No. 13-373

In the Supreme Court of the United States

SONEET R. KAPILA, PETITIONER

v.

INTERNAL REVENUE SERVICE

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

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the bankruptcy court correctly determined that the Internal Revenue Service (IRS) was not the "initial transferee" of a debtor's property under 11 USC 550(a)(1), where the IRS received from a taxpayer a cashier's check that the taxpayer itself had previously received from the debtor.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 23-26) is not published in the Federal Reporter but is reprinted at 517 Fed. Appx. 840. The order of the district court (Pet. App. 19-22) is unreported. The opinion of the bankruptcy court (Pet. App. 1-18) is reported at 446 B.R. 564.

JURISDICTION

The judgment of the court of appeals was entered on April 23, 2013. The petition for a writ of certiorari was filed on July 13, 2013. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In March 2007, the Internal Revenue Service (IRS) assigned a revenue officer to collect unpaid employment taxes owed by a Florida corporation,

Best Lab Deals (Best Lab). Pet. App. 2. The revenue officer's research revealed that Best Lab was an active corporation, and that Vance Moore, Jr. served as its president, secretary, treasurer, and director. *Ibid.* The revenue officer sent Best Lab a letter informing it that the IRS would levy its assets unless the back taxes were paid. *Id.* at 3.

Moore was also the principal of ATM Financial Services, LLC (ATM), a separate corporation that purported to manage and service automated teller machines but was in fact a Ponzi scheme. Pet. App. 2. To pay Best Lab's delinquent taxes, Moore used ATM's funds to purchase a cashier's check made payable to "U.S. Treasury" in the amount of $536,686.91. *Id.* at 3. The check identified "NSB 02 Best Lab Deals, Inc." as the remitter. *Ibid.* Moore then mailed the check to the IRS. *Ibid.* Accompanying the check was a letter, signed by Moore on Best Lab's letterhead, that referred to the check as "my certified check" and directed the IRS to apply the check's proceeds to Best Lab's outstanding tax debt. *Ibid.* When the IRS received the check, it credited the payment as the letter had requested. *Ibid.*

2. Approximately eight months later, ATM filed for bankruptcy. Pet. App. 3. Petitioner, the bankruptcy trustee for ATM, filed an adversary proceeding against the IRS seeking recovery of the tax payment on the theory that it had been a fraudulent transfer. *Id.* at 4.

The Bankruptcy Code provisions that address fraudulent transfers permit a bankruptcy trustee to avoid, *inter alia*, any transfer of the debtor's property that took place within two years of the bankruptcy filing and either (1) was made with the intent to hin-

der, delay, or defraud creditors, or (2) occurred when the debtor was in certain financial trouble (*e.g.*, when it was insolvent) and failed to return "reasonably equivalent value" to the debtor. 11 U.S.C. 548(a)(1). Under 11 U.S.C. 550, the trustee is entitled, without exception, to recover the fraudulently transferred property (or the value of that property) from either "the initial transferee of [the] transfer" or "the entity for whose benefit [the] transfer was made." 11 U.S.C. 550(a)(1). Alternatively, the trustee may recover from "any immediate or mediate transferee of [the] initial transferee," 11 U.S.C. 550(a)(2), unless that subsequent transferee was a good-faith transferee, see 11 U.S.C. 550(b) (precluding recovery from, *inter alia*, a subsequent 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").

In this case, the bankruptcy court concluded, on cross-motions for summary judgment, that Section 550 did not permit petitioner to recover the tax payment from the IRS. Pet. App. 1-15. As an initial matter, the IRS conceded, and the bankruptcy court agreed, that ATM had "fraudulently transferred funds under § 548 of the Bankruptcy Code" in this case. *Id.* at 4. The bankruptcy court determined, however, that the IRS was a subsequent transferee, rather than the initial transferee, of ATM's funds, and that the IRS had accepted those funds in good faith as the payment of Best Lab's antecedent tax debt. *Id.* at 4-12.

The bankruptcy court explained that "[Best Lab], not the IRS, was the initial transferee of [ATM's] funds." Pet. App. 9; see *id.* at 6-11. The court reasoned that Best Lab was, as a literal matter, "the first

recipient of the debtor's fraudulently-transferred funds." *Id.* at 6 (quoting *Martinez* v. *Hutton (In re Harwell)*, 628 F.3d 1312, 1322 (11th Cir. 2010)); see *id.* at 8-9. The bankruptcy court observed that Moore "wore at least two corporate hats in the course of this brief transaction: one as [ATM's] principal and another as [Best Lab's]." *Id.* at 8. First, "[h]e went into the bank as [ATM's] principal, withdrew funds from ATM's bank account, and used the monies to purchase the cashier's check." *Ibid.* Then, "[a]t some point after Moore received the cashier's check, he 'transferred' the funds to [Best Lab] to submit to the IRS." *Ibid.* Finally, Moore "put on his [Best Lab] hat, wrote the IRS a letter on [Best Lab] letterhead, and mailed the check and letter to the IRS on behalf of [Best Lab]." *Id.* at 8-9.

The bankruptcy court recognized that circuit precedent had "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." Pet. App. 6-7 (quoting *In re Harwell*, 628 F.3d at 1322). The court found, however, that neither of the prerequisites for application of that equitable exception—(1) "that [Best Lab] did not have control over the funds" and (2) "that [Best Lab] 'acted in good faith and as an innocent participant in the fraudulent transfer'"—was present in the circumstances of this case. *Id.* at 9 (quoting *In re Harwell*, 628 F.3d at 1323).

With respect to the first prerequisite, the bankruptcy court rejected petitioner's contention that Best Lab "did not have control of the funds transferred to the IRS." Pet. App. 10. The court observed that

"Moore controlled both the debtor and [Best Lab]"; that he "could have easily not transferred the cashier's check to the IRS or drawn another made out to whomever Moore wished to pay"; and that Best Lab had "benefited greatly from [the] transfer." *Ibid*; see *id.* at 9 (explaining that Moore's mailing of the check and letter to the IRS on Best Lab's behalf "demonstrat[ed] control over the funds in his capacity as [Best Lab's] principal"). With respect to the second prerequisite, the bankruptcy court found that Moore's fraudulent intent in operating ATM as a Ponzi scheme precluded the argument that he was acting in good faith in accepting ATM funds to pay Best Lab's tax debt. *Id.* at 9-10.

The bankruptcy court additionally reasoned that applying the equitable "conduit" exception to the definition of "initial transferee" in this case would "turn[] the rationale for the exception on its head." Pet. App. 10; see *id.* at 9. The court stated that the purpose of the exception is simply to avoid imposing liability as an initial transferee on an entity that lacked control over the funds and knowledge of the debtor's financial condition. *Id.* at 9. "The purpose thus is *not* to enable the trustee to more easily skip over insolvent entities to reach deep pockets, which is in essence what [petitioner] is attempting here." *Ibid.*

3. The district court affirmed the bankruptcy court's judgment. Pet. App. 19-22. It found the bankruptcy court's analysis "persuasive[]" and declined to apply the Ninth Circuit's decision in *Abele* v. *Modern Financial Plans Services, Inc. (In re Cohen)*, 300 F.3d 1097 (2002). Pet. App. 21. The district court explained that "[t]o hold in this case that [Best Lab] was not a transferee of the check would ignore the

transfer of the funds represented by the check." *Id.* at 21 n.1 "Clearly," the court continued, "Moore's manipulation of the transaction, acting as the alter ego of both entities, effectively transferred the funds to [Best Lab] which then transferred the funds to the IRS." *Ibid.*

4. The court of appeals likewise affirmed on "the well-reasoned opinion of the bankruptcy court." Pet. App. 26; see *id.* at 24-26. The court of appeals declined to consider petitioner's new alternative argument that the IRS was liable under Section 550(a)(1) as the "entity for whose benefit" the fraudulent transfer was made, finding that petitioner had forfeited that argument by failing to assert it in a timely fashion. *Id.* at 24-26.

ARGUMENT

Petitioner contends (Pet. 14-30) that the court of appeals erred in affirming the bankruptcy court's determination that the IRS was not the initial transferee of ATM's funds. The court of appeals' unpublished per curiam decision is correct and does not warrant further review.

1. The Bankruptcy Code authorizes recovery, without exception, of fraudulently transferred property (or the value of such property) from "the initial transferee * * * or the entity for whose benefit [the] transfer was made." 11 U.S.C. 550(a)(1). It also generally allows recovery of the property (or its value) from "any immediate or mediate transferee of such initial transferee," 11 U.S.C. 550(a)(2), subject to certain exceptions. One of those exceptions precludes recovery from a subsequent 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." 11 U.S.C. 550(b)(1).

The bankruptcy court found, and petitioner does not dispute, that the IRS accepted the cashier's check in this case "for value" (namely, satisfaction of Best Lab's tax debt), "in good faith," and "without knowledge" that a fraudulent transfer had occurred. Pet. App. 11-12. Petitioner contends that it may recover the tax payment anyway, on the theory that the IRS was the initial transferee rather than a subsequent transferee. The bankruptcy court correctly rejected that argument, holding that, on the facts of this case, Best Lab, "not the IRS, was the initial transferee of the debtor's funds." *Id.* at 9.

The course of events in this case involved two different transfers: one from ATM to Best Lab, and then another from Best Lab to the IRS. See Pet. App. 21 n.1 ("Moore's manipulation of the transaction, acting as the alter ego of both entities, effectively transferred the funds to [Best Lab] which then transferred the funds to the IRS."). Moore first "went into the bank as [ATM's] principal, withdrew funds from ATM's bank account, and used the monies to purchase the cashier's check." *Id.* at 8. The initial transfer then occurred when, "at some point after Moore received the cashier's check, he 'transferred' the funds to [Best Lab] to submit to the IRS." *Ibid.* The second transfer occurred when, as Best Lab's officer, Moore "wrote the IRS a letter on [Best Lab] letterhead, and mailed the check and letter to the IRS on behalf of [Best Lab]." *Id.* at 8-9.

Petitioner's view that Best Lab was *not* the initial transferee would produce anomalous results. The fraudulent "transfer * * * of an interest of the

debtor in property," 11 U.S.C. 548(a)(1), that provided the basis for petitioner's suit was necessarily complete as soon as Moore, acting in his capacity as Best Lab's corporate officer, elected to treat the cashier's check as an asset of Best Lab. See 11 U.S.C. 101(54)(D) (defining "transfer" broadly 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"). At that point, ATM no longer had control or authority over the distribution of the check or the funds withdrawn to purchase the check. On petitioner's view, however, neither Best Lab, nor the IRS (which did not yet have the check), nor any other entity was the "transferee" of that completed "transfer." That position—which essentially puts the check in limbo for the period during which Best Lab had control over its disposition—makes little sense as a logical matter and cannot be squared with the text of the relevant statutes.

2. The bankruptcy court correctly concluded (Pet. App. 9-11) that, to the extent courts may create an "equitable exception" to Section 550 "to avoid unduly harsh outcomes for unwitting recipients" of a debtor's property (*e.g.*, a delivery service that is obligated by contract simply to transport a check from one place to another), such an exception would be unwarranted here. The bankruptcy court considered and rejected the contention that Best Lab was "a mere conduit or lacked sufficient control of the funds." *Ibid.* As the court had earlier observed, Moore "demonstrat[ed] control over the funds in his capacity as [Best Lab's] principal" when he "wrote the IRS a letter on [Best Lab] letterhead" and "mailed the check and letter to the IRS on behalf of" Best Lab. *Id.* at 8-9. The court

accordingly rejected petitioner's contention that Best Lab "did not have control of the funds transferred to the IRS," explaining that "Moore controlled both [ATM] and [Best Lab] and could have easily not transferred the cashier's check to the IRS or drawn another made out to whomever Moore wished to pay." *Id.* at 10.

Petitioner asserts that property interests for bankruptcy purposes are defined by state law, Pet. 16 (citing *Butner* v. *United States*, 440 U.S. 48 (1979)); that state law gave Best Lab no interest in the funds at issue here, Pet. 16-21; and that "[t]he ruling in this case represents no less than a principle that equity controls over the law," Pet. 29. But even if petitioner is correct that Florida law would have prohibited Best Lab from negotiating or endorsing the check (Pet. 20), the bankruptcy court was still correct in concluding that Best Lab functionally had control over the funds. Petitioner does not contest that, as a practical matter, Moore had discretion over whether to deliver the check to the United States (as payment for Best Lab's tax deficiency or for any other purpose Moore designated) or whether instead to return the funds to ATM (either by giving back the check or destroying it), see Pet. 21. Petitioner also does not contest that, in choosing among those options, Moore elected to treat the cashier's check as Best Lab's property and to dispose of the check in a manner that served Best Lab's interests.

To be sure, Moore's course of conduct was improper, since in converting ATM's funds to Best Lab's benefit he breached his duty of loyalty to ATM. The purpose of Section 550(b), however, is to protect good-faith subsequent transferees who take for value, even

in circumstances where the initial transfer was improper. The fact remains that, in mailing the check to the IRS with an accompanying letter on Best Lab letterhead, and in instructing the IRS to apply the payment to Best Lab's outstanding tax debt, Moore acted in his capacity as corporate officer of Best Lab. Pet. App. 8-9. Moore's exercise of dominion and control over the funds in that capacity necessarily implies the existence of a prior transfer from ATM to Best Lab.

3. The result below is inconsistent with the Tenth Circuit's decision in *Rupp* v. *Markgraf*, 95 F.3d 936 (1996). In that case, a husband and wife were principals of the corporate debtor; the wife used corporate funds to purchase a cashier's check payable to her husband's personal creditors; the check was sent to her husband; and her husband sent the check to the creditors. *Id.* at 937-938. The Tenth Circuit concluded that the husband was not the initial transferee. *Id.* at 940. The decision below is also in tension with the Ninth Circuit's decision in *Abele* v. *Modern Financial Plans Services (In re Cohen)*, 300 F.3d 1097 (2002), in which a debtor purchased a cashier's check made payable to one of her husband's creditors; the check was given to her husband; and her husband gave the check to the creditor. *Id.* at 1100, 1104-1105. The Ninth Circuit concluded—based in large part on a determination that Arizona-law provisions similar to the Florida-law provisions cited in the petition precluded the husband and wife from exercising control over the check—that the creditor was the initial transferee under Section 550. *Id.* at 1104-1107.

For three reasons, however, the decision below does not warrant this Court's review. First, the deci-

sion below does not establish the law of the Eleventh Circuit because, as an unpublished summary affirmance of a bankruptcy-court decision, the decision would not be binding on any future Eleventh Circuit panel. See 11th Cir. R. 36-2. Indeed, petitioner cites two published Eleventh Circuit decisions that he contends support his own legal position. See Pet. 23-24 (citing *Nordberg* v. *Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196, 1200 (1988), and *IBT Int'l, Inc.* v. *Northern (In re Int'l Admin. Servs., Inc.)*, 408 F.3d 689, 707 (2005)). And any conflict between the decision below and prior decisions of the same court of appeals can be resolved without this Court's intervention. See *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957) (per curiam).

Second, even assuming that a future Eleventh Circuit panel would agree that the IRS is not an initial transferee in a case like this, it might nevertheless allow a trustee in petitioner's position to recover on an alternative ground. Section 550 permits recovery, irrespective of good faith, not only from an initial transferee, but also from "the entity for whose benefit [the] transfer was made." 11 U.S.C. 550(a)(1). Petitioner argued in the court of appeals that the IRS in this case was "the entity for whose benefit [the] transfer was made," but the court concluded that this argument had not been adequately preserved. Pet. App. 24-26. This Court should not intervene before the court of appeals itself has had the opportunity to consider all possible alternative arguments, and a case in which only one of the alternatives has been preserved would be a poor vehicle for considering the application of Section 550 to this particular fact pattern.

Third, petitioner identifies no reason to believe that the question presented here arises with any frequency. Petitioner also identifies no need for this Court to address the application of Section 550 more generally. To the contrary, petitioner states that, although various circuits use different "terminology" to describe the appropriate inquiry, Pet. 23, "there is no discernible difference" in the circuits' application of Section 550 to "money transfers," Pet. 26.

Although petitioner identifies one decision in which the Ninth Circuit perceived a theoretical distinction between the Seventh Circuit's approach and the Eleventh Circuit's approach, see Pet. 26, even that decision recognizes that the approaches are "similar" and only "slightly different," *Universal Serv. Admin. Co.* v. *Post-Confirmation Comm. of Unsecured Creditors of Incomnet Commc'ns Corp. (In re Incomnet, Inc.)*, 463 F.3d 1064, 1070-1071 (9th Cir. 2006) (citing *Bonded Fin. Servs., Inc.* v. *European Am. Bank*, 838 F.2d 890, 893-894 (7th Cir. 1988), and *In re Chase & Sanborn Corp.*, 848 F.2d at 1199). The Seventh and Eleventh Circuits themselves treat their approaches as congruent, and the petition itself points out that a number of circuits have relied on both Seventh and Eleventh Circuit precedent in formulating their own approaches. See *Citicorp N. Am., Inc.* v. *Official Comm. of Unsecured Creditors (In re TOUSA, Inc.)*, 680 F.3d 1298, 1315 (11th Cir. 2012) (favorably citing *Bonded Financial Services, Inc.*); *Paloian* v. *La Salle Bank, N.A.*, 619 F.3d 688, 692 (7th Cir. 2010) (favorably citing *Nordberg* v. *Arab Banking Corp. (In re Chase & Sanborn Corp.)*, 904 F.2d 588 (11th Cir. 1990)); Pet. 24-25 (citing *Bailey* v. *Big Sky Motors, Ltd. (In re Ogden)*, 314 F.3d 1190, 1202 (10th Cir. 2002); *Christy*

v. *Alexander & Alexander of N.Y. Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*, 130 F.3d 52, 57-58 (2d Cir. 1997), cert. dismissed, 524 U.S. 912 (1998); *Security First Nat'l Bank* v. *Brunson (In re Coutee)*, 984 F.2d 138, 140-141 (5th Cir. 1993)). Thus, any differences between the circuits do not involve the general principles that apply in this area, but rather concern the application of those principles to a fairly idiosyncratic fact pattern. Further review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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