

**UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION**

In re:

Case No. 3:10-bk-2805-PMG

Lydia Cladek, Inc.,

Debtor.

Chapter 11

Terry J. Soifer, not individually but as
Creditor Agent for the Cladek Creditors Trust,

Plaintiff,

vs.

Adv. No. 3:12-ap-193-PMG

Five T, Inc., a/k/a The Latin King Restaurant,
a/k/a Latin King Restaurant 401k ESOP,
d/b/a Latin King,

Defendant.

ORDER ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

THIS CASE came before the Court to consider the Motion for Summary Judgment filed by the Plaintiff, Terry J. Soifer, not individually but as Creditor Agent of the Cladek Creditors Trust for the bankruptcy estate of Lydia Cladek, Inc.

The Plaintiff commenced this action by filing a Complaint to avoid certain fraudulent transfers pursuant to the Bankruptcy Code and Florida law, and to recover the transfers pursuant to §550 of the

Bankruptcy Code. Under an equitable exception to §550(a)(1) established by the Eleventh Circuit Court of Appeals, a trustee may not recover fraudulently-transferred funds from an initial transferee if the initial transferee did not have control over the transferred funds, and if the initial transferee acted in good faith in the transfer.

In this case, the initial transferee of the funds transferred by the Debtor is an Employee Stock Ownership Plan. Based on the current record, the Court cannot determine whether the Plan had control over the transferred funds and acted in good faith in connection with the transfers. Accordingly, the Court cannot determine whether the Plan is entitled to assert the equitable exception to §550 established by the Eleventh Circuit, and the Plaintiff's Motion for Summary Judgment should be denied.

I. Background

The Debtor, Lydia Cladek, Inc., was engaged in the business of purchasing high interest automobile installment contracts from car dealers at a discounted price, and collecting payments from the borrowers under the contracts. (Complaint, ¶15; Answer, ¶15).

The Debtor was operated as a Ponzi scheme. (Main Case, Doc. 530, Order Confirming Plan, ¶15)(“Upon the evidence presented at the hearing the Court finds and concludes that Lydia Cladek, Inc. was operated as a Ponzi Scheme.”).

In 2003 and 2005, the Defendant advanced the total sum of \$195,257.87 to the Debtor. (Complaint, ¶23; Answer, ¶24). Specifically, on January 1, 2003, the Defendant advanced the sum of \$95,257.87 to the Debtor, on January 31, 2003, the Defendant advanced the sum of \$60,000.00 to the Debtor, and on January 2, 2005, the Defendant advanced the sum of \$40,000.00 to the Debtor, for the total sum of \$195,257.87. (Complaint, Exhibit A).

Between January 27, 2009, and October 2, 2009, the Debtor made a series of check transfers that totaled the sum of \$280,000.00. (Complaint, ¶¶22, 23, Exhibit A; Answer, ¶¶22, 24). The checks from the Debtor were in various amounts on seven different dates, and were made payable to “Latin King Restaurant ESOP.”

The checks were endorsed on the back with the notation “for deposit only to Iowa State Bank Latin King Rest.” (Doc. 39, Exhibit A). The funds from the checks were deposited into an account that was maintained under the name “Latin King Restaurant Employee Stock Ownership Plan.” (Doc. 40, Exhibit C).

On April 5, 2010, the Debtor filed a petition under Chapter 11 of the Bankruptcy Code.

II. The Plaintiff’s Complaint

On March 1, 2012, the Plaintiff filed a Complaint to Avoid and Recover Fraudulent Transfers Pursuant to 11 U.S.C. §§544, 548, and 550 and Fla. Stat. §§726.105, 726.106, and 726.108. The sole Defendant named in the Plaintiff’s original Complaint was Five T, Inc., a/k/a The Latin King Restaurant, a/k/a Latin King Restaurant 401k ESOP, d/b/a Latin King.

The focus of the Plaintiff’s fraudulent transfer action is found at Paragraph 23 of the Complaint, which provides:

[D]uring the course of Defendant’s relationship with the Debtor, (i) the Defendant paid a total of \$195,257.87 to the Debtor; and (ii) the Defendant received a total of \$280,000.00. Therefore, the Debtor made transfers to Defendant totaling \$84,742.13 in excess of what the Defendant paid to the Debtor (the “Profit Payments”).

(Complaint, ¶23). The Plaintiff seeks to avoid and recover the Profit Payments from the Defendant as actually fraudulent transfers under §548(a)(1)(A) of the Bankruptcy Code and §726.105(1)(a) of the

Florida Statutes, and as constructively fraudulent transfers under §548(a)(1)(B) of the Bankruptcy Code and §726.105(1)(b) of the Florida Statutes.

With respect to actually fraudulent transfers under §548 and Florida law, a plaintiff must show that (1) the debtor transferred an interest in property, and that (2) the transfer was made with the actual intent to hinder, delay, or defraud creditors. In cases involving Ponzi schemes, courts typically infer fraudulent intent because such a scheme is fraudulent by definition. “For that reason, ‘any acts taken in furtherance of [a] Ponzi scheme . . . are also fraudulent. Every payment made by the debtor to keep the scheme ongoing [is] made with actual intent to hinder, delay, or defraud creditors, primarily the new investors.’” In re Pearlman, 472 B.R. 115, 123-24 (Bankr. M.D. Fla. 2012).

With respect to constructively fraudulent transfers under §548 and Florida law, a plaintiff must show that (1) there was a transfer of an interest in the debtor’s property within two (or four) years of the petition, (2) the debtor received less than reasonably equivalent value in exchange for the transfer, and (3) the debtor was insolvent on the date that the transfer was made. In cases involving Ponzi schemes, courts typically find that the debtor receives “value” for any transfers up to the amount of the transferee’s principal investment, but that a debtor’s transfers in excess of the investor’s principal investment are not made for value and may be subject to recovery by the trustee. In re Pearlman, 472 B.R. at 124-25.

In this case, the Court has found that the Debtor was operated as a Ponzi scheme. (Main Case, Doc. 530, ¶15). The Plaintiff alleges in his Complaint that the Defendant received transfers from the Debtor that exceeded the Defendant’s advances by the sum of \$84,742.13 (the Profit Payments), that the primary source of the Profit Payments was the investment of other investors, and that the Profit

Payments were made in furtherance of the Ponzi scheme. (Doc. 23, Exhibit A, Affidavit of Edward W. Buttner, IV). Accordingly, the Plaintiff seeks to recover the Profit Payments as actually and constructively fraudulent transfers under §548 and §550 of the Bankruptcy Code and Florida law.

III. The Defendant's Response

The checks from the Debtor were made payable to "Latin King Restaurant ESOP," and deposited into the account of the "Latin King Restaurant Employee Stock Ownership Plan." (Doc. 39, Exhibit A; Doc. 40, Exhibit C). The only entity named as a Defendant in the Plaintiff's original Complaint was Five T, Inc., a/k/a The Latin King Restaurant, a/k/a Latin King Restaurant 401k ESOP, d/b/a Latin King.

In response to the Plaintiff's Complaint, the Defendant filed the Affidavit and Supplemental Affidavit of Robert Tursi (Tursi), as the Trustee of The Latin King Restaurant Profit Sharing Plan. (Docs. 34, 40). In his Supplemental Affidavit, Tursi asserts:

All disbursements from Lydia Cladek were paid to the retirement plan account over which I was and am the trustee. (¶13).

I manage and oversee the account to which the checks were deposited solely as the Trustee for the Plan. (¶18).

At no time was Five T, Inc., d/b/a The Latin King Restaurant in possession of the funds nor did it have the ability to direct use, possession or distribution of funds. (¶16).

To be clear, the named Defendant did not "receive" the funds. The funds were deposited to an account over which the Defendant corporation does not have dominion and control. . . . The corporate Defendant has never been legally permitted to utilize funds deposited to the account because they are not Defendant's funds, and Defendant has never done so. (¶19).

(Doc. 40, ¶¶13, 16, 18, 19). Generally, therefore, Tursi asserted that the corporation named as the sole Defendant in the Plaintiff's original Complaint is a separate entity from the employees' profit sharing plan, and that the corporate Defendant was not the transferee of the funds from the Debtor.

IV. The Plaintiff's Amended Complaint

After the Defendant filed Tursi's Supplemental Affidavit, the Plaintiff filed a Motion for Leave to File Amended Complaint to Add Party Defendants. (Doc. 41). In the Motion, the Plaintiff requested permission to amend his Complaint to add as defendants (1) The Latin King Restaurant Profit Sharing Plan a/k/a Latin King Restaurant Employee Stock Ownership Plan, and (2) Robert James Tursi as Trustee of The Latin King Restaurant Profit Sharing Plan a/k/a Latin King Restaurant Employee Stock Ownership Plan, and (3) all unknown employees and beneficiaries of the Plan.

The Court granted the Motion as to the Profit Sharing Plan and Tursi as Trustee of the Plan, and the Plaintiff was permitted to file an Amended Complaint that includes the Plan and Tursi, as Trustee, as additional defendants in this action.

V. The Plaintiff's Motion for Summary Judgment

In the Motion for Summary Judgment currently under consideration, the Plaintiff asserts that he is entitled to a judgment in his favor on the fraudulent transfer claims because "there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." F.R.Civ.P. 56(a).

The Debtor's checks were payable to "Latin King Restaurant ESOP," and were deposited into a bank account owned by "Latin King Restaurant Employee Stock Ownership Plan." (Doc. 39, Exhibit A; Doc. 40, Exhibit C). According to the Plaintiff, "[t]he record is clear that the Transfers were made in the form of checks made payable to 'Latin King Restaurant ESOP,' which were endorsed by a Latin

King entity, and then deposited into an account owned by ‘Latin King Restaurant Employee Stock Ownership Plan.’” (Doc. 41, Plaintiff’s Motion to Amend Complaint, ¶5).

The Plaintiff was authorized to add the Employee Stock Ownership Plan as a Defendant in this action.

In opposition to the Plaintiff’s Motion for Summary Judgment, Tursi asserts that he was under a fiduciary duty to manage the Plan funds in accordance with the terms of the Plan, and that he fully complied with his fiduciary duties. (Doc. 40, ¶¶14, 15). “The account is a trust account which affiant must administer in his fiduciary capacity as the Trustee of the retirement plan.” (Doc. 40, ¶19).

Tursi further contends that the payments received by the Plan were for the benefit of the Defendant’s employees, and were paid to third-party employees as part of their benefits. (Doc. 34, ¶¶4-6). According to the Defendants, the Plan “did not receive the funds for its own account or benefit. The funds were and are part of an employee retirement plan. Funds were paid to employees who earned the benefits paid.” (Doc. 36, p. 4).

Generally, therefore, the Defendants assert that the funds were paid to the corporation’s employees or former employees as retirement benefits in accordance with Tursi’s fiduciary obligations under the retirement plan. (Doc. 40).

In response to the Defendant’s contention that the Plan did not receive the funds for its own account, the Plaintiff asserts that §550(a)(1) of the Bankruptcy Code permits a trustee to recover fraudulent transfers from the “initial transferee” or beneficiary of an avoided transfer. 11 U.S.C. §550(a)(1). In this case, the Plaintiff contends that the Plan is “the entity that received the funds directly from [the Debtor], not Defendant’s employees.” (Doc. 39, ¶ 18). Consequently, the Plaintiff

asserts that the Plan is the “initial transferee” of the transfers, “even if it received the transfers for the benefit of its employees.” Accordingly, the Plaintiff asserts that the Plan is “liable for recovery under section 550(a)(1)” of the Bankruptcy Code. (Doc. 39, ¶17).

VI. Conclusion

In the Eleventh Circuit, three factors are generally considered in determining whether an entity is an “initial transferee” for purposes of recovery under §550(a)(1). First, the Court considers whether the entity is the first recipient of the debtor’s fraudulently-transferred funds. Second, the Court considers whether the entity is a “mere conduit,” with no control over the transferred funds. And third, the Court considers whether the entity has acted without bad faith, and is simply an innocent participant to the fraudulent transfer. In re ATM Financial Services, LLC, 446 B.R. 564, 569 (Bankr. M.D. Fla. 2011)(citing In re Harwell, 628 F.3d 1312 (11th Cir. 2010)). In establishing these three factors, the Eleventh Circuit Court of Appeals has concluded that:

[I]nitial recipients of the debtor’s fraudulently-transferred funds who seek to take advantage of equitable exceptions to §550(a)(1)’s statutory language must establish (1) that they did not have control over the assets received, i.e., that they merely served as a conduit for the assets that were under the actual control of the debtor-transferor *and* (2) that they acted in good faith and as an innocent participant in the fraudulent transfer.

In re Harwell, 628 F.3d 1312, 1323 (11th Cir. 2010)(Emphasis in original). The analysis established by the Eleventh Circuit is a “judicially created, equitable exception to the literal statutory language of ‘initial transferee.’” In re Florida Manufacturing & Distribution, 484 B.R. 847, 852-53 (Bankr. S.D. Fla. 2012).

In this case, the Court cannot determine from the record whether the transfers may be recovered from the Defendants as initial transferees. The Plaintiff acknowledges that the transfers were made by

virtue of checks payable to “Latin King Restaurant ESOP,” and deposited into an account owned by “Latin King Restaurant Employee Stock Ownership Plan.” (Doc. 41, ¶5). The Plan is a profit sharing plan that is governed by Iowa and other applicable law. (Doc. 40, Exhibit A). The Defendants have filed an Affidavit indicating that the funds were held for the benefit of the Defendant’s employees, and “were paid to third-party employees as part of their benefits.” (Doc. 34, ¶¶4-7). Tursi is a trustee under the Plan who served as a fiduciary in the administration of the Plan’s funds. (Doc. 40, ¶¶14, 15).

Additionally, Tursi asserts in his Affidavit that the Defendants (1) did not knowingly participate in a Ponzi scheme or have any reason to believe that the Debtor’s business was not a legitimate operation, and that the Defendants (2) believed that the Debtor was investing in automobile loans and earning income as a result of the investments. (Doc. 34, Paragraphs 8, 9).

For these reasons, the Plaintiff’s Motion for Summary Judgment should be denied. Genuine disputes exist in the record as to whether the Defendants had control over the funds received from the Debtor, whether the Plan was a “mere conduit” for the funds in accordance with its fiduciary obligations, and whether the Defendants acted in good faith in receiving the transfers. Consequently, the Court cannot determine whether the Plaintiff is entitled to recover the transfers from the Defendants as initial transferees under §550(a)(1) of the Bankruptcy Code, or whether the Defendants are entitled to assert the equitable exceptions to §550(a)(1) established by the Eleventh Circuit Court of Appeals.

Accordingly:

IT IS ORDERED that the Motion for Summary Judgment filed by the Plaintiff, Terry J. Soifer as Creditor Agent of the Cladek Creditors Trust, is denied.

DATED this 19 day of June, 2013.

BY THE COURT

Paul M. Glenn

PAUL M. GLENN
United States Bankruptcy Judge