Nos. 15-2308, 15-2362

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

MARCIA MEOLI,

Plaintiff-Appellee-Cross-Appellant,

v.

THE HUNTINGTON NATIONAL BANK,

Defendant-Appellant-Cross-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

BRIEF OF AMERICAN BANKERS ASSOCIATION, MICHIGAN BANKERS ASSOCIATION, THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, THE CLEARING HOUSE ASSOCIATION L.L.C., THE OHIO BANKERS LEAGUE, THE CONSUMER BANKERS ASSOCIATION, AND THE FINANCIAL SERVICES ROUNDTABLE, AS AMICUS CURIAE IN SUPPORT OF APPELLANT AND REVERSAL OF THE DISTRICT COURT'S JUDGMENT

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1 and this Court's Rule 26.1, each of American Bankers Association, Michigan Bankers Association, The Securities Industry and Financial Markets Association, The Clearing House Association L.L.C., The Ohio Bankers League, The Consumer Bankers Association, and The Financial Services Roundtable states that it is not a subsidiary of any corporation; that no publicly held corporation holds 10% or more of its membership or ownership interests; and that it does not control, is not controlled by, and is not under common control with any publicly owned corporation.

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STATEMENT OF INTEREST

American Bankers Association ("**ABA**") is the principal national trade association of the banking industry in the United States.[1] ABA has members in each of the fifty states and the District of Columbia, more than 1,000 of which are national banks. ABA member banks hold approximately 90% of the domestic assets of the banking industry in the United States. ABA frequently appears in litigation as a party or amicus where the issues raised in a case are of widespread importance and concern to the industry. ABA is authorized to pursue its national-bank members' interests in ensuring a consistent and reasonable interpretation of the transferee provisions of the Bankruptcy Code.

The Michigan Bankers Association ("**MBA**") is the premier trade organization for Michigan's banking industry. The MBA, founded in 1887, is a nonprofit trade association serving Michigan's banks. The MBA's members have more than 3,000 branches located throughout the state and have combined assets of more than $200 billion.

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[1] Pursuant to Federal Rule of Appellate Procedure 29(c)(5), the undersigned counsel states that no party's counsel authored this brief in whole or in part. No party or its counsel contributed money that was intended to fund preparing or submitting this brief. No person — other than the amicus curiae, their members, or their counsel — contributed money intended to fund preparing or submitting this brief.

The Securities Industry and Financial Markets Association ("**SIFMA**") is the voice of the U.S. securities industry. SIFMA represents the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the United States, serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association.

The Clearing House Association L.L.C. ("**TCH**") is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C., which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost $2 trillion each day, which is nearly half of the automated clearing house, funds transfer and check image payments made in the United States. The Clearing House entities, dating to 1853, are owned by the world's largest commercial banks, which collectively hold more than half of all U.S. deposits and employ over one million people in the United States and more than two million people worldwide.

The Ohio Bankers League ("**OBL**") is a nonprofit trade association that represents the interests of Ohio's commercial banks, savings banks, savings associations as well as their holding companies and affiliated organizations. The Ohio Bankers League has nearly 200 members, which represents the overwhelming majority of all depository institutions doing business in the state. The majority of OBL members make commercial loans and have commercial deposit accounts similar to the relationships at issue in this case. OBL membership represents the full spectrum of FDIC-insured depository institutions, including small mutual savings associations owned by their depositors, community banks that are locally owned and operated, and large regional and multistate holding companies that have several bank and non-bank affiliates and conduct business from coast to coast. Ohio depository institutions directly employ more than 130,000 people in Ohio.

The Consumer Bankers Association ("**CBA**") is the only national financial trade group focused exclusively on retail banking and personal financial services — banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institutions.

As *advocates for a strong financial future*™, The Financial Services Roundtable ("**FSR**") represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

The amici and their member institutions have a significant interest in ensuring this Court appreciates the serious consequences that would result from the rule adopted by the district court, requiring a bank to pay out $55 million in funds it did not keep. As other courts of appeals have explained — and as this case demonstrates — the lower courts' interpretation of "transferee" exposes all banks and financial intermediaries to "great and unimagined liability," leaving them "vulnerable to nuisance suits and settlements" by bankruptcy trustees empowered with broad examination powers such as those under Federal Rule of Bankruptcy Procedure 2004. *See Christy v. Alexander & Alexander of N.Y. Inc.* (*In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*), 130 F.3d 52, 56 (2d Cir. 1997). Exorbitant monitoring costs "would fall on solvent customers without significantly increasing the protection of creditors." *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988). The amici seek to assist the Court in understanding precisely how the lower courts erred and misapplied this Court's precedents and why significant policy concerns should lead this Court to reject the lower courts' novel interpretation of the undefined statutory term "transferee."

ARGUMENT

As defendant-appellant Huntington National Bank has demonstrated in its principal brief, the district court adopted an interpretation of the word "transferee" that conflicts with the widely accepted interpretation of that undefined statutory term. Adopting the bankruptcy court's reasoning, the district court held that, under the Bankruptcy Code, a bank is a "transferee" of all funds deposited to a client's deposit account — even where those funds are paid out at the deposit account holder's direction via checks, automatic payments, wire transfers, and the like. For all the reasons Huntington's principal brief asserts, this was clear legal error.

The lower courts refused to apply well-theorized precedent interpreting the word "transferee," opting instead for a strained interpretation that illogically requires a bank to pay out $55 million in funds that flowed through it but that it did not keep. The lower courts disregarded several courts of appeals' clearly articulated policy reasons for rejecting such an interpretation, providing an excellent example of something the Eleventh Circuit warned against in another of the leading transferee cases: that the lower courts' brand of hyper-technical but impractical application of the transferee provisions of the Bankruptcy Code could bring the whole system down. *See Nordberg v. Societe Generale* (*In re Chase & Sanborn Corp.*), 848 F.2d 1196, 1199, 1202 (11th Cir. 1988).

As the Eleventh Circuit noted, the results in fraudulent conveyance cases must make sense, both factually and equitably, lest the weight of sweeping fraudulent transfer liability simply become unbearable. This "requires courts to step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable." *Id.* at 1199. Courts must "consider the goal of a law, and the effect of a particular ruling." *Id.* at 1202. Otherwise, the court warned, "As the Supreme Court has noted in another context, '[t]his system could easily fall of its own weight if courts or scholars become obsessed with hair-splitting distinctions' and lose sight of the real purpose of the laws being applied." *Id.* (quoting *United States v. Bailey*, 444 U.S. 394, 406–07 (1980)). The bankruptcy system could indeed fall of its own weight if freighted with a policy that permits avoidance actions (and results) as here, requiring a bank to pay $55 million that it did not keep. This Court should reject such a policy.

In Parts I and II, the amici offer additional authority to demonstrate how profound the lower courts' error was. In Part III, the amici offer policy considerations that have informed other courts of appeals' analyses but that the lower courts disregarded.

I. THE LOWER COURTS' RULING IS CONTRARY TO THE RULE ADOPTED IN ALL COURTS OF APPEALS.

The lower courts' interpretation of "transferee" is contrary to an overwhelming body of case law. Every court of appeals to have interpreted the word "transferee" for purposes of the Bankruptcy Code's avoidance provisions has either expressly adopted, or ruled consistently with, the modern "dominion and control" test for transferee status that was adopted by Judge Easterbrook (joined by Judge Posner) in a unanimous Seventh Circuit panel in *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890 (7th Cir. 1988):

- *Richardson v. Preston* (*In re Antex, Inc.*), 397 B.R. 168 (B.A.P. 1st Cir. 2008).
- *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).
- *Bowers v. Atlanta Motor Speedway, Inc.* (*In re Se. Hotel Props. Ltd. P'ship*), 99 F.3d 151, 156 (4th Cir. 1996).
- *Sec. First Nat'l Bank v. Brunson* (*In re Coutee*), 984 F.2d 138, 141 (5th Cir. 1993).
- *First Nat'l Bank of Barnesville v. Rafoth* (*In re Baker & Getty Fin. Servs., Inc.*), 974 F.2d 712 (6th Cir. 1992); *see also Taunt v. Hurtado* (*In re Hurtado*), 342 F.3d 528, 533–34 (6th Cir. 2003).
- *Luker v. Reeves* (*In re Reeves*), 65 F.3d 670, 676 (8th Cir. 1995).
- *Abele v. Modern Fin. Plans Servs., Inc.* (*In re Cohen*), 300 F.3d 1097, 1102 & n.2 (9th Cir. 2002).

- *Malloy v. Citizens Bank of Sapulpa* (*In re First Sec. Mortg. Co.*), 33 F.3d 42, 44 (10th Cir. 1994); *see also Bailey v. Big Sky Motors, Ltd.* (*In re Ogden*), 314 F.3d 1190, 1202 (10th Cir. 2002).

- *Nordberg v. Societe Generale* (*In re Chase & Sanborn Corp.*), 848 F.2d 1196, 1200 & n.11 (11th Cir. 1988) (discussing then-recently decided *Bonded Financial* and adopting a consistent test); *see also Andreini & Co. v. Pony Exp. Delivery Servs.* (*In re Pony Exp. Delivery Servs., Inc.*), 440 F.3d 1296, 1300-01 (11th Cir. 2006) (describing *Bonded Financial* as the equivalent of the Circuit's own test).

Two other circuits' pre-Bankruptcy Code (i.e., pre-1978) precedents are entirely consistent with the modern rule:

- *In re Erie Forge & Steel Corp.*, 456 F.2d 801, 804–05 (3d Cir. 1972) (observing that "although money deposited in a checking account in the ordinary course of business itself becomes the property of the bank, a transfer of the depositor's property has not occurred because of the obligation of the bank to pay checks drawn on the deposit").

