

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. 98-70022

SECURITY BANK

Defendant

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

Plaintiff

vs.

ADV. PRO. NO. 98-70025

STORY COUNTY BANK & TRUST

Defendant

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

Plaintiff

vs.

ADV. PRO. NO. 98-70029

AMCORE BANK, N.A.

Defendant

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

Plaintiff

vs.

ADV. PRO. NO. 98-70032

COMMERCIAL BANK

Defendant

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

Plaintiff

vs.

ADV. PRO. NO. 98-70035

FIRST FEDERAL SAVINGS & LOAN
ASSOCIATION OF GALION

Defendant

APPEARANCES:

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

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

Presently under consideration by the Court are motions ("Motions"), filed on June 1, 1999, on behalf of Security Bank, First Federal Savings & Loan Association of Galion, Amcore

Bank, N.A., Story County Bank & Trust and Commercial Bank¹ (collectively, the “Movants”), requesting dismissal of certain causes of action asserted by Richard C. Breeden (“Breeden” or “Trustee”)² in the above-referenced adversary proceedings. The Trustee, in his amended complaints, filed February 26, 1998, *inter alia*, seeks to avoid as fraudulent certain pre-petition transfers made by the Debtors to the Movants. 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 amended complaints do not comply with the particularity requirements of Fed.R.Bankr.P. 7009(b).

The Motions were originally scheduled to be heard on July 8, 1999, and were 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

¹ There are two adversary proceedings pending against Commercial Bank, namely Adv. Pro. No. 98-70032 and Adv. Pro. No. 98-70508. This decision will only address the relief sought with respect to Adv. Pro. No. 98-70032 in which the Trustee filed an amended complaint. As suggested by the Trustee in his memorandum of law, filed August 31, 2000, in Adv.Pro.No. 98-70508, the Court would request that the parties attempt to resolve things so that the Trustee’s claims against Commercial Bank can be litigated together in a single adversary proceeding. If the parties are unable to reach an agreement, they may return to the Court for resolution of the matter.

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.

the terms of the stipulation, all motions to dismiss the Trustee's causes of action to avoid alleged fraudulent conveyances 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 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 those 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 §§ 273-275. 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 October 30, 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 to the extent that they sought dismissal of the fraudulent conveyance actions based upon actual fraud pursuant to the NYD&CL § 276 and Code § 548(a)(1)(A).

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 amended complaints, the apparent basis for the Trustee's causes of action alleging fraudulent transfers in the above-referenced adversary proceedings is an allegation that the Debtors operated 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." Movants are alleged to be financial

institutions that claim to have loaned monies to one or more of the Debtors. 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. Funds received by the Debtors from a variety of sources were commingled into a single account, referred to as the “Honeypot.” Between March 29, 1990 and March 29, 1996, the Debtors made payments to the Movants using funds from the Honeypot. 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 October 30, 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.P. 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), the Court found that the Trustee's complaint against the defendant, seeking to avoid certain transfers pursuant to the actual and constructive fraudulent conveyance provisions of Code § 548(a)(1) and NYD&CL §§ 271-278, did not comply with Fed.R.Civ.P. 9(b) and Fed.R.Bankr.P. 7009. The complaint in *Nationwide* 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 Honey pot." (*Nationwide* Complaint at ¶ 14). The Court found that the Trustee had not indicated 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.

Unlike the complaint in *Nationwide*, the Trustee’s amended complaints in the above-referenced adversary proceedings identify the Movants/Defendants as financial institutions that claimed to have loaned monies to one or more of the Debtors in connection with certain transactions identified in the complaints. The Trustee identifies the amount of the payments made by the Debtors in connection with the loan transactions. In connection with the causes of action alleging fraudulent conveyances, the Trustee asserts that the Debtors were insolvent as early as 1990 and remained insolvent continuously until they filed their bankruptcy petitions because the payments from the lessees of the equipment were inadequate to pay all the obligations due to investors and financial institutions. The Trustee also alleges that the payments to the Movants were made with the actual intent to hinder, delay or defraud creditors. These allegations, as discussed in *Walnut Street*, are sufficiently plead with particularity to meet the standards set forth in Fed.R.Bankr.P. 7009.

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

Movants acknowledge that the claims asserted against them are identical to those considered by the Court in the February 1999 Decision in which the Court declined to dismiss the Trustee’s cause of action based on Code § 548(a)(1)(A). They are also identical to those considered by the Court in a decision issued subsequent to the filing of the Motions. *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) (“February 2001 Decision”) (addressing motions seeking dismissal of the Trustee’s causes of action/counterclaims for actual fraud based on NYD&CL §

276).

The Movants, relying on *In re Independent Clearinghouse Co.*, 77 B.R. 843 (D.Utah 1987) and *Stratton v. Equitable Bank*, 104 B.R. 713 (D.Md. 1989), *aff'd* 912 F.2d 464 (4th Cir. 1990), argue that the Court in its February 1999 Decision did not consider the fact that if the banks were not involved in the Ponzi scheme as perpetrators of the fraud or as victims who received an exorbitant profit, then they did not receive fraudulent conveyances. *See* Movants' Memoranda of Law, filed June 1, 1999, at 15. Movants contend that the Trustee's complaints are defective because they do not allege that the banks were any of the financial institutions that received multiply-pledged leases or fictitious leases or that they were investors. *Id.* at 16.

These arguments, however, are more appropriately addressed in the context of motions for summary judgment, which was the case in both *Independent Clearinghouse* and *Stratton*. As this Court discussed in its February 1999 Decision,

[i]n considering a motion brought under Fed.R.Civ.P. 12(b)(6), which is made applicable to this proceeding by Fed.R.Bankr.P. 7012(b), this Court must accept all of the non-movant's allegations as true, and will grant the motion to dismiss "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." (citation omitted). Because a pre-answer order of dismissal deprives the plaintiff of an opportunity to present any evidence on the merits of the case, motions under Fed.R.Civ.P. 12(b)(6) are treated with disfavor, and are granted only with extreme caution. (citations omitted).

February 1999 Decision at 18.

Upon review of the issues raised by the Movants, the Court determines that they are factually and legally identical to those addressed by the Court in the February 1999 Decision (*see* February 1999 Decision at 20-22) with respect to the Trustee's causes of action pursuant to Code

§ 548(a)(1)(A) and in the February 2001 Decision with respect to NYD&CL § 276. Accordingly, the findings of fact and conclusions of law in those Decisions are incorporated in the present decision by reference, except with respect to the specific transaction amounts identified in the amended complaints.

Based on the foregoing, it is hereby

ORDERED that the Movants' Motions to dismiss the Trustee's causes of action seeking to avoid certain prepetition transfers based on Code § 548(a)(1)(A) and NYD&CL § 276 pursuant to Fed.R.Bankr.P. 7009(b) are denied, and it is finally

ORDERED that the Movants' Motions to dismiss the Trustee's causes of action seeking to avoid certain prepetition transfers based on Code § 548(a)(1)(A) and NYD&CL § 276 pursuant to Fed.R.Bankr.P. 7012(b) are denied.

Dated at Utica, New York

this 20th day of April 2001

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge