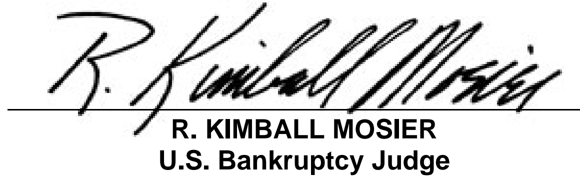
The below described is SIGNED.

Dated: April 05, 2011



R. KIMBALL MOSIER
U.S. Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

In re: In re D.E.I. SYSTEMS, INC. aka DELTA FIBERGLASS, aka DELTA EQUIPMENT INDUSTRIAL SYSTEMS, INC., aka DELTA ENVIRONMENTAL, INC., Debtor.	Bankruptcy Number: 07-24224 Chapter 7 Judge R. Kimball Mosier
KENNETH A. RUSHTON, Trustee, Plaintiff, v. DAVID BEVAN, and BENEDICT BICHLER, Defendants.	Adversary Proceeding No. 09-02082

ORDER SIGNED

MEMORANDUM DECISION ON DEFENDANTS' MOTION FOR PARTIAL SUMMARY JUDGMENT AND TRUSTEE'S CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT

The matter before the Court is the Motion for Partial Summary Judgment (Motion) filed by Defendants, David Bevan (Bevan) and Benedict Bichler (Bichler) (jointly Defendants), and

the Cross-Motion for Partial Summary Judgment (Cross-Motion) filed by the Chapter 7[1] Trustee, Kenneth A. Rushton, (Trustee) addressing the applicability of § 546(e) to the payments alleged to be fraudulent transfers. The Court heard arguments on the Motion and Cross-Motion on September 14, 2010. For the reasons set forth in this Memorandum Decision, the Court grants the Trustee's Cross-Motion and denies the Defendants' Motion.

Jurisdiction

The Trustee commenced this adversary proceeding seeking recovery of payments he alleges were fraudulent transfers from the Debtor to the Defendants. "Core" matter jurisdiction rests in this Court under 28 U.S.C. §§ 157(b)(2)(H) and 1334.

Factual Background

Prior to May 2004, Defendants owned 100% of the outstanding stock of Delta Equipment Industrial Systems, Inc. d/b/a DEI Systems, Inc., a Utah corporation (DEI-UT). Through a series of transactions (collectively referred to as the Purchase Agreement), Defendants sold 44.843% of their shares of DEI-UT to Environmental Services Group (ESG) for the purchase price of $4,000,000 and DEI-UT redeemed 43.946% of Defendants' shares of DEI-UT for $3,920,000 (the Redemption Amount). The Redemption Amount was to be paid on closing by DEI-UT in cash, by certified check or by wire transfer of immediately available funds to the account or accounts designated by the [Defendants]." At the time of closing, the Defendants delivered the redeemed shares to DEI-UT.

As part of the Purchase Agreement, ESG made a secured loan to DEI-UT in the amount of $7,520,000, which included the $3,200,000 Redemption Amount. ESG wired the $7,520,000

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[1] All chapter and section references are contained in Title 11 of the United States Code (2006) unless otherwise specified herein.

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from its account at Union Bank of California, N.A., (Union Bank) to a trust account of the Debtors' attorneys, Ray, Quinney & Nebeker (RQN), at Wells Fargo Bank, N.A.(Wells Fargo). Pursuant to the Purchase Agreement and Bichler's instructions, the sum of $2,088,576 from the $3,920,000 Redemption Amount was wired from the Wells Fargo account to Bichler's account at Barnes Bank. Pursuant to the Purchase Agreement and instructions from Bevan, the sum of $1,831,124 from the Redemption Amount was dispersed by a check drawn on RQN's Wells Fargo account, payable to Bevan. Union Bank, Wells Fargo Bank and Barnes Bank are hereinafter collectively referred to as the "Banks."

As a final stage of the Purchase Agreement, DEI-UT merged into D.E.I. Systems, Inc., (DEI). On September 7, 2007, DEI filed for chapter 11 bankruptcy protection. On April 15, 2008, it converted its case to one under chapter 7 and the Trustee was appointed. On February 25, 2009, the Trustee commenced this adversary proceeding on theories of fraudulent transfer against Bevan and Bichler to recover the funds paid to them by DEI-UT. The $2,088,576 and $1,831,124 payments of the Redemption Amount paid to the Defendants are hereinafter referred to as the "Payments."

Discussion

Summary judgment is appropriate if no genuine issues of material fact exist and the movant is entitled to judgment as a matter of law.[2] As the parties do not dispute the facts as stated above (at least for purposes of this Motion and Cross-Motion), and the issue before the Court is one of legal analysis and application, the issue is appropriate for summary judgment.

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[2] Fed. R. Civ. P. 56(c)(2).

A. Section 546(e).

The sole legal issue before the Court in this matter is whether § 546(e)[3] limits the Trustee's ability to avoid the Payments under § 544. Pursuant to § 546(e) a trustee may not avoid a transfer that fits under either of two "safe harbor" provisions. The first safe harbor provision applies to margin payments as defined in §§ 101, 741, or 761 and settlement payments as defined in §§ 101 or 741. The second safe harbor provision applies to transfers made in connection with a securities contract, as defined in § 741(7), commodity contract, as defined in § 761(4), or a forward contract, that is made before the commencement of the case.[4] Both safe harbor provisions have an additional element: the payment or transfer the trustee is seeking to avoid must be "made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency."[5]

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[3] Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

§ 546(e).

[4] *Id.*

[5] *Id.*

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In the present case the Defendants contend that the Payments were transfers made by and to financial institutions and that both safe harbors of § 546(e) are applicable.

B. Defendants' Interpretation of § 546(e) Produces an Absurd Result.

The Defendants argue that the Payments were accomplished by wire transfers and drafts and are therefore transfers made by or to (or for the benefit of) a financial institution and may not be avoided by the Trustee. Stated another way, because the parties to the Purchase Agreement used the banking industry to effect the Payments, the Payments cannot be avoided. A statute ought to be construed so that no clause, sentence, or word shall be superfluous, void or insignificant and to give effect, if possible, to every clause and word of a statute.[6] Adopting the Defendants' argument would render much of the language in § 546(e) superfluous. The Court cannot conceive of a transfer or payment, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stock broker, financial participant or securities clearing agency that would not be accomplished with the use of the banking industry. If the use of the banking industry is sufficient to provide protection for transfers or payments identified in § 546(e), it would be unnecessary to enumerate any business entities in § 546(e) other than financial institutions.

When interpreting statutes, a court must first look to the language of the statute and only seek extrinsic guidance if the statute is ambiguous or if its application as written produces an absurd result.[7] The Defendants' interpretation of § 546(e) produces an absurd result because such an interpretation would mean that no settlement payment or transfer in connection with a

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[6] *Duncan v. Walker*, 533 U.S. 167, 174 (2001).

[7] *See Lamie v. U.S. Tr.*, 540 U.S. 526, 534 (2004); *St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772, 791 (1981) (Stevens, J., concurring).

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securities contact may be avoided if the payment is effected with the assistance of the banking industry. To be avoidable, the payment would need to be a cash payment, or perhaps an exchange for gold, diamonds, or land as the result of a barter agreement.

Because the interpretation proposed by the Defendants produces an absurd result and because courts have disagreed on the applicability of § 546(e),[8] the Court will look to Congressional intent to determine how the statute should be applied in this case.[9] Section 546 was enacted to "protect the nation's financial markets from the instability caused by the reversal of settled securities transactions."[10] With later amendments, Congress sought to calm "concern[s] about the volatile nature of the commodities and securities markets . . . and 'to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries.'"[11]

This Congressional intent does not require a reading of § 546(e) that would provide protection to transactions that do not require the involvement of financial institutions. Such a

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[8] *See, e.g.*, *QSI Holdings, Inc. v. Alford*, 382 B.R. 731, 738 (W.D. Mich. 2007) ("While the purpose of the § 546(e) exemption is easily understood from a policy standpoint, it has proved far more difficult to understand in practical application. Given the cross purposes of bankruptcy creditors and former shareholders or other prebankruptcy payment recipients, the § 546(e) exemption has become a battleground of semantics and legal frameworks as litigants and the courts attempt to establish its limits within the statutory language. Despite numerous cases that have considered the statutory language and legislative history of §[] 546(e) . . . in an attempt to discern the Congressional intent, little has been gleaned to formulate any decisive standard to determine which transactions fall within the exemption. Consequently, some 25 years after the enactment of the exemption from avoidance for settlement payments in the securities trade, the courts continue to be a forum for disputes over the construction of §[] 546(e) . . . .").

[9] *Russell v. United States*, 551 F.3d 1174, 1178 (10th Cir. 2008).

[10] *Kaiser Steel Corp. v. Charles Schwab & Co., Inc. (Kaiser I)*, 913 F.2d 846, 848 (10th Cir. 1990) (citation omitted).

[11] *Id.* at 849.

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reading would be much too broad to fulfill the expressed Congressional intent as explained in *Kaiser I* and *Kaiser II*[12]. With an equally plausible and more appropriate reading of the statute available—as explained below—the Court determines that § 546(e) is not intended to provide an expansive safety net that protects transactions simply because a bank honors a customer's instruction to pay.

C. The Payments Were Not Transfers Made By or To or For the Benefit of a Financial Institution.

The Payments are not protected by § 546(e) because the Payments were not transfers made by or to or for the benefit of a financial institution. The case law relied upon by the Defendants is distinguishable. Applicable case law, and in particular controlling case law, interpreting § 546(e) have focused on the definitions of settlement payments or securities contracts and not on whether the transfer was made by or to (or for the benefit of) a financial institution.[13] Because this element is necessary for both safe harbors, a finding that a transfer did not satisfy this element would preclude the application of § 546(e) in this case.

An analysis of the Purchase Agreement clearly reveals that the Payments were made by the Debtor to the Defendants for the benefit of the Defendants. Defendants' characterize the Payments as a flow of cash paid by the Banks to the Defendants. Defendants maintain that "the transfers made at the closing of the [Purchase Agreement] were 'settlement payments' that were

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[12] *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser) (Kaiser II)*, 952 F.2d 1230 (10th Cir. 1991).

[13] In *Kaiser II*, the court did discuss payments made "by or to" a stockholder but noted that the plaintiff did not dispute that the transfers were made by a stockbroker, a clearing agency or financial institution but instead argued that § 546(e) only protects payments received by brokers, financial institutions and clearing agencies.

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first transferred 'to' three 'financial institutions' (i.e. Union Bank, Wells Fargo, and Barnes Bank, and then transferred 'by' these three financial institutions to the Defendants." The Defendants' "view of things might be arguable if a bank account consisted of money belonging to the depositor and held by the bank. In fact, however, it consists of nothing more or less than a promise to pay, from the bank to the depositor . . . ."[14] "The relationship of bank and depositor is that of debtor and creditor, founded upon contract."[15] Initially the Court notes that any transfer from Union Bank is irrelevant to the issue before the Court because the Trustee does not seek to avoid ESG's loan to the Debtor. The Wells Fargo bank account did not consist of money belonging to the Debtor but consisted of nothing more or less than Wells Fargo's promise to pay the $7,520,000 as directed or ordered by RQN. RQN acted as the Debtor's agent[16] and the Debtor, through RQN, had the right, subject to the Purchase Agreement, to receive payment from Wells Fargo or order payment to another party. The transfers the Trustee seeks to avoid were not payments by Wells Fargo to the Defendants' banks and then to the Defendants, they were transfers from the Debtor to the Defendants, of Wells Fargo's promise to pay. As discussed below, Wells Fargo had no dominion over the RQN trust account. RQN, as the account holder had dominion over the account and Wells Fargo was obligated to make funds available upon demand by RQN.[17] Bichler exercised his right to receive payment that the Debtor

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[14] *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 21 (1995) (citations omitted).

[15] *Bank of Marin v. England*, 385 U.S. 99, 101 (1966).

[16] The Purchase Agreement does not define RQN's role but, at a minimum, RQN was acting as agent for the Debtor.

[17] As far as Wells Fargo was concerned there was not even a transfer of the right to receive payment, it was simply honoring its promise to pay as directed by RQN.

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transferred to him by directing that funds be wired to Barnes Bank. Bevan's right to receive payment was transferred to him by check. The contracts between Wells Fargo and RQN, and Bichler and Barnes Bank were independent from and unrelated to the Payments. The simple fact that a bank honors a customer's instruction to pay is not a sufficient basis to protect all settlement payments, margin payments or transfers in connection with a securities contract, commodity contract or forward contract.

Even if the Payments are viewed as a flow of cash, they were not payments or transfers made by or to or for the benefit of a financial institution. The 10th Circuit has adopted what is commonly referred to as the "conduit" theory and has held that banks are not initial transferees in transactions where they are simply honoring their contracts with their customers.[18] Because banks have no dominion over a customers account, they are conduits not transferees.[19] The definition of "transfer" in § 101 includes parting with property or an interest in property.[20] To qualify as a transferee, a party must acquire a beneficial interest in the property.[21] If a party is not a transferee in a transaction, it cannot be a transferor of the same property.[22]

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[18] *Rupp v. Markgraf*, 95 F.3d 936, 939 (10th Cir. 1996) ("We held that the bank was not the initial transferee because it 'was obligated to make the funds available to Mr. Hobbs upon demand and, therefore, acted only as a financial intermediary.'"); *see also Malloy v. Citizens Bank of Sapulpa (In re First Sec. Mortg. Co.)*, 33 F.3d 42, 43–44 (10th Cir. 1994).

[19] *Id.*

[20] § 101(54)(D).

[21] *Munford v. Valuation Research Corp. (In re Munford)*, 98 F.3d 604, 610 (11th Cir. 1996); *Brandt v. Hicks, Muse & Co., Inc. (In re Healthco Int'l, Inc.)*, 195 B.R. 971, 982 (Bankr. D. Mass. 1996).

[22] *Brandt*, 195 B.R. at 982.

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Wells Fargo was not a transferee under the Purchase Agreement because it did not acquire any beneficial interest as a result of the Purchase Agreement. Wells Fargo undertook its contractual obligations with RQN prior to the closing of the Purchase Agreement. Its contractual commitment did not change as a result of the Purchase Agreement or the Payments. The Defendant's banks were not transferees because they received no beneficial interest in any property as a result of the Purchase Agreement or the Payments. None of the Banks took, or parted with, a beneficial interest in the Payments from the Debtor to the Defendants nor in the stock transferred from the Defendants to the Debtor. There was no "transfer" under § 546(e) by or to or for the benefit of a financial institution so no protection is available to any of the parties to the Purchase Agreement under § 546(e).

The roles the Banks played in this case are clearly different than the significant role played by the banks in cases where courts have held that § 546(e) is applicable. In *Contemporary Industries*[23], the bank acted as an escrow agent and received the purchase price funds and the shares and distributed the purchase price funds. In *QSI Holdings*[24], the bank acted as an exchange agent and received a cash payment from the purchasers, collected the shares to be purchased, then transferred the securities and distributed the cash.

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[23] *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 983 (8th Cir. 2009) [hereinafter *Contemporary Indus.*].

[24] *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.)*, 571 F.3d 545, 548 (6th Cir. 2009) [hereinafter *QSI Holdings*].

D. The Payments Were Not Settlement Payments of the Type Commonly Used in the Securities Trade.

In addition, and on alternative grounds, the Payments are not protected by the first safe harbor because they were not settlement payments of the type "commonly used in the securities trade." "Settlement payment" is broadly defined as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade."[25] "The term 'settlement' includes the delivery of securities in exchange for funds . . . ."[26] Settlement is also defined as the "completion of a securities transaction."[27] A settlement payment includes the payment in an LBO of a publicly held company.[28]

But even if the Payments were settlement payments, they are not settlement payments of the type "commonly used in the securities trade," so they are not settlement payments for purposes of § 546(e). The phrase "commonly used in the securities trade" must modify all of the listed settlement payments to avoid having a circular definition that defines a settlement payment as a settlement payment.[29] To extend the definition of 'settlement payment' to include any

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[25] § 741(8); *see Kaiser I*, 913 F.2d at 848.

[26] Securities Transactions Settlements, Securities Act Release No. 7022, Exchange Act Release No. 33023, Investment Company Act Release No. 19768, Fed. Sec. L. Rep. (CCH) ¶ 85,232 n.3 (Oct. 6, 1993) (citing 15 U.S.C. § 78c(a)(23)(A)).

[27] *Kaiser I*, 913 F.2d at 849 (quoting A. Pessin & J. Ross, Words of Wall Street: 2000 Investment Terms Defined 227 (1983)).

[28] *See id.* at 849 & 850 n.8 (noting that an LBO of publicly traded stock was a securities transaction because it was under the jurisdiction of the Securities and Exchange Commission).

[29] *See Kaiser II*, 952 F.2d at 1237 ("The clear aim of the definition is to encompass all 'settlement payments' commonly used in the securities trade.") (citations omitted); *Zahn v.*

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payment made for securities, even if the payment has no indicia of settlement payments "commonly used in the securities trade," "would not only deprive the definition of meaning, it would also render superfluous the statutory examples of types of settlement payments enumerated in § 741(8)."[30] The types of settlement payments that are commonly used in the securities trade include those that involve the "clearance and settlement" system, including the "street-side settlement" and the "customer-side settlement."[31] Transactions involving publicly traded securities are of the type "commonly used in the securities trade."[32]

Even if § 546(e) does apply to private securities transactions, the transaction must still reflect "indicia of [settlement payments] 'commonly used in the securities trade'" to be protected.[33] Additional indicia include a large number of shareholders, a clearance and settlement

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Yucaipa Capital Fund, 218 B.R. 656, 675 (D.R.I. 1998); *Official Comm. of Unsecured Creditors of Norstan Apparel Shops, Inc. v. Lattman (In re Norstan Apparel Shops, Inc.)*, 367 B.R. 68, 76 (Bankr. E.D.N.Y. 2007) [hereinafter *Norstan*].

[30] *See Norstan*, 367 B.R. at 76.

[31] *See Kaiser II*, 952 F.2d at 1237–39; *Buckley v. Goldman, Sachs & Co.*, No. 02-CV-11497-RGS, 2005 U.S. Dist. LEXIS 9626, at *28–29 (D. Mass. May 20, 2005) ("The object that Congress sought to accomplish by enacting § 546(e) was to protect the operation of the security industry's clearance and settlement system. That interest is not furthered in any meaningful sense by bringing [a transaction] like the one at issue in this case under the exemption of § 546(e) . . . .").

[32] *Norstan*, 367 B.R. at 76 ("The 'securities trade' in this statutory context plainly means the public securities markets."); *see also Jewel Recovery, L.P. v. Gordon (In re Zale Corp.)*, 196 B.R. 348, 353 (N.D. Tex. 1996) (suggesting *Kaiser II* is limited to public transactions); *Kapila v. Espirito Santo Bank (In re Bankest Capital Corp.)*, 374 B.R. 333, 345–46 (Bankr. S.D. Fla. 2007). *Contra Brandt v. B.A. Capital Co. LP (In re Plassein Int'l Corp.)*, 590 F.3d 252 (3d Cir. 2009); *QSI Holdings*, 571 F.3d 545; *Contemporary Indus.*, 564 F.3d 981.

[33] *See QSI Holdings*, 571 F.3d at 550.

