UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

THE BENNETT FUNDING GROUP, INC.	CASE NO. 96-61376 Chapter 11
Debtors	Substantively Consolidated

N.W. INVESTORS II, L.L.C.

Plaintiff

vs. ADV. PRO. NO. 98-70056A

STANDARDBRED ENTERPRISES, LTD. and
HELMER, JOHNSON & MISIASZEK

Defendants

RICHARD BREEDEN, Trustee for THE BENNETT FUNDING GROUP, INC. and BENNETT MANAGEMENT AND DEVELOPMENT CORP.

Intervenor/Defendant

APPEARANCES:

SIMPSON, THACHER & BARTLETT Attorneys for § 1104 Trustee 425 Lexington Avenue New York, New York 10017	KENNETH CROWLEY, ESQ. Of Counsel
BERKMAN, HENOCH, PETERSON & PEDDY, P.C. Attorneys for N.W. Investors 777 Zeckendorf Boulevard Garden City, NY 11530-2112	RONALD M. TERENZI, ESQ. Of Counsel
HELMER, JOHNSON & MISIASZEK Attorneys for Standardbred 405 Court Street Utica, New York 13502	GRANT JOHNSON, ESQ. Of Counsel MICHAEL MISIASZEK, ESQ. Of Counsel

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

MEMORANDUM-DECISION, PROPOSED FINDINGS OF FACT,
CONCLUSIONS OF LAW AND REFERENCE

N.W. Investors II, L.L.C. ("NWI"), the plaintiff in this adversary proceeding, has moved for partial summary judgment on its second cause of action. The motion, which was argued before the Court at Utica, New York, on June 25, 1998, was opposed by the Defendant Standardbred Enterprises, Ltd. ("SEL") and the Intervenor/Defendant, Richard C. Breeden, Trustee ("Trustee").[1]

JURISDICTIONAL STATEMENT

The Court has jurisdiction over the parties and subject matter of this adversary proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a) and (c)(1).

FACTS

Vernon Downs is a racetrack owned and operated by Mid-State Raceway, Inc. ("Mid-State") in Vernon, New York. In December 1995 Patrick Bennett ("P. Bennett"), the chief

[1] On August 21, 1998, the Court, by letter, advised the parties that it would not rule on the instant motion pending the trial of a related proceeding commenced by the Trustee against SEL (Adv. Pro. No. 97-70099). Both adversary proceedings seek a determination by this Court of the ownership of the Stock. On January 14, 1999, the trial of Adv. Pro. No. 97- 70099 having not yet occurred, NWI asked the Court to again consider its pending motion. The Court has agreed to do so.

financial officer of The Bennett Funding Group, Inc. ("BFG"),[2] transferred 126,657 shares of stock ("Stock") in Mid-State to SEL in exchange for a promissory note ("Note") in the amount of $1,950,000, dated December 28, 1995. *See* NWI's Motion at Exhibit B. Under the terms of the Note, interest payments of $195,000 were payable annually by SEL beginning on December 30, 1996, with a final payment of $2,145,000 due at maturity on December 30, 1999. *See id.* Pursuant to a Sale and Assignment Agreement, dated March 1, 1996, P. Bennett sold and assigned all his right, title and interest in the Note to NWI for $1,950,000, payable by April 1, 1996. *See id.* at Exhibit C.

On or about June 27, 1996, NWI, through its counsel, notified SEL that the loan was being accelerated due to an alleged default arising out of SEL's purported insolvency. *See id.* at Exhibit D. On or about November 1, 1996, in order to induce NWI to forbear from enforcing its rights under the Note, NWI and SEL entered into a Security and Escrow Agreement ("Escrow Agreement") whereby SEL agreed to deliver two stock certificates evidencing the Stock to Helmer, Johnson & Misiaszek ("HJM"), as Escrow Agent. *See id.* at Exhibit A. The Escrow Agent was required to retain the Stock and thereafter turn over same to NWI upon the occurrence of certain events of default by SEL.

On or about April 1, 1997, NWI, by and through its attorneys, notified SEL and HJM that a default now existed under the Note and the Escrow Agreement based on SEL's alleged failure to make the interest payment due and payable on March 30, 1997, as extended by agreement from December 30, 1996, and demanded compliance with the terms of the Escrow Agreement,

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[2] On March 29, 1996, BFG and three other related corporate entities filed voluntary chapter 11 petitions ("Bennett companies"). On April 18, 1996, the Court approved the appointment of Richard C. Breeden as Trustee in the cases.

including delivery of the stock certificates. *See id.* at Exhibit E.

SEL and HJM resisted a turnover of the stock certificates, asserting that NWI had provided no proof that it had, in fact, paid for the Note. *See id.* at Exhibit F.

Thereafter, on or about May 9, 1997, NWI commenced an action against SEL and HJM in New York State Supreme Court, Nassau County ("State Court Action") seeking, *inter alia*, turnover of the stock certificates to NWI. *See id.* at Exhibit M. The Trustee, however, moved to intervene in the State Court Action and, after having his motion granted, successfully sought removal of the State Court Action ultimately to this Court.

ARGUMENTS

NWI asserts that there are no questions of fact and that as a matter of law as between itself, SEL and HJM, NWI has an unfettered right to take possession of the stock certificates pursuant to the second cause of action alleged in its complaint. It argues that it has met every condition asserted by HJM, as Escrow Agent, including providing copies of checks to refute both SEL and HJM's contention that NWI did not provide fair consideration for the Note from P.Bennett. Finally, NWI asserts that granting it summary judgment in the instant adversary proceeding will not interfere with the rights being asserted by the Trustee in the companion adversary proceeding (Adv. Pro. No. 97-70099), in which the Trustee seeks to set aside the initial purchase of Stock by P.Bennett and its subsequent transfer to SEL as fraudulent transfers. NWI admits that if the Trustee is successful in the companion adversary proceeding to which NWI is a party defendant, he will acquire rights in the Stock superior to NWI.

In opposition, the Trustee, seeking to convince the Court that it must look beyond just the second cause of action, asserts that there are numerous questions of fact which are disputed. The Trustee rejects NWI's contention that granting of summary judgment will not prejudice the Trustee. The Trustee points out that if this Court awards possession of the stock certificates to NWI, he will then have to separately litigate with NWI over issues of value and good faith.

As examples of factual questions, the Trustee focuses on the initial sale of the Stock from P.Bennett to SEL in return for a $1.95 million note which he alleges "reeks" with fraud given the allegedly insolvent character of SEL at the time of the sale, its complete control by P.Bennett's wife, as owner and sole stockholder, the sale price of $1.95 million for stock worth nearly $4.5 million at the time of the sale, as well as the deposition testimony of various witnesses familiar with the sale. The Trustee also draws attention to the subsequent sale or assignment of the Note to NWI "on the eve of the Bennett Companies bankruptcy," a sale which allegedly was not supported by any proof that P.Bennett received $1.95 million from NWI, except for the vague recollection of the transaction by Neil Wager, the principal of NWI. This was followed by the almost immediate declaration of default by NWI on the SEL note and the subsequent execution of the Escrow Agreement which purported to secure the previously unsecured note (which agreement would inevitably once again go into default) with the stock certificates. Finally, the commencement of the action on the Escrow Agreement in a state court in Nassau County, New York, which had no familiarity with the proceedings in the bankruptcy case, including the assertion by the Trustee of the existence of a fraudulent transfer which enabled P.Bennett to initially acquire the Stock.

Standardbred also opposes the motion asserting that it is caught in the middle of the

dispute between NWI and the Trustee and is, therefore, hesitant to have its attorneys turn over the stock certificates to either party. Standardbred also echoes the argument of the Trustee that there is a serious question of fact regarding proof that NWI ever gave any consideration to P.Bennett in order to acquire the Note.

DISCUSSION

There does not appear to be any dispute amongst the parties to the instant adversary proceeding that this Court exercises "related to" jurisdiction over it pursuant to 28 U.S.C. §§ 1334(b) and 157(a) and (c)(1).[3]

Under Federal Rule of Civil Procedure ("Fed.R.Civ.P.") 56(c), as incorporated by reference in Federal Rule of Bankruptcy Procedure ("Fed.R.Bankr.P.") 7056, summary judgment must be granted when there is "no genuine issue as to any material fact [such] that the moving party is entitled to judgment as a matter of law." *Federal Deposit Ins. Corp. v. Bernstein,* 944 F.2d 101, 106 (2d. Cir. 1991). Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits... show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Alexander & Alexander Services, Inc. v. These Certain Underwriters at Lloyd's,*

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[3] In its initial Petition for Removal filed with the United States District Court for the Eastern District of New York dated July 28, 1997, the Trustee alleges, at paragraph 5 of that Petition, that the "civil proceeding relates to case under Title 11." NWI in its most recent motion filed with the Court on December 31, 1998, seeking reconsideration of its decision to "table" the summary judgment motion acknowledges that the instant adversary proceeding is non-core. *See* NWI Motion for Reconsideration at 8. SEL appears to be without a position on the issue of this Court's jurisdiction over the instant adversary proceeding.

London, 136 F.3d 82, 86 (2d Cir. 1998) (quoting Fed.R.Civ.P. 56(c)). Furthermore, all inferences are to be drawn in favor of the non-moving party. *Id.* (citing *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.,* 475 U.S. 574, 587, 106 S.Ct. 1348, 1356, 89 L.Ed.2d 538 (1986)).

NWI asserts that the Note was purchased from P.Bennett on or about March 1, 1996 for a purchase price of $1.95 million and at such time it is claimed by NWI that all P.Bennett's rights, title and interest in the note were acquired by NWI. The Trustee disputes these facts and argues that NWI never displayed adequate proof of purchase[4] or that the sale occurred in good faith. The Trustee points to numerous factors which he alleges indicates bad faith on the part of NWI. For example, the Trustee asserts that the sale of the Note occurring "on the eve of the Bennett companies' bankruptcy", the vagueness of circumstances surrounding the transaction, the almost immediate declaration of default on the Note by NWI, the execution of the Agreement followed by the second inevitable default of SEL on the Note, the commencement of the State Court Action by NWI in a venue having no familiarity with the bankruptcy cases of the Bennett Companies, all suggest bad faith on NWI's part. In response, NWI does not directly address the issue of whether they acted in good faith in the original transfer of the Note. NWI merely indicates that all rights, title and interest in the note were acquired from P.Bennett.

