UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

THE BENNETT FUNDING GROUP, INC.

Debtors

CASE NO. 96-61376
Chapter 11
Substantively Consolidated

RICHARD C. BREEDEN, as Trustee for
THE BENNETT FUNDING GROUP, INC.

Plaintiff

vs.

ADV. PRO. NO. 98-70510

FIRST NATIONAL BANK OF CARMI
FIRST NATIONAL BANK OF CARMI AS
AGENT FOR JANE ABSHER
FIRST NATIONAL BANK OF CARMI AS
AGENT FOR HENRY ABSHER
FIRST NATIONAL BANK OF CARMI AS
AGENT FOR RON ABSHER
FIRST NATIONAL BANK OF CARMI AS
AGENT FOR HENRY ABSHER D/B/A
ABSHER OIL COMPANY

Defendants

RICHARD C. BREEDEN, as Trustee for
THE BENNETT FUNDING GROUP, INC.

Plaintiff

vs.

ADV. PRO. NO. 98-70503

AMERICAN FEDERAL BANK

Defendant

RICHARD C. BREEDEN, as Trustee for
THE BENNETT FUNDING GROUP, INC.

Plaintiff

vs. ADV. PRO. NO. 98-70489

BANK OF WESTERN INDIANA

Defendant

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Presently under consideration by the Court are motions (Motions"), filed on July 22, 1999, by First National Bank of Carmi, as Agent and on its own behalf,[1] and American Federal Bank, and on August 9, 1999, by Bank of Western Indiana (collectively, the "Movants"),

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[1] First National Bank of Carmi serves as agent for, *inter alia*, Jane and Ron Absher. On July 22, 1999, the Trustee commenced separate adversary proceedings against Jane Absher (Adv. Pro. No. 98-42451) and Ron Absher (Adv. Pro. No. 98-40182). The Trustee indicates in his memorandum of law, filed August 31, 2000, that he would dismiss the two adversary proceedings against Jane and Ron Absher if provided with proof that they are duplicative of that filed against First National Bank of Carmi (Adv. Pro. No. 98-70510). *See* Trustee's Memorandum of Law at Footnote 31. Accordingly, the Court would request that the parties attempt to resolve those matters. If the parties are unable to reach an agreement, they may return to the Court for resolution of the matters.

requesting dismissal of certain causes of action asserted by Richard C. Breeden ("Breeden" or "Trustee")[2] in the above-referenced adversary proceedings. The Trustee, *inter alia*, seeks to avoid as fraudulent certain pre-petition transfers made by the Debtors to the Movants. He also seeks turnover of any monies recovered as property of the estate pursuant to Code §§ 541 and 542. Pursuant to Rule 7012(b) of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P."), the Movants contend that the Trustee fails to state a claim under the fraudulent conveyance provisions of Code § 548(a)(1) and New York's version of the Uniform Fraudulent Transfer Act ("UCFA"), codified as New York Debtor & Creditor Law ("NYD&CL") § 271-276. The Movants also argue that the Trustee's factual allegations set forth in his complaints do not comply with the particularity requirements of Fed.R.Bank.P. 7009(b). Finally, Movants request that the Trustee's causes of action seeking turnover be dismissed.

The Motions were originally scheduled to be heard on August 26, 1999, and have been adjourned and carried on the Court's calendar pursuant to a stipulation executed by the Trustee and the Movants, as well as by various other financial institutions, on or about October 11, 1999.[3] Under the terms of the stipulation, all motions to dismiss the Trustee's causes of action asserted in various adversary proceedings were stayed pending a decision by the former United States Bankruptcy Appellate Panel for the Second Circuit ("BAP") in connection with the appeal of a decision rendered by this Court on February 9, 1999. *See Breeden v. Gloucester Bank and Trust*

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[2] The Trustee was appointed chapter 11 trustee of the consolidated estates of eight related entities, including The Bennett Funding Group, Inc. ("BFG") (collectively, the "Debtors"), which filed for bankruptcy under chapter 11 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"), between March 29, 1996, and July 25, 1997 when the debtor estates were consolidated pursuant to an order of this Court.

[3] By Order dated October 25, 1999, the Court approved the stipulation.

Co. (In re The Bennett Funding Group, Inc.), Case No. 96-61376, Adv. Pro. No. 98-70037 (Bankr. N.D.N.Y. Feb. 9, 1999) ("February 1999 Decision). In the February 1999 Decision the Court denied Gloucester Bank's motion to dismiss certain causes of action of the Trustee, including that alleging constructive fraudulent conveyances pursuant to NYD&CL §§ 273-275, based on a finding that if the Trustee was able to prove a lack of good faith on the part of the transferor, namely BFG, he would establish that the transactions at issue were not made for fair consideration. *See* February 1999 Decision at 32. On March 17, 1999, the Court issued separate decisions in six other adversary proceedings commenced by similarly situated banks, incorporating and adopting the conclusions of law of the February 1999 Decision in their entirety.

On July 22, 1999, the former BAP granted leave to the seven banks to appeal the above-referenced decisions with respect to the issue of "fair consideration" in a constructive fraud cause of action based on NYD&CL § 273, 274 and 275. The BAP rendered its decision on May 25, 2000 ("BAP Decision") concluding that only the good faith of the transferee, not that of the transferor, is to be considered when determining fair consideration for purposes of constructive fraudulent transfers.

Following the BAP Decision, the Motions were again placed on the Court's calendar. Opposition to the Motions was filed by the Trustee on August 31, 2000, and a hearing was held in Utica, New York, on September 14, 2000. In accordance with the February 1999 Decision, as well as the BAP Decision, this Court signed an Order in each of the adversary proceedings herein on September 29, 2000, granting the Movants' Motions to the extent that they sought dismissal of the constructive fraudulent conveyance causes of action based on Code § 548(a)(1)(B) and NYD&CL §§ 273-275. The Court reserved on the Movants' Motions, filed

pursuant to Fed.R.Bankr.P. 7009(b) and 7012(b) to the extent that they sought dismissal of the fraudulent conveyance actions based upon actual fraud pursuant to the NYD&CL § 276. The Court also reserved decision on the Motions insofar as they sought dismissal of the Trustee's causes of action seeking turnover pursuant to Code §§ 541 and 542.

JURISDICTIONAL STATEMENT

The Court has jurisdiction over the parties and subject matter of these adversary proceedings pursuant to 28 U.S.C. §§ 1334 and 157(a), (b)(1), (b)(2)(A), (H) and (O).

FACTS

As set forth in his complaints, the apparent basis for the Trustee's causes of action in the above-referenced adversary proceedings is an allegation that the Debtors were operating an elaborate "Ponzi scheme" whereby the Debtors leased equipment and provided financing to vendors and manufacturers of the equipment. The Trustee alleges that the Debtors financed their capital and cash flow needs by (i) obtaining investments and loans by pledging the same lease multiple times to investors and pledging that same lease to a financial institution and (ii) pledging to investors fictitious leases." (Complaints at ¶ 9). Because the lease payments from the lessees were insufficient to satisfy the obligations due investors and financial institutions, the Debtors met their obligations by using funds raised from new investors or leases pledged to others. (*Id.* at ¶ 11). Funds received by the Debtors from a variety of sources were commingled into a single

account, referred to as the "Honeypot." (*Id.*). Between March 29, 1990 and March 29, 1996, the Debtors made payments to the Movants using funds from the Honeypot. (*Id*. at ¶ 13). It is those transfers of funds to the Movants which the Trustee now seeks to avoid.

DISCUSSION

Motion to Dismiss for Failure to Plead Fraud with Particularity pursuant to Fed.R.Bankr.P 7009(b)

Having previously granted the Movants' Motions to dismiss the causes of action based on constructive fraud by virtue of the Court's Order, dated September 29, 2000, the Court need only address the Movants' Motions pursuant to Fed.R.Bankr.P. 7009(b) as they apply to the Trustee's causes of action based on actual fraud pursuant to Code § 548(a)(1)(A) and NYD&CL § 276.

> Under the actual fraudulent transfer provision of Code § 548(a)(1), a prepetition transfer will be avoidable if the debtor "made such transfer . . . with the actual intent to hinder, delay, or defraud" a present or future creditor. Similarly, NYD&CL § 276 provides that "[e]very conveyance made . . . with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." Under either statute, the fraud which must be pleaded with particularity is that of the debtor-transferor; knowledge of the fraud or other misconduct on the part of the transferee is not an element of the plaintiff's proof.

Breeden v. Walnut Street Securities (*In re The Bennett Funding Group, Inc.),* Case No. 96-61376, Adv. Pro. No. 98-70256, slip op. at 6-7 (Bankr. N.D.N.Y. Nov. 24, 1998) (citations omitted).

In *Walnut Street* the Trustee alleged that the defendants were brokers who sold fraudulent

interests in the Debtors' Ponzi operation and that every commission that they received had the indirect effect of prolonging the scheme. The Court concluded that the Trustee had provided sufficient information to the defendants to allow for effective litigation and denied their motion to dismiss pursuant to Fed.R.Bankr. 7009(b). *Id.* at 7-8.

In *Breeden v. First Nationwide (In re The Bennett Funding Group, Inc.)*, Case No. 96-61376, Adv. Pro. No. 98-70528 (Bankr. N.D.N.Y. Nov. 25, 1998) ("Nationwide I Decision"), the Court found that the Trustee's complaint against the defendant did not comply with Federal Rules of Civil Procedure ("Fed.R.Civ.P.") 9(b) and Fed.R.Bankr.P. 7009 in that the Trustee had simply alleged the payment of money by the Debtors to the defendant without indicating why the money was paid, what services or property were provided by the defendants in exchange or how the transaction operated to defraud creditors of the Debtors. *Id.* at 5. The Court noted that "mere invocation of the phrase 'Ponzi scheme' does not by itself satisfy the requirement of Fed.R.Civ.P. 9(b)." *Id.* The Court noted that "[m]issing from the complaint is any factual allegation that even remotely suggests a nexus between this fraud and the alleged payments to Defendants. Without a more precise description of this nexus, Defendant cannot fairly be expected to prepare a coherent answer to the Trustee's allegations of fraud . . . ." *Id.* at 6. The complaint in *Nationwide*, filed March 27, 1998, merely alleged that "[o]ne or more Debtors made payments to Defendant in the amounts and on or about the dates set forth on Exhibit A hereto . . . . The transfers were paid to Defendant from the Honeypot." (*Nationwide* Complaint at ¶ 14). A review of the complaints in the adversary proceedings presently under consideration by the Court reveals the same lack of specificity that was found in the *Nationwide* complaint. The Trustee argues that the Defendants have been actively involved in this case over the past four years and are fully

aware of the issues and "are perfectly capable of answering the complaints if they wish to deny liability for the transfers made to them pre-petition." *See* Trustee's Memorandum of Law, filed August 31, 2000, at 31-32. That may, indeed, be the case but under the standards discussed in both *Walnut Securities* and *Nationwide*, the Defendants should not be expected to have "to respond to an extremely broad-based allegation of fraudulent intent, without having the slightest indication of what its role in the fraud is alleged to be." *See Breeden v. First Nationwide (In re The Bennett Funding Group, Inc.)*, Case No. 96-61376, Adv. Pro. No. 98-70528, slip op. at 5 (Bankr. N.D.N.Y. April 27, 1999) ("Nationwide II Decision") (declining to reconsider its prior ruling rendered in the Nationwide I Decision). Accordingly, the Movants' Motions, to the extent that they seek dismissal of the Trustee's causes of action based on actual fraud are granted pursuant to Fed.R.Bankr.P 7009(b).

Motion to Dismiss pursuant to Fed.R.Bankr.P. 7012

Because the Court will grant the Movants' request for dismissal pursuant to Fed.R.Bankr.P. 7009(b), it need not address the Motions requesting dismissal of the Trustee's causes of action alleging actual fraudulent conveyances pursuant to Fed.R.Bankr.P. 7012 at this time.[4]

Motion to Dismiss Code § 541 and § 542 Cause of Action for Turnover

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[4] On February 21, 2001, the Court rendered a decision with respect to the seven banks referenced above denying the motions seeking dismissal of the Trustee's causes of action/counterclaims for actual fraud based on NYD&CL § 276. *See Breeden v. Gloucester Bank and Trust Co. et al. (In re The Bennett Funding Group, Inc.)*, Case No. 96-61376 (Bankr. N.D.N.Y. Feb. 21, 2001).

In addition, the Movants seek dismissal of the Trustee's claim for turnover pursuant to Code § 542 on the basis that a dispute exists as to whether the transfers can be recovered by the Trustee. The Trustee responds that it would be inappropriate to dismiss the turnover claim but acknowledges that any relief sought by him would have to await a determination whether the Movants are liable for fraudulent conveyances.

Code § 542 requires turnover of property of the estate to the Trustee. *See Dunes Hotel Associates v. Hyatt Corp.*, 245 B.R. 492, 505 (D.S.C. 2000).

> Until a judicial determination has been made that the property was, in fact, fraudulently transferred, it is not property of the estate. If it were, the trustee could simply use a turnover action under 11 U.S.C. § 542, and the two (2) years statute of limitation of § 546(a) for actions under §§ 544 and 548 could be avoided.

In re Saunders, 101 B.R. 303, 304-5 (Bankr. N.D. Fla. 1989). Code § 550 allows the Trustee to recover for the benefit of the estate the property preferentially or fraudulently transferred. Thus, Code § 550 does not become operational until the Trustee has successfully avoided the transfers pursuant to Code § 544 or § 548. *See id.* Pursuant to Code § 541(a)(3), property recovered by the Trustee under Code § 550 becomes property of the estate automatically as a matter of law. *See Dunes Hotel* at 505. Pursuant to Code § 542(a), the Trustee has the right to demand the turnover of property of the estate which he may use, sell or lease under Code § 363. *See generally In re Bostic*, 171 B.R. 270, 274 (Bankr. N.D. Ohio 1994) (addressing right of trustee to demand turnover of property avoided as a preferential transfer); *Jobin v. Resolution Trust Corp.*160 B.R. 161, 170 (D. Colo. 1993); *see also Dunes Hotel*, 245 B.R. at 505 (noting that "§ 542 mandates only the turnover of 'property of the estate' to a bankruptcy trustee").

Accordingly, the Court concludes that while the Trustee initially has no independent

cause of action based on Code § 542, he is entitled to seek turnover of property transferred to the Movants if found to have been fraudulently conveyed. Therefore, the Court will deny as premature that portion of the Movants' motions which seeks dismissal of the Trustee's cause of action for turnover.

Based on the foregoing, it is hereby

ORDERED that the Movants' Motions seeking dismissal of the Trustee's causes of action based on actual fraud pursuant to Fed.R.Bankr.P. 7009(b) are granted without prejudice to the Trustee's filing and serving amended complaints in the respective adversary proceedings in accordance with this Decision within 30 days of this Order; and it is finally

ORDERED that the Movants' Motions seeking dismissal of the Trustee's causes of action seeking turnover pursuant to Code §§ 541 and 542 are denied.

Dated at Utica, New York

this 20th day of April 2001

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge