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COMMENT

UNLIMITED LIABILITY FOR BANKS: DEPOSITS AS FRAUDULENT TRANSFERS

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I. INTRODUCTION

A "transfer" is "disposing of or parting with—(i) property; or (ii) an interest in property" under the Bankruptcy Code (the Code).[1] This seemingly simple statutory definition, coupled with a frequently cited legislative intent to broadly interpret transfer, has caused some controversy within the federal courts.[2] Specifically, there is controversy as to a trustee's attempt to avoid, as to allegedly fraudulent transfers, and as to a debtor's deposits into a bank account.

To illustrate this issue with a hypothetical, imagine an individual that operated an intricate Ponzi scheme. In the traditional sense, he solicited investments from friends, family, and acquaintances with promises of large capital returns, only to expend the monies for personal use and funnel investment funds into fabricated returns for the previous investor that was induced to subsidize the scheme.[3] Imagine an individual who ultimately defrauded two dozen investors, causing a loss of roughly $7 million.[4]

Our hypothetical schemer was thorough and careful, issuing investors promissory notes detailing their interest rates and due dates.[5] But despite successful maintenance of his system for some three years, he ultimately faced a twenty-count indictment, including charges of money laundering

1. 11 U.S.C. § 101(54)(D) (2012). For additional discussion of a "transfer" under the Bankruptcy Code, see *infra* p. 110 and note 61.

2. *See* Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 208 (4th Cir.) (discussing the various courts that have employed the legislative history in determining whether a conveyance constitutes a transfer under the Bankruptcy Code), *cert. denied*, 138 S. Ct. 314 (2017).

3. United States v. Whitley, 544 F. App'x 154, 156 (4th Cir. 2013). The facts in the above hypothetical are based squarely on the debtor-defendant James Edward Whitley. Whitley was indicted in September 2010 by a grand jury and later pled guilty to two counts—one of wire fraud and one of money laundering—admitting to the operation of a fraudulent investment scheme. *Id.* at 155–56. The egregious nature of Whitley's scheme and the impact of the statements given by the victims caused the district court to vary upward from the sentencing guidelines and impose concurrent sentences of 120 months on each of the two counts. *Id.* at 156.

4. *Id.* at 156.

5. *Id.*

and wire fraud.[6] After he pled guilty and was sentenced to a considerable amount of time in prison, a group of creditors filed an involuntary petition for bankruptcy against him.[7]

Throughout the operation of his scheme, our debtor maintained a personal checking account at a bank to manage his investment monies—he deposited funds, wrote checks, and sent and received wire transfers.[8] While the debtor deposited millions of dollars into his account in the peak of his scheme, at the time the bankruptcy petition was filed, only a few dollars remained in the account.[9] Shortly thereafter, the trustee filed a complaint against the bank where the debtor maintained his checking account.[10] Specifically, the trustee contended various deposits and wire transfers made and received by the debtor constituted fraudulent transfers from the debtor to the bank and were therefore subject to the trustee's avoidance powers.[11] The trustee alleged that the bank was aware of the debtor's illegal activity, and permitted the debtor to use the account in furtherance of his scheme.[12]

If the trustee is unable to recover the funds he alleges were fraudulently transferred out of the debtor's account, the estate will be made up only of the remaining funds. However, if the trustee may pursue the transfers and successfully avoid them as fraudulent, the estate will be replenished and better positioned to satisfy the claims of creditors, though the bank may be collaterally responsible for the actions of the debtor. [13]

One may inquire as to how the bank could possibly be liable for the criminal actions of a customer who simply maintains a checking account. Ponzi schemes often involve targeting vulnerable, elderly individuals to

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6. *Id.* at 155.

7. *In re Whitley*, 848 F.3d at 206.

8. *Id.*

9. Brief in Opposition at 5, Ivey v. First Citizens Bank & Tr. Co., 138 S. Ct. 314 (2017) (No. 16-1330), 2017 WL 3327807, at *5.

10. *See In re Whitley*, 848 F.3d at 206 (detailing the procedural history of the case).

11. *Id.* at 205–06. A debtor who transfers funds with the actual intent to hinder, delay, or defraud creditors subjects those transfers to the avoidance powers of the trustee pursuant to § 548. 11 U.S.C. § 548(a)(1)(A) (2012).

12. *In re Whitley*, 848 F.3d at 205–06.

13. *See* 11 U.S.C. § 550 (outlining the remedies available as a consequence of an avoidable transfer). Further, the trustee can seek damages from the initial transferee—in this case, the bank that operated the accounts used to perpetuate the debtor's Ponzi scheme. Specifically, § 550(a)(1) allows the trustee to recover, for the benefit of the estate, the value of the property from "the initial transferee of such transfer or the entity for whose benefit such transfer was made[.]" *Id.* § 550(a)(1) (providing such relief when the property itself that was transferred cannot be readily recovered and returned to the estate).

induce them to invest their savings in hopes of increasing their retirement funds or leaving a greater inheritance to their heirs.[14] For these reasons, Ponzi schemes can be devastating for the victims who are induced to invest.[15] To combat the effects, the trustee will deploy all available resources to make the victims whole. In the case of the hypothetical, the trustee's only recourse is to exercise his avoidance powers and seek recovery of the funds from a transferee, which the trustee alleges the bank is.[16] If the trustee is unable to recover monies fraudulently acquired and expended by the debtor, the estate will be inadequate to satisfy claims of secured creditors, let alone the victims, who, by virtue of their unsecured promissory note, will be entitled to very little in bankruptcy proceedings.

In contrast, if the court were to allow the trustee to recover funds from the bank as a transferee, while victims would be made whole, banks would face potentially unlimited liability.[17] In the case of our hypothetical debtor, the account was depleted by the time of filing.[18] If the court were to permit the trustee to avoid deposits as fraudulent transfers, the bank would be required to compensate the estate for the value of the funds repeatedly

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14. *See, e.g.*, Cecilio Padilla, *Man Convicted for Ponzi Scheme Took More Than $90 Million from Elderly Victims*, FOX 40 (July 29, 2013, 4:11 PM), http://fox40.com/2013/07/29/man-convicted-for-ponzi-scheme-took-more-than-90-million-from-elderly-victims/ [https://perma.cc/NJ9C-LPAV] (featuring a classic example of a common theme among Ponzi schemes—elderly victims). *See also* Associated Press, *Michigan Man Targets the Elderly in $46.5M Ponzi Scheme*, FOX NEWS (Dec. 3. 2014), http://www.foxnews.com/us/2014/12/03/michigan-man-gets-30-years-for-465m-ponzi-scheme.html [https://perma.cc/2JGR-GEQH] (detailing a $46.5 million Ponzi scheme targeting elderly individuals).

15. *See, e.g.*, Denisse Salazar, *Elderly Victims Confront Man Who Ran $11 Million Fraud*, ORANGE COUNTY REG. (Dec. 17, 2009, 3:23 PM), http://www.ocregister.com/2009/12/17/elderly-victims-confront-man-who-ran-11-million-fraud/ [https://perma.cc/CAQ9-5KB8] ("About [thirty] of the victims, some of whom are now deceased, testified . . . . They told the court how being defrauded out of their life savings affected them emotionally, physically[,] and financially.").

16. *See* Craig T. Lutterbein, Note, *"Fraud and Deceit Abound" but do the Bankruptcy Courts Really Believe Everyone is Crooked: The* Bayou *Decision and the Narrowing of "Good Faith"*, 18 AM. BANKR. INST. L. REV. 405, 405–06 (2010) ("Ponzi schemes present unique problems for bankruptcy courts. . . . In Ponzi schemes, early investors are simply paid from the investments of later investors."). Thus, in some instances the trustee may pursue early investors who received a return at the expense of later investors. *Id.* at 406. Under these circumstances, "bankruptcy courts overseeing the liquidation of Ponzi schemes are forced to decide what is the most equitable way to divide the remaining money between the defrauded investors." *Id.*

17. *See* Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 893 (7th Cir. 1988) (illuminating the significant risks to banks and financial intermediaries if courts were to treat them as initial transferees and impose liability).

18. *See supra* text accompanying note 9.

deposited and withdrawn by the debtor.[19] The ramifications of a ruling in favor of the trustee would be disastrous for banks; how would they vet every customer maintaining a simple checking account? The costs would likely flow down to all consumers through a bank's necessity to acquire greater insurance or charge inflated fees out of fear of being liable for a potential debtor's transfers into his own account.[20]

This dilemma is precisely the issue the Supreme Court declined to hear on certiorari in late 2017.[21] Although the Court did not provide its reasoning as to why it elected not to consider the issue, one can speculate that it was because the Court deemed this controversy to be less than a true split entrenched in the circuit courts.[22] Despite the statutory definition of transfer having been interpreted differently in various circuits, it is important to note that the different rulings were on very distinct facts.[23] As will be discussed, *infra*, one circuit decided that a mere transfer of funds into a bank account constitutes a transfer under the Bankruptcy Code—rendering it avoidable by the trustee.[24] In contrast, as in our hypothetical, one circuit

19. *See* 11 U.S.C. § 550 (2012) (providing the trustee with a remedy to pursue a transferee of fraudulent transfers for the value conveyed).

20. *See Bonded Fin. Servs., Inc.*, 838 F.2d at 892 ("Fraudulent conveyance law protects creditors from last-minute diminutions of the pool of assets in which they have interests. They accordingly need not monitor debtors so closely, and the savings in monitoring costs make businesses more productive." (citing Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 833 (1985); Robert Charles Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 554–60 (1977))).

21. Bill Rochelle, *Features: Two Bankruptcy Cases on the Supreme Court's Calendar: Plus Other Circuit Splits Waiting in the Wings*, 38-11 AM. BANKR. INST. J. 28, 68 (2017).

22. *See* Brief in Opposition, *supra* note 9, at 9 (arguing the circuit split between the Fourth, Ninth, and Tenth Circuits is illusory due to the distinct facts on which differing outcomes were decided and claiming instead "no split exists"). In the brief in opposition of certiorari in *In re Whitley*, the respondent insists the Court need not grant certiorari, as the Court "resolve[s] *genuine* splits—different circuits reaching different results on similar facts." *Id.* Despite respondent's position that there is no such genuine split on this legal issue, it remains true that various lower courts and circuit courts have reached diverging holdings as to whether a deposit can constitute a transfer. Therefore, even if the issue is not yet ripe for the Court's judgment, these diverging courts still require guidance to address the issue when faced with a deposit that a trustee seeks to avoid as a fraudulent transfer.

23. *Compare* Locke v. Schafer (*In re* Schafer), 294 B.R. 126, 131–32 (N.D. Cal. 2003) (finding a debtor that withdrew funds and deposited them in a new bank account with the intent to prevent a creditor from attaching his funds was a fraudulent transfer), *with* Furr v. TD Bank, N.A. (*In re* Rollaguard Sec., LLC), 570 B.R. 859, 871 (Bankr. S.D. Fla. 2017) (determining the trustee could not recover against the bank for fraudulent transfers resulting from a debtor's deposit into his own unrestricted bank account because the bank was not negligent in its maintenance of the debtor's account).

24. *See generally* Redmond v. Tuttle, 698 F.2d 414, 418 (10th Cir. 1983) ("Debtors were under no legal compulsion to transfer the funds; they had complete control over the decision to deposit the

held a deposit did not constitute a transfer within the context of a Ponzi scheme.[25] Notably, the circuit that declined to deem a deposit as a transfer did so on the trustee's attempt to hold a bank liable for funds deposited and withdrawn using a checking account.[26] By the time of the filing for bankruptcy, the estate was depleted and the trustee's only avenue of recovery for the creditors and victims of the schemes was to recover the funds he alleged were fraudulently transferred to the bank.[27]

Consistency lacks within the United States bankruptcy and federal courts as to whether a debtor's deposit or withdrawal into or out of his bank account can constitute a transfer, rendering it subject to the avoidance powers of the trustee.[28] Specifically, there is a divide within the Fourth Circuit, Ninth Circuit, and Tenth Circuit on this precise issue.[29] What can be said conclusively is that the determination of whether a deposit rises to the level of a transfer is a highly fact-specific inquiry, which is evidenced by the inconsistent decisions among courts. This comment seeks to analyze that divide, determine how "transfer" should be interpreted, and provide guidance to courts and practitioners through factors they may consider when faced with a deposit a trustee seeks to avoid as a fraudulent transfer. This comment will also consider the effect on banks and financial

checks and what instructions to include and cannot now claim that the bank's handling of the deposits renders them something other than voluntary transfers." (citing Huebner v. Trapp (*In re* Huebner), 18 B.R. 193, 195 (Bankr. W.D. Wis. 1982))). *See* discussion *infra* Part IV.

25. *See* Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 210 (4th Cir.) (holding a debtor's deposits and withdrawals throughout the course of a Ponzi scheme did not rise to the level of transfers that could be avoided by the trustee), *cert. denied*, 138 S. Ct. 314 (2017).

26. *Id.* at 206–07.

27. *See* 11 U.S.C. § 542 (2012) (requiring a creditor or any individual or entity in possession, custody, or control of property of the debtor to turn over the property to the trustee, provided it has value to the estate); Jubber v. Bank of Utah (*In re* C.W. Mining Co.), 749 F.3d 895, 897 (10th Cir. 2014).

28. *Compare* Haag v. Nw. Bank (*In re* Haag) (*Haag I*), No. 10-07917-EWH, Adv. No. 10-01207-EWH, 2012 WL 4465353, at *6 (B.A.P. 9th Cir. Sept. 27, 2012) (holding a debtor's withdrawal of currency from his bank account, placement into a safety deposit box, and subsequent deposits into his wife's account were fraudulent transfers), *aff'd*, 584 F. App'x 620 (9th Cir. 2014), *with Furr*, 570 B.R. at 877 (precluding the trustee from avoiding, as allegedly fraudulent transfers, a debtor's deposits into his own bank account).

29. *See In re Whitley*, 848 F.3d at 210 (holding a debtor's deposits into an unrestricted checking account did not constitute transfers to the bank maintaining the account); Bernard v. Sheaffer (*In re* Bernard), 96 F.3d 1279, 1283 (9th Cir. 1996) (declaring both depositing and withdrawing money from bank accounts constitutes a transfer and emphasizing the breadth of the definition of transfer under the Bankruptcy Code); *Tuttle*, 698 F.2d at 418 (asserting depositing checks into a debtor's account constituted a voluntary, avoidable transfer).

intermediaries should courts impose liability on them as initial transferees of an account holder's deposits and withdrawals.

II. BACKGROUND

By way of background, bankruptcy law is exclusively an issue of federal law and largely governed by statute.[30] Title 11 of the United States Code, commonly referred to as the Bankruptcy Code, sets forth procedures that govern a bankruptcy case and related proceedings.[31] The Code serves as a mechanism for promoting uniformity in the application and administration of bankruptcy laws throughout the United States.[32]

A bankruptcy case is born from the filing of a petition.[33] Such a petition may be filed by the debtor himself, or in certain cases, by creditors of a debtor.[34] In other words, bankruptcy may be commenced voluntarily or involuntarily. The commencement of bankruptcy is accompanied by the immediate privilege of the automatic stay pursuant to § 362.[35] The stay essentially prevents actions against the debtor by way of collection efforts, foreclosures, garnishments, and the like, shielding the debtor and allowing for the bankruptcy process to begin without interruption.[36]

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30. U.S. CONST. art. I, § 8, cl. 4. The exclusive federal jurisdiction vested in bankruptcy courts derives from Article I, Section 8 of the United States Constitution. *Id.*; *see also* 28 U.S.C. § 1334 (2012) (declaring district courts have original and exclusive jurisdiction of all cases under Title 11, subject to specific exemptions); Stern v. Marshall, 564 U.S. 462, 474 (2011) (explaining bankruptcy judges hear and adjudicate "all core proceedings arising under [T]itle 11, or arising in a case under [T]itle 11" (quoting 11 U.S.C. § 157(a))). Bankruptcy judges have been appointed in each of the federal districts for fourteen-year terms. *Id.* at 473.

31. *See* 11 U.S.C. § 103 (describing the applicability of the different chapters within Title 11 to bankruptcy proceedings). "In 1978, Congress fundamentally restructured bankruptcy law by passing the new Bankruptcy Code." Begier v. I.R.S., 496 U.S. 53, 63 (1990). Within Title 11, there are individual subsections governing the various chapters of bankruptcy available. For example, Chapter 7 governs liquidation, while Chapter 11 governs reorganization. *Compare* 11 U.S.C. §§ 721–728 (providing guidelines on collection, liquidation, and distribution of the estate), *with id.* § 1121 (discussing filing of a reorganization plan).

32. *See* U.S. CONST. art. I, § 8, cl. 4 (highlighting the importance of uniformity in the context of bankruptcy law).

33. *See, e.g.*, 11 U.S.C. § 301(a) (stating a voluntary case is commenced by the filing of a petition pursuant to whichever chapter the debtor is seeking relief under).

34. *Compare id.* § 301 (governing the filing of voluntary bankruptcies), *with id.* § 303 (governing the filing of involuntary bankruptcies). Notably, only a Chapter 7 or Chapter 11 bankruptcy may be commenced involuntarily. *Id.* § 303(b). A petition may also be filed jointly pursuant to § 302 by a debtor and his or her spouse. *Id.* § 302.

35. *See id.* § 362 (outlining the function and procedure of the automatic stay).

36. *Id.* A primary goal of bankruptcy is to provide debtors with a "fresh start" to their financial affairs. Grogan v. Garner, 498 U.S. 279, 286 (1991). The automatic stay helps to effectuate the goal

Once a petition is filed, an "estate" is created.[37] An estate is comprised of all of the debtor's legal or equitable interests in property at the time of filing.[38] Additionally, a trustee is appointed and charged with a wide variety of duties within the case.[39] Generally, a trustee is charged with the duty to collect and liquidate the property of the estate, investigate the finances of the debtor, and be accountable for all property received.[40]

Along with the appointment of the trustee and automatic creation of the estate pursuant to § 541, a debtor completes a schedule detailing its liabilities and its creditors, who are subsequently sent notice of the filing.[41] Creditors are then able to file a proof of claim to be allowed or disallowed by the court.[42] Once creditors have filed their claims against the debtor, the logical next step is to evaluate the assets of the debtor within the estate. Section 541 details which interests in property a debtor possesses are property of the estate.[43]

The assembly and maintenance of the estate is a crucial aspect of the trustee's duties.[44] Consequently, the trustee seeks to preserve and maximize

of providing a fresh start by allowing "insolvent debtors [to] reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'" *Id.* (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)).

37. 11 U.S.C. § 541.

38. *Id.* § 541(a)(1); *see also* Ohio v. Kovacs, 469 U.S. 274, 284 n.12 (1985) ("The commencement of a case under the Bankruptcy Code creates an estate[,] which, with limited exceptions, consists of all the debtor's property wherever located." (citing 11 U.S.C. § 541)).

39. 11 U.S.C. § 704 (outlining the duties of the trustee). A trustee is charged with the authority to litigate any issue in a bankruptcy case. Thomas D. Buckley, *The Untapped Power of Bankruptcy's Wild Card: The United States Trustee*, 6 J. BANKR. L. & PRAC. 249, 250 (1997). Further, the trustee serves the system, rather than the debtor or a particular creditor, and acts in the "public interest to promote efficiency and to protect and preserve the integrity of the bankruptcy system." *Id.* at 268 n.22.

40. 11 U.S.C. § 704.

41. *Id.* § 521.

42. *Id.* § 501. Any creditor may file a proof claim, while an equity security holder may file a proof of interest. *Id.* § 501(a). A proof of claim is deemed allowed subject to the objection of a party in interest. *Id.* § 502.

43. *Id.* § 541. Property of the estate includes all "legal or equitable interests of the debtor in property as of the commencement of the case." *Id.* § 541(a)(1). Property of the estate will not include specific exemptions, such as any interest of the debtor as a lessee under a lease of nonresidential real property, any funds placed in an education individual retirement account, and any interest of the debtor in liquid or gaseous hydrocarbons. *Id.* § 541. A comprehensive list of the items that will not become property of the estate may be found at § 541(b)(1)–(10). Although some property may be exempt, it is still included as part of the compilation of the estate initially, despite its potential to be unreachable by creditors.

44. *Id.* § 704(a)(1).

the estate to satisfy as many creditors' claims as possible.[45] In furtherance of that goal, a trustee may avoid certain pre-petition transfers or attack post-petition transfers.[46] This is the trustee's power of avoidance.[47] An important goal of bankruptcy law is to promote equality of distribution of property to creditors, with a natural preference for secured creditors.[48] In furtherance of that goal, the Bankruptcy Code prevents: (1) creditors from dissecting the debtor's estate shortly before the filing of bankruptcy,[49] (2) debtors from preferring one creditor over another,[50] or (3) debtors from reducing the value of their estate shortly before or upon filing.[51]

These provisions ensure fairness in addressing each claim, and the trustee's avoidance powers equip the trustee with the tools to prevent this sort of harm to the estate.[52] A trustee may set aside conveyances, including payments, sales, exchanges, and liens, that are inconsistent with the Code.[53] The consequence of a conveyance being deemed avoidable is the property

45. *See id.* ("The trustee shall . . . collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest[.]").

46. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 68 (1986) ("Section 541 allows the trustee to step into the shoes of the debtor in gathering property of the estate, and the avoiding powers . . . augment that activity by giving the trustee certain other powers to bring assets into the estate.").

47. *See* 11 U.S.C. § 547(b) (providing the trustee's ability to avoid certain transfers); *see also* JACKSON, *supra* note 46 (describing the trustee's avoidance powers as "bring[ing] assets into the estate"). The various avoidance powers are set forth in Chapter 5 of the Bankruptcy Code. *See* 11 U.S.C. § 501 (outlining the contents of Chapter 5, entitled "Creditors, The Debtor, and The Estate").

48. *See* Stellwagen v. Clum, 245 U.S. 605, 617 (1918) (stating the system of bankruptcy is designed to fairly distribute property of the debtor).

49. *See* 11 U.S.C. § 362 (protecting the debtor by instituting an automatic stay; resulting in creditors being unable to pursue enforcement efforts against a debtor until bankruptcy proceedings allow for collection).

50. *See id.* § 547 (preserving the estate through prohibiting debtors from making payments to certain creditors, thus demonstrating preferential treatment).

51. *See id.* § 548 (prohibiting various transfers of assets out of the estate shortly after filing).

52. *See* JACKSON, *supra* note 46, at 70 ("As with all bankruptcy rules, the basis of avoiding powers should be to protect the advantages of bankruptcy's collectivization of the debt-collection process."). These provisions also implicate the trustee's avoidance powers. *See* Jubber v. Bank of Utah (*In re* C.W. Mining Co.), 749 F.3d 895, 898 (10th Cir. 2014) ("A trustee may avoid a post-petition transfer of estate property that was not authorized by the Bankruptcy Code or the court." (citing 11 U.S.C. § 549)). "Any transfer made in violation of the automatic stay is void and the parties are returned to the status quo as it existed before the violation occurred." *Id.* at 899 (citing Franklin Savs. Ass'n v. Office of Thrift Supervision, 31 F.3d 1020, 1022 (10th Cir. 1994)).

53. *See* JACKSON, *supra* note 46, at 70 (illustrating avoidance powers in the context of the trustee's power to assert the rights of a hypothetical lien creditor).

or property interest being conveyed will be recovered by the trustee and become property of the estate.[54] In some instances, for example when real property is conveyed, a court may order the recovery of the value of the property at the time of the conveyance.[55] Further, in some instances, recovery may be sought not just from the initial transferee, but from later transferees or a party who benefited from the conveyance.[56]

Evaluating whether a conveyance may be avoided often requires inquiry into whether a transfer of property in fact occurred.[57] *New York County National Bank v. Massey*[58] provided early guidance from the United States Supreme Court as to the issue of whether a deposit may constitute a transfer. The Court advised, "[A] deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor . . . . It is not a transfer of property as a payment, pledge, mortgage, gift, or security."[59] *Massey* was issued in 1904, more than seventy years prior to the enactment of the Code, and should therefore be considered in light of its historic posture.[60]

The modern Code defines "transfer" as "the creation of a lien; the retention of title as a security interest; the foreclosure of a debtor's equity of redemption; or each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing or parting with—property; or an interest in property."[61] The Bankruptcy Code does not define what

54. 11 U.S.C. § 541(a)(3). The remedies for avoidable transfers are set forth in § 550. *Id.* § 550.

55. *See id.* § 549 (allowing for recovery of the value of the property fraudulently transferred).

56. *Id.* § 550(a)(2).

57. *See, e.g.*, *id.* § 547 (providing for avoidance of certain preferential transfers, requiring the trustee to first establish a transfer occurred).

58. N.Y. Cty. Nat'l Bank v. Massey, 192 U.S. 138 (1904).

59. *Id.* at 147.

60. *See id.* (setting forth the Court's interpretation of "transfer" in 1904).

61. 11 U.S.C. § 101(54). "The Bankruptcy Act of 1898 defined 'transfer' to 'include the sale and every other and different mode of disposing of or parting with property, or the possession of property, absolutely or conditionally, as a payment, pledge, mortgage, gift or security.'" Petition for a Writ of Certiorari at 5, Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 138 S. Ct. 314 (2017) (No. 16-1330), 2017 WL 1756947, at *5 (quoting The Bankruptcy Act of 1898, ch. 541, § 1, Pub. L. No. 55-541, 30 Stat. 544, 545 (repealed 1978)). When the Bankruptcy Act is contrasted with the current Bankruptcy Code, the initial definition is far narrower and more restrictive. In fact, "Congress fundamentally restructured bankruptcy law . . . ." *Id.* (quoting Begier v. I.R.S., 496 U.S. 53, 63 (1990)). This was accomplished by "delet[ing] 'potentially limiting words' in the former definition, to make it 'as broad as possible.'" *Id.* (quoting S. REP. NO. 95-989, at 27 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5813).

constitutes an "initial transferee."[62]

III. RELEVANT BANKRUPTCY CODE PROVISIONS IN WHICH THE DEFINITION OF "TRANSFER" IS OUTCOME DETERMINATIVE

There are several provisions within the Bankruptcy Code in which the definition of transfer is a threshold question.[63] Notably, these provisions interact and overlap with the trustee's avoidance powers.[64]

> It is thus essential to determine what property belongs to the estate and how to treat transactions involving the debtor's property. These issues are bound up with the [Bankruptcy] Code's definition of "transfer," which is often critical to the proper administration of a bankruptcy case. Whether a particular act qualifies as a "transfer" can affect the estate's holdings and the assets available to satisfy creditors' claims.[65]

The pre- and post-petition actions that may be set aside by a trustee often turn on the issue of whether a certain conveyance made by a debtor constitutes a transfer.[66] Therefore, the interpretation of the definition is crucial to these determinations. The following examples illustrate the importance of how transfer is defined and interpreted.

A. *Pre-Petition Avoidance Actions*

As to pre-petition avoidance actions, §§ 547 and 548 are common instances of avoidable conveyances.[67]

62. *See* Christy v. Alexander & Alexander of N.Y. Inc. (*In re* Finley), 130 F.3d 52, 56 (2d Cir. 1997) (asserting "initial transferee" is not defined in the Bankruptcy Code and discussing how it should be interpreted).

63. *See* 11 U.S.C. § 547 (governing preferential transfers); *id.* § 548 (governing fraudulent transfers); *id.* § 549 (governing post-petition transfers). Various other Bankruptcy Code provisions that "turn directly on whether a particular transaction constitutes a 'transfer'" include §§ 522(g), 541, 550, and 727, among others. Petition for a Writ of Certiorari, *supra* note 61, at 4. The "definition is central to multiple [Bankruptcy] Code provisions that circumscribe transactions involving a debtor's property. And those provisions matter critically to bankruptcy's core functions . . . ." *Id.* at I.

64. *Compare* 11 U.S.C. § 548 (allowing the trustee to avoid fraudulent transfers and recover the funds or property from the transferee), *with id.* § 547 (permitting the trustee to recover transfers made by a debtor that prefer certain creditors over others).

65. Petition for a Writ of Certiorari, *supra* note 61, at 3–4.

66. *See, e.g.*, 11 U.S.C. § 547 (authorizing a trustee to avoid preferential transfers, requiring first a finding that a transfer occurred).

67. *See id.* (authorizing a trustee to avoid any transfer that prefers one creditor at the expense of others); *see also id.* § 548 (outlining when a trustee may avoid a transfer based on a finding that it was fraudulently made).

1. Section 547

Section 547 governs conveyances that prefer one creditor over another.[68] "Much of the bankruptcy process and most provisions of the Bankruptcy Code sort out rights among creditors . . . [who] generally share in assets of the estate ratably in accordance with the value of their nonbankruptcy entitlements."[69] It is important, therefore, for the trustee to satisfy creditors' claims in such a way that is equitable and compliant with the Code.[70] It is rare that an estate has sufficient assets to satisfy all claims, which appears obvious when considering the insolvency of the debtor and the necessity of filing bankruptcy in the first place. Consistent with the goal of promoting "equality of distribution[,]" a debtor's ability to repay creditors is subject to the requirements set out in § 547.[71]

Thus, a conveyance made by the debtor, if it satisfies § 547,[72] may be reached by the trustee and avoided, rendering the interests transferred part of the estate.[73] In the context of a debtor's bank as the alleged transferee, the right to setoff often becomes entangled.[74] This added layer of complexity is derived from the bank often being a creditor of the debtor—for example, where a debtor has an outstanding balance on a loan in which the bank is the lender and the bank captures funds in the debtor's account to offset the amount due.[75] The interaction between banks as transferees

68. *Id.* § 547.

69. Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 727–28 (1984).

70. *See* Stellwagen v. Clum, 245 U.S. 605, 617 (1918) (discussing the manner of distribution of a debtor's assets to creditors "fairly and equally").

71. Emil A. Kleinhaus & Alexander B. Lees, *Debt Repayments as Fraudulent Transfers*, 88 AM. BANKR. L.J. 307, 308 (2014) (quoting Lawson v. Ford Motor Co. (*In re* Roblin Indus., Inc.), 78 F.3d 30, 40 (2d Cir. 1996)).

72. To satisfy § 547 and establish a preferential transfer, a trustee has the burden of proving six elements by a preponderance of the evidence: "(1) a transfer of the debtor's property, (2) on account of an antecedent debt, (3) to or for a creditor's benefit, (4) while the debtor was insolvent, (5) within [ninety] days prior to bankruptcy[,]" and (6) that provided the creditor with more than it would have had the transfer not occurred and the creditor instead pursued its claim in liquidation. Redmond v. Rainstorm, Inc. (*In re* Lone Star Pub Operations, LLC), 465 B.R. 212, 215 (Bankr. D. Kan. 2012).

73. 11 U.S.C. § 547.

74. *See id.* § 553 (governing a creditor's right to offset a debt that arose before the commencement of a bankruptcy case).

75. *See* Lawrence Kalevitch, *Setoff and Bankruptcy*, 41 CLEV. ST. L. REV. 599, 600 (1993) (discussing the right to setoff in the bankruptcy process and procedure and the controversy that surrounds it). When a bank as a creditor employs the right to setoff, the debtor may apparently be preferring the bank's right to repayment at the expense of his other creditors, however the details of this issue are out of the scope of this comment. *See id.* ("Traditional bankruptcy has honored setoff even though this has the effect of conferring a priority on holders of setoff rights.").

and setoff will be discussed, *infra*, in the discussion of the benefit gained by the financial institution from the deposit.

2. Section 548

Section 548 governs fraudulent transfers by a debtor.[76] The Code's provisions relating to fraudulent transfers protect creditors from the debtor engaging in transactions that hinder their rights of having their claims satisfied.[77] There are four types of fraudulent transactions that are subject to avoidance: (1) transfers made with actual intent to hinder, delay, or defraud creditors;[78] (2) transfers made for less than reasonably equivalent value;[79] (3) transfers by a general partner to a partner while the general partner was insolvent or "became insolvent as a result of the transfer;"[80] and (4) "transfers by debtors to self-settled trusts in which the debtor is a beneficiary."[81] This provision is crucial to the prevention of debtors diminishing their estate through actual or constructive fraud.[82] Despite bankruptcy's exclusively federal jurisdiction, several states have provisions that mirror § 548 to reinforce its goals and principles.[83]

Before the trustee can seek to avoid a fraudulent transfer pursuant to § 548, a prerequisite is that the court determine a transfer in fact occurred.[84] Therefore, § 548 is a leading example of a Bankruptcy Code provision in

76. 11 U.S.C. § 548.

77. *See* Kleinhaus & Lees, *supra* note 71 ("[T]he basic object of fraudulent conveyance law is to see that the debtor uses his limited assets to satisfy *some* of his creditors; it normally does not try to choose among them." (quoting Boston Trading Grp., Inc. v. Burnazos, 835 F.2d 1504, 1509 (1st Cir. 1987))).

78. *See* John Ames et al., *Preferences and Fraudulent Transfers Under the Bankruptcy Code: A Primer in Pain*, THE AMERICAS RESTRUCTURING AND INSOLVENCY GUIDE, 2008/2009 107, 113 http://www.americasrestructuring.com/08_SF/p107-115%20Preferences%20and%20fraudulent%20transfers.pdf [https://perma.cc/JJK3-4X2B] (instructing transfers with the intent to impair the rights of a creditor are commonly referred to as "actually fraudulent").

79. *See id.* (explaining transfers made for less than equivalent value are often referred to as "constructively fraudulent").

80. *Id.*

81. *Id.*

82. *See id.* at 114 (resolving the differences between actual and constructive fraud).

83. *Accord* TEX. BUS. & COM. CODE ANN. § 24.005 (mirroring 11 U.S.C. § 548 in determining what circumstances warrant avoidance of a fraudulent transfer).

84. *See* 11 U.S.C. § 547 (2012) (detailing how a transfer may be avoided, implying that a transfer must first be performed); *see also* Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 210 (4th Cir.) ("[W]e find that the deposits and wire transfers at issue here are not § 101(54) 'transfers' . . . [and] therefore cannot be avoidable transfers under § 548(a)."), *cert. denied*, 138 S. Ct. 314 (2017).

which the interpretation of transfer is a dispositive question. Recall the hypothetical raised in the introductory portion of this comment.[85] Had the debtor conveyed currency accumulated in his Ponzi scheme and intentionally concealed it from creditors or the trustee to evade attachment or collection into the estate, a classic fraudulent transfer would have occurred.[86] In the alternative, had the debtor conveyed his property to another for far below market value only to appear insolvent and without assets to creditors, another traditional fraudulent transfer would have occurred.[87]

Instead, the debtor repeatedly deposited and withdrew funds from a checking account at his bank, resulting in the funds of unknowing investors being expended on matters other than the purported investment opportunity.[88] Despite the apparent intent to defraud his investors, the debtor did not fraudulently transfer any funds in the conventional sense.[89] Thus, as the trustee assembled the estate, he perceived the bank maintaining the checking account as a transferee of funds being fraudulently transferred in and out of the debtor's account and sought relief accordingly.[90]

B. *Post-Petition Avoidance Actions*

1. Section 549

Section 549 governs post-petition transfers of property belonging to the estate.[91] This provision provides a trustee with the authority to avoid an unauthorized transfer of property of the estate made after the commencement of the bankruptcy case.[92] As with §§ 547 and 548, this provision turns on whether a particular conveyance constitutes a transfer to

85. *See supra* text accompanying note 3.

86. *See* 11 U.S.C. § 548(a)(1)(A) (prohibiting transfers with the intent to delay or hinder collection or defraud creditors).

87. *See id.* § 548(a)(1)(B) (precluding conveyance of a debtor's property for less than market value).

88. *In re Whitley*, 848 F.3d at 206.

89. *See id.* at 210 (holding no transfer occurred when the debtor deposited and withdrew funds from an ordinary, unrestricted checking account).

90. *Id.* at 206–07.

91. 11 U.S.C. § 549.

92. *Id.*; *see also* Vázquez Laboy v. Doral Mortg. Corp. (*In re* Vázquez Laboy), 647 F.3d 367, 375 (1st Cir. 2011) ("[A]n avoidance action allows a bankruptcy trustee to cancel an improper conveyance or recover for the estate the value of the improperly conveyed property [pursuant to § 549]." (citing 11 U.S.C. §§ 544, 545, 547(b), 548(a), 549(a))).

invoke the trustee's powers. Section 549 was designed to protect "the bankruptcy estate following its inception" and is "equitable in nature."[93] If such a transfer is deemed to have occurred, the applicable remedy is that the trustee may recover the property transferred either from the initial transferee, or an immediate or mediate transferee of the initial transferee, for the benefit of the estate.[94]

Between each of the examples briefly discussed, the trustee has the authority to avoid certain conveyances in his power and duty to maximize a debtor's estate once a petition has been filed.[95] Within each of these provisions, many cases have grappled with the issue of what activity constitutes a transfer under the Code.[96] Specifically, and relevant to this comment, cases have addressed the question of whether a deposit or withdrawal made by a debtor constituted a transfer.[97] It can be observed from a survey of the relevant cases that two conflicting schools of thought have emerged: a broad interpretation of what constitutes a transfer, and a narrow one.[98] This difference of opinion by courts has materialized into a circuit split between the Fourth Circuit, Ninth Circuit, and Tenth Circuit.[99]

93. Jobin v. Youth Benefits Unlimited, Inc. (*In re* M&L Bus. Mach. Co.), 59 F.3d 1078, 1082 (10th Cir. 1995).

94. *See In re* Bankvest Capital Corp., 375 F.3d 51, 62 (1st. Cir. 2004) (discussing a complaint filed pursuant to § 549 of the Bankruptcy Code to avoid payments made by a debtor) (citing 11 U.S.C. § 550(a)).

95. *See* 11 U.S.C. § 704 (describing a trustee's duty to collect all assets of the debtor to maximize the property interests available to satisfy the claims against the debtor); *see also* Batlan v. Bledsoe (*In re* Bledsoe), 569 F.3d 1106, 1109 (9th Cir. 2009) ("Under 11 U.S.C. § 544(b)(1), a trustee 'may avoid any transfer of an interest of the debtor in property . . . that is voidable under applicable law.'").

96. *See, e.g.*, Zubrod v. Kelsey (*In re* Kelsey), 270 B.R. 776, 780 (B.A.P. 10th Cir. 2001) (detailing the argument of the debtor's wife—the recipient of the funds in question—that the debtor did not transfer his sole property and therefore the conveyance was not an avoidable transfer).

97. *See, e.g.*, Locke v. Schafer (*In re* Schafer), 294 B.R. 126, 131 (N.D. Cal. 2003) (confronting the issue of whether a debtor's deposit into a checking account is a transfer and holding a deposit unambiguously falls within the broad definition of transfer for purposes of the Bankruptcy Code).

98. *Compare In re Bledsoe*, 569 F.3d at 1113 (invoking *In re Bernard's* extremely broad definition and interpretation of transfer within the Bankruptcy Code and stating that deposits may constitute transfers), *with* Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 208–09 (4th Cir.) (explaining the long-standing precedent in the Fourth Circuit is that bank deposits are not transfers), *cert. denied*, 138 S. Ct. 314 (2017). *But see* Redmond v. Tuttle, 698 F.2d 414, 418 (10th Cir. 1983) (finding a debtor's deposit of checks into a bank account was a voluntary transfer). The broad interpretation has materialized in the Ninth Circuit and Tenth Circuit, and the narrow interpretation has arisen out of the Fourth Circuit.

99. *In re Whitley*, 848 F.3d at 210; Bernard v. Sheaffer (*In re* Bernard), 96 F.3d 1279, 1282 (9th Cir. 1996); *Tuttle*, 698 F.2d at 417 n.8.

As will be discussed, *infra*, this split is not reserved to the circuits and is similarly entrenched in bankruptcy court and district court decisions.

Despite the Supreme Court's declination to grant certiorari as to this issue, an analysis of the merits of each side of the split's construction is warranted to aid the remaining circuits and lower courts as well as practitioners in their analysis should they face this issue. Further, this comment seeks to highlight factors that a court faced with this issue may consider in determining whether, under the individual facts of its case, a debtor's deposit should constitute a transfer.

IV. CIRCUITS THAT HAVE DECIDED THE ISSUE ARE SPLIT AS TO WHETHER A DEPOSIT CONSTITUTES A TRANSFER

As discussed, *supra*, the plain language of the Bankruptcy Code's definition of "transfer" includes "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing or parting with—(i) property; or (ii) an interest in property."[100] Thus, the question at issue in this comment is squarely an issue of statutory interpretation.[101] The Fourth Circuit, Ninth Circuit, and Tenth Circuit have varying interpretations of this provision.

A. *Tenth Circuit*

In 1983, just five years after Title 11 was codified, the Tenth Circuit decided *Redmond v. Tuttle*.[102] In *Tuttle*, a voluntary joint bankruptcy petition was filed alongside a schedule of assets reflecting no cash in the debtors' bank accounts.[103] A few months later, the trustee received a letter from First National Bank informing him that the debtors held approximately $4,500 in a checking account with them.[104] The trustee recovered the funds for the estate and the debtors responded by claiming they were unaware of the existence of the funds in the account and subsequently sought an exemption of those funds.[105] The bankruptcy and district courts denied

100. 11 U.S.C. § 101(54)(D); *see supra* text accompanying note 61.

101. *See* Barnhill v. Johnson, 503 U.S. 393, 397–98 (1992) ("'What constitutes a transfer and when it is complete' is a matter of federal law." (quoting McKenzie v. Irving Tr. Co., 323 U.S. 365, 369–70 (1945))).

102. Redmond v. Tuttle, 698 F.2d 414 (10th Cir. 1983).

103. *Id.* at 415.

104. *Id.*

105. *Id.*

the debtors' amendment to exempt the property.[106] Before the Tenth Circuit, the debtors argued that they should be granted leave to freely amend,[107] but the Tenth Circuit rejected that argument, reasoning that assets that are fraudulently transferred only to be later recovered by the trustee lose their eligibility for exemption.[108] The Tenth Circuit ultimately determined that the deposits—specifically, twenty-seven checks—were voluntary transfers of funds out of the estate, rendering them property of the estate ineligible for exemption.[109]

B. *Ninth Circuit*

The first landmark decision to address this issue within the Ninth Circuit was *Bernard v. Sheaffer* (*In re Bernard*).[110] *In re Bernard* arose from a Chapter 7 debtor, Alan Bernard, who had withdrawn $44,010 from his account in February prior to October of the same year that he and his wife filed bankruptcy in.[111] A creditor filed an adversary suit opposing the Bernards being entitled to discharge, and Alan Bernard later testified that he depleted his account on the advice of counsel to evade attachment and spent the funds on vacations during which he lost a large amount of the money to gambling.[112] Consequently, the estate became "virtually worthless" and the Bernards were denied discharge.[113] The bankruptcy court found the Bernards' withdrawals to be fraudulent transfers warranting denial and revocation of discharge, and the Ninth Circuit affirmed in 1996.[114] The

106. *Id.* at 415–16.