- *Cusick v. Second Nat'l Bank,* 115 F.2d 150, 152 n.4 (D.C. Cir. 1940) ("If both depositor and the bank intend, at the time the deposit is made, that it be subject to withdrawal and not applied to payment of the depositor's debt to the bank, the transaction does not constitute a transfer . . . . If, however, the deposit is given by the depositor or received by the bank as a payment on the depositor's note, a transfer occurs . . . .").

As *Bonded Financial* noted, its "perspective had impressive support under the 1898 Code." *Bonded Financial*, 838 F.2d at 893.

Even the name of the test attributed to *Bonded Financial* — the "dominion and control test" — is excellent evidence that the test is actually the comprehensively theorized product of several courts of appeals. *Bonded*

Financial did not use the word "control." *Id.* ("[T]he minimum requirement of status as a 'transferee' is dominion over the money or other asset . . ."). Several months after the *Bonded Financial* decision in 1988, however, the Eleventh Circuit cited approvingly and ruled consistently with *Bonded Financial* in *Chase & Sanborn*, using the word "control" in enunciating its test:

> When trustees seek recovery of allegedly fraudulent conveyances from banks, the outcome of the cases turn on whether the banks actually controlled the funds or merely served as conduits, holding money that was in fact controlled by either the transferor or the real transferee.

Chase & Sanborn, 848 F.2d at 1200.

Later cases, including this Court's *Hurtado* case, simply refer to the resulting (and widely adopted) test as the "dominion and control test." *See, e.g.*, *Hurtado*, 342 F.3d at 533 ("The test *Bonded* created has come to be known as the dominion-and-control test, and has been widely adopted" (internal quotation marks omitted).); *see also In re Incomnet, Inc.*, 463 F.3d 1064, 1071 (9th Cir. 2006) (noting that several circuits "combined" *Bonded Financial*'s "dominion" test and *Chase & Sanborn*'s "control" test, "or at least combined their names").

It is against this vast body of authority approving and adopting the rule of (or a rule consistent with) *Bonded Financial* that this Court should analyze whether the lower courts are correct that they alone have identified fundamental flaws in *Bonded Financial*'s reasoning.

II. THE LOWER COURTS' NEWLY THEORIZED "TRANSFEREE" RULE RESULTS FROM THREE KEY ERRORS.

Three foundational errors undergird the lower courts' analysis. First is the district court's focus on whether a "transfer" occurred when Huntington received deposits for Cyberco. Second is the lower courts' insistence that a bank can use deposited funds "for its own ends." Third is the lower courts' view that this Court's precedents only control the definition of an "initial" transferee but not a "subsequent" transferee. This court and other courts of appeals have considered and rejected these erroneous analyses. A ruling endorsing these errors would significantly affect parties like the amici, and thus they warrant closer examination.

A. Whether A Deposit Is A "Transfer" Does Not Answer The Question Of Who Is The "Transferee" Of The Deposit.

Good evidence that the district court's cursory analysis is flawed is that it begins and ends by analyzing whether a "transfer" occurred when Huntington received deposits for Cyberco. *See Opinion and Order Adopting Report and Recommendation* ("Dist. Ct. Op."), RE 81, Page ID #6361 (framing the issue as whether "for the purpose of the Bankruptcy Code, a transfer of funds has occurred"); *id.* at Page ID #6362 (concluding its analysis by observing that "other courts have concluded that a deposit into a bank account constitutes a transfer"). Whether a deposit is a "transfer" does not answer the question of who is the "transferee" of the deposit. A deposit may be a transfer of something to someone, but that says nothing about to whom the deposit is transferred.

No court of appeals defines the word "transferee" mechanically as one who receives a "transfer," as that term is defined in 11 U.S.C. § 101(54). For example, the Second Circuit specifically considered and declined to adopt a simplistic rule that "the word 'transferee' means the person to whom [a payment] is transferred." *See Christy v. Alexander & Alexander of N.Y. Inc.* (*In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*), 130 F.3d 52, 57 (2d Cir. 1997). Rather, *Finley* held that as a matter of statutory interpretation, a transferee is "the entity to whom the payment is made" or "the one to whom the funds ultimately should go." *See id.* (emphasis added). Similarly, the Eleventh Circuit explained that courts refuse to "employ[] an overly literal interpretation" of the Bankruptcy Code's transferee provisions to allow trustees to recover from banks and other agents who are not "real parties to the transaction." *Nordberg v. Societe Generale* (*In re Chase & Sanborn Corp.*), 848 F.2d 1196, 1199–1200 (11th Cir. 1988). The district court's analysis errs by focusing on the wrong question and conducting minimal analysis on the question of who is a transferee of deposited funds.

