disclose the account in Walldesign's general ledger or other records." Pet. App. 4a–5a. He thus managed to keep the account a secret, even as he drained it of funds by making purchases from "roughly 130 individuals and entities." Pet. App. 5a. Of critical importance, Bello did not transfer the money to himself before using it to pay these other individuals and entities; rather, he had the money transferred to them directly from the Preferred Account.

Each of the petitioners in this case benefited from Bello's fraudulent conduct. Donald Buresh and Sharon Phillips sold land in St. Helena, California to RU Investments, LLC—a Bello-owned entity with no relation to Walldesign—for $220,000. They were paid using checks that bore Walldesign's name and that were drawn from Walldesign's Preferred Account. Pet. App. 6a. As for petitioner Lisa Anne Henry, she provided interior design services to Bello to the tune of $230,000. She too was paid with checks that drew on Walldesign's Preferred Account.

2. When Walldesign filed for bankruptcy in 2012, the United States Trustee appointed the Offi-

cial Committee of Unsecured Creditors. (The respondent here—Brian Weiss, the liquidation trustee of Walldesign Liquidating Trust—is the Committee's successor in interest.) The Bankruptcy Court, upon learning of the transfers made from the Preferred Account, authorized the Committee to bring adversary proceedings against Bello and various recipients of the transfers. As relevant here, the Committee sued the petitioners, alleging that all of the payments out of Walldesign's account constituted fraudulent transfers subject to recovery under § 550 of the Bankruptcy Code.

Section 550 provides that, if a transfer is deemed fraudulent and "avoided," the trustee may recover the fraudulently transferred property from "the initial transferee of such transfer or the entity for whose benefit such transfer was made." 11 U.S.C. § 550(a), (a)(1). The statute further provides that the trustee may recover from subsequent transferees, but only in narrow circumstances; subsequent transferees who take "for value," "in good faith, and without knowledge of the voidability of the transfer" are not liable to the estate. *Id.* at § 550(a)(2), (b)(1).

In the Bankruptcy Court, the Committee argued that all of the petitioners were initial transferees of the funds from the Preferred Account, and thus strictly liable for the return of the funds fraudulently transferred to them. The Committee argued in the alternative that the petitioners were liable to the estate *even if* they qualified as subsequent transferees: By accepting Walldesign's checks in conjunction with deals they knew had nothing to do with Walldesign, they failed to act "in good faith,

and without knowledge of the voidability of the transfer." § 550(b)(1).

The petitioners moved for summary judgment. They argued that they qualified as subsequent transferees, not initial transferees: According to them, Bello effectively transferred Walldesign's funds to himself when he used Walldesign's Preferred Account. As a result, they said, Bello was the initial transferee, and they were mere subsequent transferees. The petitioners further argued that they had no reason to doubt the appropriateness of Bello's payments, making them good-faith subsequent transferees, immune from liability under § 550.

The Bankruptcy Court granted summary judgment: Without explaining its reasoning, the court stated that the petitioners qualified as good-faith, *subsequent* transferees. Pet. App. 54a–59a.

3. The Committee appealed to the District Court, which reversed the Bankruptcy Court's decision. It held that the petitioners qualified as initial transferees as a matter of law.

The District Court explained that the Code does not define "transferee." The Ninth Circuit, however, has held that "a transferee is one who has dominion over the money or other asset," which is to say "the right to put the money to one's own purposes." Pet. App. 46a (quoting *In re Incomnet, Inc.*, 463 F.3d 1064, 1070 (9th Cir. 2006)). Bello lacked such dominion: "Although the transfers Bello made" from the Preferred Account "were improper and breached his duty to the corporation, he effected them in his capacity as a Walldesign representa-

tive." Pet. App. 50a. As a result, he lacked "dominion over the funds … in his personal capacity," and could not qualify as the initial transferee. Pet. App. 50a. That title belonged to the petitioners, who directly received the funds from Walldesign's account.

Because it held that the petitioners were initial transferees as a matter of law, the District Court did not address whether the petitioners would have been liable even as subsequent transferees under § 550.

4. The Ninth Circuit affirmed. Like the District Court, the Ninth Circuit explained that a "transferee" is someone who obtains "dominion over the money" received—in other words, someone with "the *right* to put the money to [his] own purposes." Pet. App. 9a (quoting *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988)). The "touchstones" for transferee status are thus "legal title and the ability of the transferee to freely appropriate the transferred funds." Pet. App. 10a (quoting *Mano-Y & M, Ltd. v. Field (In re Mortgage Store, Inc.)*, 773 F.3d 990, 996 (9th Cir. 2014)). Since Bello had no title to the funds, and no right to freely appropriate them, he did not qualify as a transferee *at all*, let alone the initial transferee. Instead, the initial transferees were the first individuals to obtain dominion over the funds after they left Walldesign's account; namely, the petitioners.

Judge Nguyen dissented. To avoid inequitable results, she said, the Ninth Circuit ought to abandon the dominion test. Instead, it should define

"transferee" on a case-by-case basis, using flexible principles to "evaluate [each] transaction in its entirety to make sure that [the court's] conclusions are logical and equitable." Pet. App. 33a (quoting *Mano-Y*, 773 F.3d at 996). And even under the dominion test, she argued, the court should have held that Bello, not Walldesign, was the true owner of the Preferred Account: She claimed that, because Bello acted adversely to Walldesign when he established the Preferred Account, he necessarily did so in his personal capacity rather than in his capacity as a corporate agent. Thus, Judge Nguyen concluded, the Preferred Account belonged to Bello under California law. Pet. App. 36a–37a.

REASONS FOR DENYING CERTIORARI

The Court should deny the petition. *First*, there is no circuit split as to the question actually presented by this case: "all of the circuit courts addressing the issue have concluded that a principal who directs a debtor corporation to issue a check to pay for a personal debt is not an initial transferee." *In re Antex, Inc.*, 397 B.R. 168, 173 (B.A.P. 1st Cir. 2008). *Second*, while there is a lopsided split regarding the test for determining "transferee" status, it is not relevant to this case. *Finally*, the Ninth Circuit correctly held that the petitioners were initial transferees of the fraudulent transfers at issue.

I. THERE IS NO CIRCUIT SPLIT CONCERNING § 550's APPLICATION TO TRANSACTIONS LIKE THIS ONE.

This case does not implicate a circuit split. No court of appeals holds that a corporate principal

like Bello—that is, a corporate insider who uses corporate funds for his own purposes by transferring them directly from the corporation to a third party—is an initial transferee under § 550. *Id.* To the contrary, *every* court of appeals to have considered the issue has come out the other way.

A. The question whether corporate principals in Bello's position qualify as "initial transferees" turns on the meaning of § 550. That statute says, in relevant part:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—
>
> > (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
> >
> > (2) any immediate or mediate transferee of such initial transferee.
>
> (b) The trustee may not recover under section (a)(2) of this section from—
>
> > (1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or
> >
> > (2) any immediate or mediate good faith transferee of such transferee.

11 U.S.C. § 550. In sum, § 550 first says that transferees are liable to the estate for the value of all avoided transfers. *Id.* at (a)(1)–(2). But it goes on to exempt from its scope subsequent transferees—that is, non-initial transferees—that take the property "for value," in "good faith and without knowledge of the voidability of the transfer." The result is a system in which initial transferees are strictly liable to the estate for avoided transfers, while subsequent transferees are liable only in narrow circumstances.

The Bankruptcy Code never defines the term "transferee," which presumptively retains its ordinary meaning: "a person to whom a transfer is made." *Random House Unabridged Dictionary* 2010 (2d ed. 1987); Black's Law Dictionary 1727 (10th ed. 2014) ("One to whom a property interest is conveyed."). The Bankruptcy Code defines "transfers" to include "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—(i) property; or (ii) an interest in property." 11 U.S.C. § 101(54)(D). Reading "transferee" in light of this statutory definition, it refers to anyone who receives "property" or "an interest in property."

That, however, simply raises the question of the sense in which one must *receive* property (or a property interest) in order to qualify as a transferee. Is mere possession enough, or is something more required?

All courts agree that merely possessing property is not enough, and that "transferee" must therefore "mean something different from 'possessor' or

'holder' or 'agent.'" *Bonded*, 838 F.2d at 894. After all, initial transferees are strictly liable under 11 U.S.C. § 550 for any transfers they receive that turn out to have been fraudulent. Thus, if the word "transferee" included every entity that had *any* degree of possession over property, then every bank that received a wire transmission—indeed, every "armored car company" asked to pick up "valuables or specie to carry"—would be strictly liable in bankruptcy if its receipt of funds turned out to be the first step in a voidable transfer. *Bonded*, 838 F.3d at 893. Moreover, if mere possession were enough to make a transferee, the "entity that initially receive[d] the property from the debtor *via a courier* would not be the *initial* transferee (because of the courier's intervention)," and would therefore "escape the strict liability that (a)(1) contemplates." *In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*, 130 F.3d 52, 57 (2d Cir. 1997). These consequences of reading "transferee" to include anyone in possession of funds would be "absurd." *Bonded*, 838 F.3d at 894.

B. The foregoing establishes that, whatever "transferee" means, it includes only those who receive property or a property interest, and who acquire something more than mere physical possession. That resolves this case: When a corporate principal directs a corporation to pay funds *directly* to a third party, and when in doing so he acquires no legal interest in the transferred funds, he does not receive the funds, and so he does not qualify as a "transferee." Rather, the third party is the initial transferee. Here, Bello never personally received the funds that the petitioners received; those funds

were transferred directly from Walldesign's account to the petitioners. Accordingly, the petitioners, not Bello, were the initial transferees in the challenged transactions.

This conclusion is hardly controversial: There is no appellate court in which a corporate principal like Bello would be deemed an initial transferee under § 550. To the contrary, "all of the circuit courts addressing the issue have concluded that a principal who directs a debtor corporation to issue a check to pay for a personal debt is not an initial transferee." *In re Antex*, 397 B.R. at 173; *see, e.g.*, Pet. App. 19a; *Boyer v. Belavilas*, 474 F.3d 375, 377 (7th Cir. 2007); *In re Video Depot, Ltd.*, 127 F.3d 1195, 1199 (9th Cir. 1997); *In re Se. Hotel Props. Ltd. P'ship*, 99 F.3d 151, 153–54 (4th Cir. 1996); *Rupp v. Markgraf*, 95 F.3d 936, 939 (10th Cir. 1996).

The rule is not to the contrary in the Eleventh and Sixth Circuits—the two circuits that the petitioners suggest would have come out the other way in this case. Pet. 10–13. The Eleventh Circuit addressed the issue in *Norberg v. Arab Banking Corp.* (*In re Chase & Sanborn Corp.*), 904 F.2d 588 (11th Cir. 1990), which involved a bankruptcy trustee's attempt to recover, under § 550, money that a debtor corporation called Chase & Sanborn transferred to a bank. Chase & Sanborn transferred that money to repay a personal loan that the bank had issued to Alberto Duque—Chase & Sanborn's owner. *Id.* at 590–91. The trustee argued that, since the money went straight from Chase & Sanborn to the bank, the bank qualified as an initial transferee. But according to the bank, Duque qualified as the

initial transferee because the funds were used to pay down his account. *Id*. at 598. The Eleventh Circuit sided with the trustee. The funds, it explained, went straight from Chase & Sanborn to the bank. While Duque might well have directed the transfer, the court dismissed this fact as "entirely irrelevant to the 'initial transfer' issue.'" *Id*. at 598. What mattered was that "neither Duque nor any other party exercised any control over the funds *after they left* Chase & Sanborn," meaning that Duque could not have been the initial transferee. *Id*. at 600 (emphasis added).

In arguing that the Sixth Circuit would have resolved this case differently, the petitioners rely on *In re Nordic Village, Inc.*, 915 F.2d 1049 (6th Cir. 1990), *rev'd on other grounds*, 503 U.S. 30 (1992). That case involved the IRS's appeal of a decision holding it liable as the initial transferee of a fraudulent conveyance. *Id*. at 1051. The IRS received the transfer in the form of a cashier's check from Joseph Lah—an officer and shareholder of the debtor Nordic Village. Lah, in turn, obtained the cashier's check from a bank by drawing a countercheck, made payable to the bank, from Nordic's corporate account. *Id*. at 1050. The IRS argued that the district court erred in deeming it an initial transferee, strictly liable under § 550: Instead, the IRS argued, it was a *subsequent* transferee and Lah was the initial transferee. The Sixth Circuit affirmed without deciding the meaning of "initial transferee." It concluded that *even if* the IRS were a subsequent transferee, as it contended, it was still liable under § 550 because it accepted Lah's

checks with "knowledge of the voidability of the transfer." *Id.* at 1056.

In a footnote, the Sixth Circuit did refer to "substantial support for the conclusion that when a corporate officer takes checks drawn from corporate funds to pay personal debts, the corporate officer, and not the payee on the check is the initial transferee." *Id.* at 1055 n.3. This is of course dicta, because the Sixth Circuit resolved the case without regard to whether the IRS or someone else was the initial transferee. And this dicta does not even affirmatively endorse the petitioners' view; rather, it simply acknowledges support for the view, which turns out to consist of one opinion from a district court and another from a bankruptcy court. *Id.* (citing *Ross v. United States (In re Auto-Pak, Inc.)*, 73 B.R. 52, 54 (D.D.C. 1987) and *Still v. American Nat'l Bank & Trust Co. (In re Jorges Carpet Mills, Inc.)*, 50 B.R. 84 (Bankr. E.D. Tenn. 1985)).

It is true that, in the decision below, the Ninth Circuit described *In re Nordic* as standing for the proposition that "corporate principals may be strictly liable as initial transferees where they misuse company funds for personal gain." Pet. App. 17a. But for all the reasons just explained, that is a misreading of dicta from *In re Nordic*. And neither the Ninth Circuit nor the petitioners have identified any appellate decision *holding* that a corporate principal who has funds directed from a corporate account directly to a third party counts as an initial transferee.

II. THE LOPSIDED CIRCUIT SPLIT THAT THE PETITION FOR CERTIORARI IDENTIFIES DOES NOT JUSTIFY REVIEW.

The petitioners seek review of a circuit split regarding the test that courts ought to apply in assessing transferee status. Pet. 10–16. That split does not justify review, for three reasons. *First*, the split is lopsided; contrary to the petitioners' argument, the divide over the test for determining whether someone is an initial transferee pits the Eleventh Circuit against every other appellate court to have addressed the issue. *Second*, as the preceding section foreshadowed, this case does not implicate the split, since all courts agree that third parties (like the petitioners) who receive direct transfers from a corporate debtor's account (such as Walldesign's Preferred Account) qualify as "initial transferees." *Finally*, the "dominion test" that the Ninth Circuit applied below correctly defines "transferee."

A. The Eleventh Circuit is the only circuit to have rejected the "dominion test."

1. Again, every court agrees that "transferee" means "something different from 'possessor' or 'holder' or 'agent.'" *Bonded*, 838 F.2d at 894. But if mere possession is not enough, what is? In response to this question, courts have developed two basic frameworks: The dominion test (sometimes called the "dominion-and-control test"), and the control test.

The dominion test. The dominion test avoids the problems with an overexpansive understanding of "transferee" by reading the word to require more

than mere possession. The approach originates with *Bonded*, in which the Seventh Circuit, in an opinion by Judge Easterbrook, held that "the minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes." *Bonded*, 838 F.2d at 893. In other words, individuals and entities become transferees of funds only by obtaining "legal title to [the funds] and the ability to use them as [they] see[] fit." *Incomnet*, 463 F.3d at 1071.

This is a perfectly natural understanding of "transferee," which typically connotes someone who receives property or a property interest with the right to use it for himself. It would be unnatural, for example, to refer to a bailee (like a valet) as a "transferee." *Cf. In re Quigley Motor Sales*, 75 F.2d 253, 255 (2d Cir. 1935) ("Mere possession of another's property passes no interest to the bailee's trustee in bankruptcy.") Moreover, the Code defines "transfer" to include the disposition of property, and property is typically disposed of by the transfer of legal title. Since "transferee" is naturally understood to include only those recipients of property who have the right to do with it what they want, and since this reading avoids the bizarre consequences of the broader, alternative understanding, the narrower reading is also the preferable one. *See Deal v. United States*, 508 U.S. 129, 134 (1993) ("We are not disposed to give the statute a meaning that produces such strange consequences.")

The control test. The control test approaches the question differently: Rather than asking whether the word "transferee" can be read to have

a meaning narrower than the broadest one possible, courts applying the control test admit that their approach "is not based in statutory language." *Martinez v. Hutton (In re Harwell)*, 628 F.3d 1312, 1322 (11th Cir. 2010). Instead, the control test "is an exception based on the bankruptcy courts' equitable powers." *Id*. It entails two steps. At the first step, the court accepts the broadest possible reading of § 550, and identifies the "recipient of a debtor's fraudulently-transferred funds." *In re Custom Contractors, LLC*, 745 F.3d 1342, 1349–50 (11th Cir. 2014). And so, under this approach, "the owner of the first pair of hands to touch the property is," *presumptively*, "the initial transferee." *In re Finley*, 130 F.3d at 56.

At the second step, however, the recipient may rebut this presumption by showing:

> (1) "that [it] did not have control over the assets received, i.e., that they merely served as a conduit for the assets that were under the actual control of the debtor-transferor," and
>
> (2) "that [it] acted in good faith and as an innocent participant in the fraudulent transfer."

In re Harwell, 628 F.3d 1312, 1323 (11th Cir. 2010). In asking these questions, courts "must step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable." *In re Pony Exp. Delivery Servs., Inc.*, 440 F.3d 1296, 1302 (11th Cir. 2006) (internal quotation marks omitted). "The control test" is thus "a very flexible, pragmatic one," in which courts "look be-

yond the particular transfers in question to the entire circumstances of the transactions." *Id.* (quoting *In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1199 (11th Cir. 1988)).

In sum, courts applying the control test accept that bare possession of the debtor's property is enough to qualify as a "transferee." But these courts have "carved out an equitable exception to the literal statutory language of 'initial transferee,'" excluding "recipients who are 'mere conduits' with no control over the" debtor's property. *Harwell*, 628 F.3d at 1322

2. The Eleventh Circuit is the only appellate court that applies the control test. The petitioners say that the Sixth Circuit does too, Pet. 11–12 but that is wrong: The Sixth Circuit applies the dominion test. *See Meoli v. Huntington Nat'l Bank*, 848 F.3d 716, 725 (6th Cir. 2017). So do the Fourth, Fifth, Seventh, Eighth, Ninth, and Tenth Circuits, along with the First Circuit's Bankruptcy Appellate Panel. *See In re Se. Hotel Properties Ltd. P'ship*, 99 F.3d 151, 156 (4th Cir. 1996); *Matter of Coutee*, 984 F.2d 138, 141 (5th Cir. 1993); *In re Smith*, 811 F.3d 228, 244 (7th Cir. 2016) (citing *Bonded*, 838 F.2d at 893); *In re AgriProcessors, Inc.*, 859 F.3d 599, 605 (8th Cir. 2017); Pet. App. 11a–12a; *Rupp v. Markgraf*, 95 F.3d 936, 939 (10th Cir. 1996); *In re Antex*, 397 B.R. at 172.

Just last year, the Sixth Circuit expressly held that "[a]n initial transferee must have 'dominion' over the funds to be an 'initial transferee" under the statute." *Meoli*, 848 F.3d at 725, (quoting *Taunt v. Hurtado (In re Hurtado)*, 342 F.3d 528,

533 (6th Cir. 2003)). The court explained that it had "repeatedly and approvingly quoted the Seventh Circuit's original articulation of the test: '[T]he minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes.'" *Id.* (quoting *In re Hurtado*, 342 F.3d at 533). This test "distinguishe[s] 'mere possession' from 'ownership,' so that 'a party is not to be considered an initial transferee if it is merely an agent who has no legal authority to stop the principal from doing what he or she likes with the funds at issue.'" *Id.* (quoting *In re Hurtado*, 342 F.3d at 533).

The petitioners ignore the Sixth Circuit's *Meoli* decision completely, and argue that the court adopted the control test with one sentence in *Nordic Village*, already quoted above: "There is substantial support for the conclusion that when a corporate officer takes checks drawn from corporate funds to pay personal debts, the corporate officer, and not the payee on the check is the initial transferee." 915 F.2d at 1055 n.3. Again, that language is dicta. And regardless, all courts—including courts that apply the dominion test—agree that an individual makes himself an initial transferee "by first directing a transfer" from a debtor's bank account "into his or her personal bank account and then making the payment from his personal account." Pet. App. 14a (quoting *In re Video Depot, Ltd.*, 127 F.3d 1195, 1199 (9th Cir. 1997)); *supra* 6–12. So if that is the sort of conduct to which the dicta in *In re Nordic* refers, it is not even a lukewarm endorsement of the control test.

In sum, the Sixth Circuit did not adopt the control test in *Nordic*, and in any event applies the dominion test today. The Eleventh Circuit is the only circuit that applies the control test.

B. The circuit split has no bearing on this case.

The petitioners characterize this case as presenting the abstract question of how to define "transferee" for purposes of § 550. But the split between the Eleventh Circuit and everyone else on that broad issue is irrelevant to the disposition of this case: As explained above, even the Eleventh Circuit has held that corporate principals do not qualify as the initial transferees of funds transferred directly from corporate accounts to third parties. *See Norberg v. Arab Banking Corp.*, 904 F.2d at 598–600. Thus, even in the Eleventh Circuit, the petitioners would have qualified as initial transferees. Whether the dominion or control test is right, therefore, makes no difference here.

It should come as no surprise that there is no circuit split concerning whether "a principal who directs a debtor corporation to issue a check to pay for a personal debt" qualifies as "an initial transferee." *In re Antex*, 397 B.R. at 173. The reason is simple: Regardless of whether courts apply the dominion test or the control test, these cases come out the same way.

Begin with the dominion test. Again, that approach defines "transferee" to include only those with "legal title to [the funds] and the ability to use them as [they] see fit." *Incomnet*, 463 F.3d at 1071. Whether someone has legal title and the right to

use property are ultimately questions of state law. *See Butner v. United States*, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law."). But the Liquidation Trust is aware of no state in which a corporate principal obtains these rights by directing corporate funds to some third party for his own benefit. Thus, any court that applies the dominion test to such facts will reach the same result that the Ninth Circuit did below.

As for the control test, even its broad definition of "transferee" sweeps in only those who *receive* the debtor's property. But when a corporate officer transfers corporate funds *directly* from a corporate account to a third party, he has not received the debtor's property. Thus, a corporate officer in these circumstances is not a transferee under even the Eleventh Circuit's broad reading of § 550(a). As a result, there is no reason to reach the control test's second step—there is no need to inquire into the degree to which the corporate principal "controlled" the funds. After all, even under the control test, it is irrelevant whether the corporate principal had "control over the assets" or "acted in good faith," *In re Custom Contractors*, 745 F.3d at 1349–50, unless he actually received the funds in question.

C. The dominion test, which the Ninth Circuit applies, correctly defines "transferee."

1. The petitioners insist that the dominion test "lacks any grounding in the Code's text." Pet. 16. For this reason, they say, the Court ought to grant certiorari and adopt the control test.

This has things backwards: It is the *control test* that lacks any textual basis. The only circuit to have adopted the test has expressly said so, in a case on which the petitioners rely:

> [T]his Court carved out an equitable exception to the literal statutory language of "initial transferee," known as the mere conduit or control test, for initial recipients who are "mere conduits" with no control over the fraudulently-transferred funds. … *The mere conduit or control test is a judicial creation that is not based in statutory language, but is an exception based on the bankruptcy courts' equitable powers*.

In re Harwell, 628 F.3d at 1322 (internal citations omitted; emphasis added).

Rather than relying on a supposed "equitable authority" to make "exception[s]" to the statutory text, *id*., courts applying the dominion test endeavor to *interpret* the text. The dominion test begins with the recognition that "'[t]ransferee' is not a self-defining term." *Bonded*, 838 F.2d at 894. And there are at least two senses of the word. In one sense, the word refers to anyone who holds or possesses, to any degree, the debtor's property. This sense would include even financial intermediaries and couriers. The second sense refers to those who receive property with the right to use it as they see fit.

The second sense is the better reading given the Bankruptcy Code's text and structure. For one thing, it avoids the bizarre consequences that

would result from the broader reading—for example, it avoids making every intermediary financial institution a potential "initial transferee." *Supra* 9. The second sense also better suits the function of fraudulent-conveyance law: "protect[ing] creditors from last-minute diminutions of the pool of assets in which they have interests." *Bonded*, 838 F.2d at 892. "Exposing financial intermediaries and couriers to the risk of disgorging a 'fraudulent conveyance' … would lead them to take precautions, the costs of which would fall on solvent customers without significantly increasing the protection of creditors." *Id*. at 893. The second, narrower sense of "transferee" avoids this consequence, by limiting transferee status to those who obtain actual interests in the property—those who are, in general, better positioned than financial intermediaries and other mere possessors to detect and prevent fraud.

Of the two potential interpretations of "initial transferee," courts applying the dominion test rightly prefer the one that avoids producing "strange consequences," *Deal*, 508 U.S. at 134, and that "furthers rather than obstructs the [Code's] purpose," Scalia & Garner, Reading Law §4, p.63 (2012). Indeed, not even the petitioners argue for the alternative reading. That is because the control test for which they advocate "is not based in statutory language." *In re Harwell*, 628 F.3d at 1322.