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method, substantial value of securities, and a potential impact on financial markets.[34] Other indicia are the anonymity of the buyer and seller, buyer and seller working through one or more intermediaries that are heavily involved in effecting the exchange,[35] or utilizing the Depository Trust Company (DTC) to accomplish exchange. [36]

The Payments do not demonstrate any indicia of settlement payments "commonly used in the securities trade." In *Norstan*, two stockholders owned 100% of the company and sold their shares for over $55,000,000.[37] The court in that case found that the transfers did not constitute settlement payments because the transactions were not of the type commonly used in the securities trade.[38] Similar to *Norstan*, in this case the shares were of a small entity privately held by two stockholders and no indicia of settlement payments "commonly used in the securities trade. If more than $55,000,000 is not a sufficient amount to be an indicia of transactions commonly used in the securities trade, certainly the lesser amount of $3,920,000 in this case is not.

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[34] *See id.*

[35] *See, e.g.*, *Kaiser I*, 913 F.2d at 847–48 (explaining payment process using Charles Schwab and Bank of America as intermediaries).

[36] *See Alfa, S.A.B. de C.V. v. Enron Creditors Recovery Corp. (In re Enron Creditors Recovery Corp.)*, 422 B.R. 423, 425–26 (S.D.N.Y. 2009).

[37] *See Norstan*, 367 B.R. at 73.

[38] *See id.* at 77.

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E. The Payments Were Not Transfers in Connection With a Securities Contract.

The Court also concludes that the second safe harbor provision of § 546(e) is inapplicable to the Payment. The parties do not dispute that the Purchase Agreement is a securities contract. Assuming, for purposes of this analysis, the Payments were transfers made by or to (or for the benefit of) the Banks, the transfers were not made "in connection with" a securities contract. To avoid the absurd result that all that is required to invoke the protection of § 546(e) is to write a check to effect a transfer made in connection with a securities contract, the phrase "in connection with" requires that the transfer to be causally connected to the securities contract.[39] The Banks were not involved with the substance of the Purchase Agreement and the Purchase Agreement did not require the Banks' involvement. Not only could any bank have facilitated the Payments, because the Payments could have been made in cash, the Payments could have been effected without the involvement of any bank. It is doubtful that the Banks were even aware of the reason for the transfers of funds between the Banks. The transfers of funds between the Bank were not causally connected to the Purchase Agreement and therefore was not a transfer made "in connection with" the Purchase Agreement.

At most, the Payments would be transfers effected "through" the Banks. Because the Purchase Agreement was not dependent on a bank's involvement and any transfer was effected with only minimal bank involvement, the transfers effected by the banks were not the type contemplated by the statute. To read § 546(e) as protecting a transfer, simply because it is

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[39] *See, e.g.*, Webster's New World Dictionary of American English 295 (Victoria E. Neufeldt ed., 3d ed. 1988); Webster's New Collegiate Dictionary 237 (Henry Bosley Woolf ed., 1979).

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effected by check or wire transfer, but not protecting a cash transfer for the same transaction, is absurd.

In this case the Payments effected by the Banks were simply transfers made to honor a preexisting contract between the Banks and their account holders. Without requiring a greater "connection" than the oblivious facilitation of a transfer by a bank, virtually all securities transactions would be protected under § 546(e). If Congress had intended to protect virtually all securities transactions, it could have easily done so and there would be no need for the extensive Congressional language in § 546(e).

A transfer "in connection with" a securities contract requires more than mere facilitation of the transfer by a bank to trigger protection under § 546(e). The minimal role played by the Banks in this case stand in contrast to the more significant roles played by banks as intermediary entities in some of the decisions that have addressed § 546(e).[40] Because the Banks were not essential to the Purchase Agreement, the Court finds that any transfers by the Banks were not transfers "in connection with" the Purchase Agreement.

Conclusion

The Payments were not transfers made "by or to (or for the benefit of) a financial institution," were not settlement payments "commonly used in the securities trade" and were not transfers made "in connection with" a securities contract. To extend § 546(e) protection to the Payments would be absurd and not in furtherance of Congressional intent.

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[40] *See QSI Holdings*, 571 F.3d at 548; *Contemporary Indus.*, 564 F.3d at 983.

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SERVICE LIST

Service of the foregoing Memorandum Decision on Defendants' Motion for Partial Summary Judgment and Trustee's Cross-Motion for Partial Summary Judgment will be effected through the Bankruptcy Noticing Center to the following parties.

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