No. 17-1210

In the Supreme Court of the United States

LISA ANNE HENRY, ET AL., PETITIONERS

v.

BRIAN WEISS, TRUSTEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

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In his brief in opposition, respondent concedes that the courts of appeals are divided on the legal standard for determining who qualifies as an "initial transferee" under the Bankruptcy Code. Respondent nevertheless urges the Court to deny review, primarily arguing that this case does not implicate the circuit conflict. In so arguing, however, respondent simply ignores the key transaction at issue here—Mr. Bello's act of depositing corporate funds into a separate, secret account over which he had complete control. The central issue in this case is whether that act rendered Mr. Bello an initial transferee. And as

the Ninth Circuit expressly recognized, the resolution of that issue squarely implicates the conflict on the governing legal standard.

Once that underbrush is cleared away, respondent has conspicuously little to say. Respondent does not identify any problem with this case as a vehicle in which to resolve the question presented. Nor does he dispute the importance of the question; the frequency with which it arises in bankruptcy courts; or the practical difficulty of obtaining the Court's review. This case presents the Court with an ideal opportunity to resolve an acknowledged conflict among the courts of appeals and to ensure uniformity in the interpretation of the Bankruptcy Code. The petition for a writ of certiorari should be granted.

1. Although respondent disagrees about the precise nature of the circuit conflict, he recognizes, as he must, that the courts of appeals are "split" as to the legal standard for "assessing transferee status" under the Code. Br. in Opp. 13. In arguing that this case does not implicate the conflict, respondent simply assumes the answer to the question presented. What is more, respondent mischaracterizes the decisions of several courts of appeals by focusing on the labels courts affix to their tests, rather than on the actual legal standards they apply in determining initial-transferee status. The relevant question is whether a person who obtains funds from a debtor and exercises control over the funds must also have the legal authority to do so in order to qualify as an initial transferee. The conflict on that question warrants the Court's review in this case.

a. Respondent primarily contends (Br. in Opp. 6-12, 18-19) that this case does not implicate the circuit conflict on the legal standard for determining who qualifies as an initial transferee. Respondent's contention turns on the premise that "[Mr.] Bello did not transfer the money to

himself" before paying petitioners. *Id.* at 2. In stating that premise, however, respondent disregards the step that constituted the initial transfer here: Mr. Bello's act of depositing corporate funds into a separate, secret account in his exclusive personal control. To be sure, respondent takes the position on the merits that this act did not constitute a transfer because Mr. Bello did not obtain *legal title* to the funds when placing them into the secret account. See, *e.g.*, *id.* at 9-10. But it is only by assuming the correctness of his position that respondent is able to characterize this case as one in which "a corporate principal causes a corporation to transfer funds directly to a third party." *Id.* at 1.

Under the legal standards applied by the Sixth and Eleventh Circuits, however, putting corporate funds into a separate account in an individual's exclusive personal control unquestionably constitutes a transfer, rendering Mr. Bello the initial transferee of the funds here. See Pet. 11-13. The Ninth Circuit expressly acknowledged as much, recognizing that its decision conflicted with decisions of the Sixth and Eleventh Circuits. See Pet. App. 17a-18a, 23a-24a.

b. Respondent attempts to muddy the waters by recharacterizing the governing legal standards in those and other circuits. Respondent is mistaken.

i. As to the Eleventh Circuit: respondent seeks to explain away the court's decision in *In re Harwell*, 628 F.3d 1312 (2010), by relying on its earlier decision in *In re Chase & Sanborn Corp.*, 904 F.2d 588 (1990). See Br. in Opp. 10-11. In *Chase & Sanborn*, a corporate principal obtained a loan at a bank and paid the corporation to act as a guarantor on a loan; in that role, the corporation subsequently made all the payments on the loan. See 904 F.2d at 591-592. The Eleventh Circuit explained that the corporate principal did not qualify as the initial transferee

of those payments because he never "exercised any control over the funds after they left [the corporation]." *Id.* at 600. It emphasized that the "transfers at issue did not pass even momentarily" through a separate account "subject to" the corporate principal's "use or control." *Ibid.*