2. In her dissent below, Judge Nguyen argued that applying the dominion test here would lead to inequitable results. Specifically, she argued that it would be inequitable to make the petitioners refund the estate and that, since bankruptcy courts "are courts of equity," the petitioners ought not be

made to do so. Pet. App. 31a (quoting *Young v. United States*, 535 U.S. 43, 50 (2002)).

The first problem with this argument is that the equitable nature of bankruptcy "does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness." *In re Kmart Corp.*, 359 F.3d 866, 871 (7th Cir. 2004) (citation omitted, alteration in original). To the contrary, "[c]ourts of equity can no more disregard statutory … requirements and provisions than can courts of law." *Armstrong v. Exceptional Child Ctr., Inc.*, 135 S. Ct. 1378, 1385 (2015) (quoting *I.N.S. v. Pangilinan*, 486 U.S. 875, 883 (1988)). And there is no conceivable reading of § 550 in which anyone other than the petitioners was the initial transferee of the money they received directly from Walldesign's bank account. The equities cannot change this.

In any event, equitable principles support the Ninth Circuit's holding. Consider again, the function of fraudulent-conveyance law: It exists to "protect[] creditors from last-minute diminutions of the pool of assets in which they have interests." *Bonded*, 838 F.2d at 892. Because parties who transact with debtors are better positioned than creditors to snuff out any impropriety in these transactions, fraudulent-conveyance law puts the burden of detecting fraud on them. The Ninth Circuit's holding—that recipients of transfers from corporate accounts, rather than the misbehaving corporate officers who order the transfers, qualify as initial transferees—promotes this objective. The opposite rule does not: Making the misbehaving corporate officer the "initial transferee" would contradict the

purposes of fraudulent-conveyance law, by making only the fraudster himself—the party *least* likely to protect the creditors—strictly liable as an "initial transferee" for diminution of the pool of assets. As the Ninth Circuit observed, "foxes (like corporate cheats) rarely guard henhouses (like corporate treasuries) with much success." Pet. App. 16a. That, however, is exactly what the petitioners' approach would require. There is nothing equitable about depriving creditors of this important protection.

Judge Nguyen's approach—defining "transferee" to include individuals who, for their own benefit, direct the transfer of funds to others—would have the additional inequitable effect of limiting the number of parties from whom defrauded creditors may seek recourse. With § 550, Congress decided that defrauded creditors ought to be able to seek the return of fraudulently transferred funds from two individuals: The "initial transferee" and "the entity for whose benefit" the fraudulent "transfer was made." 11 U.S.C. § 550(a)(1). If the person who misappropriated funds for his own benefit generally qualified as the "initial transferee" then, in cases involving fraud by corporate insiders, the "initial transferee" and the "person for whose benefit [the] transfer was made" would generally be the same person. The effect would be to halve the number of individuals from whom defrauded creditors can seek recourse in such cases.

In addition to leading to inequitable results generally, Judge Nguyen's test leads to inequitable results under the facts of this case. Each of the petitioners, given their face-to-face dealings with Bello,

was far better positioned than the creditors were to detect his fraud—particularly since each was paid using Walldesign's checks in connection with transactions they knew had nothing to do with Walldesign. Even if the petitioners are innocent of wrongdoing, as they insist, so too are Walldesign's creditors. And so, when it comes to fairness, the relevant question is who among the innocent parties can most fairly be made to shoulder the costs of Bello's misconduct. The answer is the petitioners, since they were better positioned to prevent the fraud at the outset.

It is also important to note that all three of the petitioners have filed third-party complaints against Bello in the Bankruptcy Court, seeking contribution and indemnification. *In re Walldesign*, No. 13-ap-1414, Doc. 13 (Bankr. C.D. Cal. 2014); *In re Walldesign*, No. 13-ap-1420, Doc. 10 (Bankr. C.D. Cal. 2014). If they can indeed prove entitlement to this relief, that would eliminate any supposed inequities. In other words, this is not a situation in which the petitioners are without recourse.

* * *

In sum, the Ninth Circuit's holding does not implicate the lopsided split on which the petitioners base their petition for certiorari.

CONCLUSION

The petition should be denied.

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Respectfully submitted,

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