

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

CURRAN V. NIELSEN CO, INC.,

BKY 4-92-6328

Debtor.

THOMAS F. MILLER, AS TRUSTEE
OF THE BANKRUPTCY ESTATE OF
CURRAN V. NIELSEN CO., INC.,

Plaintiff,

-vs.-

ADV 4-95-164

T.C. SHEET METAL CONTROL BOARD
TRUST FUND,

FINDINGS OF UNDISPUTED FACT,
CONCLUSIONS OF LAW
AND ORDER FOR JUDGMENT

Defendant.

At Minneapolis, Minnesota, November 29, 1995.

The above-entitled matter arises by Complaint filed by the Chapter 7 Trustee, Thomas F. Miller ("Trustee"), who is seeking to avoid and recover for the benefit of the estate a transfer made by the Debtor, Curran V. Nielsen Co., Inc. ("Debtor"), to the defendant, T.C. Sheet Metal Control Board Trust Fund ("Defendant"), in the sum of \$19,299.91 pursuant to 11 U.S.C. §§ 547(b) and 550(a). Because the essential facts of this case are not in dispute, the parties to this action have submitted this matter to the Court for resolution on the submission of stipulated facts, exhibits, and briefs.

FINDINGS OF UNDISPUTED FACTS

1. On or about June 29, 1992, the Debtor, who was a roofing contractor, transferred a check in the amount of \$19,299.91 to the Defendant.

2. The bankruptcy case was originally commenced as an involuntary Chapter 11 case by the filing of a petition on September 17, 1992. The order for relief under Chapter 11 was

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entered by this Court on October 13, 1992. The case was converted to Chapter 7 by order entered May 10, 1993, effective May 17, 1993.

3. The subject transfer was made within ninety days of the commencement of the bankruptcy case.

4. The transfer was of the Debtor's property and was for fringe benefits owed by the Debtor to various defined benefit and/or contribution plan funds established pursuant to the provisions of a collective bargaining agreement between the Debtor and the sheet metal workers union.

5. Pursuant to the terms of the collective bargaining agreement, the Debtor was contractually obligated to regularly contribute to the union pension fund in specified amounts on behalf of its employees. The Debtor's contributions were used to provide pension benefits to covered employees. A failure to pay the required funds would constitute a breach of the collective bargaining agreement and give rise to liquidated damages.

6. The Debtor has no contractual relationship with the Defendant. The Defendant was, however, authorized to receive, collect, and administer payments for fringe benefits owed by the Debtor to various funds. It also had the right to take certain action on behalf of the various defined benefit and/or contribution plan funds to enforce payment under the collective bargaining agreement.

7. The Defendant was a fiduciary that acted as a clearinghouse for approximately eight defined benefit and/or contribution plan funds related to sheet metal workers, pursuant to the provisions of the collective bargaining agreement between the Debtor and the sheet metal workers union.

8. The Debtor became delinquent in making the contributions as required under the terms of the collective bargaining agreement. Counsel for the Defendant wrote a demand letter to the Debtor indicating that there was a delinquency for the months of February and March of 1992, and that litigation would ensue if the delinquency was not cured.

9. As such, the funds transferred by the Debtor were not made in the ordinary course of the Debtor's financial affairs but, rather, represented a payment on a past due account.

10. The Defendant received the funds from the Debtor via a check. The check was endorsed by the Defendant and deposited into its investment account. None of the funds were, however, ever retained by the Defendant but, rather, were distributed to various defined benefit and/or contribution plan funds.

11. If the transfer had not been made and the Debtor had been liquidated under Chapter 7, the various defined benefit and/or contribution plan funds would not have received the funds.

12. The Defendant has no claim or recovery against the various defined benefit and/or contribution plan funds for any money and will have none in the event a judgment is entered against it in this adversary proceeding.