That is a far cry from what happened here. Mr. Bello deposited checks made out to Walldesign into a separate, secret account over which he exercised complete control. As a result, what was missing in *Chase & Sanborn* is present in this case: the funds did pass through a separate account, and Mr. Bello did exercise control over the funds. The contrast between this case and *Chase & Sanborn* highlights why Mr. Bello is an initial transferee under the Eleventh Circuit's standard: Mr. Bello satisfies that standard both because he "ha[d] control over the assets received" and because he did not "act[] in good faith and as an innocent participant in the fraudulent transfer." *Harwell*, 628 F.3d at 1323. And as respondent acknowledges, that standard conflicts with the legal standard applied by other circuits. See Br. in Opp. 14-16.[1]

ii. As to the Sixth Circuit: respondent seeks to distinguish as dicta the discussion in *In re Nordic Village, Inc.*, 915 F.2d 1049 (1990), rev'd on other grounds, 503 U.S. 30 (1992). See Br. in Opp. 11-12. There, citing "substantial" authority, the Sixth Circuit explained that, "when a corporate officer takes checks drawn from corporate funds to pay personal debts, the corporate officer[] and not the

[1] Respondent repeatedly contends that the circuit conflict is "lopsided." See, *e.g.*, Br. in Opp. 13. Even if that were true, but see pp. 4-6 & n.2, *infra*, this Court routinely grants review on bankruptcy questions with only a single circuit on one side of the conflict, in light of the compelling need for uniformity. See, *e.g.*, *Midland Funding, LLC* v. *Johnson*, 137 S. Ct. 1407, 1411 (2017); *Clark* v. *Rameker*, 134 S. Ct. 2242, 2246 (2014); *Hall* v. *United States*, 566 U.S. 506, 511 & n.1 (2012).

payee on the check is the initial transferee." 915 F.2d at 1055 n.3. Accordingly, if the corporate principal "is viewed as having taken money illegally from [the corporation], he is the 'initial transferee.'" *Id.* at 1055.

That reasoning is unequivocal and on point here. To be sure, the Sixth Circuit did not resolve whether the principal in *Nordic Village* took the money illegally. See 915 F.2d at 1055 & n.3. The salient question here, however, is whether "it can be said with confidence that [the Sixth Circuit] would decide the case differently because of language in an opinion in a case having substantial factual similarity" to the one here. See Stephen M. Shapiro et al., *Supreme Court Practice* § 6.31(a), at 479 (10th ed. 2013). The answer to that question is surely yes: Mr. Bello was a "corporate officer" who exercised control over "corporate funds to pay personal debts" without the corresponding legal authority to do so. *Nordic Village*, 915 F.2d at 1055 n.3.

Respondent suggests (Br. in Opp. 16-18) that the Sixth Circuit has since effectively overruled *Nordic Village* by adopting what it has labeled a "dominion-and-control" test. As a preliminary matter, the Ninth Circuit did not take that view: in the decision below, it cited *Nordic Village* in acknowledging that its legal standard conflicted with the Sixth Circuit's. See Pet. App. 17a-18a.

In fact, neither of the Sixth Circuit decisions cited by respondent indicates a different view on the question presented—specifically, whether a person is an initial transferee where he obtains an interest that allows him to exercise actual control over the debtor's funds without the corresponding legal authority to do so. In *Meoli* v. *Huntington National Bank*, 848 F.3d 716 (6th Cir. 2017), a bank received deposits from an account holder, which retained the right to withdraw the deposits. See *id.* at 725. The Sixth Circuit held that the bank was not the initial

transferee because it *neither* exercised actual control over the funds *nor* had the legal authority to do so. See *ibid.* *Meoli* was therefore not a case, like *Nordic Village* or this one, where the would-be transferee had actual control but lacked legal authority. Conversely, in *In re Hurtado*, 342 F.3d 528 (6th Cir. 2003), the recipient of the funds *did* have "legal title to the funds" and thus the "legal authority to do what she liked" with them. *Id.* at 535. Although the Sixth Circuit referred to "dominion" in that case, see, *e.g.*, *id.* at 533, it had no occasion to address whether the *absence* of legal authority defeats initial-transferee status. On that question, *Nordic Village* is the Sixth Circuit's final word; indeed, far from disavowing *Nordic Village* in *Meoli*, the Sixth Circuit cited it approvingly (albeit for a different proposition). See 848 F.3d at 732-734.[2]

In short, there can be no legitimate doubt that this case would have come out differently if it had been decided in the Sixth or Eleventh Circuits (or in numerous district or bankruptcy courts, see Pet. 14). Accordingly, the acknowledged circuit conflict on the legal standard for initial-transferee status warrants the Court's review here.

