

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF RHODE ISLAND

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In re: :  
  
ANTON NOLL, INC. : BK No. 99-13744  
Debtor : Chapter 7  
:  
ANDREW S. RICHARDSON, Trustee :  
Plaintiff :  
  
vs. : A.P. No. 99-1134  
  
UNITED STATES OF AMERICA :  
Defendant :  
- - - - -x

TITLE: *Richardson v. United States (In re Anton Noll, Inc.)*

CITATION:

**OPINION AND ORDER**

APPEARANCES:

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BEFORE JAMES A. GOODMAN, United States Bankruptcy Judge

Before the Court is the Chapter 7 Trustee's Complaint against the Internal Revenue Service ("IRS") seeking to recover \$260,892.54 as a fraudulent transfer under 11 U.S.C. § 548. The primary issue before me is whether or not the IRS is an initial transferee and therefore subject to strict liability under 11 U.S.C. § 550. For the reasons set forth below, I find that the IRS is not an initial transferee. Furthermore, I find that there are no issues of fact regarding the IRS's good faith defense under 11 U.S.C. § 550(b)(1), and I find that the IRS has taken for value, in good faith, without knowledge of the voidability of the transfer avoided and is therefore not liable to the Trustee.

#### **FACTS**

The parties have submitted this case on a stipulated record. Anton Noll, Inc. is a corporation that operated a zinc alloying and metal fabrication business. Michael F. Sparfven is the former president and CEO of Anton Noll. One hundred percent of the company stock is owned by Sparfven & Co., a separate corporation entirely controlled and owned by Mr. Sparfven. Michael Sparfven was personally indebted to the IRS for unpaid federal income tax obligations for the tax years 1995, 1996, and 1997. On June 21, 1999, the IRS filed a Notice of Federal Tax

Lien against Sparfven in Indian River County, Vero Beach, Florida, and the IRS's lien attached to a piece of real estate owned by Sparfven in Vero Beach.

On August 25, 1999, Sparfven, as president of Anton Noll, caused the company to write check no. 101 to the order of "Cash" in the amount of \$260,892.54. In the memo of the check the following was written, "IRS \$260,892.54." Sparfven then personally endorsed the back of the check and presented it to Slade's Ferry Bank (hereinafter the "Bank"), instructing it to issue a treasurer's check in the amount of \$260,892.54 payable to the "Internal Revenue Service." The very same day, Sparfven personally took the treasurer's check to the Warwick, Rhode Island office of the IRS and presented it to Revenue Officer Dominic Cambra as full satisfaction of Sparfven's personal income tax liability for the tax years 1995, 1996, and 1997. Revenue Officer Cambra did not know the source of the funds utilized to purchase the treasurer's check and applied the funds as directed by Sparfven. At this time, Anton Noll was not indebted to the IRS and Anton Noll received no value from the IRS in exchange for the payment.

Anton Noll continued to operate its business for approximately one month and on September 23, 1999, it was

petitioned into a state court receivership. One week later, on October 1, 1999, an involuntary petition was filed against Anton Noll and on October 6, 1999, Andrew Richardson, Esq., was appointed interim Chapter 7 Trustee. On October 29, 1999, the Order for Relief entered. On December 22, 1999, the Trustee filed the instant proceeding. In April 2000, the IRS filed a Certificate of Release of Federal Tax Lien as to Michael Sparfven in Indian River County, Vero Beach, Florida.

On October 25, 2000, a trial on the merits was scheduled on the Trustee's Complaint. After a Chamber's conference and a hearing on the record the parties stipulated that the Trustee has established all the material facts of a fraudulent transfer under 11 U.S.C. § 548(a)(1)(B). Specifically, it is stipulated that the Debtor, within one year before the bankruptcy, transferred an interest in property of the Debtor, receiving less than reasonably equivalent value in exchange for such transfer, and the Debtor was insolvent on the date the transfer

was made.<sup>1</sup> The primary issue before me is whether the IRS qualifies as an initial transferee under Section 550(a)(1).

#### DISCUSSION

Section 550 of the Code defines the liability of a transferee where a transaction has been avoided under the trustee's Section 548 avoidance powers. The statute states in relevant part:

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section ...548... of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from-

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

(b) The trustee may not recover under section (a)(2) of this section from-

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

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<sup>1</sup> In its brief, the IRS now argues that it never stipulated that the Debtor received less than reasonably equivalent value in exchange for the transfer. My recollection of the hearing and the chambers conference is that all material facts under Section 548 were agreed to and as part of that agreement, I took the matter under submission without a trial. I am going to hold the IRS to its stipulation made in chambers and during the October 25, 2000 hearing.

(2) any immediate or mediate good faith transferee of such transferee.

11 U.S.C. § 550. The distinction between an "initial transferee" under § 550(a)(1) and "immediate" or "mediate" transferees under § 550(a)(2) is significant. "The trustee's right to recover from an initial transferee is absolute." *Schafer v. Las Vegas Hilton Corp. (In re Video Depot, Ltd.)*, 127 F.3d 1195, 1197-98 (9<sup>th</sup> Cir. 1997). Knowledge or culpability on the part of the initial transferee is irrelevant. *Richardson v. Federal Deposit Insurance Corp. (In re M. Blackburn Mitchell, Inc.)*, 164 B.R. 117, 123 (Bankr. N.D. Cal. 1994). "On the other hand, the trustee may not recover from a subsequent transferee if the subsequent transferee accepted the transfer for value, in good faith, and without knowledge of the transfer's voidability. . . . Subsequent transferees therefore have a defense unavailable to initial transferees." *In re Video Depot*, 127 F.3d at 1198 (citations omitted).

The term "initial transferee" is not defined by the Bankruptcy Code and both sides have pointed to the Seventh Circuit opinion of *Bonded Fin. Servs. Inc. v. European American Bank*, 838 F.2d 890 (7<sup>th</sup> Cir. 1988), as setting the standard for resolving the issue at bench. I agree that *Bonded* sets forth

the appropriate standard and will utilize it herein. See *Perrino v. Salem, Inc.*, 243 B.R. 550, 554-55 (D. Me. 1999) ("As the Bankruptcy Court correctly noted in its decision, the First Circuit has yet to address transferee status under § 550 of the Bankruptcy Code. Moreover, the Bankruptcy Court correctly recognized that the *Bonded* decision is widely regarded as setting forth the definitive statement of the law with regard to transferee status under § 550 of the Bankruptcy Code").

In *Bonded*, the principal of the debtor corporation, Ryan, instructed the corporation to make a check in the amount of \$200,000 payable to the bank. 838 F.2d at 891. Ryan sent the check to the bank with explicit instructions to deposit the funds in his personal account and the bank complied. *Id.* Ten days later, Ryan instructed the bank to debit his personal account \$200,000 and apply the funds to his personal loan with the bank, and again, the bank complied. *Id.* It was determined that the \$200,000 transfer was a fraudulent conveyance and the bankruptcy trustee sought to recover these funds from the bank, arguing that the bank was an initial transferee under § 550(a)(1). *Id.* The Seventh Circuit Court of Appeals found that the bank was not an initial transferee even though it was payee.

*Id.* at 893. It stated that the bank had to follow the instructions that accompanied the check and in that regard it acted as a mere conduit. *Id.* The Court went on to state that:

we think the minimum requirement of status as a "transferee" is dominion over the money or other asset, the right to put the money to one's own purposes. When A gives a check to B as agent for C, then C is the "initial transferee"; the agent may be disregarded. ...

As the Bank saw the transaction on January 21, it was Ryan's agent for the purpose of collecting a check from Bonded's bank.... It received nothing from Bonded that it could call its own; the Bank was not Bonded's creditor, and Ryan owed the Bank as much as ever. The Bank had no dominion over the \$200,000 until January 31, when Ryan instructed the Bank to debit the account to reduce the loan; in the interim, so far as the Bank was concerned, Ryan was free to invest the whole \$200,000 in lottery tickets or uranium stocks. As the Bank saw things on January 31, it was getting Ryan's money.

*Id.* at 893-94 (citations omitted).

I find that the facts of the instant case are very similar to those in *Bonded*. Here, Anton Noll issued a check made payable to "Cash" and delivered the check to Sparfven. Thereafter, Sparfven endorsed the check individually and not in his capacity as president of Anton Noll. I look to Rhode Island law to determine Sparfven's property interests in the \$260,000. See *Perrino v. Salem*, 243 B.R. at 554. Under the Rhode Island version of the Uniform Commercial Code, an instrument made



payable to "cash" is an instrument payable to the bearer. R.I. Gen. Laws § 6A-3-111. A bearer is defined as "the person in possession of an instrument." R.I. Gen. Laws § 6A-1-201(5). An instrument made payable to cash is negotiated upon delivery and the transferee becomes a holder who, in turn has the right to enforce payment in his or her own name. See R.I. Gen. Laws §§ 6A-3-202; 6A-3-301. Under these circumstances, Sparfven is the bearer of the Anton Noll check made payable to "Cash" and Sparfven obtained the right to payment in his own name when he took delivery of the check. In other words, Sparfven had dominion and control over the \$260,892 and he was free to invest the whole \$260,000 "in lottery tickets or uranium stocks" the minute he took delivery of the check. *Bonded*, 838 F.2d at 894.

This transaction is the classic two step transaction described in *Bonded*, with the first transfer being to Sparfven and the second to the IRS. Sparfven was more than a mere conduit as suggested by the Trustee because as soon as the Anton Noll check was handed to Sparfven, he was free to do what he wanted with those funds. This situation differs from one where a debtor corporation, at the direction of its principal, makes a check payable to "ABC Bank." The principal, thereafter takes

the check to the bank, instructing the bank to issue a treasurer's check payable to a creditor of the principal. In this example the principal is a mere conduit because he or she has no rights in the check.

All of the cases cited by the Trustee to support his argument that Sparfven was just a mere conduit are distinguishable in one important respect. The funds that were fraudulently transferred in those cases went directly from the debtors through the bank to the third-party creditors. None of the principals individually had any rights in the funds as the money changed hands. See e.g. *Rupp v. Markgraf*, 95 F.3d 936 (10<sup>th</sup> Cir. 1996) (debtor's principal instructed bank to use debtor's funds to purchase a cashier's check made payable to the principal's creditor and cashier's check clearly indicated that the debtor was the purchaser); *In re M. Blackburn Mitchell, Inc.*, 164 B.R. 117 (principal caused the debtor to make a check payable to the order of the bank and the bank issued a cashier's check to principal's creditor); *In re Video Depot, Ltd.*, 127 F.3d 1195 (the cashier's check made payable to the principal's creditor was purchased directly by the debtor and the cashier's check clearly indicated that the purchaser was the debtor). All

of these cases found the third-party creditor liable as an initial transferee under § 550(a)(1). I can say, without hesitation, that I agree with those cases; however, in the instant case Sparfven had dominion and control over the funds before they passed to the IRS's hands. Accordingly, for the foregoing reasons, I find that the IRS is not an initial transferee under § 550(a)(1).

I now must focus on whether the IRS has any liability under § 550(b)(1). I find that it does not. The Section states that a trustee may not recover from an immediate or mediate transferee if such transferee "takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided." 11 U.S.C. § 550(b)(1). The parties have stipulated that IRS took without knowledge of the source of the funds used to purchase the Slade's Ferry treasurer's check. Notwithstanding that stipulation, the Trustee argues that there is an issue of fact that should preclude my entering judgment in favor of the IRS at this time. The Trustee argues that because the IRS did not release its lien on Sparfven's Vero Beach real estate until April 2000, some four months after the filing of the adversary proceeding, there is a question of fact as to

whether the IRS had knowledge of the voidability of the transaction at the time it gave value. The Trustee equates giving value with the administrative function of the IRS releasing its lien. In support of his argument, the Trustee quotes Section 6325 of the Internal Revenue Code, which states:

(a) Release of lien.--Subject to such regulations as the Secretary may prescribe, the Secretary shall issue a certificate of release of any lien imposed with respect to any internal revenue tax not later than 30 days after the day on which--

(1) Liability satisfied or unenforceable.--The Secretary finds that the liability for the amount assessed, together with all interest in respect thereof, has been fully satisfied or has become legally unenforceable

26 U.S.C. § 6325(a)(1).

I do not equate the IRS's administrative function of releasing a lien to be synonymous with giving value under 11 U.S.C. § 550(b)(1). It is undisputed that on the date of the transfer the IRS applied the proceeds of the cashier's check to Sparfven's personal tax liabilities for the tax years 1995 through 1997. In all respects, the IRS gave value-- it extinguished a debt. I am not surprised that it took several months after that point for the IRS to release its lien on the real estate. The fact that the debt was paid on August 25, 1999, made the IRS's lien worthless because there was no longer

any debt to support the lien. As of August 25, 1999, the IRS had no knowledge of the source of the funds and is not liable under § 550(b)(1).

For the foregoing reasons, the Trustee's Complaint is DENIED and DISMISSED, and judgment shall enter in favor of the IRS.

Enter Judgment consistent with this opinion.

Dated at Providence, Rhode Island, this 7<sup>th</sup> day  
of  
March, 2001.

/s/ James A. Goodman  
James A. Goodman  
U.S. Bankruptcy Judge\*

\*For the District of Maine, sitting by designation.