CONCLUSIONS OF LAW

Section 547(b) of the Bankruptcy Code empowers a trustee to:

avoid the transfer to a creditor of an interest in property of the debtor that is made (1) on or within ninety days [or one year if the creditor is an insider] before the date of the filing of the bankruptcy petition, (2) while the debtor was insolvent, (3) on account of an antecedent debt, and (4) which enables the creditor to receive more than it would have received in a bankruptcy liquidation.

Lovett v. St. Johnsbury Trucking, 931 F.2d 494, 497 (8th Cir.

1991). See 11 U.S.C. § 547(b). The burden falls upon the trustee to prove that a particular transfer is avoidable as preferential under § 547(b). Id. § 547(g).

Although the recovery of a transfer or its value necessarily depends upon its avoidance, Congress deliberately distinguished between avoiding a transfer and recovering from the transferee. It is through § 550, which "prescribes the liability of a transferee of an avoided transfer," that the Code "enunciates the separation between the concepts of avoiding a transfer and recovering from the transferee." H.R. Rep. No. 595, 95th Cong., 1st Sess. 375, reprinted in 1978 U.S.C.C.A.N. 5963, 63331; S. Rep. No. 989, 95th Cong., 2d Sess. 90, reprinted in 1978 U.S.C.C.A.N. 5787, 5876. As such, once the trustee has established all of the elements of a preferential transfer under § 547(b) and effectively negated any defenses advanced under subsection (c), § 550 governs the remedy of recovery. Subsection (a) of § 550 provides the basic remedial rule on liability and the determination as to whom is liable for an avoided transfer:

[T]o the extent that a transfer is avoided under section . . . 547 . . . , 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 the transfer was made

11 U.S.C. § 550(a) (emphasis added).¹

The plain language of § 550(a)(1) imposes absolute liability

¹Although a trustee "is entitled to only a single satisfaction," id. § 550(d), § 550 effectively gives the trustee the discretion to determine who recovery may be had from and therefore permits the trustee to pursue the "deep pocket." In re Acadiana Elec. Serv., Inc., 66 B.R. 164, 166, 168 (Bankr. W.D. La. 1986).

on an "initial transferee" that is in possession of the actual property transferred by a debtor which has been successfully avoided under § 547(b).² However, in instances in which the trustee is seeking to recover the "value" of the property transferred, rather than the actual property itself, from a party who is no longer in possession of the property and derived no benefit from the transfer, courts have developed various theories in an attempt to ameliorate a perceived inequity that arises from the imposition of liability on an innocent, but technically "initial," transferee. Notably, courts have carved out an exception to liability and refused to allow a trustee to recover the value of a preferential transfer in instances in which a trustee seeks the literal application of § 550(a)(1) to an entity that merely served as an agent or conduit for a specified transfer.

The seminal decision in this regard is Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890 (7th Cir. 1988), which held:

Although the Bankruptcy Code does not define "transferee", and there is no legislative history on the point, we think the minimum requirement of status as a "transferee" is dominion over the money or other asset, the [legal] right to put the money to one's own purposes. When A gives a check to B as agent for C, then C is the initial transferee; the agent may be disregarded. This perspective had impressive support under the 1898 Code .

. . .

²Although the Code does not define the term "initial transferee," the ordinary, dictionary definition of the words, especially when gauged against the remainder of the statutory scheme, reveals that an "initial transferee" under § 550(a)(1) is the first entity that receives a "transfer" of "property or an interest in property" directly from the debtor by any "mode, direct or indirect, absolute or conditional, voluntary or involuntary." See Black's Law Dictionary 704 & 1342 (5th ed. 1979) (defining the terms "initial" and "transferee"). See also 11 U.S.C. §§ 101(54), 550(a)(2).

Id. at 893. According to the court, an entity does not have the requisite dominion or control over the funds transferred unless it is, in essence, "free to invest the whole [amount] in lottery tickets or uranium stocks." Id. at 894. The court in Bonded Financial emphasized that a literal application of § 550(a)(1) would render financial intermediaries and even armored car companies absolutely liable for avoided transfers as initial transferees. Id. at 893. The court concluded that for purposes of avoidance, the term "transferee" must be construed in an equitable sense that takes into account the policies which lie at the heart of the avoidance provisions. Id. at 895. As such, a "transferee" must, the court postulated, be something different than a mere "holder," "possessor," or "agent" and cannot be treated for purposes of recovery under § 550(a) as "'anyone who touches the money.'" Id. at 894. A party who serves as a mere intermediary is not an initial transferee because it holds the funds "only for the purpose of fulfilling an instruction to make the funds available to someone else." Id. at 893.

Similarly, the Court of Appeals for the Eleventh Circuit adopted the dominion or control test for determining whether an entity is an "initial transferee" and, in Nordberg v. Societe Generale (In re Chase & Sandborn Corp.), 848 F.2d 1196 (11th Cir. 1988), indicated that:

The test articulated by our court is a very flexible, pragmatic one; in deciding whether debtors had controlled property subsequently sought by their trustee, courts must "look beyond the particular transfers in question to the entire circumstance of the transactions."

The control test, then, as adopted by this court, simply requires courts to step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable. This approach is consistent with the equitable concepts underlying

bankruptcy law. . . .

We are not creating new law, or even expanding on the existing doctrine. Bankruptcy courts considering the question of whether a defendant is an initial transferee have traditionally evaluated that defendant's status in light of the entire transaction. And, in the past, courts have refused to allow trustees to recover property from defendants who simply held the property as agents or conduits for one of the real parties to the transactions. Had these courts employed an overly literal interpretation of [the statute], they could have allowed the trustees to recover the funds from the defendants. Instead, they determined that, although technically the defendants received the funds from the debtors and could be termed "initial transferees," the defendants had never actually controlled the funds and therefore it would be inequitable to allow recovery against them.

Id. at 1999-1200 (footnote & citations omitted).

When an avoidable transfer is made through a mere innocent conduit that receives no beneficial interest from the transfer, the clear weight of authority embraces the essential conclusions reached in Bonded Financial and Nordberg and holds that such a conduit is not an "initial transferee" for purposes of recovery under § 550(a)(1). See, e.g., Luker v. Reeves (In re Reeves), 65 F.3d 670, 675-76 (8th Cir. 1995) (embracing the dominion and control test for determining whether an entity is an initial transferee under § 550(a)); Malloy v. Citizens Bank (In re First Sec. Mortgage Co.), 33 F.3d 42, 43-44 (10th Cir. 1994); Security First Nat'l Bank v. Brunson (In re Coutee), 984 F.2d 138, 140-41 (5th Cir. 1993) (law firm that deposited debtor's funds into trust account was not an initial transferee since the funds were being held in a merely fiduciary capacity for the debtors); First Nat'l Bank v. Rafoth (In re Baker & Getty Fin. Services, Inc.), 974 F.2d 712, 722 (6th Cir. 1992); Danning v. Miller (In re Bullion Reserve), 922 F.2d 544, 548-49 (9th Cir. 1991); Nordberg v. Arab Banking Corp. (In re Chase & Sandborn Corp.), 904 F.2d 588, 597-600 (11th Cir. 1990) (opining

that when a bank receives money to pay off a debt it is owed, it is not a mere conduit; however, when a bank receives the "money for the sole purpose of depositing it into a customer's account, on the other hand, the bank never has actual control over the funds and is not a section 550 initial transferee."); Lowry v. Security Pac. Bus. Credit, Inc. (In re Columbia Data Prods, Inc.), 892 F.2d 26, 28 (4th Cir. 1989) (ruling that "a party cannot be an initial transferee if [it] is a mere conduit for the party who had a direct business relationship with the debtor."); Huffman v. Commerce Sec. Corp. (In re Harbour), 845 F.2d 1254, 1256 (4th Cir. 1988) (opining that a literal interpretation of § 550(a)(1) is too "narrow to fit all circumstances"); Commercial Recovery Inc. v. Mill Street, Inc. (In re Mill Street, Inc.), 96 B.R. 268, 269 (Bankr. 9th Cir. 1989) (indicating that the test to determine whether an entity is a mere conduit, rather than an initial transferee, is "whether the transfer was made 'solely for the purpose of benefitting the eventual transferee'"); Kaiser Steel Resources, Inc. v. Jacobs (In re Kaiser Steel Corp.), 110 B.R. 514, 519 (D. Colo.) (noting that courts have excepted from the scope of the definition of an initial transferee those parties which act as mere custodians or serve as intermediate clearinghouses between the debtor and the creditor who has the beneficial interest in the item transferred), aff'd, 913 F.2d 846 (10th Cir. 1990); O'Neal v. Southwest Missouri Bank (In re Broadview Lumber Co., Inc.), 168 B.R. 941, 963 (Bankr. W.D. Mo. 1994); Official Comm. of Unsecured Creditors v. United States Dept. of Labor (In re Dairy Stores, Inc.), 148 B.R. 6, 9-10 (Bankr. D.N.J. 1992) (finding that the Department of Labor acted merely as an agent for the employees and an administrator of the payments; it

enjoyed no benefit from the receipt of the monies collected and enforced their rights under the Fair Labor Standards Act solely for ministerial purposes); Davis v. Davenport (In re Davenport), 147 B.R. 172, 185 (Bankr. E.D. Mo. 1992); Belford v. Breck (Medical Cost Management, Inc.), 115 B.R. 406, 408 (Bankr. D. Conn. 1990) (indicating that "[a]n initial transferee must have the right to control the transferred funds, rather than merely be a conduit for the entity that has that right."); Machinery & Steel Serv., Inc. v. Dalton (In re Machinery & Steel Serv., Inc.), 112 B.R. 478, 480 (Bankr. D. Mass. 1990) (finding union that received checks from employer to be passed on to employee pension and welfare funds was not an initial transferee); Kupetz v. United States (In re Williams), 104 B.R. 296, 299 (Bankr. C.D. Cal. 1989) (concluding that "an escrow company is merely a conduit through which funds flow from a purchaser to a seller"). Accord 4 Collier on Bankruptcy ¶ 550.02, at 550-12 (Lawrence P. King et al. eds., 15th ed. 1995). But see Mixon v. Mid-Continent Sys., Inc. (In re Big Three Transp., Inc.), 41 B.R. 16, 20-21 (Bankr. W.D. Ark. 1983) (ruling that the plain and unambiguous language of § 550(a)(1) should be read literally).

In the instant case, the Defendant had no direct business or contractual relationship with the Debtor, but was merely an intermediary or conduit between the bankrupt Debtor and the various defined benefit and/or contribution plan funds. Although the Defendant obtained possession of the funds transferred, it received no benefit whatsoever from the transfer and had no legal right to use the funds that came into its possession for its own purposes. It merely acted as an agent or clearinghouse for the payments

received on behalf of employees covered under the collective bargaining agreement. It is those employees who were the beneficiaries under the contract. The Defendant served in a fiduciary capacity and, like the transferee in Bonded Financial, held the funds "only for the purpose of fulfilling an instruction to make the funds available to someone else." Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 893 (7th Cir. 1988). The fact that the Defendant had the ability to enforce the payment on behalf of the employees covered under the collective bargaining agreement and actually undertook collection efforts does not alter its status as a mere agent or vest it with the requisite dominion or control over the transferred funds.

Since the Trustee may not avoid the transfer and recover the value of the property transferred from the Defendant in this case under §§ 547(b) and 550(a), the Court need not address the other defenses raised by the Defendant.

ORDER FOR JUDGMENT

Accordingly, IT IS HEREBY ORDERED THAT judgment be entered in favor of the defendant, T.C. Sheet Metal Control Board Trust Fund, and against the plaintiff-trustee, Thomas F. Miller. The plaintiff's Complaint is hereby dismissed with prejudice on the merits and without costs.

LET JUDGMENT BE ENTERED ACCORDINGLY.


Nancy C. Dreher
United States Bankruptcy Judge