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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

In re:)	Case No. 14-25820-D-11
)	
INTERNATIONAL MANUFACTURING)	District Court No.
GROUP, INC.,)	2:18-cv-0289 MCE (BK)
)	
Debtor.)	
_____)	
)	Adv. Pro. No. 16-2082-D
BEVERLY N. McFARLAND, Trustee,)	Docket Control No. MBL-5
)	
Plaintiff,)	
)	
v.)	DATE: January 31, 2018
)	TIME: 10:00 a.m.
BATTLE CREEK STATE BANK,)	DEPT: D
)	
Defendant.)	
_____)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

16
17 On November 20, 2017, defendant Battle Creek State Bank (the
18 "Bank") filed a motion for summary judgment against the
19 plaintiff, International Manufacturing Group, Inc., a liquidating
20 debtor ("IMG"), by and through its plan administrator, The
21 Beverly Group, Inc. (the "plan administrator"), pursuant to Fed.
22 R. Civ. P. 56, made applicable in this proceeding by Fed. R.
23 Bankr. P. 7056, or in the alternative, for summary adjudication
24 of certain facts. The plan administrator filed opposition, the
25 Bank filed a reply, and the court issued a tentative ruling in
26 advance of the initial hearing. Pursuant to that ruling, the
27 hearing was continued and the parties filed supplemental briefs
28 on the issue of whether the alleged illegality of a particular

1 agreement necessarily means IMG did not receive reasonably
2 equivalent value in exchange for the challenged transfers. For
3 the following reasons, the court submits to the district court
4 the following findings of fact and conclusions of law, pursuant
5 to 28 U.S.C. § 157(c)(1), with the recommendation that the motion
6 be granted.¹

7 Summary judgment is appropriate when there exists "no
8 genuine dispute as to any material fact and the movant is
9 entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a).
10 The Supreme Court discussed the standards for summary judgment in
11 a trilogy of cases: Celotex Corp. v. Catrett, 477 U.S. 317
12 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986); and
13 Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574
14 (1986). In a motion for summary judgment, the moving party bears
15 the initial burden of persuasion in demonstrating that no issues
16 of material fact exist. Anderson, 477 U.S. at 255. A genuine
17 issue of material fact exists when the trier of fact could
18 reasonably find for the non-moving party. Id. at 248. The court
19 may consider pleadings, depositions, answers to interrogatories,
20 and any affidavits. Celotex at 323. To demonstrate the presence
21 or absence of a genuine dispute, a party must cite to specific

22

23 1. In June of 2016, the Bank moved to withdraw the
24 reference of this adversary proceeding; the district court denied
25 the motion without prejudice. The adversary proceeding is now
26 much farther along, the parties do not dispute that the Bank is
27 entitled to a jury trial, and resolution of this motion may well
28 be dispositive of the adversary proceeding. For these reasons,
and as the Bank has not consented to entry of final orders or
judgment by this court, the court finds it appropriate to make a
recommendation to the district court despite that court's
suggestion that pre-trial motions might be resolved by this
court.

1 materials in the record, or submit an affidavit or declaration by
2 a competent witness based on personal knowledge. See Fed. R.
3 Civ. P. 56(c)(1), (4). Where the movant bears the burden of
4 persuasion as to the claim, it must point to evidence in the
5 record that satisfies its claim. Anderson, 477 U.S. at 252.
6 Once the moving party has met its initial burden, the non-moving
7 party must show specific facts demonstrating the existence of
8 genuine issues of fact for trial. Id. at 256.

9 By its complaint, the plan administrator seeks to avoid and
10 recover, pursuant to California law, as permitted by § 544(b) of
11 the Bankruptcy Code, certain pre-petition payments made by IMG to
12 the Bank as actual and/or constructive fraudulent transfers. The
13 Bank's motion is based on "good faith" and "for value" defenses.
14 That is, as to the actual fraudulent transfer claims, the Bank
15 contends it took the payments in good faith and for a reasonably
16 equivalent value given to IMG, and therefore, that the payments
17 are not avoidable. See Cal. Civ. Code § 3439.08(a). As to the
18 constructive fraudulent transfer claims, the Bank contends its
19 evidence demonstrates the plan administrator will be unable to
20 make a prima facie case that the payments were made without IMG
21 receiving a reasonably equivalent value for them, and therefore,
22 that they are not avoidable. See Cal. Civ. Code § 3439.04(a)(2).

23 In September of 2008, five and a half years before IMG's
24 bankruptcy case was filed, the Bank made a \$1,200,000 loan to an
25 individual named Larry Carter and an LLC of which he was the
26 manager, N9FX, LLC ("N9FX"). The loan was secured by a security
27 interest in an airplane owned by Carter or N9FX. Carter
28 testifies in support of the motion that he and IMG's principal,

1 Deepal Wannakuwatte, agreed that Carter would loan IMG the
2 \$1,200,000 Carter was borrowing from the Bank and IMG would make
3 the monthly payments on the airplane loan directly to the Bank.
4 Wannakuwatte executed, as president and CEO of IMG, a promissory
5 note for \$1,200,000 in favor of Carter, which stated, "Monthly
6 payments in the amount of \$9,486.59 will be made to the airplane
7 loan." Declaration of Larry Carter, DN 127, Ex. 3. That was the
8 exact amount of the monthly payment Carter was to make on the
9 Bank loan. The Bank's Loan Transaction History Summary Inquiry
10 shows IMG made the payments regularly and on time and the plan
11 administrator does not dispute that.²

12 As to both the actual and constructive fraudulent transfer
13 claims, the Bank contends IMG received reasonably equivalent
14 value for its monthly payments to the Bank because those payments
15 reduced the amount due from IMG to Carter under the IMG/Carter
16 promissory note. In other words, they were payments on an
17 antecedent debt, which generally fall within the definition of
18 "value" under California fraudulent transfer law. "Value is
19 given for a transfer or an obligation if, in exchange for the
20 transfer or obligation, property is transferred or an antecedent
21 debt is secured or satisfied" Cal. Civ. Code § 3439.03.
22 Although the antecedent debt owing by IMG was to someone - Larry

23
24 2. The Bank loan, by its terms, would have been all due and
25 payable on September 2, 2013. In 2011, an individual named Jerry
26 Nelson purchased Carter's sole member interest in N9FX (and
27 therefore in the airplane), and the balance due on the Bank loan,
28 \$1,147,325, was paid off with the sale proceeds. See Declaration
of Gerald C. "Jerry" Nelson, filed April 12, 2017, in connection
with the motion designated DC No. BJ-1. By this adversary
proceeding, the plan administrator seeks to avoid and recover the
monthly payments IMG paid the Bank, a total of \$246,650. As it
was not made by IMG, the balloon payment is not in issue.

1 Carter - other than the recipient of the monthly payments - the
2 Bank, the payments resulted in an indirect benefit to IMG in the
3 form of the partial satisfaction of its debt to Carter - in
4 amounts corresponding to the amounts of the monthly payments IMG
5 made to the Bank.

6 "It is well settled that 'reasonably equivalent value can
7 come from one other than the recipient of the payments, a rule
8 which has become known as the indirect benefit rule.'" Frontier
9 Bank v. Brown (In re Northern Merch., Inc.), 371 F.3d 1056, 1058
10 (9th Cir. 2004) (citation omitted). Thus, for example, the
11 shareholders of a company that already owed money to a bank
12 signed a promissory note to the bank for a second loan, the
13 proceeds of which were paid directly to the company which, in
14 turn, granted the bank a security interest in its assets to
15 secure the second loan. Later, when the company's bankruptcy
16 trustee sought to avoid the security interest as a fraudulent
17 transfer, the Ninth Circuit held:

18 Although Debtor was not a party to the October loan, it
19 clearly received a benefit from that loan. In fact,
20 [the bank] deposited the \$ 150,000 proceeds of the
21 October Loan directly into Debtor's checking account.
22 Because Debtor benefitted from the October Loan in the
23 amount of \$ 150,000, its grant of a security interest
24 to [the bank] to secure Shareholder[s'] indebtedness on
25 that loan, which totaled \$ 150,000, resulted in no net
26 loss to Debtor's estate nor the funds available to the
27 unsecured creditors. To hold otherwise would result in
28 an unintended \$ 150,000 wind-fall to Debtor's estate.
Accordingly, Debtor received reasonably equivalent
value in exchange for the security interest it granted
to [the bank].

26 Id. at 1059.

27 The plan administrator contends, however, that because IMG
28 was actually the front for a sizeable Ponzi scheme, and because

1 the plan administrator claims to have established or to be able
2 to establish that Carter was deeply involved in that scheme, the
3 agreement between them - the IMG/Carter promissory note - was an
4 illegal contract, and therefore, void and unenforceable as
5 between Carter and IMG. Therefore, Carter could not have
6 enforced the note as against IMG and when IMG made the monthly
7 payments to the Bank pursuant to the note, IMG was not satisfying
8 a valid antecedent debt owed to Carter. Accordingly, IMG
9 received nothing of value in exchange, notwithstanding that IMG,
10 not Carter, received the consideration for the payments - the
11 \$1.2 million proceeds of the Bank loan. The argument is based on
12 the doctrine that the courts will not enforce an illegal
13 contract.³

14 The plan administrator frames the issue as follows:

15 Here, Battle Creek is attempting to retain the
16 benefits of fraudulent transfers made by IMG in
17 furtherance of its illegal enterprise and pursuant to a
18 contract that is illegal under Ninth Circuit law [later
19 citing Donnell v. Kowell, 533 F.3d 762 (no pin cite)
20 (9th Cir. 2008)]. The contract between IMG and Carter
21 is the "groundwork" for Battle Creek's claim that the
22 payments were made for reasonably equivalent value.
23 Battle Creek elected to rely on the validity of
24 whatever transaction existed between IMG and Carter
when it accepted payments from IMG without evaluating
the payor, without conducting any underwriting
regarding the payor, and without examining the
underlying transaction. Allowing Battle Creek to
retain the payments made by IMG here effectively
insulates the contract between IMG and Carter despite
the disputed facts raised in the opposition as to

25 3. "It is well established that no recovery can be had by
26 either party to a contract having for its object the violation of
27 law. The courts refuse to aid either party, not out of regard
28 for his adversary but because of public policy. Where it appears
that a contract has for its object the violation of law, the
court should sua sponte deny any relief to either party." Smith
v. California Thorn Cordage, Inc., 129 Cal. App. 93, 99-100
(1933) (citation omitted).

1 Carter's right to enforce the illegal contract or
2 recover based on rescission. IMG received no genuine,
3 legitimate, tangible value from paying money to Battle
Creek. It only deepened the problems and losses to
creditors from facilitating the Ponzi scheme.

4 Plan Administrator's Supplemental Memorandum, filed January 17,
5 2018, at 4:10-20. The court does not agree.

6 First, the determination of reasonably equivalent value
7 "must be made as of the time of the transfer" (Greenspan v.
8 Orrick, Herrington & Sutcliffe LLP (In re Brobeck, Phleger &
9 Harrison LLP), 408 B.R. 318, 341 (Bankr. N.D. Cal. 2009), citing
10 BFP v. Resolution Trust Corp., 511 U.S. 531, 546 (1994)), whereas
11 the plan administrator has not focused its analysis on the time
12 period in which IMG made the monthly payments. In fact, most of
13 the documents filed by the plan administrator as exhibits in
14 support of its Ponzi scheme argument are dated after April of
15 2011, when the Bank loan was paid off in full.

16 Second, the plan administrator has cited no authority for
17 the proposition that the doctrine of unenforceability of illegal
18 contracts is or should be applied against one who was not a party
19 to the illegal contract and who committed no wrongdoing himself.⁴
20 In other words, the plan administrator has cited no case applying

21
22 4. As indicated above, the plan administrator has attempted
23 to inject alleged wrongdoing on the part of the Bank into the
24 analysis. As quoted above, the plan administrator maintains that
25 "Battle Creek elected to rely on the validity of whatever
26 transaction existed between IMG and Carter when it accepted
27 payments from IMG without evaluating the payor, without
28 conducting any underwriting regarding the payor, and without
examining the underlying transaction." This argument is more
appropriately considered on the issue of the Bank's good faith,
discussed below. For present purposes, it is enough to say there
was no wrongdoing on the part of the Bank in the formation or
execution of the allegedly illegal contract - the IMG/Carter
promissory note.

1 the doctrine of unenforceability of illegal contracts to defeat a
2 "for value" defense to a fraudulent transfer action, and in fact,
3 cases involving Ponzi schemes have rejected the plan
4 administrator's position.

5 In Image Masters, Inc. v. Chase Home Fin., 489 B.R. 375
6 (E.D. Pa. 2013), the debtor, operating what turned out to be a
7 \$65 million Ponzi scheme, sold wrap-around mortgages to
8 homeowners, who then made their total monthly mortgage payments
9 to the debtor, who, in turn, contractually promised to make the
10 monthly payments on the underlying first mortgages. When the
11 scheme collapsed, the trustee sued the holders of the first
12 mortgages to recover the monthly payments that had been made by
13 the debtor on behalf of the homeowners. The bankruptcy court
14 granted the mortgage holders' Rule 12(b)(6) motion, holding the
15 trustee had failed to plausibly state a claim that the transfers
16 were made without reasonably equivalent value to the debtor. In
17 re Image Masters, Inc., 421 B.R. 164, 177-80 (Bankr. E.D. Pa.
18 2009).

19 The district court affirmed, holding that each monthly
20 payment made by the debtor to a first mortgage holder resulted in
21 a dollar-for-dollar reduction in the debtor's liability to the
22 homeowner. Image Masters, Inc., 489 B.R. at 389. "Thus, there
23 was no depletion to Image Masters' estate as a result of this
24 transaction because the payment to the lender was matched by an
25 equivalent reduction in Image Masters' obligation to the
26 homeowner. From the perspective of estate preservation, the
27 transaction was a wash." Id. at 390. The fact that the debtor
28 was a Ponzi scheme did not change the analysis. Id. "The proper

1 focus of the reasonably equivalent value inquiry is the specific
2 transaction sought to be avoided, not the transfer's collateral
3 effects on the welfare of a debtor's business." Id. Finally,
4 the court found that

5 the practical implications of the Trustee's approach -
6 that is, focusing on the overall effect on a debtor's
7 business rather than the specific transaction - would
8 render constructively fraudulent all transfers made by
9 a Ponzi scheme debtor within the statutory time period.
This does not comport with the relevant statutory
language, nor the cases within this circuit, which
intimate that transfers made by Ponzi scheme debtors
may confer reasonably equivalent value.

10 Image Masters, Inc., 489 B.R. at 390.^{5 6}

11 The trustee in Balaber-Strauss v. Sixty-Five Brokers (In re
12 Churchill Mortg. Inv. Corp.), 256 B.R. 664 (Bankr. S.D.N.Y.
13 2000), aff'd Balaber-Strauss v. Lawrence, 264 B.R. 303, 308

14
15 5.

16 Simply because a debtor conducts its business
17 fraudulently does not make every single payment by the
18 debtor subject to avoidance. If so, every vendor
19 supplying goods to the debtor would receive an
avoidable fraudulent transfer when the debtor paid the
vendor's invoice. Every employee, even lower-level
custodial and clerical employees, would be required to
20 return their wages, regardless of the work they
performed. Landlords would have to return rent
21 payments, even if the debtor actually occupied the
leased premises. No one conducting business with a
22 debtor operating a Ponzi scheme could prevent the
avoidance of payments they received from the debtor,
23 regardless of the extent of the transferee's knowledge
or culpability or the actual services provided. The
24 law does not require this result.

25 Cuthill v. Greenmark, LLC (In re World Entm't, Inc.), 275 B.R.
641, 658 (Bankr. M.D. Fla. 2002).

26 6. The Ninth Circuit has also held that transfers by Ponzi
27 scheme debtors to their investors may confer reasonably
equivalent value, in the form of satisfaction of the investors'
28 restitution claims. See In re United Energy Corp., 944 F.2d 589,
595 (9th Cir. 1991).

1 (S.D.N.Y. 2001), made an argument very similar to the plan
2 administrator's argument in the present case. She brought 61
3 adversary proceedings to avoid and recover commissions paid by
4 the debtors to the brokers who originated mortgages and solicited
5 investments in the debtors' businesses, which turned out to be a
6 Ponzi scheme. The trustee did not assert the brokers had any
7 knowledge of the Ponzi scheme or that they had themselves acted
8 wrongfully in any way. Rather, she claimed the Ponzi scheme "was
9 fueled and perpetuated by the Brokers' activities in soliciting
10 investors. In providing a substantial portion of Churchill's
11 actual revenues and in fostering the appearance of legitimate
12 business operations, the Debtors' mortgage origination activities
13 played an essential role in the Ponzi scheme." 256 B.R. at 667.
14 Thus, the trustee's position was that the commissions paid by the
15 debtors to the brokers, "although reasonably equivalent in value
16 to the services provided in a marketplace sense, were
17 constructively fraudulent simply because the commissions were
18 paid by an entity engaged in a Ponzi scheme." Id. at 674.⁷ The
19 court phrased the issue this way:

20 May the Brokers be held liable to repay commissions,
21 which they earned in good faith and in fair exchange
22 for services actually rendered, merely because the
23 Debtors' management was independently engaged in a
24 fraudulent enterprise? Stated differently, may the
25 Brokers' services, as a matter of law, be deemed of no
26 value to the Debtors because the Debtors' operation as
27 a Ponzi scheme was facilitated or prolonged by the
28 funds received by the Debtors through those services?

25 Id. at 675. The court's answer was no.

27 7. Although the trustee apparently did not use the term
28 "illegal" contract, her argument was the same as the plan
administrator's here.

1 The court concluded, "The statutes are quite clear. The
2 focus of the inquiry in both [state and federal law] is the
3 specific transaction the trustee seeks to avoid, i.e., the quid
4 pro quo exchange between the debtor and transferee, rather than
5 an analysis of the transaction's overall value to a debtor as it
6 relates to the welfare of the debtor's business." 256 B.R. at
7 678. Emphasizing the purpose of the fraudulent transfer statutes
8 - "to preserve the assets of the estate" (id.), the court
9 concluded that "the analysis which must be used to determine
10 value is a commercial equation which looks to the actual
11 transaction between the debtor and the transferee, and the Court
12 must measure 'what was given and received' in that transaction."
13 Id. at 679.

14 The court cited Merrill v. Allen (In re Universal Clearing
15 House Company), 60 B.R. 985 (D. Utah 1986), in which the court
16 rejected the trustee's position that "because the [brokers']
17 services deepened the debtors' insolvency and furthered a
18 fraudulent [Ponzi] scheme, the services were 'without legally
19 cognizable value.'" Churchill, 256 B.R. at 679, quoting
20 Universal Clearing House, 60 B.R. at 998. The Universal Clearing
21 House court, as in Churchill, held that the reasonably equivalent
22 value analysis "should focus on the value of the goods and
23 services provided rather than on the impact that the goods and
24 services had on the bankrupt enterprise." 60 B.R. at 1000.
25 Thus, the court held the services of the debtors' sales agents
26 constituted value for the payments they received. Id.

27 The fatal legal flaw in [the trustee's position], as a
28 matter of fraudulent conveyance analysis, is that it
focuses not on a comparison of the values of the mutual

1 consideration actually exchanged in the transaction
2 between the Broker and the Debtor, but on the value, or
3 more accurately stated, the supposed significance or
4 consequence of the Broker-Debtor transaction in the
5 context of the Debtors' whole Ponzi scheme. But the
6 statutes and case law do not call for the court to
7 assess the impact of an alleged fraudulent transfer in
8 a debtor's overall business. The statutes require an
9 evaluation of the specific consideration exchanged by
10 the debtor and the transferee in the specific
11 transaction which the trustee seeks to avoid, and if
12 the transfer is equivalent in value, it is not subject
13 to avoidance under the law.

14 Churchill, 256 B.R. at 680. Thus, the Churchill court held:

15 Fraudulent conveyance law is grounded in equity
16 and is designed to enable a trustee or creditors to
17 avoid a transfer in a transaction where the transferee
18 received more from the debtor than the debtor received
19 from the transferee. The remedy of avoidance seeks to
20 rectify the disparity between that which the transferee
21 gave and that which the transferee got in the
22 transaction. It is this disparity that makes it
23 equitable to require the transferee to repay the excess
24 in value of what he received over what he gave up in
25 the transaction. [¶] In this case there was no
26 disparity between the commissions and the value of the
27 Brokers' services. Equity, and the law, would be
28 ill-served by granting relief on these complaints.

Churchill, 256 B.R. at 682.

In the present case, the Bank gave consideration, in the
form of a \$1.2 million loan, the proceeds of which were
immediately received by IMG, and IMG gave consideration in the
form of the monthly payments on the loan. Thus, as a matter of
economic reality, and as a matter of the net worth of IMG's
estate, IMG received reasonably equivalent value in exchange for
the payments. The plan administrator has cited no authority for
the proposition that the injection of Carter into the transaction
as, in essence, an intermediary for the \$1.2 million, should

1 change the outcome.⁸ Further, viewing the IMG/Carter promissory
2 note as an arguably illegal contract for the purpose of negating
3 the value of the \$1.2 million IMG received would not serve the
4 policies underlying the illegal contract doctrine.

5 "The [doctrine] is grounded on two premises: first, that
6 courts should not lend their good offices to mediating disputes
7 among wrongdoers;[fn] and second, that denying judicial relief to
8 an admitted wrongdoer is an effective means of deterring
9 illegality." Bateman Eichler, Hill Richards, Inc. v. Berner, 472
10 U.S. 299, 306 (1985). Here, the court is not resolving a dispute
11 between two wrongdoers; in fact, as discussed below, the court
12 finds the Bank has made a showing it acted in good faith and the
13 plan administrator has not demonstrated there is a disputed issue
14 of material fact on that point. Thus, the court, in granting the
15 Bank's motion, would not be granting relief to an admitted
16 wrongdoer. And granting this motion would not deter illegality
17 in that neither party to the allegedly illegal agreement -
18 neither Carter nor IMG, when they arranged for IMG to make the
19 payments, considered the impact on the Bank as the possible

20 _____
21 8. Under the plan administrator's theory, Carter's presence
22 as a party to the IMG/Carter promissory note makes all the
23 difference. That is, the plan administrator argues that if the
24 note was an illegal contract, Carter would have had against IMG
25 not only no breach of contract claim but also no claim for
26 restitution. The Bank's exhibits reveal, however, that IMG knew
27 in advance that Carter would be borrowing the \$1.2 million and
28 would then turn around and loan it to IMG. "Deepal, Here is the
loan offer on the airplane and I think it looks as good as any
other. . . . Shall I take the loan? Larry." Bank's Ex. 4.
Arguably, the Bank, having been induced to make the loan to
Carter by IMG's promise, through Carter, to make the monthly
payments, would have had a direct claim against IMG for
restitution if IMG had not made the payments. Thus, when IMG
made the payments to the Bank, it was arguably reducing its own
obligation to the Bank for restitution.

1 recipient of fraudulent transfers years after the monthly
2 payments were made. Nor are parties to future contracts likely
3 to consider such matters.

4 In short, the plan administrator's argument is a stretch too
5 far. Application of the illegal contract doctrine would punish
6 an innocent party for the alleged illegality of two other parties
7 by depriving it of an otherwise valid "for value" defense as to
8 the monthly payments IMG made on the \$1.2 million it received.
9 Concomitantly, applying the rule here would result in a windfall
10 to the estate in that IMG received and retained the \$1.2 million
11 and the estate would also recover the monthly payments IMG made
12 in exchange for the use of those monies. The court concludes the
13 Bank has met its initial burden of persuasion in demonstrating
14 that there are no triable issues of material fact as to whether
15 IMG received reasonably equivalent value in exchange for the
16 monthly payments it made to the Bank; that is, the Bank has made
17 a showing sufficient for summary judgment IMG did receive such
18 value. Despite the opportunity for further briefing, the plan
19 administrator has not shown specific facts demonstrating the
20 existence of genuine issues of fact for trial.

21 As for the good faith issue, the court finds the Bank has
22 satisfied its initial burden of persuasion in demonstrating that
23 no genuine issues of material fact exist. The person who has
24 been the Bank's president since 1993 testifies the Bank knew
25 nothing about IMG or Wannakuwatte at the time it made the loan;
26 that the Bank does not unilaterally decide where to send account
27 statements; that in this case, at Carter's request, the
28 statements were addressed to N9FX and Carter and sent in care of

1 JTS Communities, Inc; that between October of 2008 and April of
2 2011, the Bank received the monthly payments and was paid off in
3 April of 2011; that at no time between those dates did the Bank
4 know of IMG's and Wannakuwatte's fraud, or have knowledge of any
5 facts that would suggest the payments the Bank was receiving from
6 IMG were made with the intent to defraud its creditors, or have
7 knowledge of any facts that would have suggested IMG was
8 insolvent at the time it made the payments, or receive any
9 information suggesting there was any suspicious activity on the
10 part of IMG. The Bank's president concludes: "There was nothing
11 unusual about the way Battle Creek received the payments on the
12 fully secured Loan with Carter. In my experience, there are
13 numerous situations where a payment from a third party is
14 entirely acceptable. Having received no calls from anyone, no
15 documentary evidence indicating that there was an issue, we did
16 not suspect that any issues existed as to the payments received
17 from IMG." Declaration of Roger Brestel, DN 128, ¶ 15.

18 The plan administrator's only argument in opposition is that
19 the single fact that the loan payments were made by someone (IMG)
20 other than the Bank's obligor (Carter/N9FX) was enough of a red
21 flag to put the Bank on inquiry notice that something suspicious,
22 and possibly fraudulent, was going on. Thus, the plan
23 administrator states, "Battle Creek's files are devoid of any
24 information regarding why it was receiving payments on its note
25 from a third party not obligated on the debt" and

26 the mere receipt by a financial institution of payments
27 on a loan from a third party not obligated on the debt
28 is a red flag warranting inquiry by the bank, since on
its face, without any information or investigation into
the basis for the third party to be making the

1 payments, the payments appear to be gifts by the payor
2 that would be subject to avoidance as fraudulent
3 transfers unless (a) based on an investigation into the
4 underlying relationship of the parties and transactions
5 between them, the party making the payments is somehow
6 receiving reasonable value in exchange for the
7 transfers, or (b) an investigation into the financial
8 status of the payor shows that entity, IMG, was fully
9 solvent and could legitimately donate its assets for
10 the benefit of Carter.

11 Plaintiff's Opp., DN 132, at 18:21-19:6.

12 The plan administrator has cited a single case for this
13 proposition. In that case, Development Specialists, Inc. v.
14 Hamilton Bank, N.A. (In re Model Imperial, Inc.), 250 B.R. 776
15 (Bankr. S.D. Fla. 2000), the bank made a loan to a company it
16 knew had no assets and it knew the company the money was actually
17 going to was maxed out on its line of credit with and subject to
18 borrowing restrictions by a group of other banks. The bank's
19 senior vice president knew the real borrower's inability to incur
20 additional debt was the only reason the "paper company" was used
21 as the bank's nominal borrower. In other words, there was a lot
22 more in the nature of red flags than a bank receiving payments
23 from someone other than its named borrower.


24 In short, the court is not persuaded that the mere receipt
25 of regular and timely monthly payments from someone other than a
26 bank's borrower is, in and of itself, sufficient to put the bank
27 on inquiry notice of something irregular going on with the payor.
28 Further, the plan administrator has not suggested there are
additional facts it might present showing there were any other
red flags that should have put the Bank on inquiry notice.⁹

9. The discovery bar date and the deadline to disclose
(continued...)

1 Thus, in response to the Bank's prima facie case as to its good
2 faith defense, the plan administrator has failed to show specific
3 facts demonstrating that there are genuine issues of fact for
4 trial.

5 For the reasons stated, the court submits these findings of
6 fact and conclusions of law to the district court with the
7 recommendation that the Bank's motion be granted and that
8 judgment be entered in favor of the Bank and against the plan
9 administrator.

10 **Dated:** February 07, 2018
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14 Robert S. Bardwil, Judge
United States Bankruptcy Court

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27 _____
28 9. (...continued)
experts have passed.