

High Court Tax Refund Ruling Indicates State Law Authority

By **Todd Meyers and Alfred Lurey** (February 27, 2020)

On Feb. 25, The U.S. Supreme Court issued its decision in *Rodriguez v. Federal Deposit Insurance Corp.*,^[1] a case involving a dispute between (1) the trustee in bankruptcy of a defunct bank holding company, and (2) the FDIC, as receiver for the bank holding company's failed bank subsidiary, over the ownership of a federal income tax refund that was payable by the U.S. Department of the Treasury to the bank holding company as the parent of a consolidated tax filing group.



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The members of the consolidated tax filing group (including the parent and the bank) were parties to a tax allocation agreement at all times relevant to the dispute.

Resolving a split in the circuits, the Supreme Court, in *Rodriguez*, abrogated a federal common law rule that had been embraced by a number of federal courts, including the U.S. Court of Appeals for the Tenth Circuit in the case before it, in adjudicating disputes among members of a consolidated tax filing group over the ownership of a tax refund paid to the parent of the group by a taxing authority, when the tax refund was attributable to the earnings history of a member of the group other than the parent.^[2]



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Most of the reported cases in which the effect of this rule was at issue, including the *Rodriguez* case, involved a dispute over the ownership of tax refunds between the representative of the bankruptcy estate of a bank holding company, on the one hand, and the FDIC, as receiver for the holding company's failed bank subsidiary, on the other. The common feature of these cases was that the holding company and the bank were members of a consolidated tax filing group the members of which were parties to a tax allocation agreement.^[3]

The rule at issue in *Rodriguez* had its genesis in *Western Dealer Management Inc. v. England* (In re: *Bob Richards Chrysler-Plymouth Corp.*),^[4] and came to be known as the *Bob Richards* rule.

In that case, the U.S. Court of Appeals for the Ninth Circuit, apparently crafting a rule of federal common law, held that, absent a differing explicit or implicit agreement among the members of a consolidated tax filing group, a tax refund resulting solely from offsetting the losses of one member of the group, such as an operating subsidiary, against the income of the implicated member in a prior or subsequent year should inure to the benefit of the implicated member. It concluded that allowing the parent to retain such a refund in the absence of an agreement to which the implicated member was a party that allocated tax refunds to the parent of the group would unjustly enrich the parent.^[5]

As the *Bob Richards* rule evolved, the FDIC came to argue that it was not simply a stopgap rule that applied in the absence of a tax allocation agreement but that it represented "a general rule always to be followed unless the parties' tax allocation agreement unambiguously specifies a different result."^[6]

Under the FDIC's interpretation, the rule placed a thumb on the scale in favor of the

implicated member that could be rebutted only if a tax allocation agreement specifically overrode it. Bank holding company estate representatives argued, in contrast, that the Bob Richards rule had no effect in cases where a tax allocation agreement existed.

In the Rodriguez case, at each judicial level before the case reached the Supreme Court, the FDIC argued that the expansive interpretation of the Bob Richards rule applied. The bankruptcy court disagreed. Like the U.S. Court of Appeals for the U.S. Court of Appeals for the Third Circuit in *In re: Downey Financial Corp.*[7], the bankruptcy court construed the Bob Richards rule as a stopgap rule that had no application where the parties had entered into a tax allocation agreement.[8]

The bankruptcy court found the tax allocation agreement, or TAA, to be unambiguous, as both parties had contended. Construing the TAA under Colorado law, it concluded that the TAA unambiguously created a debtor-creditor relationship between the parent and the bank with respect to tax refunds.

Based on that relationship, the tax refund at issue was property of the parent's bankruptcy estate, and the bank was a creditor of the estate with respect to the parent's payment obligations to it under the TAA in respect of the bank's tax attributes. The bankruptcy court rejected the FDIC's argument that the parent received the tax refund as agent for the bank under the TAA as inconsistent with Colorado agency law, under which there can be no agency relationship where the alleged agent is not subject to the control of the alleged principal.[9]

The FDIC appealed to the district court, which reversed the bankruptcy court's judgment in favor of the parent's bankruptcy trustee.[10] Contrary to the finding of the bankruptcy court, the district court concluded that, under Colorado law, the TAA was ambiguous about the nature of the relationship between the parent and the bank created under the TAA regarding the receipt by the parent of tax refunds attributable to the earnings history of the bank.

In the court's view, the TAA was ambiguous under Colorado law because it could be reasonably interpreted to create a debtor-creditor relationship but also could be reasonably interpreted to create a principal-agent relationship.[11]

Insofar as the Bob Richards rule was concerned, the district court observed, among other things, that there had been no analysis of the need for, or the federal interests to be served by, the Bob Richards rule as a rule of federal common law, rendering the rule vulnerable on the question of its validity.

The district court eschewed the opportunity to engage in such an analysis because, in its view, the TAA itself provided a mechanism for resolving the ambiguity without the necessity of considering the validity, scope or potential impact of the Bob Richards rule.[12]

In particular, one of the provisions in the TAA provided:

The intent of this Agreement is to provide an equitable allocation of the tax liability of the Group among [the parent] and the Affiliates. Any ambiguity in the interpretation hereof shall be resolved with a view to effectuating such intent in favor of any insured depository institution.

The district court interpreted this provision as a tie-breaking provision that mandated the resolution of ambiguities under the TAA in favor of the bank.[13] Because it believed that

there was no question about the equitable allocation of a tax refund attributable to the earnings history of the bank, it interpreted the TAA as creating an agency relationship, under which the parent had collected the refund on behalf of the bank.[14]

The bank, therefore, held equitable title to the refund, and it was not property of the parent's bankruptcy estate.

The trustee appealed to the Tenth Circuit, where the FDIC continued to advocate for the expansive interpretation of the Bob Richards rule. Though acknowledging the U.S. Court of Appeals for the Sixth Circuit's criticism of the rule, however interpreted, as a questionable exercise in federal common law rulemaking[15], the Tenth Circuit considered itself bound by its earlier decision in *Barnes v. Harris*,[16] which it interpreted as adopting the expansive interpretation of the Bob Richards rule.[17]

Accordingly, it described its task as follows:

Consequently, we must look to the terms of the Agreement and, taking into account Colorado case law, decide whether it unambiguously addresses how tax refunds are to be handled and, if so, whether it purports to deviate from the general rule outlined in *Barnes* and *Bob Richards*. [18]

In construing the TAA, the Tenth Circuit relied on essentially the same factors as the district court in reaching the conclusion that an agency relationship, rather than a debtor-creditor relationship, was created under that agreement between the parent and the bank regarding tax refunds that were attributable to the earnings history of the bank.

Like the district court, the Tenth Circuit found the TAA to be ambiguous about the relationship created between the parent and the bank with respect to tax refunds and determined that the tie-breaking provision in the TAA resolved the ambiguity in the bank's favor.[19] In sum, the court concluded that the TAA's intended treatment of tax refunds, as evidenced in the tie-breaking provision, did not differ from the general federal common law rule. The tax refund at issue therefore belonged to the bank.

Though the outcome likely would have been no different if the Tenth Circuit had decided the case based solely on its interpretation of state law, by incorporating the Bob Richards rule into its analysis, the court provided a convenient pathway for seeking Supreme Court review of the legitimacy of the federal common law rule the court had embraced. Taking advantage of that opportunity, the trustee filed a petition for a writ of certiorari that was granted by the Supreme Court.[20]

The question presented for Supreme Court determination in the *Rodriguez* case was formulated as:

Whether courts should determine ownership of a tax refund paid to an affiliated group based on the federal common law "Bob Richards rule," as three Circuits hold, or based on the law of the relevant State, as four Circuits hold.

Notwithstanding that formulation of the question presented, in a somewhat unusual move, the Office of the Solicitor General, which represented the FDIC at the Supreme Court level, decided to change tack and not defend the Bob Richards rule. It instead conceded at oral argument that federal courts should not apply a federal common law rule to put a thumb on the scale when deciding which corporate group member owns some or all of a consolidated refund.[21]

Though the government argued that the Tenth Circuit's judgment in favor of the FDIC should be affirmed on grounds not implicating the Bob Richards rule, the Supreme Court vacated that judgment and remanded the case for further proceedings consistent with its abrogation of the Bob Richards rule.

It concluded that the federal government had no unique interest in determining how a tax refund should be allocated among the members of a corporate consolidated tax filing group that could justify the crafting of a federal common law rule for application in making such a determination.[22]

Finally, the Supreme Court expressed no view on how the case should be resolved under applicable state law, but observed that "whether this case might yield the same or a different result without Bob Richards is a matter the court of appeals may consider on remand." [23]

The Supreme Court's decision should not be read as limited to disputes between an estate representative of a bankrupt bank holding company and the FDIC, as receiver for a failed bank subsidiary.

It signals that state law provides the rule of decision in determining ownership of a tax refund among the members of any consolidated tax filing group, unassisted by any federal common law rule.

It also appears to abrogate the federal Bob Richards rule even as a stopgap rule when a tax allocation agreement does not exist. It in no way inhibits, however, the application of a rule of state law that might mirror the Bob Richards rule.

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[1] 589 U.S. ____ (2020) [No. 18-1269 (Feb. 25, 2020)].

[2] See, e.g., *Rodriguez v. Fed. Deposit Ins. Corp. (In re United Western Bancorp, Inc.)*, 914 F.3d 1262 (10th Cir. 2019); *Barnes v. Harris*, 783 F.3d 1185 (10th Cir. 2015); *Capital Bancshares, Inc. v. Fed. Deposit Ins. Corp.*, 957 F.2d 203 (5th Cir. 1992).

[3] See, e.g., *Cantor v. Fed Deposit Ins. Corp. (In re Downey Fin. Corp.)*, 593 F. App'x 123 (3d Cir. 2015); *Fed. Deposit Ins. Corp. v. Zucker (In re NetBank, Inc.)*, 729 F.3d 1344 (11th Cir. 2013); *Fed. Deposit Ins. Corp. v. Siegel (In re IndyMac Bancorp, Inc.)*, 554 F. App'x 668 (9th Cir. 2014); *Fed. Deposit Ins. Corp. v. AmFin Fin. Corp.*, 757 F.3d 530 (6th Cir. 2014); *Zucker v. FDIC (In re BankUnited Fin. Corp.)*, 727 F.3d 1100 (11th Cir. 2013); *Imperial Capital Bancorp, Inc. v. Fed. Deposit Ins. Corp. (In re Imperial Capital Bancorp, Inc.)*, 492 B.R. 25 (S.D. Cal. 2013).

[4] 473 F.2d 262 (9th Cir. 1973).

[5] Id. 264-65.

[6] Rodriguez, slip op. at 3.

[7] Downey, 593 F. App'x at 126.

[8] Rodriguez v. Fed. Deposit Ins. Corp. (In re United Western Bancorp, Inc.), 558 B.R. 409, 433 (Bankr. D. Colo. 2016).

[9] Id. at 431.

[10] Fed. Deposit Ins. Corp. v. Rodriguez (In re United Western Bancorp, Inc.), 574 B.R. 876 (D. Colo. 2017).

[11] Id. at 894.

[12] Id.

[13] Id.

[14] Id.

[15] See AmFin., 757 F.3d at 535-36.

[16] See note 2 *supra*.

[17] Rodriguez, 914 F.3d at 1269-1270.

[18] Id. at 1270.

[19] Id. at 1273-74. In construing the TAA, the court did not address the trustee's argument that, under applicable state law, no agency relationship was created because an essential element of the creation of an agency relationship under state law, namely, that the principal have control over the agent in connection with the subject matter of the agency, did not exist under the TAA. In contrast, the absence of such control was found by the Third Circuit to be outcome determinative in favor of a bankrupt bank holding company on the issue of ownership of a tax refund attributable to the earnings history of its failed bank subsidiary in the Downey Financial case. Downey, 593 F. App'x at 126 ("[T]he TSA cannot be read as creating a principal/agent relationship under California law because Downey Bank did not exercise control over [the holding company's] activities under the agreement.").

[20] Rodriguez v. F.D.I.C., 139 S. Ct. 2778 (2019).

[21] See Rodriguez, slip op. at 5.

[22] Id. at 4-5.

[23] Id. at 6.