

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

FOURTH BRANCH ASSOCIATES
MECHANICVILLE

CASE NO. 94-10972

Debtor Chapter 11

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

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

Before the Court is a motion for approval of a
Stipulation entered into between Fourth Branch Associates

Mechanicville ("Debtor") and its secured creditor Key Bank of New York ("Key") or or about April 11, 1994, for the use of "cash collateral" under §365 of the Bankruptcy Code (11 U.S.C. §§101-1330)("Code") and for adequate protection under Code §361. The identified "cash collateral" is a stream of court-ordered payments directed to be paid by Niagara Mohawk Power Corporation ("Niagara Mohawk") to the Debtor pursuant to an Order of this Court dated March 31, 1994. Niagara Mohawk filed an objection to Debtor's motion for approval of the Stipulation (C.P. No. 11). A hearing was held before the late Honorable Justin J. Mahoney on May 9, 1994. At that hearing, the parties were directed to further brief their respective positions as to whether Key's security interest extends to the court-ordered payments. The parties submitted briefs on the issue, which is now framed for decision before the Court.¹ This memorandum incorporates the court's findings of fact and conclusions of law as provided by Federal Rule of Bankruptcy Procedure ("FRBP") 7052 made applicable by FRBP 9014.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction of this contested matter pursuant to U.S.C.

¹ This pending submitted matter ws transferred for decision to the U.S. Bankruptcy Court in Utica, New York following the June 10, 1994 death of Judge Mahoney.

FACTS

The Debtor's sole source of income flows from its redevelopment of a hydroelectric facility on the Hudson River just south of the City of Mechanicville. The plant, originally built in 1897, is owned by Niagara Mohawk. In 1987, Albany Engineering Corporation, now a general partner of the Debtor, was approached by Niagara Mohawk to renovate and operate the plant. The Debtor was formed for the express purpose of redeveloping the hydroelectric plant.

With regard to the project, the Debtor and Niagara Mohawk entered into three agreements: 1) an Operation and Maintenance Agreement ("O&M Agreement"), dated August 14, 1989 and amended on May 16, 1990, January 9, 1991 and December 31, 1991; 2) a 40 year Lease Agreement ("Lease"), dated August 14, 1989 and 3) an Energy Sales Agreement ("Sales Agreement"), dated August 14, 1989.² In addition, Niagara Mohawk and the Debtor jointly applied for a new license from the Federal Energy Regulatory Commission ("FERC").

In order to finance the redevelopment, the Debtor borrowed money from Key in 1990 and 1993, in the respective amounts of \$900,000 and \$1,460,000. These loans are evidenced by promissory notes and loan documents which include the grant of a security interest in favor of Key covering the debtors' interest in the above-referenced agreements as well as in the license.

² It is Niagara Mohawk's position that the second and third contracts are void due to the failure to obtain approval from the Public Service Commission.

In June, 1993, the FERC issued a 50 year license to Niagara Mohawk and the Debtor as joint-licensees. Thereafter, on September 22, 1993, Niagara Mohawk issued a 90 day notice to the debtor of its intent to unilaterally terminate the O&M Agreement. Pursuant to the notice, Niagara Mohawk ceased making payments to the Debtor under the Agreement after December 22, 1993. The Debtor sought a preliminary injunction against Niagara Mohawk in New York State Supreme Court, Albany County ("State Court"), to prevent Niagara Mohawk from terminating the aforementioned O&M Agreement. When the relief was denied, the Debtor commenced the current case under Chapter 11 of the Code on March 18, 1994. At the time of the filing, the Debtor owed Key Bank approximately 1.8 million dollars on the two outstanding loans.

The Debtor removed the pending state court litigation to the this Court and sought emergency relief from the Court for payments from Niagara Mohawk for its ongoing production and supply of power. (Adversary Proceeding Case No. 94-91066)

After a hearing on March 28, 1994, the Court remanded the pending litigation to state court and modified the automatic stay to permit the litigation to proceed. The Court directed Niagara Mohawk to pay the debtor 3.2 cents per kilowatt hour for electricity provided to Niagara Mohawk from December 23, 1993 through March 30, 1994, totaling \$128,199.20. It further directed Niagara Mohawk to make monthly payments for the ongoing electricity provided by the Debtor pending determination and without prejudice to the parties' rights in the State Court action. This directive was embodied in a written order dated March 31,

1994. These Court-ordered payments are the subject of the present motion and of the proposed Stipulation presented for the Court's approval.

