UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
FORT LAUDERDALE DIVISION
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In re: TOUSA, INC., *et al.*, Debtors.	Chapter 11 Cases Case No. 08-10928-JKO Jointly Administered
OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF TOUSA, INC., *ET AL.*, Plaintiffs, vs. CITICORP NORTH AMERICA, INC., *ET AL.*, Defendants.	**Adv. Pro. No. 08-1435-JKO**

REPLY MEMORANDUM IN SUPPORT OF PLAINTIFF'S CROSS MOTION FOR SUMMARY JUDGMENT ON COUNT XIX OF THE THIRD AMENDED ADVERSARY COMPLAINT

The central issue in these cross motions for summary judgment on Count XIX – on what date were TOUSA's rights in a $207.3 million tax refund transferred – should be decided in Plaintiff's favor. With respect to that issue, no material facts are in dispute. Citicorp contends that the transfer occurred when liens on TOUSA's general intangibles were perfected on August 1, 2007. But that contention requires Citicorp to ignore section 547(e)(3), the statutory provision that determines the time of transfer; to rely on a decision that the Eleventh Circuit held (and that Citicorp largely concedes) has been superseded by statutory amendments; and to misread two other Eleventh Circuit decisions indicating that a claim comes into existence only when all of its legal elements are in place. Here, as Citicorp acknowledges, TOUSA had no rights to the tax

refund until the end of its tax year on December 31, 2007. That concession should dispose of the matter because, under section 547(e)(3), the transfer was not made until TOUSA acquired rights in the property.

In response to Plaintiff's motion for summary judgment, Wells Fargo and Citicorp have now asserted that there are material disputed facts concerning the requirements of section 547(b)(5) (*i.e*., whether the transfer enabled the creditor to receive more than the creditor would have received under a hypothetical chapter 7 distribution) and that they have not yet abandoned certain affirmative defenses to Count XIX.[1] Accordingly, Plaintiff does not now request entry of judgment on Count XIX but, instead, requests only a partial summary judgment that the transfer occurred within the ninety day preference period, on December 31, 2007, and denial of Citicorp's motion for summary judgment, which is predicated on the erroneous argument that the transfer occurred on August 1, 2007, when liens on TOUSA's general intangibles were perfected.

I. SECTION 547(e)(3) DETERMINES THE TIME OF THE TRANSFER

Section 547(e)(3) of the Bankruptcy Code states, "For purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred." Citicorp's reply memorandum ("Citi Reply"), like its motion for summary judgment, fails to contain a single reference to this statutory provision. Instead, Citicorp points to section 9-203(b) of the New York U.C.C., which states that a security interest attaches to collateral when the "debtor has rights in the collateral *or the power to transfer rights in the collateral to a secured party*." (Emphasis added.) Relying on that provision, Citicorp repeatedly claims that the critical issue is

[1] See Second Lien Agent's Response To Plaintiff's Cross-Motion For Summary Judgment On Count XIX of the Third Amended Adversary Complaint (Adv. Pro. D.E. 346) at 5-7; Reply Memorandum In Support Of Citicorp North America, Inc.'s Motion For Summary Judgment Dismissing Count XIX of the Third Amended Adversary Complaint And In Opposition To Cross Motion (Adv. Pro. D.E. 347) at 15-16.

whether the TOUSA's expectation of a tax refund was *transferable* before the preference period.[2] If so, Citicorp claims, the security interest in TOUSA's general intangibles attached and was perfected before the preference period, and the transfer occurred at the time of perfection.

Citicorp is wrong. Section 547(e)(3) determines the time of the transfer here. "[N]otwithstanding the effect of state perfection law, § 547(e)(3) and the legislative history thereto require that as a matter of federal law 'a transfer is not made' between the debtor and creditor until some property right can pass in the *specific* collateral from the debtor to the creditor." *Redmond v. Mendenhall*, 107 B.R. 318, 322 (D. Kan. 1989) (emphasis added). "[J]ust because state law deems a transfer perfected at a certain date does not necessarily mean that the state-controlled perfection date is the date the *transfer* is deemed made for federal bankruptcy law purposes." *Ibid*. (emphasis in original).

Section 547(e)(3) was enacted specifically to overturn cases such as *Grain Merchants of Indiana, Inc. v. Union Bank & Savings Co.*, 408 F.2d 209 (7th Cir. 1969), and *DuBay v. Williams*, 417 F.2d 1277 (9th Cir. 1969). See *In re Tabita*, 38 B.R. 511, 513 (Bankr. E. D. Pa. 1984) (section 547(e)(3) "was codified to overrule such cases as *Grain Merchants*"); *In re Siemers*, 249 B.R. 205, 208 (Bankr. D. Neb. 2000) (same). In *Grain Merchants*, the debtor collected on certain accounts receivable during the preference period and deposited the funds with the bank-creditor. The Seventh Circuit held that the transfer to the bank occurred before the preference period, when the bank's security agreement with the debtor was executed and filed.

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[2] See, *e.g.*, Citi Reply at 2 (arguing that "contingent interests in collateral are transferable"); *ibid*. (claiming that "transferable interest in a tax refund is . . . transferable property"); *id.* at 3 (claiming that under New York law, "contingent rights are transferable"); *id*. at 4 (discussing New York decision that "'future contingent interests in personal property are alienable.'"); *id*. at 7 (claiming that question in this case is "whether TOUSA's interest in the tax refund was transferable before the preference period.").

"Such a holding, however, is now expressly contrary to the provisions of section 547(e)(3) of the Code." *Tabita*, 38 B.R. at 514.

II. *SEGAL V. ROCHELLE* DOES NOT CONTROL THIS CASE

Citicorp continues to argue that *Segal v. Rochelle*, 382 U.S. 375 (1966), is controlling here. Citicorp is wrong.

The question in *Segal* was whether certain anticipated tax refunds were property of the estate within the meaning of section 70a(5) of the Bankruptcy Act, which brought within the estate "property which prior to the petition . . . [the bankrupt] could by any means have transferred." The Court first asked whether the refunds were "property" within the meaning of the statute. To answer that question, the Court turned to the purposes of the Act and concluded that the refund claim was "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as 'property' under § 70a(5)." 382 U.S. at 380.

Citicorp concedes that this aspect of *Segal*'s holding is no longer good law and disclaims any reliance on it. Citi Reply at 8 ("*Bracewell* endorsed the reasoning of several earlier decisions finding that *Segal*'s sufficiently rooted test did not survive the enactment of the Bankruptcy Code. The First Lien Agent simply has not relied on the sufficiently rooted test.") (internal quotations and citations omitted).

The second question in *Segal* was whether the refunds were property "which prior to the petition . . . [the bankrupt] could by any means have transferred." The Court held that the refunds could have been transferred. But the second holding in *Segal* cannot control here for two reasons. First, as Citicorp also concedes, transferability is no longer a component of the definition of the estate's property under the Bankruptcy Code. See 11 U.S.C. § 541 (defining

property of the estate); Citi Reply at 7 ("[T]he Bankruptcy Code no longer uses the 'transferability' test in defining estate property."). Therefore, transferability no longer controls whether a potential tax refund is property. Second, under section 547(e)(3), "transferability" does not determine the time of a transfer. Under the express terms of the statute, a "transfer is not made until the debtor has acquired rights in the property transferred." That unambiguous language leaves no room to argue that a transfer occurred before the debtor acquired rights in the property, merely because a security interest could have attached at some earlier time. Because of these statutory changes, *Segal* does not control.

III. CITICORP MISREADS THE ELEVENTH CIRCUIT'S MALPRACTICE CASES

Citicorp tries to explain away the Eleventh Circuit's decisions in *In re Witko*, 374 F.3d 1040 (11th Cir. 2004), and *In re Alvarez*, 224 F.3d 1273 (11th Cir. 2000), but fails. In both cases, the question was whether the debtor's legal malpractice claim was property of the estate. In *Witko*, the court held that the claim was not property of the estate because injury was a required element of a legal malpractice claim, but the claimed injury occurred after the petition was filed. In *Alvarez*, the injury occurred as of the filing of the petition, so the claim was held to be property of the estate.

Citicorp claims to find support in *Alvarez* from the fact that the malpractice claim was property of the estate even though recovery under the claim was contingent; the claim had not been successfully prosecuted and no recovery had been obtained when the petition was filed. That argument misses the point entirely. Plaintiff contends that TOUSA acquired rights in the tax refund upon the occurrence of the final event that was necessary to support a claim for the refund, *i.e.*, the end of the tax year. On that date, TOUSA's claim was "contingent" and had not yet been "monetized" in exactly the way that the malpractice claim in *Alvarez* was contingent

and had not yet been monetized. At the end of the tax year, TOUSA had not yet received the refund, and there could be no certainty that TOUSA's claim would not be rejected or reduced by the IRS, just as a legal malpractice claim could be rejected, or the damages reduced, by a court.

The importance of *Alvarez* and *Witko* is not the recognition that a debtor may have rights in property that is subject to such contingencies – a proposition that Plaintiff has never disputed – but that a debtor can have no property interest in a claim before the legal prerequisites for that claim have been satisfied.[3] As *Witko* explained, a malpractice cause of action "*did not exist* until [the debtor's] alimony action concluded with an adverse action that was proximately caused by his attorney's negligence."[4] 374 F.3d at 1043. (emphasis added). When, in *Alvarez*, the final essential element of a malpractice claim occurred as of the petition date, the debtor had rights in a malpractice cause of action, even if the value of that property was contingent on the ultimate resolution of the litigation.

IV. TOUSA DID NOT ACQUIRE RIGHTS IN THE TAX REFUND UNTIL THE END OF THE TAX YEAR

Applying the principles of *Witko* and *Alvarez*, TOUSA had no "rights" in the tax refund until the end of the tax year. If TOUSA had requested a refund based on net operating losses over the period from January 1, 2007 through December 30, 2007, the request would have been denied as a matter of law. Losses through December 31, 2007 (not December 30, 2007 or some

[3] Citicorp inexplicably continues to rely on *Kendrick v. King Lumber, Inc.*, 14 B.R. 764 (Bankr. W.D. Ok. 1981), for its purported "holding" that a security interest may attach to an "inchoate right" to a tax refund. But as we previously explained (Plaintiff's Cross-Motion at 9), the tax refund in *Kendrick* was "inchoate" only in the sense that it had not yet been paid. All prerequisites to claim the refund had occurred, and the claim for the refund had been submitted to the IRS, before the preference period.

[4] Citicorp criticizes our description of *Witko* and *Alvarez* as decisions turning on whether all events necessary to establish a property interest had occurred by the petition date. Citi Reply at 12-13. But that is exactly the lesson of those cases, even if they do not use the words "all events necessary." *Alvarez* held that a property interest in the claim arose on the date when all three of the elements of the cause of action had occurred; *Witko* held that there was no property interest in the claim before the third (and final) element had occurred.

earlier date) were a legal prerequisite to the refund. See Plaintiff's Cross-Motion For Summary Judgment And Opposition To Citicorp North America Inc.'s Motion For Summary Judgment On Count XIX Of The Third Amended Adversary Complaint (Adv. Pro. D.E. 335) at 3-4.

Citicorp concedes that TOUSA could not have carried back net operating losses incurred over a portion of 2007, and that TOUSA had no legal claim to a tax refund until the end of the tax year, *i.e*., December 31, 2007. Citi Reply at 11 ("Nobody disputes that point. But the issue here is not whether TOUSA could actually have received a tax refund in the middle of the year.").[5] The best that Citicorp can offer is the argument that an expected net operating loss can be used to obtain an extension of time for payment of taxes. See Citi Reply at 11-12. The extension of time, however, has no effect on the amount of tax that ultimately must be paid (or refunded), and if the effect of the extension is to delay payment of taxes that ultimately must be paid, the taxpayer must pay interest. Treasury Reg. § 301.6601-1(e)(2). None of this has any application to this case, and Citicorp does not even pretend that it does. Citicorp is unable to cite even a single decision suggesting that the ability to obtain an extension of a tax filing deadline has significance under the Bankruptcy Code. In any event, the question here is when TOUSA acquired rights in the *refund*; whether or when TOUSA acquired rights to seek a filing extension is an entirely different matter.

Nor does Citicorp address the myriad cases that hold, in a wide variety of contexts, that tax refunds should be treated as property at the end of the tax year. See Plaintiff's Cross-Motion at 5. Those cases, like section 547(e)(3), focus on the debtors' "rights" to a refund, which arise

[5] However, Citicorp continues to suggest that TOUSA had incurred net operating losses long before the end of the tax year. See, *e.g*., Citi Reply at 8 n.3. Those claims are misleading, at best, because for tax purposes, a net operating loss, by definition, can occur only over the course of an entire tax year. See Plaintiff's Cross Motion at 3-4. The claim that TOUSA suffered net operating losses by August 2007 is akin to claiming that a football team trailing at halftime had already suffered a "loss."

only when the requirements for claiming a refund under the tax code have been satisfied. Whether TOUSA had an "expectancy" of a refund (Citi Reply at 11) or "anticipated" a refund (*ibid.*) does not matter if TOUSA was unable to submit a valid *claim* for a refund. That claim could not be submitted until the end of the tax year, and that is the date on which the transfer occurred.

CONCLUSION

For the above-stated reasons, the Official Committee of Unsecured Creditors respectfully requests that, pursuant to Rule 56 of the Federal Rules of Civil Procedure and Rule 7056 of the Federal Rules of Bankruptcy Procedure, the Court enter partial summary judgment for Plaintiff on Count XIX of the Third Amended Adversary Complaint, and that the Court deny the Motion By Citicorp North America, Inc., As Administrative Agent For The First Lien Term Loan, For Summary Judgment Dismissing Count XIX Of The Third Amended Adversary Complaint.

Dated: May 22, 2009

I HEREBY CERTIFY that I am admitted to the Bar of the United States District Court for the Southern District of Florida and I am in compliance with the additional qualifications in this Court set forth in Local Rule 2090-1(A)

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I HEREBY CERTIFY that the undersigned attorneys are appearing *pro hac vice* in this matter pursuant to court order dated July 10, 2008 [D.E. 1360, 1362, 1363 in Ch. 11 No. 08-10928]

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CERTIFICATE OF SERVICE

I hereby certify that on May 22, 2009, I caused a true and correct copy of Reply Memorandum In Support Of Plaintiff's Cross Motion For Summary Judgment On Count XIX Of The Third Amended Adversary Complaint to be served by e-mail on:

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