UNITED STATES DISTRICT COURT
EASTERN DISTRICE OF MICHIGAN
SOUTHERN DIVISION

In re: PEGGY LYNN TORPEY,

Case Number: 19-13577
Honorable David M. Lawson

TIMOTHY J. MILLER, Chapter 7
Trustee,

Appellant,

v.

PHILIP SANDELL,

Appellee.
____/

OPINION

Although one purpose of the Bankruptcy Code is to ensure a "fresh start" for debtors, an equally important purpose is to provide for an equitable distribution of the bankrupt's assets among her creditors. Struggling financially, and behind on her mortgage, Peggy Lynn Torpey borrowed money from her paramour, Philip Sandell, who was more than willing to help her. But when that help was not sufficient to right Torpey's financial ship, she sought relief from her creditors by filing a Chapter 7 bankruptcy petition. Before she filed, though, she paid back Sandell almost all of what he had lent her. Believing that those payments rightfully belonged to Torpey's bankruptcy estate, her trustee filed an adversary proceeding to recover them, alleging that the money Sandell received preferred him over Torpey's other creditors. After a trial, the bankruptcy court held that Sandell did not qualify as an "insider," which would have required him to disgorge those payments received within a year before Torpey filed her Chapter 7 petition. The trustee appealed. I vacate the judgment and remand for further proceedings.

I.

Peggy Torpey filed her Chapter 7 petition on July 27, 2018. When she did that, her property became part of a newly created bankruptcy estate. 11 U.S.C. § 541(a). Appellant Timothy Miller was appointed trustee, whose duties included maximizing the value of the estate and the equitable distribution of it to the creditors. 11 U.S.C. § 704(a)(1); *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 352 (1985). One of the longtime principles of bankruptcy law is that all creditors of each class shall be treated equally. 11 U.S.C. § 726(b). And when a debtor attempts to prefer one creditor over another — say, by paying her debt to that creditor within a certain time before filing her bankruptcy petition — the trustee has the power to set aside those payments and recover the money for the bankruptcy estate. 11 U.S.C. § 547(b); *In re C–L Cartage Co., Inc.*, 899 F.2d 1490, 1492 (6th Cir. 1990) ("The bankruptcy code attempts to ensure that all creditors similarly situated receive equal treatment, by allowing the trustee to recover certain payments or transfers of property which prefer some creditors over others.").

Payments made to any creditor within 90 days before the debtor files her bankruptcy petition can be avoided and recovered for the estate as preferences. 11 U.S.C. § 547(b)(4)(A). But when the creditor is an "insider" of the debtor, the Bankruptcy Code enlarges the time period for avoidance to one year before the bankruptcy filing. 11 U.S.C. § 547(b)(4)(B).

Torpey lost her regular income stream when she was discharged from the Department of Defense for health reasons. She was entitled to a military pension, but monthly payments, although accumulating, would not start for a year. When Torpey fell behind on her mortgage, Sandell offered to help her by loaning her enough to bring her mortgage payments current. He obtained a home equity loan and transferred $10,000 to Torpey, which she used to reinstate her mortgage. They anticipated that Torpey would repay him when she received a lump-sum pension payment.

Sandell also withdrew cash from his account from time to time to help Torpey with other living expenses. From July 2017 through 2018, Torpey had borrowed at least $26,940.

It is undisputed that Torpey made payments to Sandel on February 22, 2018, and April 17, 2018, totaling $22,300, when she was insolvent. When the bankruptcy petition was filed, only $4,640.39 remained owing on the loans. Those payments were not made within 90 days of Torpey's bankruptcy filing. But they were made within one year and subject to avoidance if Sandell can be considered an "insider."

The Bankruptcy Code defines "insider" to include a "relative of the debtor or of a general partner of the debtor." 11 U.S.C.A. § 101(31)(A)(i). But courts have recognized that the statutory list of presumptive insiders is not exhaustive, *see* 11 U.S.C. § 102(2) (stating that when used in the Bankruptcy Code, "'includes' and 'including' are not limiting"), and those creditors whose relationships with the debtor are analogous or equivalent to a statutory category have been found to be "non-statutory insiders," *U.S. Bank Nat. Ass'n ex rel. CWCapital Asset Mgmt. LLC v. Vill. at Lakeridge, LLC*, --- U.S. ---, 138 S. Ct. 960, 963 (2018).

The sole issue presented to the bankruptcy court for trial was whether Sandell qualified as a non-statutory insider because of his relationship with Torpey. Much of the underlying facts were uncontested. For about eight years, and at least a year before the bankruptcy filing, Torpey and Sandell were engaged in a romantic relationship. They owned no joint property (although Sandell cosigned on an auto loan for Torpey), had no children in common, and had no joint investments or debts. Both had careers in the military. They cared for each other: Torpey accompanied Sandell (who had hearing difficulties) to doctor visits to help him understand the medical advice, and Sandell did the driving because Torpey took medication that prevented her from operating a car. The bankruptcy court found that neither controlled the other's finances.

The evidence also showed that Torpey and Sandell spent time together on an almost daily basis, sharing morning coffee and meals together. They spent holidays together, and shared confidential information. For example, Torpey testified that other than her sister and daughter, Sandell was the only person she told about filing for bankruptcy. And although they maintained separate homes, Sandell spent the night at Torpey's home three to five nights per week, and they cohabitated with a significant degree of familiarity.

The bankruptcy court found that Sandell's financial contributions to Torpey were "not frequent throughout the relationship but episodic and in response to Debtor's particularized desperate need for finances in an unfortunate financial period of her life," Trial Tr. at 132-33, ECF No. 5, PageID.431-432, referring to Torpey's military disability discharge and resulting lack of income. They paid their own bills, although Torpey had limited access to Sandell's bank accounts, helping him because of his unfamiliarity with online banking.

But Sandell frequently helped Torpey with her day-to-day expenses by periodically withdrawing cash from his bank account for her to pay for her utilities, groceries, and car insurance. They did not keep their financial information from each other, and it is clear that they trusted each other over anyone else to handle their respective banking and financial transactions.

At the trial's conclusion, the bankruptcy court found that the features of Torpey's and Sandell's relationship did not have the requisite earmarks of a marriage, and it held, therefore, that Sandell did not qualify as a non-statutory insider. The court entered judgment dismissing the trustee's complaint to avoid the loan repayments and declined to order Sandell to disgorge them to the bankruptcy estate.

The trustee timely appealed.

II.

The district court has appellate jurisdiction over this appeal, which is from the bankruptcy court's "final judgment[]" in an adversary proceeding. 28 U.S.C. § 158(a); *see Bullard v. Blue Hills Bank*, 575 U.S. 496, ---, 135 S. Ct. 1686, 1694 (2015) (observing that adversary proceedings are "'essentially full civil lawsuits carried out under the umbrella of the bankruptcy case[.]'").

The Supreme Court has segmented a bankruptcy judge's non-statutory insider determination into three issues: "the first purely legal, the next purely factual, the last a combination of the other two." *Vill. at Lakeridge, LLC*, 138 S. Ct. at 965. The first — selection of the proper legal test — is reviewed "without the slightest deference." *Ibid.* (citing *Highmark, Inc. v. Allcare Health Management System, Inc.,* 572 U.S. 559, 563 (2014)). The bankruptcy court's factual findings "are reviewable only for clear error — in other words, with a serious thumb on the scale for the bankruptcy court." *Id.* at 966 (citing Fed. Rule Civ. Proc. 52(a)(6) and Fed. Rules Bkrtcy. Proc. 7052 and 9014(c). Application of the legal test to the historical facts is a mixed question of law and fact. Although there is no hard-and-fast rule governing the standard of review for mixed questions (because "[m]ixed questions are not all alike," *id.* at 967), assessment of a creditor-debtor relationship to see if the creditor qualifies as a non-statutory insider "is about as factual sounding as any mixed question gets," and therefore is reviewed for clear error. *Id.* at 968.

Trustee Miller argues that the bankruptcy court chose the wrong test from among the choices available; but even if the test were proper, the bankruptcy judge applied it incorrectly to the record facts. In his response brief, Sandell does not say much about the proper test for determining whether he was a non-statutory insider, but he contends that he made a handshake deal to loan money to Torpey based on an expectation that he would be repaid from the lump-sum

disability distribution she was anticipating. That, he says, imbued the transaction with sufficient formalities to consider it to have been made at arm's length, disqualifying him as an insider of any variety.

A.

Neither the Supreme Court nor the Sixth Circuit has endorsed a particular test to determine if a creditor is a non-statutory insider, and the case law on the subject is sparse. The discussion usually begins with the statutory definition of "insider." As relevant to this case, the text reads:

> The term "insider" includes--
> (A) if the debtor is an individual--
> (i) relative of the debtor or of a general partner of the debtor . . . .

11 U.S.C. § 101(31)(A)(i). To consider who else might be "include[ed]" as an insider, bankruptcy courts have expanded that definition "to include positions analogous to those enumerated." *In re Longview Aluminum, L.L.C.*, 657 F.3d 507, 510 (7th Cir. 2011) (citing cases). When deciding whether a certain creditor should be included, "the relevant inquiry for the court is to consider whether the relationship at issue is similar to or has characteristics of any of the defined relationships." *Ibid.* In pursuing that inquiry, it is helpful to consider the rationale behind the legislation.