2. Tacitly recognizing that this case is a compelling candidate for further review, respondent devotes a substantial portion of his brief in opposition to a preview of his arguments on the merits. See Br. in Opp. 7-9, 19-24. Those arguments warrant only a brief response here.

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[2] In a similar vein, respondent seeks to bulk up his side of the circuit conflict by citing decisions of the Fifth, Eighth, and Tenth Circuits that he contends agree with the decision below. See Br. in Opp. 16. But those decisions do not address the question presented here, because none involved an entity that exercised actual control over a debtor's funds while lacking the legal authority to do so. See *In re Coutee*, 984 F.2d 138, 139-141 (5th Cir. 1993) (per curiam); *In re Agriprocessors, Inc.*, 859 F.3d 599, 603-605 (8th Cir. 2017); *Rupp* v. *Markgraf*, 95 F.3d 936, 937-938, 941 (10th Cir. 1996).

a. Remarkably, respondent accuses petitioners of espousing a legal standard that "lacks any textual basis." Br. in Opp. 20. That is odd. As the Ninth Circuit candidly acknowledged, it is its approach, not petitioners', that departs from the statutory text. See Pet. App. 10a (rejecting "any reliance on the meaning of 'transfer' in [Section] 101(54)(D)" and acknowledging "concerns" that its chosen approach could lead courts to "lose track of the original question proposed by the statute" (citation omitted)).

Wisely parting company with the decision below, respondent concedes that the Bankruptcy Code's definition of "transfer" applies here. See Br. in Opp. 8. But as we have explained, that definition broadly covers "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with * * * an interest in property." 11 U.S.C. 101(54)(D); see Pet. 16. And the application of that definition here is straightforward. Walldesign parted with an "interest" in its funds when Mr. Bello deposited checks made out to Walldesign into a secret account which, although formally in Walldesign's name, was subject to Mr. Bello's (and his wife's) unfettered control and which Mr. Bello in fact used solely for personal purposes. At that point, Walldesign lost all control of the funds and the practical ability to use them for its own expenses. See Pet. App. 43a-44a (noting that Mr. Bello actively concealed the account and that none of the funds were spent for Walldesign's purposes).

Indeed, Mr. Bello's action was the functional equivalent of depositing checks made to Walldesign into an account bearing Mr. Bello's own name. See Pet. App. 43a, 49a. While Mr. Bello labeled the account as belonging to Walldesign in order to avoid detection (and thus did not obtain legal title to the funds in the account), the statutory

text requires receipt by a transferee only of "*an* interest"—not of legal title. 11 U.S.C. 101(54)(D) (emphasis added).

The legislative history of Section 101(54)(D), which respondent pointedly ignores, spells out the inescapable import of the provision's language: in defining "transfer" as it did, Congress sought to encompass "any transfer of an interest in property," including a transfer of "control even if there is no transfer of title." S. Rep. No. 989, 95th Cong., 2d Sess. 27 (1978). By insisting that Walldesign part with legal title, rather than simply its control over the funds, respondent flouts the Code's text.

b. Respondent recognizes, as he must, that "transferee" can be read broadly. See Br. in Opp. 20. Respondent's sole justification for a narrower reading is that following the plain text would lead to "absurd" results in cases involving couriers and financial institutions. See *id.* at 9, 20-21. But giving the text its more natural meaning need not ensnare such intermediaries as initial transferees. Those entities may fall outside the definition of "transfer" (and thus "transferee") for other reasons: as at least one court of appeals has recognized, because an owner who deposits funds in a financial institution "continue[s] to possess, control, and have custody over" the funds, "the requisite 'disposing of' or 'parting with' property has not occurred." *In re Whitley*, 848 F.3d 205, 210 (4th Cir.) (quoting 11 U.S.C. 101(54)(D)), cert. denied, 138 S. Ct. 314 (2017). In addition, the Code further protects against absurd applications because it permits a trustee to recover the value of transferred property from a transferee only "if the court so orders," 11 U.S.C. 550(a); relying on that language, commentators have recognized that courts have discretion to prevent monetary recovery in appropriate cases. See 5 *Collier on Bankruptcy*

¶ 550.02[3], at 550-10 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2016). In any event, to the extent an atextual limitation is needed to protect an innocent intermediary from the consequences of initial-transferee status, that would not justify recognizing an even more expansive limitation here, where the text affirmatively points to the corporate fraudster as the initial transferee.

c. Again remarkably, respondent contends that "equitable principles support the Ninth Circuit's holding." Br. in Opp. 22. But the Ninth Circuit itself evidently did not agree: the majority recognized the "harsh[ness]" of the result in this case, see Pet. App. 3a, and Judge Nguyen vigorously attacked it in her dissent, see *id.* at 31a-32a, 37a-38a. It is bizarre to suggest that petitioners—a small-business owner and a couple seeking to finance their retirement—were somehow better positioned than Walldesign's creditors to unearth and bear the cost of Mr. Bello's fraud. See Br. in Opp. 23-24. Unlike creditors that accept a promise of future repayment at a premium in exchange for the attendant risk, individuals who receive checks that clear are neither obligated nor likely to investigate the financial circumstances of the payor. Indeed, respondent offers no reason to believe that petitioners are any better positioned to identify a fraudulent transfer than the financial intermediaries he concedes are exempt from initial-transferee status.

Respondent suggests (Br. in Opp. 24) that payments from Mr. Bello himself may ameliorate the potentially ruinous liability facing petitioners. But it need hardly be said that recovering from a corporate fraudster is "difficult." See Pet. App. 16a. Indeed, if recovery from Mr. Bello turns out to be available, respondent stands to gain nothing from obtaining a judgment against petitioners: as the Ninth Circuit made clear, Mr. Bello is strictly liable to respondent as the party for whose benefit the transfers

were made, and respondent "may seek a 'single satisfaction' from [Mr. Bello as well as petitioners], jointly and severally." Pet. App. 31a (quoting 11 U.S.C. 550(d)). Not only is respondent entitled to recover the amount at issue from Mr. Bello, but the creditors' committee has in fact sought to do so. See *Official Committee of Unsecured Creditors of Walldesign, Inc.* v. *Bello*, No. 13-1409 (Bankr. C.D. Cal. filed Dec. 12, 2013).

Respondent contends (Br. in Opp. 23) that the Bankruptcy Code expresses a preference for maximum recovery for creditors and that recovery from petitioners would further that purpose. Again, however, that simply assumes the answer to the question presented. Section 550 carefully balances the interests of innocent transferees against those of creditors by providing a safe harbor to subsequent transferees who accept the property for value, in good faith, and without knowledge of the voidability of the transfer. See 11 U.S.C. 550(a)-(b). Precisely because petitioners fall into that category of innocent transferees, recovery from them would undermine the Code's purposes.

3. Further review is warranted to resolve the circuit conflict on the question presented and to correct the Ninth Circuit's erroneous and deeply inequitable decision in this case. Aside from his flawed arguments about the conflict and the merits, respondent offers no reason to deny review. He does not contest the exceptional legal and practical importance of the question presented; the frequency with which it arises in bankruptcy courts; or the difficulty of obtaining appellate review given the nature of the proceedings. See Pet. 19-22. Nor does respondent identify any problem with this case as a vehicle in which to resolve the question presented. See Pet. 21. This case thus offers an optimal and rare opportunity to resolve the widespread disagreement among lower courts

on the question presented and the resulting disuniformity in the interpretation of the Bankruptcy Code.

In sum, this case presents an acknowledged circuit conflict on a question of substantial legal and practical importance. The Court should grant review to resolve the conflict and correct a persistent misreading of the Bankruptcy Code by several courts of appeals, including the Ninth Circuit in the decision below.

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The petition for a writ of certiorari should be granted.

Respectfully submitted.

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