B. The Formal Creditor/Debtor Relationship Does Not Make A Bank A Transferee.

The lower courts assert that the Seventh Circuit erred in *Bonded Financial* by failing to recognize the creditor/debtor relationship formally created when a bank holds a deposit account holder's funds: "*Bonded Financial* overlooked the fact that actual ownership of the funds had already changed upon deposit." *Bankruptcy Court's Summary Judgment Opinion* ("Bankr. Ct. SJ Op."), RE 2-4, Page ID #120; *see also* Dist. Ct. Op., RE 81, Page ID #6362 (discussing *Bonded Financial* and expressing "agree[ment] with the Bankruptcy Court's analysis and conclusion"). Notwithstanding the bankruptcy court's statements of faux deference to the remainder of *Bonded Financial*, this analysis eviscerates *Bonded Financial*, which necessarily held that the bank in that case did <u>not</u> take dominion sufficient to become a transferee "upon deposit." The sheer number of circuit court panels — and the scores of federal appellate judges — to have analyzed and adopted *Bonded Financial*'s reasoning is excellent evidence that the lower courts are wrong.

1. The Lower Courts' Statements Directly Contradict This Court's Statement That A Bank Is "Legally Bound To Follow" A Client's Instructions.

The lower courts founded their erroneous conclusion on the premise that a bank can use deposited funds "for its own ends." Dist. Ct. Op., RE 81, Page ID #6362. The district court accepted the bankruptcy court's conclusion that

Huntington "was not under any legal obligation to follow the debtor's directions" and "was vested with legal authority to do what [it] liked with the funds." *See* Bankr. Ct. SJ Op., RE 2-5, Page ID #130 (internal quotation marks omitted). The bankruptcy court referred to "the absolute control a bank exercises over its customers' deposits." *Id.* at Page ID #131. The district court "agree[d] with the Bankruptcy Court's analysis and conclusion." Dist. Ct. Op., RE 81, Page ID #6362.

The bankruptcy court's three statements above have it exactly backward — and directly contradict this Court's own statements. First, banks <u>are</u> legally obligated to follow their clients' directions as to the disposition of deposited funds. This Court in *Hurtado* stated plainly that while the bank in *Bonded Financial* "technically held the money, it was legally bound to follow [its client's] instructions." *Taunt v. Hurtado* (*In re Hurtado*), 342 F.3d 528, 533 (6th Cir. 2003); *see also Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988). Second, banks may <u>not</u> do whatever they like with clients' deposit funds. *Hurtado*, 342 F.3d at 533; *Bonded Financial*, 838 F.2d at 894. And, third, in no meaningful sense do banks exercise "absolute control" — let alone "dominion" — over deposited funds. *See, e.g.*, *Hurtado*, 342 F.3d at 530, 535; *In re Incomnet, Inc.*, 463 F.3d 1064, 1074 & n.12 (9th Cir. 2006).

The very nature of a demand deposit requires the bank to pay the deposited funds, at the depositor's direction, on demand. Elaborate federal banking reserve, capital, and supervisory requirements exist to ensure that depositors' funds are available to the depositor on demand.

As this Court's discussion in *Hurtado* makes clear, the lower courts are not the first to consider these fundamental issues. The Ninth Circuit long ago addressed the application of *Bonded Financial*'s test in light of the formal debtor/creditor relationship, concluding that title is not dominion:

> In such a case, the bank will initially take title over the depositor's funds, but it will not have dominion over them because it has no discretion over the uses to which the depositor's money is to be put. Thus, the bank is not the transferee . . . . If the third party subsequently gives that money to the bank to reduce its own debt, the bank will then have dominion and legal title, but in such a case the bank is a transferee of funds from the third party, not from the initial depositor.

Incomnet, 463 F.3d at 1074 & n.12 (citing authorities discussing the debtor/creditor relationship between a bank and its deposit account holder); *see also Chase & Sanborn*, 848 F.2d at 1200 n.11 (noting that it need not decide if a bank holding deposited funds is a subsequent transferee because the bank "is not a transferee at all").

Indeed, *Bonded Financial* analyzed and rejected a concept similar to the lower courts' theory that, upon receipt of a deposit from a third party, the bank becomes an instantaneous (subsequent) transferee of the deposit account holder (the initial transferee). The trustee in *Bonded Financial* proposed a results-based outcome similar to the one the bankruptcy court here contrived: that the "apparently formal difference — depositing the check in Ryan's account and then debiting that account — should not affect the outcome." *Bonded Financial*, 838 F.2d at 892 (emphasis added). *Bonded Financial* carefully analyzed why ultimately, in its words, "the two-step transaction is indeed different from the one-step transaction." *Id.* at 894.

Scores of federal appellate judges have recognized these straightforward principles by holding that *Bonded Financial* provides the correct interpretation of the undefined statutory term "transferee." It is unreasonable to conclude, as the lower courts implicitly do, that Circuit Judges Easterbrook and Posner (not to mention all the judges on all the circuit panels that have adopted *Bonded Financial*) "overlooked" the nature of the debtor/creditor relationship when analyzing banks' transferee status with regard to deposited funds. It is logically inescapable that the debtor/creditor relationship does not satisfy *Bonded Financial*'s requirement for dominion. A bank does not become a transferee of deposited funds until "step two," when the bank accepts the deposited funds as the ultimate recipient of the funds — such as by taking the funds as loan payments, interest payments, bank fees, or by effecting a setoff. This holding of

Bonded Financial is not dicta or some subsidiary observation: it is logically necessary to *Bonded Financial*'s theoretical moorings. Accordingly, when this Court in *Hurtado* adopted and repeatedly quoted *Bonded Financial*, it must have understood and adopted this central premise.

2. *Hurtado* Approvingly Cites Other Circuits' Precedents Consistent With *Bonded Financial*'s Rejection Of The Creditor/Debtor Distinction.

In addition to the evidence cited above and in Huntington's principal brief, two cases cited by this Court in *Hurtado* provide particularly good evidence that *Hurtado* rejected the simplistic analysis the lower courts would apply. *Hurtado* cites approvingly the Second Circuit's *Finley* case and the Tenth Circuit's *Ogden* case without ever backing away from the analysis in those cases. *Hurtado*, 342 F.3d at 533, 534 n.2 (citing *Finley*, 130 F.3d 52); *id.* at 534 n.2 (citing *Bailey v. Big Sky Motors, Ltd.* (*In re Ogden*), 314 F.3d 1190, 1202 (10th Cir. 2002)).

In *Finley*, the court held that an insurance broker was not a "transferee" of money it received and held <u>unrestricted</u>. The broker deposited a policyholder's premium payment to its own bank account; held the premium as its own for 10 days; wrote a check to the insurer for the premium amount payable from its own account; and sent the check to the insurer. *Finley*, 130 F.3d at 55. The policyholder went bankrupt, and its trustee sued the broker. *Id.* at 53. *Finley* held that the broker was not a transferee of the premium payment, because it had eventually been paid over to the insurer. *Id.* at 59.

This is notable for several reasons. The broker in *Finley* inarguably received a "transfer" (as defined in 11 U.S.C. § 101(54)), and had far more than technical or formal control of the premium funds: the broker kept the funds in its own deposit account for 10 days, and had the legal right to keep (but did not keep) a percentage of the premium as a commission. *See id.* at 57, 59. Nonetheless, as noted above, the Second Circuit in *Finley* applied the principles of *Bonded Financial* to hold that the broker was not a transferee, even though the broker "was no stranger to" the policyholder or the transaction. *Id.* at 58.

The court refused, unlike the lower courts here, to make the existence of a commercial relationship — like the formal creditor/debtor relationship — a kind of scale-tipping factor: "[W]e do not think that the existence of a commercial relationship determines the issue." *Id.* at 58. The court held that "a commercial entity that, in the ordinary course of its business, acts as a mere conduit for funds and performs that role consistent with its contractual undertaking in respect of the challenged transaction, is not an initial transferee . . . ." *Id.* at 59. (Note that no party ever suggested that the broker's bank — in whose accounts the premium sat for up to 10 days in one instance — was any kind of transferee.)

Hurtado also cites *Ogden*, in which the Tenth Circuit held that an escrow agent was not an initial transferee of funds received for its client. *See Ogden*, 314 F.3d at 1193, 1204. *Ogden* likewise confirmed that *Bonded Financial* requires "full dominion and control over [funds] <u>for one's own account</u>, as opposed to receiving them in trust or as agent for someone else." *See id.* at 1204 (internal quotation marks omitted) (italics removed) (emphasis added). *Ogden*'s entire analysis is consistent with the rule that a transferee is one who (1) receives in the chain of title "for [his] own account," *id.*, and (2) "ultimately" controls the disposition of the funds to the next transferee, if any, in the chain of title, *see Finley*, 130 F.3d at 57. The *Hurtado* panel citing these cases approvingly could not have overlooked these facts and commercial realities.

None of *Finley*, *Ogden*, or this Court's two precedents declare simply that one who takes formal title <u>without dominion</u> is a transferee. The bank in *Baker & Getty* was clearly a transferee: when handed a cashier's check <u>for a loan payment</u>, it exercised immediate dominion by directing that the funds be held in an agent's account until the funds cleared and automatically were applied to the loan. *See First Nat'l Bank of Barnesville v. Rafoth* (*In re Baker & Getty Fin. Servs., Inc.*), 974 F.2d 712, 722 (6th Cir. 1992). The bank was an initial transferee of the funds because they were from the outset presented to make a loan payment. Likewise, Barbara Hurtado was clearly a transferee: she received both title and dominion over funds deposited to her account, even if she chose to use them only as her fraudster son directed. *Hurtado*, 342 F.3d at 535. Unlike a bank holding demand deposits, she was not under any legal obligation to use the funds as her son directed. She was not subject to elaborate federal banking reserve, capital, and supervisory requirements requiring that her son's funds be available to him on demand.

C. *Hurtado* Applies To All Transferees, Not Just Initial Transferees.

The district court also accepted the bankruptcy court's premise that *Hurtado* adopted only that portion of *Bonded Financial* that addresses "initial" transferees. Dist. Ct. Op., RE 81, Page ID #6361; Bank. Ct. SJ Op., RE 2-5, Page ID #130–31. This is incorrect. *Hurtado* adopted *Bonded Financial*'s rule of statutory interpretation applicable to all transferees when *Hurtado* held that *Bonded Financial* "requir[es] that a party do more than merely touch the money before becoming a transferee." *Hurtado*, 342 F.3d at 533 (internal quotation marks omitted) (emphasis added). *Hurtado* then quoted *Bonded Financial*'s key holding, which also is not limited to defining initial transferees:

> "[W]e think 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."

Id. (quoting *Bonded Financial*, 838 F.2d at 893) (alteration in original) (emphasis added). Although *Hurtado* involved a defendant who happened to be an initial transferee, *Hurtado*'s analysis and statements about the bank in *Bonded Financial* cannot be reconciled with the view that *Hurtado* did not purport to define "transferee."

The lower courts imply that, despite all of the above, *Hurtado* failed to comprehend that *Bonded Financial* (1) necessarily decided the point in time at which the bank had sufficient dominion and control to become any kind of "transferee" of deposited funds, and (2) involved a bank holding deposited funds for ten days before becoming a (subsequent) transferee by receiving a loan payment. *Hurtado* did not fail to comprehend these principles.

Bonded Financial is such an excellent bellwether case because it demonstrates that sometimes banks are indeed transferees. Its facts underscore both (1) when a bank is not any kind of transferee of deposited funds (i.e., during the ten days the $200,000 remained in Mr. Ryan's deposit account), and (2) when a bank becomes some kind of transferee of deposited funds (i.e., the moment Mr. Ryan used the funds to make a loan payment to the bank). *Bonded Financial*, 838 F.2d at 891.

Note that it is irrelevant to this analysis whether the bank is an initial or subsequent transferee — the bank is simply a transferee. Indeed, in *Bonded Financial*, upon Mr. Ryan's $200,000 loan payment to the bank, the bank became both an initial transferee of the deposit account holder (Mr. Ryan) and a subsequent transferee of the third party (Bonded Financial) that earlier deposited the $200,000 to the account. In such a situation, depending on which entity goes bankrupt, the bank will be either one or the other — but only because it became at some point a transferee by receiving the loan payment. This alone demonstrates the fundamental error of the lower courts' contrived distinction between initial and subsequent transferees.

Hurtado logically must have adopted *Bonded Financial*'s definition of a "transferee," not just a definition of "initial transferee" as the lower courts insist. There is no logical basis for creating a different test — which is undoubtedly why no court of appeals, despite the variety of factual scenarios presented, has ever devised a different test for "subsequent" transferees than the well accepted test for all transferees.

D. The Bankruptcy Court In 2009 Accepted, Before It In 2012 Rejected, *Bonded Financial*.

A unique aspect of the lower court proceedings should give this Court further comfort rejecting the lower courts' flawed analyses. The bankruptcy court fundamentally disagreed with *Bonded Financial* in its 2011 and 2012 opinions. But it agreed with *Bonded Financial* in 2009 — before it made its factual conclusions about Huntington's good faith and lack of knowledge.

In 2009, the bankruptcy court ruled that Huntington was not an initial transferee of funds that Teleservices wired to Cyberco's deposit accounts at

Huntington, citing *Bonded Financial* as authority. *Oct. 7, 2009 Bankruptcy Court Bench Opinion* ("Bankr. Ct. Bench Op."), RE 4-4, Page ID #585–91. The bankruptcy court held no reservations that this Court had fully adopted the *Bonded Financial* test. The court went as far as to state that "Huntington, in its role as solely the bank with which Cyberco had its own depository relationship, was not the recipient of any of these transfers . . . or a transferee for purposes of Section 550." *Id.* at Page ID #591, lines 19–23 (emphasis added).

The bankruptcy court then approvingly described *Bonded Financial*'s "dominion and control" test at length. *Id.* at Page ID #591–95. The court noted that this Court in *Baker & Getty* and *Hurtado* "adopt[ed] *Bonded*'s dominion and control test," and elaborated by saying, "This Court will not address either in detail because they apply that test no differently than did the Seventh Circuit in *Bonded*." *See id.* at Page ID #595, lines 10–16 (emphasis added); *see also id.* at Page ID #596, lines 2–4 (noting that the *Bonded Financial* "test must first determine whether the named defendant was even the intended recipient of the property transferred" (emphasis added)).

But later, in its 2011 opinion, the bankruptcy court indicated that it was likely to switch its view and rule that Huntington was liable as a transferee based solely on its status as Cyberco's depository bank. *See Bankruptcy Court's Opinion Re: Bifurcated Issues* ("Issues Op."), RE 3-6, Page ID #297–300 (discussing *Hurtado* and Huntington's receipt of deposits at length). The Court made no attempt in 2011 to reconcile its newly theorized views with its holdings in 2009.

Finally, in its 2012 opinion, the bankruptcy court gave full airing to its novel theory. *See* Bank. Ct. SJ Op., RE 2-4, Page ID #115, to RE 2-5, Page ID #137. Recognizing that the theory was at odds with *Bonded Financial*'s theoretical underpinnings, the court criticized Judge Easterbook's analysis in that case and framed *Hurtado* as only narrowly endorsing part of the *Bonded Financial* test — in stark contrast to the court's view of *Hurtado* as expressed in its 2009 opinion. *See id.* at Page ID #120, 130–31.

For its part, the district court recognized that "[t]his issue was obviously problematic for the Bankruptcy Court." Dist. Ct. Op., RE 81, Page ID #6361. But the district court then simply noted that it "generally agrees with the Bankruptcy Court" and conducted essentially no independent analysis of the issue. *Id.* at Page ID #6361–62.

This Court should reject the lower courts' revision of a century's worth of sound bankruptcy precedent. Even if this Court determines it is not constrained by *Hurtado*, this Court should follow the reasoning of *Bonded Financial* and the other courts of appeals to conclude that a bank is not a transferee of funds held in a client's deposit accounts.

III. POLICY CONSIDERATIONS COUNSEL AGAINST THE LOWER COURTS' UNPRECEDENTED INTERPRETATION OF "TRANSFEREE."

The widely accepted definition of "transferee" adopted in *Hurtado* is supported by policy considerations thoroughly vetted in the courts of appeals in cases such as *Bonded Financial*, *Finley*, and *Chase & Sanborn*. These considerations continue to compel an interpretation of "transferee" that does not include a bank that holds deposited funds for payment at its client's direction. In this context, it is important to recognize that the amici are <u>not</u> advocating freeing banks from "transferee" status, like any party, for amounts they receive and keep as their own. Nor do the amici advocate freeing banks from normal federal and state civil liability for truly culpable banks that might aid and abet or conspire with fraudsters.[2] The policy considerations here relate to banks that hold funds that they ultimately pay out to third parties at their clients' direction.

[2] In this case, two of Teleservices' creditors sued Huntington unsuccessfully. *See El Camino Res., Ltd. v. Huntington Nat'l Bank*, 712 F.3d 917 (6th Cir. 2013). The fact that recourse is available for culpable conduct is an additional argument favoring the courts of appeals' various interpretational and policy reasons for limiting the "transferee" provisions of the Bankruptcy Code.

A. Systemic Costs Of Monitoring Millions Of Deposits And Wire Transfers For Which Banks Could Be Held Liable Would Be Enormous.

Judge Easterbrook, in *Bonded Financial*, explained persuasively why policy considerations and the "functions of fraudulent conveyance law" weigh in favor of a practical interpretation of "transferee" in the Bankruptcy Code. *See Bonded Financial*, 838 F.2d at 893. The rule prevents "waste" and "costs of monitoring" hundreds of millions of transactions per week that would be required if banks had to inquire how transferors obtained all deposited funds received for clients' accounts. *See id.* at 892–93. As Judge Easterbrook noted, these exorbitant costs "would fall on solvent customers without significantly increasing the protections of creditors." *Id.* at 893. He noted:

> The potential costs of monitoring and residual risk are evident when the transferees include banks and other financial intermediaries. The check-clearing system processes more than 100 million instruments every day; most pass through several banks as part of the collection process; each bank may be an owner of the instrument or agent for purposes of collecting at a given moment. Some of these instruments represent funds fraudulently conveyed out of bankrupts, yet the cost of checking back on the earlier transferors would be staggering.

Id.

These principles are on prominent display in this case. As the bankruptcy court's 2011 opinion describes at length, Huntington undertook significant investigation and monitoring activities at its own expense. *See* Issues Op., RE 3-1, Page ID #180, to RE 3-2, Page ID #201. Despite those efforts, the bankruptcy court here nonetheless found culpability on Huntington's part by broad inferential leaps as to what Huntington would have discovered (and been able to stop from happening) had its security officer, Mr. Rodriguez, told more than one colleague about the past conduct of its client's principal officer. *See id.* at Page ID #201 (inferring what "presumably" would have been discovered, "established," and "concluded" if Mr. Rodriguez had reported Mr. Watson's background check to more than one colleague). As this case illustrates, Judge Easterbrook's policy arguments remain sound today: the monitoring costs of a financial system the lower courts imagine would indeed be "staggering."

B. Banks Would Be Subject To "Great And Unimagined Liability" And "Nuisance Suits And Settlements."

The Second Circuit in *Finley* practically predicted the case before this Court. Criticizing bankruptcy courts that interpret "transferee" too broadly, Judge Jacobs warned that banks should not be subject to "great and unimagined liability that is mitigated only by powers of equity." *Finley*, 130 F.3d at 56. Instead, trustees and bankruptcy courts should be limited by a reasonable statutory construction of the word "transferee." *See id.* Otherwise, the result "would be to render every conduit vulnerable to nuisance suits and settlements.

The Seventh Circuit [in *Bonded Financial*] has characterized as 'misleading' the use of equity to separate sheep from goats . . . ." *Id.*

This explains one reason that Judge Easterbrook expressly noted that the Court was not appealing to equity but was "employ[ing] considerations of policy to *define* 'transferee.'" *See Bonded Financial*, 838 F.2d at 895 (italics in original). As Huntington's principal brief underscores, defendants subject to a court's equity are still subject to nuisance suits and settlements. Defendants protected by a predictable <u>definition</u> are normally protected from trustees' frivolous lawsuits disregarding that definition.

For example, in nearly every bankruptcy case, a creditors' committee or trustee would have incentive — perhaps an ethical obligation — to consider whether any arguable basis exists to avoid and seek recovery from each of the debtor's banks for the value of every deposit that came into the debtor's bank account before bankruptcy. There may be little reason for a creditors' committee or trustee <u>not</u> to attempt or threaten recovery and require the banks to prove their good faith, as the lower courts presume most banks will be able to do. Trustees and creditors' committees could use the very flexible procedures pursuant to Federal Rule of Bankruptcy Procedure 2004 to seek facts that would complicate a bank's good faith and lack of knowledge defenses: "Rule 2004 discovery is broader than discovery under the Federal Rules of Civil Procedure, and has fewer procedural safeguards. It can be legitimately compared to a fishing expedition." *In re Drexel Burnham Lambert Grp., Inc.*, 123 B.R. 702, 711 (Bankr. S.D.N.Y. 1991) (emphasis added); *cf. Chereton v. United States*, 286 F.2d 409, 413 (6th Cir. 1961) (noting that examinations under the pre-Code precursor to Rule 2004 "may even be a fishing expedition"). The cost, inefficiency, and unfairness could be enormous — as could the potential payoff to creditors and bankruptcy trustees.

Here the bankruptcy court chose not to exercise its discretion to reduce Huntington's liability. *See* Bankr. Ct. SJ Op., RE 2-5, Page ID #137, to RE 2-6, Page ID #150. The bankruptcy court's approach would establish a legal regime that presumes liability, permits trustees' nuisance suits and settlements, and leaves it to bankruptcy courts' equitable power to reduce (or, as here, not reduce) banks' liability by tens or hundreds of millions of dollars. This is not a rational system. There should be little question why the courts of appeals that have considered this proposition of federal bankruptcy policy have uniformly rejected it in favor of *Bonded Financial*'s "'more functional rule.'" *See Finley*, 130 F.3d at 56 (quoting *Bonded Financial*, 838 F.2d at 894).

Lest this Court think the amici unreasonably concerned about trustees' propensity to file baseless nuisance suits, consider the trustee's original legal position in this case: that Huntington was the initial transferee of all deposited funds. *See* Bankr. Ct. Bench Op., RE 4-4, Page ID #585, lines 12–21. The trustee argued that Huntington had "no basis in law or fact to support [its] claim that it is not the initial transferee. The moment that Teleservices deposited funds in Cyberco's account a transfer was accomplished and title to the funds passed to Huntington." *Id.* The trustee's position flouted even the narrowest reading of *Bonded Financial* and *Hurtado*, but accused its opponent of having "no basis in law or fact" for asserting a position supported by every single court of appeals. This is distressing, especially considering the considerable power that bankruptcy trustees wield. The bankruptcy court may have rejected the trustee's argument initially, but it reached the same result by simply rebranding Huntington a subsequent transferee of $55 million that it did not keep as its own.

The trustee and bankruptcy court in this case demonstrated that the *Bonded Financial* and *Finley* courts were rightly cautious to define "transferee" — as a matter of statutory interpretation, not equity — to exclude banks and other conduits that are not the ultimate recipients of transfers.

The lower courts here did exactly what the Supreme Court and Eleventh Circuit warned against. The bankruptcy court became "obsessed with hair-splitting distinctions" by which a "system could easily fall of its own weight." *United States v. Bailey*, 444 U.S. 394, 406–07 (1980). The lower courts "los[t] sight of the real purpose of the laws being applied," and failed to "step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable." *Nordberg v. Societe Generale* (*In re Chase & Sanborn Corp.*), 848 F.2d 1196, 1199, 1202 (11th Cir. 1988). They failed to "consider the goal of a law, and the effect of a particular ruling." *Id.* at 1202. The bankruptcy system could indeed fall of its own weight if freighted with a policy that permits avoidance actions (and results) that require a bank to pay $55 million that it did not keep. This court should reject the lower courts' analysis and reverse the district court's judgment.

CONCLUSION

The Court should hold that Huntington was not a transferee of funds held as deposits and ultimately paid out to third parties at its client's direction.

Respectfully submitted,

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February 4, 2016

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) and 32(a)(7)(B) because this brief contains 6,987 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Times New Roman type style.

/s/ Joshua D. McKarcher
Joshua D. McKarcher

February 4, 2016

CERTIFICATE OF SERVICE

I certify that on February 4, 2016, I filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Sixth Circuit by using the appellate CM/ECF system.

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February 4, 2016