The Trustee alleges that NWI was a participant in the antecedent transaction involving P. Bennett, the sole purpose of which was allegedly to defraud and hinder creditors. P.Bennett's alleged attempts to shield assets and hinder creditors of the Bennett companies falls within the scope of antecedent illegality. NWI purchased the promissory note from P.Bennett. Whether

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[4] The Trustee does acknowledge that there were a series of five checks which together total $1.95 million issued by NWI not to P. Bennett, but to two of the Bennett companies.

such purchase occurred while NWI was ignorant or innocent of any illegality is an issue of fact to be determined. Thus, in order for the transfer of the Note and the subsequent execution of the Escrow Agreement to be valid, NWI must have been justifiably ignorant of any illegality. Therefore, if all the inferences are drawn in favor of the Trustee, then a genuine issue of material fact exists with regard to whether NWI was innocent of any knowledge of the alleged antecedent illegality.

The Court notes that

> [g]enerally, anyone who engages in a fraudulent scheme forfeits all right to protection, either at law or in equity. This rule was succinctly set forth long ago by Lord Mansfield. . ."The objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; but it is founded in general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may say so. The principle of public policy is this: *Ex dolo malo non oritur actio.* (Out of fraud no action arises.) No court will lend its aid to a man who founds his cause of action upon an immoral or illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the Court says he has no right to be assisted. It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff."

Kansas City Operating Corp. v. Durwood, 278 F.2d 354, 358 (8th Cir. 1960), quoting *Holman v. Johnson*, (1 Cowper 341, 343), 98 Eng. Reports Reprint 1120, 1121. Thus, cases which attempt to enforce contracts which are illegal or stem from illegal activity are clearly unenforceable, even if valid on their face. *Id.* However, when a contract is not illegal *per se* but is touched by some antecedent illegality, the problem becomes more complex. *Id.* Thus,

> "[t]here are many bargains, wholly lawful in themselves, that the parties would not have made except for the fact that an antecedent illegal transaction had taken place. A *mere casual relation* such as this, the bargain not being substantially identical with the illegal transaction and its enforcement not being the consummation of an illegal purpose, is not ground for refusal of such

> enforcement. The illegal transaction is in such cases described as 'collateral' or 'remote."

Id. at 359, quoting Corbin on Contracts, Vol. 6 § 1529, p. 1030 (emphasis added). As is indicated above, when there is merely a casual relation between an antecedent illegality and the current contract or where the illegal transaction is remote, it is not sufficient grounds to refuse to enforce a contract. In addition, "if a party seeking enforcement of an illegal contract is innocent of any wrongdoing, the rationale for refusing to enforce the bargain does not apply." *In re Randy*, 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995) (citations omitted). Furthermore, where a party "enters into an illegal bargain and is justifiably ignorant of the facts creating the illegality or if he enters into a facially valid contract and is justifiably ignorant of the other party's illegal purpose, the innocent party may generally enforce the contract." *Merrill v. Abbott (In re Independent Clearing House Co.)*, 77 B.R. 843, 858 (D. Utah 1987); *see also, Bankers Trust Co. v. Litton Systems, Inc.*, 599 F.2d 488, 493 (2nd Cir. 1979); *Gold Bond Stamp Co. of Georgia v. Bradfute Corp.*, 303 F.Supp. 532, 541 (S.D.N.Y. 1969), *aff'd* 463 F.2d 1158 (2d Cir. 1972). It follows that a party to a bargain who is aware of and was a party to the antecedent illegal transaction is not "justifiably ignorant" or "innocent" and should not be permitted to enforce a contract despite the fact that it is valid on its face.

The case law set forth herein indicates some presumption for enforcement of contracts, even if tainted with illegality, if the party seeking enforcement is truly innocent. The assertions of the Trustee cast doubt on the innocence or ignorance of NWI and suggests knowledge of illegality. The Court has an obligation to ascertain the true facts with respect to the transactions which led up to the Assignment/Sale of the Note and the execution of the Escrow Agreement. While it is enticing to view NWI's second cause of action in isolation as it urges this Court to do,

such a limited view simply ignores the multiple allegations of fact asserted by the Trustee which, if supported by the proof at trial, will arguably result in the dismantling of the entire series of transactions, commencing with P.Bennett's initial purchase of the Stock. To isolate NWI's second cause of action by viewing it in a vacuum does not promote judicial economy and may very well result in later prejudice to the Trustee, as well as other parties. .

Based upon the foregoing, it is hereby

Recommended to the United States District Court for the Northern District of New York pursuant to 28 U.S.C. § 157(c)(1) that NWI's motion for partial summary judgment on its second cause of action be denied.

Dated at Utica, New York

this 1st day of February 1999

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge