

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

AMERICAN SECURITIES & LOAN,
INC.,

Case No. 84-1230-W J

Debtor.

ROBERT F. CRAIG, Trustee,

Adv. Pro. No. 87-0288

Plaintiff,

Chapter 11

DAIN BOSWORTH, INCORPORATED,

Defendant.

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MEMORANDUM OF DECISION

ON MOTION TO DISMISS OR FOR SUMMARY JUDGMENT

On June 1, 1988 a telephonic hearing on Dain Bosworth, Inc.'s motion to dismiss or for summary judgment was conducted in Des Moines, Iowa. Steven J. Kinnunen appeared on behalf of the defendant, Dain Bosworth. David D. Begley appeared on behalf of the plaintiff, the Chapter 11 trustee. The dispute under consideration arises out of transfers made by certain creditors/depositors of the debtor to Dain Bosworth.

FACTS

The debtor, American Securities and Loan (ASL) is a failed industrial savings institution located in Council Bluffs, Iowa. On August 9, 1984, the Auditor of the State of Iowa closed ASL and placed it into receivership. The next day ASL filed a petition for relief under Chapter 11 of

the Bankruptcy Code. On December 30, 1985 the undersigned's predecessor, Judge Richard F. Stageman, appointed Robert F. Craig as the Chapter 11 trustee.

Prior to its demise, ASL transferred \$45,175.00 to Dain Bosworth via two checks. One check, numbered 23460 and dated May 17, 1984 was for \$30,135.00 and the other, numbered 26965 and dated July 9, 1984 was for \$15,040.88. Check 23460 reads "Pay to the order of Dain Bosworth credit to account for John and Blanche Aronson." Dain Bosworth is also the payee of check number 26965. The check lists John and Blanche Aronson as remitters.

The Aronsons were creditors of ASL, presumably as depositors. John and Blanche each held a cash account for securities trading with the Omaha office of Dain Bosworth. Dain Bosworth is a stockbroker and a member of the New York Stock Exchange.

On May 10, 1984 the Aronsons purchased through Dain Bosworth, thirty bonds issued by the Inverness County Metropolitan Improvement District. The Aronsons paid \$30,135.00 for the bonds. \$15,067.50 of the purchase price was charged to Blanche's cash account and an identical amount was charged to John's account. On May 18, 1984, Dain Bosworth received check number 23460 as a settlement payment in full satisfaction of the Aronsons' obligation on their bond purchases. Accordingly, Dain Bosworth credited the Aronson's accounts.

On July 3, 1984 the Aronsons purchased Sarpy County SID

bonds in the amount of \$15,040.88. Of the purchase price, \$10,027.25 was charged to Blanche's account and the remaining \$5,013.63 was charged to John's account. On July 11, 1984, Dain Bosworth received check number 26965 as a settlement payment in full satisfaction of the Aronsons' obligation for the Sarpy County SID bonds. Upon receipt of the check, Dain Bosworth credited the Aronsons' account.

On December 29, 1987, the trustee filed an adversary complaint naming Dain Bosworth as defendant. The trustee did not name the Aronsons as defendants. The trustee claims that the transfers of the two checks are preferential transfers thus voidable under 11 U.S.C. section 547(b).¹ On

¹ 11 U.S.C. section 547(b) reads as follows:

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made--

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider;

January 29, 1988 the trustee amended his complaint asserting Dain Bosworth was the initial transferee of the transfer.

DISCUSSION

Dain Bosworth advances three arguments in support of its motion. First it claims that 11 U.S.C. section 546(e) prevents the trustee from avoiding the transfer at issue. Second it maintains that as an immediate or mediate transferee of the payments, it is immune from the trustee's action under 11 U.S.C. section 550(b). Third, Dain Bosworth argues that the trustee's action should be dismissed for failing to join the Aronsons as indispensable parties.

Dain Bosworth brings its motion under Bankruptcy Rule 7012(b) or, in the alternative, under Rule 7056. Rule 7012(b) incorporates Fed.R.Civ.P. 12(b). This rule allows as a defense to a claim the failure to state a claim upon which relief can be granted. This rule further provides that if a motion asserts such a defense and matters outside the pleadings are presented to the court, the motion shall be treated as one for summary judgment under Fed.R.Civ.P. 56. Bankruptcy Rule 7056 states that Fed.R.Civ.P. 56 applies in bankruptcy proceedings. Dain Bosworth asks the court to consider matters outside of the pleadings. Therefore, the court considers Dain Bosworth's motion as one for summary judgment.

Summary judgment is proper if there is no issue as to any material fact and the moving party is entitled to

judgment as a matter of law. Bankruptcy Rule 7056; Holloway v. Lockhart, 813 F.2d 874, 878 (8th Cir..1987). The court must view the evidence in the light most favorable to the non-moving party and give the non-moving party the benefit of all reasonable inferences which may be made from the record. Fair v. Fulbright, 844 F.2d 567, 569 (8th Cir. 1988). In view of these standards, the court finds that Dain Bosworth is entitled to judgment as a matter of law under its first theory.

11 U.S.C. section 546(e) provides as follows:

(e) Notwithstanding sections 544, 545, 547, 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title. ²

This provision is indeed obscure. The court's research reveals only two cases that have discussed it. ³ In an effort to disinter section 546(e), the court first turns to

² The immunities provided by section 546(e) expressly do not apply to section 548(a)(1) actions based on transfers made with the intent to hinder, delay or defraud a creditor. Section 548(a)(1) is not implicated in this case since the trustee brings his action under section 547.

³ In re Republic Financial Corp., 75 B.R. 840 (Bankr. N.D. Okla. 1987) and Matter of Intern. Gold Bullion Exchange, Inc., 53 B.R. 660 (Bankr. S.D. Fla. 1985).

legislative history.

The subsection is a product of the 1982 amendments to the Code entitled "Technical and Substantive Changes in Bankruptcy With Respect to Securities and Commodities." 4 Collier on Bankruptcy 546.05 at 546-22 (15th ed. 1988). The House Report accompanying the legislation sets out the purpose of the amendments:

The commodities and securities markets operate through a complex system of accounts and guarantees. Because of the structure of the clearing systems in these industries and the sometimes volatile nature the markets[sic], certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market.

The Bankruptcy Code now expressly provides certain protections to the commodities market to protect against such a "ripple effect." One of the market protections presently contained in the Bankruptcy Code, for example, prevents a trustee in bankruptcy from avoiding or setting aside, as a preferential transfer, margin payments made to a commodity broker (see 11 U.S.C. Sec. 764(c)).

The thrust of several of the amendments contained in H.R. 4935 is to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market. The amendments will ensure that the avoiding powers of a trustee are not construed to permit margin or settlement payments to be set aside except in cases of fraud and that, except as otherwise provided, the stay provisions of the Code are not construed to prevent brokers from closing out the open accounts of insolvent customers or brokers. The prompt closing out or liquidation of such open accounts

freezes the status quo and minimizes the potentially massive losses and chain reactions that could occur if the market were to move sharply in the wrong direction.

H.R. Rep. No. 420, 97th Cong., 2nd Sess. 1-2, reprinted in 1982 U.S. CODE CONG. & ADMIN. NEWS 582, 582-583.

To establish that it falls within the protections afforded by section 546(e), Dain Bosworth must show that:

- (1) there was a transfer;
- (2) the transfer was a margin or settlement payment;
- (3) the transfer was made to a commodity broker, forward contract merchant, stockbroker, financial institution, or clearing agency; and
- (4) the transfer was made before the commencement of the case.

There is no dispute a transfer was made. 11 U.S.C. Section 101(50) in part defines "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property..." Clearly the two checks transferred from ASL to Dain Bosworth qualify as a "transfer" under this definition.

11 U.S.C. section 741(8) defines "settlement payment" 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". The transfers in question qualify as final settlements. The funds received

by Dain Bosworth were applied to settle the Aronsons' obligations arising from their bond purchases..

11 U.S.C. section 101(48) defines "stockbroker" as a person-

(A) with respect to which there is a customer, as defined in section 741(2) of this title; and

(B) that is engaged in the business of effecting transactions in securities--

(i) for the account of others; or

(ii) with members of the general public, from or for such person's own account;

Dain Bosworth satisfies both elements of this definition. It deals with customers as the term is broadly defined in section 741(2).⁴ Secondly, it effects securities transac-

⁴ 11 U.S.C. section 741(2) provides as follows:

(2) "customer" includes--

(A) entity with whom a person deals as principal or agent and that has a claim against such person on account of a security received, acquired, or held by such person in the ordinary course of such person's business as a stockbroker, from or for the securities account or accounts of such entity--

(i) for safekeeping;

(ii) with a view to sale;

(iii) to cover a consummated sale;

(iv) pursuant to a purchase;

(v) as collateral under a security agreement; or

(continued on p. 9)

tions for the account of others as evidenced by the Aronsons' purchase of bonds.

Finally, the transfers were made before commencement of the case.

In light of these findings, the court concludes that section 546(e) precludes the trustee from pursuing the present action against Dain Bosworth.

The trustee attempts to circumvent the effect of section 546(e) by arguing that the section is not available as a defense by operation of 11 U.S.C. section 550.⁵

The trustee's argument is based on the maxim, "expressio

⁴ (continued from p. 8)

(vi) for the purpose of effecting registration of transfer; and

(B) entity that has a claim against a person arising out of--

(i) a sale or conversion of a security received, acquired, or held as specified in subparagraph (A) of this paragraph; or

(ii) a deposit of cash, a security, or other property with such person for the purpose of purchasing or selling a security;

⁵ 11 U.S.C. section 550 provides in relevant part as follows:

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

(continued on p. 10)

unius est exclusio alterius", which means the mention of one thing implies the exclusion of another. Section 546(e) does not list section 550 among the provisions from which stockbrokers are exempt. From this fact and his assertion that Dain Bosworth is an initial transferee, the trustee concludes that he may bring a section 547 action against Dain Bosworth. The court rejects this theory for two reasons.

First, contrary to the trustee's position, Dain Bosworth is not an initial transferee. A number of cases have held that where an entity acts as a mere conduit the entity is not an "initial transferee" for purposes of section 550. See In re Colombian Coffee Co., Inc., 75 B.R. 177 (S.D. Fla. 1987)(bank not an "initial transferee" where debtor corporation wires money to bank for deposit in another corporation's account); In re Black & Geddes, Inc., 59 B.R. 873 (Bankr. S.D. N.Y. 1986)(agent not an "initial transferee" where debtor transferred funds to agent who in turn transferred funds to principal); In re Fabric Buys of Jericho, Inc., 33 B.R. 334 (Bankr. S.D. N.Y. 1983)(law firm not an "initial transferee" where debtor transferred funds to law firm that

⁵ (continued from p. 9)

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

disbursed funds to law firm's client). It is important to note that in both the Colombian Coffee and Black & Geddes cases, the courts emphasized that even if the transferees in question were deemed "initial transferees" under section 550, equity considerations would prevent the trustee from recovering from the innocent transferees.

An analogous situation is presented in this case. Dain Bosworth was a mere commercial conduit of funds. It was not a creditor of ASL. It had no direct dealings with ASL. It simply received funds on deposit with ASL and used the funds to purchase bonds at the direction of two depositors of ASL. The court must rule in Dain Bosworth's favor. To rule otherwise would potentially allow a windfall recovery from an innocent party.

Secondly, the trustee's strained construction of section 546(e) impermissibly weakens the interests the section was designed to protect. As stated above, section 546(e) was enacted to prevent the collapse of securities and commodity markets that could result from widespread brokerage failures. Allowing the trustee to recover indirectly via section 550 is as threatening to the markets as is permitting the trustee to directly bring a 547 action against Dain Bosworth. The court cannot allow the protections of section 546(e) to be undermined.

Having disposed of the case on the aforementioned grounds, the court does not reach the indispensable parties issue.

CONCLUSION

WHEREFORE, based on the foregoing discussion, the court finds that Dain Bosworth is entitled to judgment as a matter of law.

Judgment shall enter accordingly.

Signed and dated this 30th day of September, 1988.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE

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Defendant.

ORDER

Based on the memorandum of decision on the motion to dismiss or for summary judgment entered today, it is hereby ORDERED that the motion for summary judgment is granted and this adversary proceeding is dismissed.

Signed and dated this 30th day of September, 1988.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE