

OCT 27 2006

HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

| | | | |
|-----------------------------|---|--------------------|-----------------|
| In re: |) | BAP No. | AZ-06-1163-KPaD |
| |) | | |
| GONZALEZ, INC., |) | Bk. No. | 02-15508-GBN |
| |) | | |
| Debtor. |) | Adv. No. | 05-00720 |
| |) | | |
| DAVID A. BIRDSELL, Trustee, |) | | |
| |) | | |
| Appellant, |) | | |
| |) | | |
| v. |) | MEMORANDUM* | |
| |) | | |
| MANCINI & ASSOCIATES, P.C., |) | | |
| |) | | |
| Appellee. |) | | |
| |) | | |

Argued and Submitted on October 19, 2006
at Phoenix, Arizona

Filed - October 27, 2006

Appeal from the United States Bankruptcy Court
for the District of Arizona

Honorable George B. Nielsen, Jr., Bankruptcy Judge, Presiding

Before: KLEIN, PAPPAS and DUNN, Bankruptcy Judges.

*This disposition is not appropriate for publication and may not be cited except when pertinent under the doctrine of law of the case or the rules of res judicata, including issue and claim preclusion. See 9th Cir. BAP Rule 8013-1.

1 The chapter 7 trustee appeals a summary judgment in favor of
2 the appellee law firm based upon the bankruptcy court's
3 conclusion that the appellee was not an "initial transferee" of
4 an avoided transfer for purposes of 11 U.S.C. § 550(a)(1).
5 Guided by the construction given this statute in a decision by
6 the Ninth Circuit entered after the summary judgment, we REVERSE.

7
8 FACTS

9 In May 2001, Jorge Arias executed a Client Retainer
10 Agreement ("Fee Agreement") with appellee, Mancini & Associates,
11 P.C., to file a defamation action against the debtor, Gonzalez,
12 Inc. Arias agreed that the appellee's fee would constitute 50
13 percent of any amount recovered from the debtor, plus costs. The
14 Fee Agreement also granted the appellee a lien for fees and costs
15 and authorized payment from funds recovered.

16 The appellee commenced suit in California state court on
17 behalf of Arias against the debtor in December 2001, seeking
18 damages in excess of \$100,000.

19 In June 2002, mediation led to an agreement between the
20 parties to settle the lawsuit for \$15,000.

21 In accordance with the settlement agreement, on June 28,
22 2002, the debtor transmitted to the appellee a \$15,000 settlement
23 check that was made payable to "Mancini & Associates, P.C." The
24 appellee deposited the entire amount of the check into its
25 attorney client trust account ("CTA").

26 Pursuant to the terms of the Fee Agreement, the appellee
27 then withdrew from the CTA its 50 percent contingency fee
28 (\$7,500).

1 On September 30, 2002, the debtor filed a chapter 11 case
2 that was converted to chapter 7 in September 2004.

3 Appellant chapter 7 trustee filed an adversary proceeding
4 against the appellee and Arias to avoid and recover the \$15,000
5 payment as a preferential transfer under 11 U.S.C. §§ 547 and
6 550(a).

7 The appellant filed a motion for summary judgment directed
8 at the \$7,500 the appellee retained from the settlement proceeds
9 as its attorney's fees. In addition to opposing the appellant's
10 summary judgment motion, the appellee filed a cross-motion for
11 summary judgment arguing that it was a "mere conduit" and not an
12 "initial transferee" of the "allegedly preferential settlement
13 payment" under § 550(a)(1).

14 A hearing on the cross-motions for summary judgment was held
15 on April 7, 2006. The court ruled that the settlement amount
16 paid by the debtor was an avoidable preference under § 547(b).

17 After ruling that the transfer was avoided under § 547, the
18 court turned to the issue of whether the appellant could recover
19 from the appellee the \$7,500 attorney's fee under § 550(a)(1).
20 The court agreed with the appellee that it was not an "initial
21 transferee" of the transfer from the debtor. Since it also was
22 established that the appellee satisfied the requirement for the
23 "good faith" defense that is available to a "mediate transferee"
24 under § 550(a)(2), the court granted appellee's cross-motion for
25 summary judgment.¹

26
27 ¹The court did not, and was not asked to, consider whether
28 the appellee might also qualify as a person for "whose benefit
such transfer was made," which would also trigger § 550(a)(1).

1 Judgment was entered pursuant to Federal Rule of Civil
2 Procedure 54(b). This timely appeal ensued.

3
4 JURISDICTION

5 The bankruptcy court had jurisdiction via 28 U.S.C. §§ 1334
6 and 157(b)(2)(F). We have jurisdiction under 28 U.S.C.
7 § 158(a)(1).

8
9 ISSUE

10 Whether the \$7,500 fee that appellee law firm withdrew from
11 funds in its CTA paid by the debtor pursuant to a settlement
12 agreement between the debtor and the appellee's client rendered
13 the firm an "initial transferee" and is recoverable by the
14 chapter 7 trustee under 11 U.S.C. § 550(a)(1).

15
16 STANDARD OF REVIEW

17 The bankruptcy court's grant of summary judgment is reviewed
18 de novo. Soldano v. United States, 453 F. 3d 1140, 1143 (9th
19 Cir. 2006.)

20
21 DISCUSSION

22 We agree with the bankruptcy court and the parties that
23 there are no genuine issues of material fact, but disagree as to
24 which party is entitled to judgment as a matter of law.

25 The question posed by the assigned error is whether the
26 appellee is an initial transferee of a \$7,500 transfer by way of
27 a check payable to the appellee that was deposited into the
28 appellee's CTA and from which account the appellee took half of

1 the funds as its attorney's fee. The bankruptcy court ruled that
2 because the appellee's access to the funds in the CTA was
3 restricted by state law, by ethical rules, and by contract, the
4 appellee lacked sufficient dominion over the funds and thus could
5 not be considered an initial transferee under § 550(a)(1).

6 On appeal, it is undisputed that the \$15,000 transfer is an
7 avoidable transfer under § 547(b). Because the concept of
8 avoidance is separate from that of recovery, the issue on appeal
9 focuses only on the recovery based on the concededly-avoided
10 transfer. See H. Rep. No. 95-595 at 375-76 (1977); S. Rep. No.
11 95-989 at 90 (1978); Lippi v. City Bank, 955 F.2d 599, 605 (9th
12 Cir. 1992); Plotkin v. Pomona Valley Imports, Inc. (In re Cohen),
13 199 B.R. 709, 718 (9th Cir. BAP 1996).

14 Hence, once a transfer is avoided the question becomes:
15 from whom can the preferential transfer be recovered?

16 11 U.S.C. § 550(a)(1) provides:

17 Except as otherwise provided in this section, to the
18 extent that a transfer is avoided under section 544,
19 545, 547, 548, 549, 553(b), or 724(a) of this title,
20 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 -

21 (1) the initial transferee of such transfer or the
entity for whose benefit such transfer was made[.]

22 The trustee has, in effect, an absolute right to recover the
23 avoided transfer from an initial transferee or from the entity
24 for whose benefit such transfer was made. Schafer v. Las Vegas
25 Hilton Corp. (In re Video Depot, Ltd.), 127 F.3d 1195, 1197-98
26 (9th Cir. 1997). The appellant argues that the appellee was an
27 initial transferee when it paid itself \$7,500 as its attorney's
28 fees from the avoided transfer and cannot escape liability by

1 "laundering money" through its CTA.

2 Although the appellee argued that it was a mere conduit and
3 that one must have "dominion and control" of funds in order to be
4 an initial transferee for purposes of § 550, the controlling
5 question is whether the appellee had "dominion" over the funds.

6 In the Ninth Circuit, an initial transferee of funds is one
7 who has "dominion" in the sense of sufficient legal control to
8 invest the funds as one chooses. Danning v. Miller (In re
9 Bullion Reserve of N. Am.), 922 F.2d 544, 548 (9th Cir. 1991),
10 following Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d
11 890, 893 (7th Cir. 1988). This is the so-called "dominion" test.

12 In contrast, the Ninth Circuit has not adopted the so-called
13 "control" test according to which one steps back and evaluates
14 the transaction in its entirety in quest of a logical and
15 equitable solution. Abele v. Modern Fin. Plans Servs., Inc. (In
16 re Cohen), 300 F.3d 1097, 1102 n.2 (9th Cir. 2002). "Control"
17 only figures in the Ninth Circuit in the sense of the legal
18 control needed to invest funds as one chooses. Id. at 1102.

19 In a decision rendered after the judgment in the present
20 appeal was entered, the Ninth Circuit clarified the dominion-
21 control analysis of who is an "initial transferee" for purposes
22 of § 550(a)(1) in Universal Serv. Admin. Co. v. Post-Confirmation
23 Comm. of Unsecured Creditors of Incomnet Commc'ns Corp. (In re
24 Incomnet, Inc.), 463 F.3d 1064, 1068-76 (9th Cir. 2006)
25 ("Incomnet"), aff'g, 299 B.R. 574 (9th Cir. BAP 2003).

26 The Ninth Circuit emphasized that "dominion" and "control"
27 are distinct concepts. Under the "dominion" test applicable in
28 the Ninth Circuit, the inquiry "focuses on whether the recipient

1 of funds has legal title to them and the ability to use them as
2 he sees fit." Id. at 1071. Under the more flexible "control"
3 test, which does not apply in the Ninth Circuit, the inquiry
4 focuses on the "entire transaction as a whole to determine who
5 truly had control of the money." Id. at 1070.

6 The Incomnet court explained that dominion "strongly
7 correlates with legal title." Id. at 1073. In most cases, those
8 with legal title to the funds will satisfy the dominion test.
9 However, dominion may also occur in situations where there is a
10 separation between legal title and the right to put those funds
11 to use. Id. at 1073-74.

12 In such situations, the focus on dominion becomes more
13 important. The court of appeals gave two examples of cases where
14 title and right to use are separated. The first situation is
15 when an "entity has legal title as a formal matter, but legally
16 does not have any discretion in the application of funds," which
17 it illustrated as follows:

18 Consider a bank that receives currency from a depositor
19 with instructions to deposit those funds into the
20 account of a third party. In such a case, the bank
21 will initially take title over the depositor's funds,
22 but it will not have dominion over them because it has
no discretion over the uses to which the depositor's
money is to be put. Thus, the bank is not the
transferee, but the conduit or agent for a general
deposit.

23 Id. at 1074.

24 The second situation involves a case where an entity lacks
25 legal title to the funds, but nevertheless has power over them.
26 To illustrate, the court gave another example:

27 The second scenario, where an entity lacks legal title
28 to funds, but nevertheless has power over them, may be
illustrated by a trustee who is able to direct the

1 disbursement of the funds in a trust account he
2 manages, even though he does not own them. Such a
3 trustee would therefore exercise dominion over the
4 funds without holding title to them.

4 Id.

5 As to restrictions imposed from sources other than the
6 transferor, Incomnet is also instructive. In analyzing the
7 Incomnet situation, the Ninth Circuit twice invoked the notion of
8 whether the funds in the hands of the putative initial transferee
9 were vulnerable to "direct seizure or discretionary spending" by
10 a third party. Id. at 1071 & 1074.

11 The Incomnet transferee was legally obligated to use the
12 funds only as directed by the Federal Communications Commission,
13 which lacked the ability to control the funds through "direct
14 seizure or discretionary spending." Noting a prior circuit
15 decision in which legal restrictions on the use of funds did not
16 preclude initial transferee status, the Ninth Circuit explained:

17 [I]t is of no consequence that USAC cannot invest funds
18 in - to use the Seventh Circuit's colorful phrase -
19 'lottery tickets or uranium stocks.' See Bonded Fin.
20 Servs., Inc., 838 F. 2d at 894. Here, USAC received
21 the funds from Incomnet without any restrictions from
22 Incomnet on their use. USAC commanded those funds and,
like other individuals, its use of those funds was
restricted by law. These legal restrictions merely
limit how USAC will exercise its dominion over the
funds; they do not preclude USAC from having dominion
at all.

23 Id. at 1075 (emphasis in original), citing Kupetz v. United
24 States (In re Cal. Trade Technical Sch., Inc.), 923 F. 2d 641,
25 647 (9th Cir. 1991).

26 Based upon the guidance provided by the Ninth Circuit, we
27 now turn to the facts of the case on appeal. Here the debtor and
28 Arias settled their state court litigation claims for \$15,000.

1 In accordance with the settlement agreement, the debtor wrote a
2 \$15,000 check payable to the appellee. The appellee deposited
3 the entire amount into its CTA. The appellee then withdrew from
4 the CTA the \$7,500 owed to it pursuant to its Fee Agreement with
5 the debtor. Within ninety days after the settlement check was
6 honored by the drawee bank, the debtor filed for bankruptcy. The
7 trustee filed an adversary proceeding seeking recovery of the
8 funds as a preferential transfer.

9 The bankruptcy court concluded that the appellee was not an
10 initial transferee, but rather a mere "conduit" of the \$7,500 it
11 retained from the settlement funds paid to Arias. On appeal, the
12 appellant argues only that the appellee is the initial transferee
13 with respect to the \$7,500 it retained as its fee. The appellant
14 is not alleging that appellee is the initial transferee of the
15 remainder of the \$15,000. Hence, that issue is not before us and
16 we need not decide it. We focus only on the \$7,500 retained by
17 the appellee.

18 The Fee Agreement that Arias entered into with the appellee
19 stated that the appellee was entitled to "50% of any amount that
20 is recovered" from the lawsuit between Arias and the debtor.
21 When Arias executed the settlement agreement and thereby
22 "recovered" \$15,000, the condition precedent to the appellee's
23 contractual right to 50 percent of its client's monetary recovery
24 was satisfied. In other words, the appellee's interest in its
25 attorney's fees became due or fixed.

26 Under California Rule of Professional Responsibility
27 4-100(A)(2), the portion of the funds belonging to the appellee
28 as its fee was required to be "withdrawn at the earliest

1 reasonable time after [the appellee's] interest in that portion
2 [became] fixed," unless disputed by the client. Arias did not
3 dispute the appellee's right to the fees. Therefore, upon
4 recovery of the settlement funds, the appellee became the legal
5 owner of the \$7,500 and was entitled to withdraw the money from
6 the CTA.

7 Even though Arias may have retained an equitable interest in
8 the settlement amount collected and may have been able to limit
9 the appellee's control over the funds as a whole, the absence of
10 any dispute over the amount of the fees left Arias with no
11 beneficial interest in the funds the appellee retained as its
12 fee. See Commercial Recovery, Inc. v. Mill St., Inc. (In re Mill
13 St., Inc.), 96 B.R. 268, 269-270 (9th Cir. BAP 1989) (under
14 § 550(a)(1), the court must separately analyze the fees retained
15 from the total amount of the preferential transfer).

16 Because the appellee obtained legal title to the \$7,500 fee
17 it retained and, by contract, had the power to pay itself, the
18 appellee had legal control over that portion of the settlement
19 amount and had sufficient authority to direct disbursement to
20 itself. That squares with dominion. Hence, the appellee is an
21 initial transferee under § 550(a)(1). As noted, we are not asked
22 to assess whether the appellee qualifies as an "entity for whose
23 benefit such transfer was made" for purposes of § 550(a)(1).
24 Incomnet, 463 F.3d at 1076; Cohen, 300 F. 3d at 1102; Mill St.,
25 96 B.R. at 269.

1 CONCLUSION

2 The bankruptcy court erred when it granted the appellee's
3 cross-motion for summary judgment. Because the appellee obtained
4 legal title to the funds pursuant to the fee agreement with its
5 client (Arias), it is an initial transferee of the \$7,500 it
6 retained as attorney's fees from the debtor's funds deposited
7 into the appellee's CTA. Since there are no genuine issues of
8 material fact and since Incomnet makes clear that the appellant
9 is entitled to judgment as a matter of law, we REVERSE and REMAND
10 with instructions to enter judgment in favor of the appellant.