> Because of his close relationship with the debtor, an insider typically knows more about the debtor's financial affairs than the debtor's other creditors, and is often in a position to influence or control, at least in part, the debtor's actions. An insider is usually the first to know that a debtor is contemplating bankruptcy. Armed with this information and power to control the debtor, the insider may step ahead of other creditors demanding payment and then influence the timing of the debtor's bankruptcy petition to avoid the ninety-day preference period. By extending the preference liability of insiders to one year, Congress made it more difficult for an insider to manipulate the timing of bankruptcy so as to avoid the effect of the preference section.

In re Henderson, 96 B.R. 820, 825 (Bankr. E.D. Tenn. 1989) (citing Nimmer, "Security Interests in Bankruptcy: An Overview of Section 547 of the Code," 17 Hous. L. Rev. 289, 293 n.10 (1980)).

Some of the courts have identified factors to assess, and many have settled on two of them: "the closeness of the relationship between the parties and . . . whether any transactions between them were conducted at arm's length." *In re U.S. Med., Inc.*, 531 F.3d 1272, 1277 (10th Cir. 2008) (quoting *In re Krehl*, 86 F.3d 737, 742 (7th Cir. 1996)); *In re Winstar Commc'ns, Inc.*, 554 F.3d 382, 396–97 (3d Cir. 2009) ("[T]he question is whether there is a close relationship between debtor and creditor and . . . anything other than closeness to suggest that any transactions were not conducted at arm's length.") (alteration and quotation marks omitted); *Matter of Holloway*, 955 F.2d 1008, 1011 (5th Cir. 1992) (same); *In re A. Tarricone, Inc.*, 286 B.R. 256, 262 (Bankr. S.D.N.Y. 2002); *see also* S. Rep. No. 95–989, at 25 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5810 ("An insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm[']s length with the debtor.").

One other court, notably the Ninth Circuit, has articulated an elemental test that must be satisfied before a creditor can be deemed an insider. *In re The Vill. at Lakeridge, LLC*, 814 F.3d 993, 1001 (9th Cir. 2016) ("A creditor is not a non-statutory insider unless: (1) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in § 101(31), *and* (2) the relevant transaction is negotiated at less than arm's length.") (emphasis added, citation omitted). This is the decision that the Supreme Court reviewed in *U.S. Bank National Association ex rel. CWCapital Asset Management LLC v. Village at Lakeridge, LLC*. To meet that test, a trustee (or another creditor) would have to prove *both* that the creditor's relationship is close enough to approximate a relationship listed specifically in the statute, *and* that the transaction was not conducted at arm's length.

As noted, the Supreme Court has not prescribed a test for identifying non-statutory insiders, and it specifically declined to do so in *Village at Lakeridge*. 138 S. Ct. at 965 ("We do not address

the correctness of the Ninth Circuit's legal test; indeed, we specifically rejected U.S. Bank's request to include that question in our grant of certiorari."). The bankruptcy court in this case, however, took guidance from the concurring opinion by Justice Sotomayor in that case, which was critical of the Ninth Circuit's elemental test and suggested alternatives.

The problem with the Ninth Circuit's two-element test, according to the concurrence, was that it was not faithful to the statutory structure. *Vill. at Lakeridge, LLC*, 138 S. Ct. at 970-71 (Sotomayor, J., concurring). Section 101(31) defines an "insider" "merely on the basis of [the creditor's] status." *Id.* at 971. Insider treatment "generally rests on the presumption that a person or entity alleged to be an insider is so connected with the debtor that any business conducted between them necessarily cannot be conducted at arm's length." *Id.* at 970. The Ninth Circuit's test ignored that presumption; instead, it required proof not only of an equivalent relationship, but also proof that the transaction under scrutiny was not conducted at arm's length. *Id.* at 971. That is not true to the statute's status-based definition. *Ibid.* ("[A]n enumerated 'insider' does not cease being an insider just because a court finds that a relevant transaction was conducted at arm's length.").

The *Village at Lakeridge* concurrence suggested two alternate possibilities. One would focus an inquiry "solely on a comparison between the characteristics of the alleged non-statutory insider and the enumerated insiders, and if they share sufficient commonalities, the alleged person or entity should be deemed an insider regardless of the apparent arm's-length nature of any transaction." *Ibid.* Another approach would look through the other end of the telescope, requiring a "broader comparison" that considers "the circumstances surrounding" the challenged transaction. If the transaction "is determined to have been conducted at less-than-arm's length," that might be "strong evidence" of a non-statutory insider relationship. But if the transaction was made at arm's

length, the opposite might be true. This approach would not focus solely on the nature of the transaction; rather the transaction must be "considered together with other aspects of the parties' relationship." *Ibid.*

The bankruptcy court in this case opted for Justice Sotomayor's first approach, concentrating on the features of the relationship between Torpey and Sandell. The trustee argues that was a mistake. He believes that the two-part test used by the Ninth Circuit is the correct rule to be applied, and he asserts that other lower courts have adopted it. He suggests that the bankruptcy court's error was its failure to examine the transaction to see if it was conducted at arm's length.

There are a couple of reasons that the trustee's analysis misses the mark. First, the Ninth Circuit's elemental test stands alone; other courts have not adopted it. The examples trustee cited (*In re Winstar Communications, Inc.*, *In re U.S. Medical, Inc.*, and *In re Krehl*) do not apply an elemental test but instead discuss "factors" that ought to be considered and weighed. Those factors are not intended by those courts to dissect a particular transaction; the determination whether a person is an "insider" is a status inquiry. The arm's-length (or not) nature of the transaction certainly may be relevant, but it is merely a means of reaching the final decision. If one is found to be an "insider," statutory or non-statutory, a finding that a particular transaction was conducted at arm's length will not change that status.

Second, adopting the Ninth Circuit's two-part test would not help the trustee, if the bankruptcy court correctly found that the debtor's and creditor's relationship was not sufficiently close to one listed in the statute. As an elemental test, the proponent must satisfy both elements. The failure of proof on one cannot be fortified by strong proof on the other. *See Vill. at Lakeridge, LLC*, 138 S. Ct. at 970 (Sotomayor, J., concurring).

The bankruptcy court did not err simply because it chose to focus its inquiry on the relationship between Torpey and Sandell. If the court would have found that their relationship approximated a marriage, that would have been the end of the inquiry under 11 U.S.C. § 101(31). The same cannot be said of the Ninth Circuit's test.

B.

The counterfactual, however, is not necessarily true. Although finding that a romantic relationship exists between debtor and creditor that equates to a spousal union may be enough to support non-statutory insider status, a negative finding on that score does not end the inquiry. The closeness of the relationship is but one factor that must be considered as part of "a broader comparison that includes consideration of the circumstances surrounding [the] relevant financial transaction." *Vill. at Lakeridge, LLC*, 138 S. Ct. at 971-72 (Sotomayor, J., concurring); *see also In re U.S. Med., Inc.*, 531 F.3d at 1272, 1277 (10th Cir. 2008) ("The inquiry then is whether there is a close relationship *and* whether there is anything other than closeness to suggest that any transactions were not conducted at arm's length." (emphasis added)). The *Village at Lakeridge* concurrence did not announce two discrete legal tests; it identified "two possible legal standards" that inform an overall inquiry into whether a relationship equates to insider status. 138 S. Ct. at 971. They are not mutually exclusive. They work together.

The insider analysis, after all, must be tackled case by case, "based on the totality of the circumstances." *Longview Aluminum*, 657 F.3d at 509.

The bankruptcy court appears to have read the *Village at Lakeridge* concurrence differently, that is, as putting forth two optional and self-contained "tests," rather than offering an overall framework for a "principled method of determining" whether a creditor qualifies as a non-statutory insider. That reading led the court to end its analysis after it found that Torpey's and

Sandell's romantic relationship did not have the attributes of a marriage. That truncated analysis was error.

The first problem is with the analysis of the relationship itself. The court characterized the question as whether "the defendant act[ed] like the debtor's spouse," and whether "there [were] sufficient commonalities between the defendant's relationship with the debtor and a marriage." Trial Tr. at 132, ECF No. 5, PageID.431. But section 101(31) is not limited to spouses; it includes any "relative of the debtor." 11 U.S.C. § 101(31)(A)(i). Certainly, a spouse qualifies. *In re Dupuis*, 265 B.R. 878, 884 (Bankr. N.D. Ohio 2001) (stating that "a spouse is, by definition, an "insider" for purposes of § 101(31)"). The definition of "relative," though, includes any "individual related by affinity or consanguinity within the third degree as determined by the common law, or individual in a step or adoptive relationship within such third degree." 11 U.S.C. § 101(45). The bankruptcy court did not consider familial relationships other than a spousal one. As the trustee pointed out, there are facts in the record that could support a comparison to sibships.

Second, after it concluded that there were insufficient similarities between the creditor-debtor relationship and a marriage, the bankruptcy court did not consider the nature of the loan transactions in the context of the admittedly close personal relationship between Torpey and Sandell. The relationship comparison by itself is not a gate that swings both ways. A positive finding can be qualifying, but a negative finding is not disqualifying. If the court determined the loan transactions to be less-than-arm's length, that could be "strong evidence" supporting insider status. *Vill. at Lakeridge, LLC*, 138 S. Ct. at 971-72 (Sotomayor, J., concurring). The analysis, however, must be wholistic, focusing on all "aspects of the parties' relationship." *Id.* at 972. Again, the ultimate question is "whether the relationship at issue is similar to or has characteristics of any of the [statutorily] defined relationships," *In re Longview Aluminum*, 657 F.3d at 510, such

that the creditor enjoys "a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor," *id.* at 509 (quotation marks and citation omitted).

The failure to consider the loan transaction as evidence of insider status is not inconsequential. There is evidence that the loans were made at less than arm's length. "[T]he widely (universally?) understood definition of an arm's-length transaction [is] a transaction conducted as though the two parties were strangers." *Vill. at Lakeridge*, 138 S. Ct. at 967-68 (citing Black's Law Dictionary 1726 (10th ed. 2014)). Some factors courts consider are whether a loan was secured; the credit worthiness of the borrower, and the lender's diligence investigating it; formalities, such as written documentation, promissory notes, and recorded security agreements; whether the creditor could control or influence the borrower; whether the creditor could limit the borrower's use of the funds; and the mutual benefits, if any, stemming from the transaction. *See Shubert v. Lucent Techs. Inc. (In re Winstar Commc'ns., Inc.),* 554 F.3d 382, 399 (3d Cir. 2009); *Anstine v. Carl Zeiss Meditec AG (In re U.S. Medical, Inc.),* 531 F.3d 1272, 1281 (10th Cir. 2008); *Miami Police Relief & Pension Fund v. Tabas (In re The Fla. Fund of Coral Gables, Ltd.),* 144 Fed. Appx. 72, 75 (11th Cir. 2005); *In re Holloway,* 955 F.2d 1008, 1012 (5th Cir. 1992); *In re Emerson,* 235 B.R. 702, 707 (Bankr. D.N.H. 1999); *Freund v. Heath (In re McIver),* 177 B.R. 366, 370 (Bankr. N.D. Fla. 1995); *Rush v. Riddle (In re Standard Stores, Inc.),* 124 B.R. 318, 325 (Bankr. C.D. Cal. 1991); *In re Moskowitz*, No. 10-73348-WLH, 2011 WL 6176210, at *7 (Bankr. N.D. Ga. Nov. 29, 2011). Some of the evidence favors a finding that the loans were not arm's-length transactions, such as the interest-free nature of the loans, the failure to keep records, the lack of a repayment timetable, and Torpey's failure to list Sandell as a creditor on her bankruptcy schedule. Other evidence may point in the opposite direction, such as Sandell's knowledge that

there was a source of repayment (the lump-sum pension distribution), the psychic benefit he may have received from helping a friend preserve a valuable asset (her home, which also was a separate place for her to live), the lack of control over the use of her funds, and the absence of any pressure from Sandell for Torpey to repay him ahead of her other creditors. Either way, the issue is a live one and ought to have been considered by the bankruptcy court.

C.

The bankruptcy court found certain facts, but the factual findings did not include any observations of the parties' relationship beyond a comparison to a marriage; nor did it assess the relevant factors of the loan transactions to determine if they shed light on non-statutory insider status. The trustee does not ask this Court specifically to declare Sandell a non-statutory insider, although he does ask that the bankruptcy court's judgment be overturned.

The better practice is to remand the case so that the bankruptcy court can apply the proper legal framework in the first instance. That court is in a better position to make the additional factual findings, and there is some reason to believe that the bankruptcy court's determination might be different on remand. *See Monasky v. Taglieri*, --- U.S. ---, 140 S. Ct. 719, 731 (2020). This Court sits as an appellate court, and, as other appellate courts have observed, it is "'a court of review, not of first view.'" *VanderKodde v. Mary Jane M. Elliott, P.C.*, 951 F.3d 397, 404 (6th Cir. 2020) (quoting *Cutter v. Wilkinson*, 544 U.S. 709, 718 n.7 (2005)).

III.

The judgment of the bankruptcy court is **VACATED**, and the case is **REMANDED** to the bankruptcy court for further proceedings.

s/David M. Lawson
DAVID M. LAWSON
United States District Judge

Dated: April 30, 2020