107. *Id.* at 416. The debtors relied on Federal Rule of Bankruptcy 110, which has since been superseded by the Bankruptcy Code of 1978. However, to the extent they are consistent with the Bankruptcy Code, the rules have "continued validity." *Id.* As to the request to exempt the property, the debtors relied on § 522. 11 U.S.C. § 522(g) (2012); *Tuttle*, 698 F.2d at 416.

108. *Tuttle*, 698 F.2d at 417–18. The Tenth Circuit's reasoning behind this decision required application of the statutory definition of transfer, and an interpretation thereof. *Id.* The court noted that the transfer is broadly defined to encompass deposits in a bank account. *Id.* at 417 n.8.

109. *Id.* at 418.

110. Bernard v. Sheaffer (*In re* Bernard), 96 F.3d 1279 (9th Cir. 1996).

111. *See id.* at 1281, 1283 (determining a deposit could constitute a transfer, thereby setting the precedent for several Ninth Circuit cases to follow).

112. *Id.* at 1281. In fact, Alan Bernard first testified that he made the withdrawal to finance a vacation, and later changed his testimony and admitted that "an attorney had advised him to [cash out] to evade attachment." *Id.* Bernard further admitted that upon withdrawal, before spending the funds on a vacation and gambling, he "stashed the cash in a safe at his home." *Id.* The advice Bernard claims he took to evade attachment demonstrates the type of culpability typically accompanying a debtor's deposits or withdrawals that are deemed transfers by the courts.

113. *Id.* at 1283.

114. *Id.*

Ninth Circuit determined that the Bernards possessed the intent to hinder or delay, and the withdrawals were made within one year prior to the Bernards' October 7, 1991 filing.[115]

In reaching its decision, the Ninth Circuit emphasized how "*extremely* broad" the definition of transfer is within the Bankruptcy Code.[116] The court also found persuasive the legislative intent behind the definition of transfer, specifically that the legislature expressly stated that "[a] *deposit in a bank account or similar account is a transfer*."[117] The Ninth Circuit extended that logic to reason that if a deposit of funds into an account constitutes a transfer, so too should the withdrawal of funds from the same account.[118] Putting it simply, the court explained "it ought to be a two-way street."[119]

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115. *Id.* at 1282–83. Section 727(a)(2)(A) provides that a debtor's right to Chapter 7 discharge may be revoked if "the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . property of the debtor, within one year before the date of the filing of the petition[.]" 11 U.S.C. § 727(a)(2)(A) (2012). The Ninth Circuit has since decided other cases similarly. For example, in *Haag I* and *Haag II*, a debtor's discharge was revoked on *In re Bernard*'s precedent. Haag v. Nw. Bank (*In re* Haag) (*Haag I*), No. 10-07917-EWH, Adv. No. 10-01207-EWH, 2012 WL 4465353, at *5–*6 (B.A.P. 9th Cir. Sept. 27, 2012), *aff'd*, 584 F. App'x 620 (9th Cir. 2014). In *Haag I*, Northwest Bank obtained a judgment against Roger Thomas Haag for $1.7 million. *Id.* at *1. Consequently, Haag filed a voluntary Chapter 7 bankruptcy petition in March 2010. *Id.* Haag later received approximately $230,000 in tax refunds, which he deposited into his personal checking account at the Bank of Tucson. *Id.* at *2. Haag later withdrew $120,000 out of the account and placed it in a safety deposit box, only to later remove and spend it. *Id.* The bankruptcy court ultimately decided that funds withdrawn in cash and placed in a safety deposit box, or in Haag's wife's personal account, constituted a fraudulent transfer and determined that Haag was not entitled to discharge. *Id.* at *3. The Bankruptcy Appellate Panel for the Ninth Circuit, and then the Ninth Circuit in 2014, both citing *Bernard*, affirmed the bankruptcy court's decision. *Id.* at *6; Haag v. Nw. Bank (*In re* Haag) (*Haag II*), 584 F. App'x 620, 622 (9th Cir. 2014).

116. *In re Bernard*, 96 F.3d at 1282.

117. *Id.* (citing S. REP. NO. 95-989, at 27 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5813).

118. *Id.* at 1282–83.

119. *Id.* at 1282. It is also worth noting that the court determined that the Bernards did not own the money "gathering dust" in their accounts. *Id.* Rather, the court adopted the position that when funds are held by a bank in an account, the "'money becomes the property of the bank and the bank becomes the debtor of the depositor for the amount deposited.'" *Id.* (quoting Chang v. Redding Bank of Commerce, 29 Cal. App. 4th 673, 681 (1994)); *see also* Crocker-Citizens Nat'l Bank v. Control Metals Corp., 566 F.2d 631, 637 (9th Cir. 1997) ("[W]hen funds are deposited, title to those funds passes immediately to the bank . . . [and] becomes the literal property of the bank . . . ." (first citing Metro. Life Ins. Co. v. S.F. Bank, 136 P.2d 853, 856 (Cal. Ct. App. 1943); Allen v. Rainey, 41 P.2d 374, 376 (Cal. Ct. App. 1935); then citing Smith's Cash Store v. First Nat'l Bank, 84 P. 663, 664–65 (Cal. 1906); *Metro. Life Ins. Co.*, 136 P.2d at 856)). This proposition that the relationship between an account holder and the corresponding bank is one of creditor and debtor is well-settled in the law, a precedent set by the Supreme Court in 1904. *See* N.Y. Cty. Nat'l Bank v. Massey, 192 U.S. 138, 145 (1904) ("[A] deposit of money upon general account with a bank creates the relation of debtor and creditor. The money deposited becomes a part of the general fund of the bank . . . and the right of the depositor is

Ancillary to its holding, the Ninth Circuit definitively stated that account holders do not own the money in their accounts, rather they own claims against their banks.[120] In determining that a debtor withdrawing funds from his own account parted with the interest it had against the bank, the Ninth Circuit deemed a deposit a transfer and laid the foundation for the split currently within the circuits. This determination becomes crucial when contrasted against other courts who have reached divergent outcomes, as the issue of whether the account holder or the bank possesses not only title, but dominion and control over the funds kept in an account turns out to be a dispositive factor in this analysis.[121]

In 2017, in *Schoenmann v. Bank of the West* (*In re Tenderloin Health*),[122] the Ninth Circuit addressed a similar issue in the context of a pre-petition payment on a loan to the lending bank.[123] A brief recitation of the facts provides that the debtor made a $190,595.50 loan payment to its bank within ninety days of filing Chapter 7 bankruptcy.[124] The trustee sought to avoid the transfer and recover the funds for the estate on the theory that the payment on the loan was a preferential pre-petition transfer.[125] The bankruptcy court found that the debtor's pre-petition payment to its bank, a secured creditor, did not enable the bank to receive more than it would otherwise have, and the district court affirmed.[126] The Ninth Circuit found that the debtor's substantial payment to its bank would have diminished the funds available for the remaining creditors.[127] Further, the court noted that the deposit would "subject the funds to [the bank's] security interest [and]

to have this debt repaid in whole or in part by honoring checks drawn against the deposits . . . ."); *see also* Bank of Commerce & Trs. v. Hatcher, 50 F.2d 719, 720 (4th Cir. 1931) (explaining a deposit results in substituting for currency a corresponding credit with the bank holding the funds).

120. *In re Bernard*, 96 F.3d at 1283.

121. *See, e.g.*, Meoli v. Huntington Nat'l Bank, 848 F.3d 716, 725 (6th Cir. 2017) (employing the "dominion and control test" to determine whether a bank is an initial transferee).

122. Schoenmann v. Bank of the W. (*In re* Tenderloin Health), 849 F.3d 1231 (9th Cir. 2017).

123. *Id.* at 1240.

124. *Id.* at 1233.

125. *See id.* at 1234 (providing an overview of the factual and procedural background); *see also* 11 U.S.C. § 547(b) (2012) (permitting a trustee to recover preferential payments made by a debtor to a creditor within ninety days of the filing of bankruptcy for the benefit of the estate). In order for a trustee to avoid such a payment by a debtor, the trustee must satisfy the "greater amount test," which requires a showing that the creditor received more than they would have in the ordinary course of distribution from the estate to all creditors. *See id.* § 547(b)(5) (outlining what is referred to as the "greater amount test").

126. *In re Tenderloin Health*, 849 F.3d at 1234.

127. *Id.* at 1245.

give [the bank] title to the funds," rendering it a transfer under the Bankruptcy Code.[128] The nature of the deposit therefore, in the eyes of the court, rose to the level of disposing of or parting with an interest in property, thus satisfying the Code's definition of transfer.[129]

The court in *In re Tenderloin Health* gave deference to the holding of *In re Bernard*, claiming the definition of transfer unambiguously encompasses a debtor's deposit or withdrawal into his bank account.[130] The key takeaway of *In re Tenderloin Health* is the importance of an inquiry into whether the deposit results in a diminishment of the estate.[131] Within the Ninth Circuit, the proposition that a debtor's deposit into his own bank account can constitute a transfer is firmly planted.[132] The reasoning first employed in *In re Bernard* has largely been controlling since. However, it should be noted that the Ninth Circuit has yet to decide this issue in the context of the Ponzi scheme fact set, much like the Fourth Circuit did in *Ivey v. First Citizens Bank & Trust Co.* (*In re Whitley*).[133] In other words, despite adopting the broad interpretation of the statutory definition of transfer, neither the Ninth Circuit nor the Tenth Circuit has yet held a bank or financial institution liable as an initial transferee for the value of deposits made by a debtor.

C. *Fourth Circuit*

As discussed at the outset of this comment, an individual who was convicted for operation of a Ponzi scheme faced his creditors filing a petition for involuntary bankruptcy against him in *In re Whitley*.[134] The trustee—in an effort to maximize the estate for the debtor's creditors and victims—attempted to recover from the bank wherein the debtor

128. *Id.* at 1243.

129. *Id.* at 1245.

130. *Id.* at 1243–44 (quoting *In re* Huff, No. 12-05001-BTB, 2014 WL 904537, at *6 (9th Cir. B.A.P. Mar. 10, 2014)).

131. *See id.* at 1244 ("The pertinent question is whether the deposit depletes the assets of the estate available for distribution to creditors."); Begier v. I.R.S., 496 U.S. 53, 58 (1990) (highlighting the goal of equal distribution among all creditors that underlies the avoidance powers of preferential pre-petition transfers by a debtor).

132. *In re Tenderloin Health*, 849 F.3d at 1244; Bernard v. Sheaffer (*In re* Bernard), 96 F.3d 1279, 1282 (9th Cir. 1996).

133. Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 210 (4th Cir.) (holding a deposit is not a transfer and declining to hold a bank liable for a debtor's use of a checking account in his Ponzi scheme), *cert. denied*, 138 S. Ct. 314 (2017).

134. *Id.* at 206.

maintained a checking account throughout the operation of his scheme as a transferee of fraudulent transfers.[135]

The bankruptcy court and district court ultimately found that although the debtor had the actual intent to defraud creditors, the transactions did not diminish the bankruptcy estate or place the funds beyond the creditor's reach and therefore were not avoidable.[136] The Fourth Circuit affirmed the lower courts but was clear in its assertion that a debtor's ordinary deposit into his own unrestricted checking account could not constitute a transfer.[137]

A frequently employed argument in opposition of a deposit constituting a transfer enlists the Supreme Court's *Massey* holding.[138] In effect, this argument highlights the Court's declaration that "a deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor . . . . It is not a transfer of property as a payment, pledge, mortgage, gift, or security."[139] An initial evaluation of this argument requires consideration that the authority relied upon is pre-Bankruptcy Code.[140] Without a doubt, prior to the enactment of the Bankruptcy Code in 1978, *Massey*'s definition of "transfer" was controlling.[141] However, the

135. *Id.* at 206–07.

136. *Id.* at 207.

137. *Id.* at 210. The Fourth Circuit's decision in *In re Whitley* consummated a circuit split among the courts as to whether a deposit can constitute a transfer. *Id.* Consequently, the trustee filed a petition for a writ of certiorari in May 2017, which the Supreme Court subsequently denied in September 2017. Rochelle, *supra* note 21.

138. *See, e.g.*, Schoenmann v. Bank of the W. (*In re* Tenderloin Health), 849 F.3d 1231, 1243 (9th Cir. 2017) (arguing for the recipient of the deposit, the bank, that depositing funds into one's credit in a bank does not reduce the value of the estate because there is no parting with title to the property.) This argument appears to be displaced because in *In re Tenderloin Health*, the debtor was not merely depositing funds into his own unrestricted account. Rather, he was making a payment to his bank, which was a secured creditor.

139. N.Y. Cty. Nat'l Bank v. Massey, 192 U.S. 138, 147 (1904).

140. *Id.* at 149 (holding a deposit is not a transfer in 1904, some seventy years prior to the enactment of Title 11 of the United States Code.). *But see* Smiley v. First Nat'l Bank of Belleville (*In re* Smiley), 864 F.2d 562, 565 (7th Cir. 1989) ("[T]he narrow definition for 'transfer' relied upon . . . can no longer be law since the Bankruptcy Reform Act took effect.").

141. *Massey*, 192 U.S. at 140. Even taking *Massey*'s ruling—that a deposit is not a transfer—as good law today, the Supreme Court's holding was interpreted as limited to deposits that are conducted in the ordinary course of maintenance of a checking account by the Fourth Circuit itself. *See* Citizens' Nat'l Bank of Gastonia v. Lineberger (*In re* Kirby-Warren Co.), 45 F.2d 522, 529 (4th Cir. 1930) (interpreting *Massey*). According to the Fourth Circuit, *Massey* unambiguously did not preclude all deposits made by a debtor from being transfers, particularly where they were "made fraudulently and collusively for the purpose of giving the bank a preference, or where they are not in reality deposits at

weight of the precedent should now be analyzed in light of Congress's intent in codifying Title 11.[142]

Despite the petitioner for certiorari in *In re Whitley* urging the Court to grant the petition by explaining, "Each side of the conflict acted against a well-developed body of law on this important issue. The existence of a clear and now-intractable split is undeniable. This Court's intervention is urgently needed[,]"[143] the Court denied the petition for certiorari.

V. FACTORS COURTS MAY CONSIDER IN ADDRESSING THIS ISSUE IN LIGHT OF THE SUPREME COURT'S DECLINATION TO CLARIFY THE LAW

Regardless of the facts, the issue of whether a deposit may constitute a transfer has proven to be outcome determinative in a number of cases.[144] It cannot be disputed that the legislative intent surrounding the Code's definition of transfer compels a broad interpretation.[145] Specifically, the Senate's report states:

> A transfer is a disposition of an interest in property. The definition of transfer is as broad as possible. Many of the potentially limiting words in current law are deleted, and the language is simplified. Under this definition, any transfer of an interest in property is a transfer, including a transfer of possession, custody, or control even if there is no transfer of title, because possession, custody, and control are interests in property. *A deposit in a bank account or similar account is a transfer.*[146]

Despite the legislative intent expressly stating that a deposit in a bank account may be a transfer, there is still ambiguity in the courts around the

all, but are payments," in which case the right to set-off does not exist, and they may be recovered as preferential." *Id.*

142. *See* S. REP. NO. 95-989, 15–18 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5801–04 (emphasizing the breadth of the definition and specifically eliminating any restrictive language surrounding transfer).

143. Petition for a Writ of Certiorari, *supra* note 61, at 13.

144. *See* Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 210 (4th Cir.) (illustrating how the refusal to recognize that a transfer occurred precluded the trustee from recovering a substantial amount of money for the estate), *cert. denied*, 138 S. Ct. 314 (2017).

145. *See In re Smiley*, 864 F.2d at 565 (comparing the pre-Bankruptcy Code definition of transfer to the legislative intent behind the modern definition of transfer).

146. S. REP. NO. 95-989, at 27 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5813 (emphasis added).

statutory definition.[147] This ambiguity derives from the fact-intensive analysis that accompanies this legal issue. In other words, under one set of facts, a deposit will constitute a transfer, while on another set of facts, it will not.[148] Given the Supreme Court's decision to not resolve the ambiguity, this comment seeks to set forth factors that may be considered when faced with a deposit that has the potential to be a fraudulent transfer. These factors are non-exhaustive and are compiled based on an exploration of the reasoning employed by the various bankruptcy, district, and circuit courts that have considered the issue.

A. *The Dominion and Control Test and Title to the Funds*

The first factor this comment proposes consideration of is who possesses title and/or dominion and control over the funds at issue.[149] The circuit courts, in applying the "dominion and control" test to transferee liability have reasoned that a transferee must gain dominion and control over the funds to be liable to a trustee.[150] Specifically, courts have instructed "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."[151] Despite the fact that banks may use the monies deposited by account

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147. *See In re* Prescott, 805 F.2d 719, 729 (7th Cir. 1986) (asserting deposits into bank accounts may clearly constitute a transfer under the Bankruptcy Code but that ordinary transfers into unrestricted accounts are not avoidable by the trustee).

148. *See* Bank of Commerce & Trs. v. Hatcher, 50 F.2d 719, 720 (4th Cir. 1931) (clarifying the distinction between deposits made in the ordinary course of business as opposed to deposits made for the purpose of giving the bank a preference).

149. *See* Schoenmann v. Bank of the West (*In re* Tenderloin Health), 849 F.3d 1231, 1234 (9th Cir. 2017) (discussing the relationship between a depositor and the bank maintaining the account). It is well-settled law that when an account holder deposits monies into a checking account, the account holder takes on the position of creditor, with the bank as its debtor. Thus, it may be inferred that the bank owns the funds within an individual's checking account. *But see In re Whitley*, 848 F.3d at 209 (asserting ordinary deposits do not change the debtor's possession, custody, or control and instead substitute the currency for a corresponding credit).

150. Meoli v. Huntington Nat'l Bank, 848 F.3d 716, 725 (6th Cir. 2017).

151. Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 893 (7th Cir. 1988). *Meoli* stated that the bank was not an initial transferee while acting as a depository bank within the ordinary course of receiving deposits or indirect loan repayments. Rather, the Sixth Circuit made the distinction that a bank becomes a transferee when the account holder instructs the bank itself to receive the funds. *Meoli*, 848 F.3d at 724–25. This is clarified through an example; when a bank receives a check from an account holder with instructions to deposit it into the individual's checking account, the bank does not assume dominion or control over the funds. *Id.* at 729. In contrast, if the account owner instructs the bank to apply the deposited check to a debt owed to the bank, the bank then gains dominion over the funds in exchange for a reduction in the individual's debt to the bank. *Id.*

holders to carry out their daily operations, the account holder does not surrender all rights to the funds simply by depositing them into her checking account.[152] Rather, the bank maintaining the checking account has the "legal rights to put deposited funds to use."[153]

Dominion has also been equated to legal control, or title to the interest.[154] In conducting this analysis, dominion and control—which equates to ownership—should be distinguished from mere possession.[155] Several circuits hold the ordinary relationship between an account holder and her bank wherein the account holder deposits funds does not result in the bank exercising dominion and control over the funds.[156] Rather, a bank's "mere maintenance of [the debtor's] checking account does not suffice to make deposits and wire transfers in that account 'transfers' from [the debtor] to the [b]ank[.]"[157] Despite several courts interpreting a transfer to require the transferee to exercise dominion or acquire title, it should be acknowledged that the legislative intent plainly disclaims that title

152. *See Meoli*, 848 F.3d at 726 (holding a depositor retains dominion and control over her deposits into a bank account). The Supreme Court's jurisprudence on this issue asserts that an account holder depositing funds into a bank does not change that account holder's interest in the funds. *See* N.Y. Cty. Nat'l Bank v. Massey, 192 U.S. 138, 145 (1904) (explaining an ordinary deposit into a checking account simply creates a relationship of debtor-creditor, not one of transferor-transferee).

153. Menotte v. United States (*In re* Custom Contractors, LLC), 745 F.3d 1342, 1350 (11th Cir. 2014). A bank's primary source of income is in fact the various funds that account holders deposit and retain in their accounts. *Id.*

154. *See* Abele v. Modern Fin. Plans Servs., Inc. (*In re* Cohen), 300 F.3d 1097, 1102 (9th Cir. 2002) ("Dominion is therefore akin to legal control (e.g., the right to invest the funds as one chooses), not mere possession." (citing Bowers v. Atlanta Motor Speedway, 99 F.3d 151, 156 (4th Cir. 1996))); *see also* Universal Serv. Admin. Co. v. Post-Confirmation Comm. of Unsecured Creditors of Incomnet Commc'ns Corp. (*In re* Incomnet, Inc.), 463 F.3d 1064, 1073 (9th Cir. 2006) ("The dominion test [the Ninth Circuit] crafted strongly correlates with legal title.").

155. *See Meoli*, 848 F.3d at 725 ("We have thus distinguished 'mere possession' from 'ownership,' so that 'a party is not to be considered an initial transferee if it is merely an agent who has no legal authority to stop the principal from doing what he or she likes with the funds at issue." (quoting Taunt v. Hurtado (*In re* Hurtado), 342 F.3d 528, 534 (6th Cir. 2003))). *In re Hurtado* characterizes the entity or individual that merely possesses or facilitates movement of the funds—but does not acquire title—as the agent of the ultimate recipient. *In re Hurtado*, 342 F.3d at 534.

156. *See Meoli*, 848 F.3d at 725 (determining the bank is not a transferee of excess deposits because the bank did not exercise dominion and control over the funds being deposited); *Bonded Fin. Servs., Inc.*, 838 F.2d at 893 (illustrating that a depository bank lacks dominion and control over customers' deposits); Nordberg v. Societe Generale (*In re* Chase & Sanborn Corp.), 848 F.2d 1196, 1200 (11th Cir. 1988) ("When banks receive money for the sole purpose of depositing it into a customer's account . . . the bank never has actual control of the funds and is not a [§] 550 initial transferee.").

157. Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 210 (4th Cir.), *cert. denied*, 138 S. Ct. 314 (2017).

need not pass to perform a transfer under the Bankruptcy Code.[158] Therefore, the application of this factor should be balanced against the Bankruptcy Code's generous and broad instructions for interpretation set forth in the Senate Report.[159]

B. *Accessibility of the Funds by the Depositor*

In conjunction with the first factor, a court should consider whether the funds allegedly transferred via deposit are freely withdrawable and accessible by the account holder. That is, a court should inquire into whether the account is unrestricted by the financial institution maintaining it.[160] When an account is unrestricted, the debtor is not disposing of the funds in any meaningful way and retains compete autonomy over them with the ability to retrieve them at any time.[161]

Meoli v. Huntington National Bank[162] explained the connection between the first two factors when asserting, "the [account holder's] right to withdraw the deposits keeps the bank from obtaining dominion and control."[163] Consequently, an unrestricted, freely withdrawable checking account is accompanied by the presumption that the account holder is not transferring her funds to the bank merely by holding them in her account. Rather, the act of depositing funds into an unrestricted checking account purely results in substituting credit for currency, which is accessible at the will of the depositor; it does not transfer title.[164] As the Second Circuit articulated:

> All of the courts that have relied on a debtor-creditor relationship between bank and depositor to preclude a finding of a transfer have emphasized not only the requirement that the funds be withdrawable at the will of the

158. *See* S. REP. NO. 95-989, at 27 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5813 ("Under this definition, any transfer of an interest in property is a transfer, including a transfer of possession, custody, or control even if there is no transfer of title, because possession, custody, and control are interests in property.").

159. *See id.* (providing guidance on the interpretation of transfer under the Bankruptcy Code).

160. *See Meoli*, 848 F.3d at 725 (discussing an account holder's ability to withdraw funds at any time from her account unless she instructs the bank otherwise).

161. Welch v. Regions Bank (*In re* Mongelluzzi), 591 B.R. 480, 493 (Bankr. M.D. Fla. 2018).

162. Meoli v. Huntington Nat'l Bank, 848 F.3d 716 (6th Cir. 2017).

163. *Id.* at 725.

164. *See* Joseph F. Hughes & Co. v. Machen, 164 F.2d 983, 987 (4th Cir. 1947) (explaining the key distinction between a deposit into an unrestricted checking account and a payment, which results in the funds no longer being freely accessible by the depositor).

depositor but also the requirement that the deposits be made in the regular course of business.[165]

This consideration of whether the account is unrestricted is so imperative that the Fourth Circuit expressly limited its holding in *In re Whitley* to the narrow circumstances presented in the facts of the case.[166] Specifically, a debtor depositing or receiving a wire transfer of funds into an *unrestricted* checking account will not convert the bank into a transferee.[167] This disclaimer affords the inference that if the account was in some way restricted or the funds were not readily accessible by the depositor, the court may have held the deposit constituted a transfer.

C. *The Effect of the Deposit on the Estate*

Next, a court should examine whether the deposit diminishes or depletes the assets of the estate available for distribution to creditors.[168] "Various irregularities might defeat the presumption that deposits ordinarily do not have the effect of diminishing the bankrupt's estate and therefore are not transfers."[169] Such an irregularity might occur when a deposit results in funds being concealed or relocated out of reach of the trustee. For instance, when a debtor withdrew all of the funds in his bank account on the eve of filing for bankruptcy and distributed them amongst his wife, his attorneys, and his mortgage, the Tenth Circuit Bankruptcy Appellate Panel held that a fraudulent transfer occurred.[170] This action resulted in a substantial reduction of funds remaining in the estate, and the Panel concluded that the

165. Katz v. First Nat'l Bank of Glen Head, 568 F.2d 964, 970 (2d Cir. 1977).

166. *See* Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 210 (4th Cir.) ("Our holding is limited to the narrow circumstances presented here."), *cert. denied*, 138 S. Ct. 314 (2017).

167. *Id.*

168. *See* Begier v. I.R.S., 496 U.S. 53, 67 (1990) (determining pre-petition payments to the Internal Revenue Service could not be avoided by the trustee because the funds were not property of the estate, and thus, the payments did not diminish the estate); *see also In re Whitley*, 848 F.3d at 210 ("[A]ny funds in the account were at all times part of the bankruptcy estate.").

169. *Katz*, 568 F.2d at 970.

170. Zubrod v. Kelsey (*In re* Kelsey), 270 B.R. 776, 782–83 (B.A.P. 10th Cir. 2001). The Tenth Circuit explained that while the funds were maintained in a checking account, the debtor had the right to withdraw the funds against the bank. *Id.* at 781. Once the debtor made such a withdrawal, he became the sole owner of the currency and it became his property. *Id.* Thus, when he conveyed portions of that currency to his wife, his attorneys, and his mortgage, he transferred his property shortly before filing for bankruptcy in violation of § 548.

debtor's conduct reflected actual intent to hinder, delay, or defraud creditors.[171]

Another irregularity might occur where the bank exercises its right of setoff. In other words, "there was an attempt at deposit[,] which the bank by its action converted into a payment on pre-existing indebtedness."[172] For example, in *In re Tenderloin Health*, the debtor deposited proceeds from a sale of property into his bank account shortly before filing for bankruptcy and at the same time made a sizeable loan payment to the bank.[173] The Ninth Circuit ultimately found the deposit diminished the funds available to the debtor's other creditors and increased the bank's secured claim against the estate.[174] The Tenth Circuit emphasized the importance of evaluating whether the allegedly fraudulent deposit "depletes the assets of the estate available for distribution to creditors."[175]

To tie this analysis to the aforementioned factors, a deposit made into an unrestricted checking account, which is withdrawable at the account holder's will, does not inherently deplete the bankruptcy estate.[176] Where funds are accessible by the depositor, they are equally accessible by the trustee and the creditors.[177] Only when a debtor's deposit has an adverse impact on the estate should a court find it to be an avoidable transfer. Even then, it is not dispositive. In *In re Whitley*, the debtor's deposits and withdrawals of investment funds in and out of his checking account ultimately depleted the estate by the time of filing.[178] Nonetheless, the Fourth Circuit still declined to impose liability on the bank maintaining the debtor's account.[179] Therefore, in addition to examining whether the

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171. *Id.* at 782.

172. Bank of Commerce & Trs. v. Hatcher, 50 F.2d 719, 720 (4th Cir. 1931).

173. Schoenmann v. Bank of the W. (*In re* Tenderloin Health), 849 F.3d 1231, 1234 (9th Cir. 2017).

174. *Id.* at 1242–43.

175. *Id.* at 1244 (citing Begier v. I.R.S., 496 U.S. 53, 58 (1990)).

176. *In re* Prescott, 805 F.2d 719, 729 (7th Cir. 1986). The inquiry into whether an alleged transfer diminishes the assets of the estate is well-grounded in the Supreme Court's jurisprudence. *See* Nat'l Bank of Newport v. Nat'l Herkimer Cty. Bank, 225 U.S. 178, 184 (1912) (stating the estate of the debtor must be diminished for a creditor to be charged with a preferential transfer).

177. *See Nat'l Bank of Newport*, 225 U.S. at 184 ("It is not the mere form or method of the transaction that the act condemns, but the appropriation by the insolvent debtor of a portion of his property to the payment of a creditor's claim, so that thereby the estate is depleted and the creditor obtains an advantage over other creditors.").

178. Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 210 (4th Cir.), *cert. denied*, 138 S. Ct. 314 (2017).

179. *Id.*

deposit negatively affected the estate, a court should consider the bank's level of knowledge or culpability as to the debtor's conduct.

D. *Benefit Gained by the Financial Institution from the Deposit*

Finally, to build off of the previous factor, a court should assess whether the bank obtained a benefit from the deposit.[180] Generally, a bank will benefit from an account holder's deposit only when the deposit is accepted by the bank as payment on a pre-existing claim against the depositor.[181] When a deposit is conveyed and accepted by a bank, "the deposit is viewed legally as a transfer in payment of the debt."[182] Thus, if the transfer amounts to a preferential transfer to the bank as a creditor, the transfer may be avoidable by the trustee.[183] This is contrasted with an ordinary deposit made into a checking account wherein the bank does not receive an advantage or any meaningful value beyond the benefits of increased funds maintained by the financial institution.[184] In the context of an ordinary deposit, a bank acts as a "financial intermediary" facilitating the movement and maintenance of funds into and out of checking accounts.[185] A financial intermediary receives no benefit, and therefore should not be designated as

180. Jubber v. Bank of Utah (*In re* C.W. Mining Co.), 749 F.3d 895, 899 (10th Cir. 2014).

181. Miller v. Wells Fargo Bank Int'l Corp., 406 F. Supp. 452, 467 (S.D.N.Y. 1975), *aff'd*, 540 F.2d 548 (2d Cir. 1976).

182. *Id.*

183. *Id.* This occurs in the context of "setoff." *See* Kalevitch, *supra* note 75, at 606–07 (illustrating the role of setoff between a debtor and a creditor). "Setoffs have remained controversial under the Bankruptcy Code as they had been under the repealed Bankruptcy Act." *Id.* at 608 (footnote omitted). In the context of an account holder and bank, setoff occurs when a bank utilizes funds held in a debtor's account to satisfy claims the bank has against the debtor. *See id.* at 607–08 ("When parties simultaneously owe each other money, which is presently payable, they agree to net-out the claims or debts out and the net debtor will pay the other the balance owing. This simple process is the origin of setoff and remains the legal basis for setoff." (footnote omitted)). Setoff results in the bank receiving better treatment than other creditors because the bank entitles itself to priority, regardless of whether or not the claim would be recognized as secured. *Id.* at 610.

184. *See Miller*, 406 F. Supp. at 467 (distinguishing between the account holder's deposit made as a payment of its debts as opposed to ordinary deposits).

185. Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 893 (7th Cir. 1988). A financial intermediary is similarly referred to as a "mere conduit." *Id.* at 891; *see also* Christy v. Alexander & Alexander of N.Y. Inc. (*In re* Finley), 130 F.3d 52, 58 n.3 (2d Cir. 1997) ("Numerous bankruptcy courts . . . have also used a mere conduit test to assess initial transferee status."); Sec. First Nat'l Bank v. Brunson (*In re* Coutee), 984 F.2d 138, 141 (5th Cir. 1993) (distinguishing between a mere conduit and an initial transferee); Hooker Atlanta Corp. v. Hocker (*In re* Hooker Invs., Inc.), 155 B.R. 332, 337 (Bankr. S.D.N.Y. 1993) ("Parties that act as conduits and simply facilitate the transfer of funds or property from the debtor to a third party generally are not deemed initial transferees . . . .").

a "transferee" by courts.[186]

Therefore, in considering this factor, a court should determine whether the bank or financial institution is an initial transferee or merely an immediate or mediate transferee.[187] In making this determination, it may be helpful to consider whether the alleged initial transferee had a duty to investigate the debtor's conduct and transactions.[188] If a financial intermediary, such as a bank, had no duty to investigate an account holder's activity, and received no benefit from the allegedly fraudulent transfers in the form of deposits, a court will likely decline to impose liability.

Considering all of the abovementioned factors, the substance of the analysis is the distinction between a deposit within the ordinary maintenance of a bank account as opposed to an extraordinary deposit or withdrawal, containing an "irregularity."[189] In essence, a court faced with this issue should "look[ ] through form to substance" and "treat the transaction according to its real nature."[190] To implement these factors, a court should also investigate whether a deposit is acting as a "cloak for a payment or other forbidden transaction."[191]

VI. CONCLUSION

Even interpreting transfer as widely as courts have—and should, in light of the legislative intent—there is still a general consensus among courts that ordinary deposits into an unrestricted checking account do not transform a depositor into a transferor, rendering banks or financial institutions

186. *See Bonded Fin. Servs., Inc.*, 838 F.2d at 893 (explaining a bank simply holds funds and fulfills the instructions of an account holder, making them available for the account holder or a recipient the account holder instructs the banks to convey the funds to). This concept of a financial intermediary is not comparable to a transferee or a recipient of the funds for its own benefit.

187. Bowers v. Atlanta Motor Speedway, Inc. (*In re* Se. Hotel Props. Ltd. P'ship), 99 F.3d 151, 154 (4th Cir. 1996) (differentiating between an initial transferee or an immediate or mediate transferee). An immediate or mediate transferee receives the benefit and protection of § 550 while a "trustee's power to recover from [initial transferees] is absolute." *Id.* (citing Danning v. Miller, 922 F.2d 544, 547 (9th Cir. 1991)).

188. *See, e.g.*, Furr v. TD Bank, N.A. (*In re* Rollaguard Sec., LLC), 570 B.R. 859, 875 (Bankr. S.D. Fla. 2017) (illustrating the Eleventh Circuit's declination to impose an affirmative duty on mere conduits, including banks, to investigate the actions of the account holder).

189. *See* Bank of Commerce & Trs. v. Hatcher, 50 F.2d 719, 720 (4th Cir. 1931) (distinguishing between a deposit in the regular course and an attempt to convert a deposit into a payment on pre-existing indebtedness); Katz v. First Nat'l Bank of Glen Head, 568 F.2d 964, 970 (2d Cir. 1977) (discussing the irregularities that may convert a deposit into a transfer).

190. *Hatcher*, 50 F.2d at 720.

191. *Id.*

liable.[192] Thus, the Supreme Court's long standing jurisprudence on the issue appears to apply with as much weight today as it did in 1904.[193] Despite the current precedent pre-dating the Code and the broadening of the definition, for a trustee to recover from a bank or financial institution as a transferee, the trustee will likely have to prove more than a debtor maintaining a mere checking account at the institution to compel a court to impose liability. If a bank were to display some level of knowledge or culpability as to an account holder's illegal conduct, it may face liability for a debtor's use of his account.

Until then, the extent of a bank's liability for fraudulent transfers apparently—and correctly—occurs in the context of preferential payments on a debt an account holder owes its bank. In other words, financial institutions seemingly face liability as transferees of fraudulent transfers only when they are creditors of the debtor, if at all.[194] This refusal to impose liability on financial institutions for a debtor's ordinary transactions with a checking account has been properly decided by the courts that have faced the issue. As one court articulated, "If there was any transfer at all in making the deposits, the Debtors were transferring funds to themselves; by making the deposits the Debtors were not disposing of or parting with the funds, and so no avoidable transfers took place."[195]

If courts allow trustees to pursue banks when a debtor—unbeknownst to the bank where it maintains its finances—uses an account in connection

192. *See* Ivey v. First Citizens Bank & Tr. Co. (*In re* Whitley), 848 F.3d 205, 210 (4th Cir.) (referencing the Senate Report and reasoning the legislature did not explicitly contemplate a debtor's "regular deposits into his own unrestricted checking account" when asserting a transfer includes a deposit), *cert. denied*, 138 S. Ct. 314 (2017).

193. *Compare* N.Y. Cty. Nat'l Bank v. Massey, 192 U.S. 138, 145 (1904) (holding a deposit into an unrestricted bank account is not a transfer), *with* Miller v. Wells Fargo Bank Int'l Corp., 406 F. Supp. 452, 467 (S.D.N.Y. 1975) ("If the deposit is accepted by the bank with an intent to apply it 'on a pre-existing claim against the depositor rather than to hold [it] subject to the depositor's checks in ordinary course' however, the deposit is viewed legally as a transfer in payment of the debt." (quoting Goldstein v. Franklin Square Nat. Bank, 107 F.3d 393, 394 (2d Cir. 1939)), *aff'd*, 540 F.2d 548 (2d Cir. 1976).

194. *See, e.g.*, Parker v. Cmty. First Bank (*In re* Bakersfield Westar Ambulance), 123 F.3d 1243, 1248–49 (9th Cir. 1997) (reversing the district court's grant of summary judgment for the bank). In *In re Bakersfield Westar Ambulance*, the debtor became delinquent on a line of credit his bank had extended to him. *Id.* at 1244. Consequently, the bank setoff the amount due from the debtor's checking account in satisfaction of the loan. *Id.* The trustee sought to avoid the setoffs as preferential transfer and the bankruptcy court granted the trustee's motion for summary judgment, accepting the trustee's argument that the setoffs were partially avoidable pursuant to § 553(b). *Id.* at 1244–45. The Ninth Circuit later affirmed the bankruptcy court's determination and held for the trustee. *Id.* at 1248–49.

195. Furr v. TD Bank, N.A. (*In re* Rollaguard Sec., LLC), 591 B.R. 859, 909 (Bankr. S.D. Fla. 2018) (citing Wiand v. Wells Fargo Bank, N.A., 86 F. Supp. 3d 1316, 1327–29 (M.D. Fla. 2015)).

with a fraud or scheme, financial institutions will face potentially unlimited liability.[196] These institutions will be at risk of becoming the "initial transferee" of infinite transfers that occur in the regular usage of consumers' checking accounts. To impose liability on banks for the conduct of their account holders is to require banks to stay abreast of the manner in which the depositors utilize their funds—a virtually impossible task and potential invasion of consumer privacy rights.[197] The following passage from *Bonded Financial Services, Inc. v. European American Bank*[198] illustrates the damaging effect imposing liability as transferees will have on banks and financial institutions:

> 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*.[199]

This logic is sound and equitable.[200] Given how incredibly common checking accounts are and the astronomical number of deposits that occur daily in the United States, to expect banks and financial institutions to closely monitor such activity out of fear of liability is futile.[201] Further,

196. *See* Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 897–98 (7th Cir. 1988) (explaining how banks cannot be expected to know the origin or nature of deposited funds and how imputed knowledge onto a bank is an outdated expectation, even in the context of criminal law).

197. *See* Roger Yu, *Americans are Hoarding Money in Checking Accounts,* USA TODAY (July 13, 2017, 7:00 AM), https://www.usatoday.com/story/money/2017/07/13/americans-hoarding-money-checking-accounts/472736001/ [https://perma.cc/4Y2T-ZZ2Z] (illustrating the growth in the amount of checking accounts and bank deposits in recent years). According to USA Today and Federal Deposit Insurance Corporation data, bank deposits rose over 6% in 2016, to $10.7 trillion. *Id.* To expect banks to monitor the deposits and withdrawals of over ten trillion dollars would require not only significantly increased labor but also an invasion of account holder's privacy to inquire into the use of funds held and exchanged in checking accounts.

198. Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890 (7th Cir. 1988).

199. *Id.* at 893 (emphasis added).

200. *See id.* at 894 ("'Transferee' is not a self-defining term; it must mean something different from 'possessor' or 'holder' or 'agent'. To treat 'transferee' as 'anyone who touches the money' and then to escape the absurd results that follow is to introduce useless steps . . . .").

201. *See In re* Essex Constr., LLC, 575 B.R. 648, 656 (Bankr. D. Md. 2017) (emphasizing the "important policy considerations [at] play that lead courts" to decline to hold that ordinary deposits into checking accounts are avoidable transfers); *see also* Menotte v. United States (*In re* Custom

assuming nearly every adult maintains a checking account, it can be inferred that "virtually every fraud—certainly, every *major* fraud—passes funds through such accounts at some point."[202] To impose liability on the institutions that consequently maintain such checking accounts would be to impose liability not in proportion to culpability. Such holdings would also result in forcing banks and financial institutions to litigate and defend claims by trustees attempting to require the bank to replenish the estate that was diminished in conjunction with a debtor's fraud or scheme.[203] The cost of exposing financial intermediaries to "the risk of disgorging a 'fraudulent conveyance'" would lead banks to spread the costs to solvent customers without increasing any noticeable protection in return.[204] The overwhelming policy reasons in favor of not imposing liability are largely consistent with courts' rulings so far: Deposits into unrestricted checking accounts in which the depositor has access and control over the funds do not constitute avoidable transfers.

Contractors, LLC), 745 F.3d 1342, 1350 (11th Cir. 2014) (discussing the important policy reasons for not holding a bank liable as an initial transferee in spite of the control it exercises over the funds in an account).

202. Brief in Opposition, *supra* note 9, at 12; *see also* Furr v. TD Bank, N.A. (*In re* Rollaguard Sec., LLC), 570 B.R. 859, 873 (Bankr. S.D. Fla. 2017) ("[I]n nearly every case where a debtor made a fraudulent transfer by check drawn on or wire transfer from a bank, the bank would have had to previously receive the funds in question, making the bank the initial transferee . . . .").

203. *See* Brief in Opposition, *supra* note 9, at 12 ("Any bank unfortunate enough to have a fraudster customer would be forced to litigate fact-intensive defenses."). The respondent in opposition in *In re Whitley* boldly describes holding banks liable for a debtor's illegal activity in connection with a checking account as "a recipe for enmeshing banks in years of litigation after every fraud, and one that courts and the Code have wisely avoided." *Id.* at 13.

204. *Bonded Fin. Servs., Inc.*, 838 F.2d at 893.