DISCUSSION

"Cash Collateral" is defined under the Code at §363(a) as:

cash...in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property subject to a security interest as provided in section 552(b) of ~~this~~ title, whether existing before or after the commencement of a case under this title.

The proposed Stipulation purports to recognize the initial Court-ordered payment of \$128,199.23 as 'cash collateral' to be deposited in a separate cash collateral account and provides that all ongoing payments be treated in like fashion. It further provides that the Debtor grant Key a post-petition security interest in accounts receivable acquired subsequent to the commencement of the case and recognizes a security interest in favor of Key in the lawsuit pending in state court, in any quantum meruit awards, settlements, agreement or other disposition of the lawsuit. (¶6 of "Stipulation and Agreement Providing for Inter Alia, Usage of Cash Collateral Pursuant To 11 U.S.C. §363; Providing Adequate Protection Pursuant to 11 U.S.C. §361").

The basis of Niagara Mohawk's objection is that Key does not have a security interest in the payments being made to the Debtor pursuant to this Court's Order, and that they are, therefore, not "cash collateral" within the meaning of Code

§363(a). In addition, Niagara Mohawk objects to broadening the sweep of Key's lien and granting additional collateral to secure that lien post-petition.

Key's Security Interest

As security for the 1990 loan, the Debtor granted Key a security interest in the following:

Security. The Borrower (Debtor) as security for the payment and performance of the Loan **hereby unconditionally, irrevocably and absolutely assigns, transfers and sets over unto the Bank (Key Bank), and grants the Bank a first continuing security interest in, all of the Borrower's right, title and interest in and to the O&M Agreement, and all money due or to become due thereunder and in and to all modifications, renewals and replacements of the foregoing, including but not limited to a certain lease agreement between the Borrower and NiMo dated August 14, 1989 (the "Lease") and an energy sales agreement dated August 14, 1989 (the "Energy Sales Agreement"). The aforesaid being collectively referred to herein as the "Collateral".**

The Borrower hereby authorizes, empowers and directs NiMo to make all payments due or to become due to the Borrower under the O&M Agreement, Lease and/or the Energy Sales Agreement directly to the Bank.

...

The Borrower authorizes and empowers the Bank in its own name, or otherwise to receive and collect all monies due or to become due the Borrower, as aforesaid, and to give all the leases, receipts and acquittances required to be given therefore and to do all things that Borrower could do under the O&M Agreement; the Assignor (Debtor) hereby appointing the Assignee (Key Bank) as its true and lawful attorney-in-fact, irrevocably for it in its name and stead and for the Bank's own benefit to ask, demand, collect, receive and sue for monies due or to become due as aforesaid and to do any and all things necessary or proper in the premises with the same force and effect as the Borrower could

have done had this assignment not been made; hereby ratifying and confirming all that the Bank may be lawfully do by virtue of such appointment as attorney-in-fact.

Paragraph 6 at pages 6-8 of the 1990 Loan Agreement. (emphasis supplied)

The collateral recited in the 1993 Loan Agreement was similar, but slightly at variance and included an interest in the Debtor's then pending license:

... a continuing security interest in all of the Borrower's right, title and interest in and to the O&M Agreement, that certain lease agreement between the Borrower and NiMo dated August 14, 1989 (the "Lease"), that certain Energy Sales Agreement dated August 14, 1989 (the "Energy Sales Agreement"), all monies due or to become due under any of the aforesaid and all of the Borrower's right, title and interest in and to all modifications, renewals and replacements of the foregoing. The Borrower further grants to the Lender, to the extent permitted by law, a security interest and assignment of all of the Borrower's right, title and interest in and to (i) that application pending before the Energy Regulatory Commission for a long term license to operate and further rehabilitate the Project (the "New License"), and (ii) the New License for the Project, if issued by the Federal Energy Regulatory Commission. All of the aforesaid being collectively referred to herein as the "Collateral".

UCC-1 financing statements were duly filed reflecting the aforementioned interests.

In reviewing the above language, the Court finds the language chosen to be clear and unambiguous. Key's security interest extends to the O&M Agreement, the Lease and the Sales Agreement, monies due thereunder, and all "modifications", "renewals" and "replacements" thereof. The three latter terms are not defined in the Uniform Commercial Code, but are given their common meaning. In the foregoing context, the terms imply

modification or changes to the underlying agreements, any renewals of the same agreements and any agreements substituted to replace them.

Nature of Court-Ordered Payments

The Debtor, in its papers, characterizes the payments ordered by the Court as "compensation under the equitable theory of quantum meruit". It is a remedy fashioned in a situation where a person has been unjustly enriched at the expense of another. Since the remedy lay in the form of an action traditionally recognized as contractual, it was necessary to imply a promise to restore the benefit, although no such promise was ever made. As stated by the New York Court of Appeals in Clark-Fitzpatrick v. Long Island R.R., 70 N.Y. 2d 382, 388 (Ct. App. 1987):

A "quasi contract" only applies in the absence of an express agreement, and is not really a contract at all, but rather a legal obligation imposed in order to prevent a party's unjust enrichment (Parsa v State of New York 64 N.Y. 2d 143, 148; Farash v Sykes Datatronics, 59 N.Y. 2d 500, 504; Bradkin v Leverton, 26 N.Y. 2d 192, 197; Smith v Kirkpatrick, 305 N.Y. 66, 73; Gromback Prods. v Waring, 293 N.Y. 609, 615; Miller v Schloss, 218 NY 400, 407; see also, 1 Williston, Contracts § 3A [3d ed]; Calamari and Perillo, Contracts §1-12, at 19 [2d ed]; 1 Corbin, Contracts § 19).

The remedy fashioned by the Court is not an agreement and cannot reasonably be viewed as a "replacement" traceable to the contracts pre-petition constituting the collateral of Key. Clearly, it does not arise from any "modifications" or "renewals" of the pre-petition contracts, which arguably were terminated by Niagara Mohawk in December 1993.

Code §552 provides in pertinent part:

(a)...property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

(b)...if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court after notice and hearing and based on the equities of the case orders otherwise.

The Debtor's right to payments arose under this Court's Order of March 31, 1994 - post-petition. As property acquired after the commencement of the case, the Court finds that this property right is not subject to Key's lien under Code §552(a). Nor does §552(b) alter this result. The Court-Ordered payments cannot be deemed 'proceeds' of Key's collateral.³

Alternatively, what the Debtor possessed pre-filing was a chose in action against Niagara Mohawk. (Citation) Properly described, it constitutes a "general intangible" under the Uniform Commercial Code. See New York Uniform Commercial Code §9-106. The language of Key's security agreement is totally devoid of language which would include choses in action or other general intangibles. The cases cited by the Debtor In re SRJ Enterprises,

³ "Proceeds" is defined under §9-306(1) of the New York Uniform Commercial Code to include "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds". McKinney's Consolidated Laws of New York (McKinney's 1990).

Inc., 150 B.R. 933 (Bankr. N.D.Ill. 1993) and In re Silvernail Mirror and Glass, Inc., 142 B.R. 987 (Bankr. M.D.Fla. 1992), are factually inapposite in that the security agreements being considered herein do not include the term "general intangibles". See also Matter of Candy Lane Corp., 38 B.R. 571, 576 (Bankr. S.D.N.Y. 1984).

Upon a review of the cases briefed by the parties regarding common law assignments, the Court finds no alternate basis to conclude that Key is secured in the interim payments ordered by the Court.

CONCLUSION

The Court finds that the stream of income paid to the Debtor pursuant to this Court's Order of March 31, 1994 is an unencumbered asset of this estate and does not constitute "cash collateral" in which Key has an interest,

Accordingly, the Debtor's motion for approval of the proposed stipulation is hereby denied.

IT IS SO ORDERED.

Dated at Utica, New York

this day of 1995

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge

