UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

THE BENNETT FUNDING GROUP, INC. Debtors	CASE NO. 06-61376 Chapter 11 Substantively Consolidated

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

Plaintiff

vs. ADV. PRO. NO. 97-70049

SPHERE DRAKE INSURANCE PLC, SPHERE DRAKE UNDERWRITING MANAGEMENT (BERMUDA) LIMITED, et al.

Defendants

APPEARANCES:

SIMPSON THACHER & BARTLETT LLP Attorneys for Trustee 425 Lexington Avenue New York, NY 10017	WILLIAM T. RUSSELL, JR. ESQ. Of Counsel
COSTIGAN & COMPANY, P.C. Attorneys for Ades and Berg Group Investors 305 Broadway - 7th Floor New York, NY 10007	WILLIAM F. COSTIGAN, ESQ. Of Counsel
WASSERMAN, JURISTA & STOLZ, P.C. Attorneys for Committee of Unsecured Creditors 225 Millburn Avenue, Suite 207 Millburn, NJ 07041	MICHAEL MCLAUGHLIN, ESQ. Of Counsel

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

MEMORANDUM-DECISION, FINDINGS OF FACT,

CONCLUSIONS OF LAW AND ORDER

Under consideration by the Court is a motion ("Motion") filed by Richard C. Breeden, chapter 11 trustee ("Trustee") of The Bennett Funding Group, Inc. ("BFG"), and other substantively consolidated debtors[1] (the "Debtors") in the above-captioned adversary proceeding on June 5, 2006, seeking judgment on the pleadings, dismissing the Ades and Berg Group Investors' Renewal of Counterclaim to the Third Amended Adversary Complaint, dated June 24, 2003 (Adv. Pro. Docket No. 456). On June 20, 2006, the Post Confirmation Official Committee of Unsecured Creditors filed what it labeled as a "joinder" in the Trustee's motion. (Adv. Pro. Docket No. 461). Opposition to the Trustee's motion was filed by William F. Costigan, Esq. ("Costigan") on behalf of the Ades and Berg Group Investors on June 26, 2006 (Adv. Pro. Docket No. 464).[2]

The motion was heard at the Court's regular motion term in Utica, New York, on June 27, 2006. Following oral argument, the Court afforded the parties an opportunity to submit additional memoranda of law. The matter was submitted for decision on July 21, 2006.

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[1] On March 29, 1996, BFG, along with Bennett Receivables Corporation, Bennett Receivables Corporation II, and Bennett Management & Development Corporation, filed voluntary petitions pursuant to chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101-1330 ("Code"). On April 19, 1996, American Marine International, Ltd. and Resort Service Company, Inc. filed voluntary petitions pursuant to chapter 11 and on April 25, 1996, an involuntary case was commenced against Aloha Capital Corporation. On April 26, 1996, The Processing Center ("TPC") also filed a chapter 11 petition. By Order dated July 25, 1997, the Court substantively consolidated the Debtors' estates.

[2] As previously found by this Court in a related matter, Costigan "represents approximately 376 investors who allegedly hold claims totaling approximately $1.8 million based on their investments with the Debtors. Early on in this case, it was alleged that there were 10,000 investors that were impacted by the Debtors' bankruptcy filing and prepetition activities." *See* Memorandum Decision, Findings of Fact, Conclusions of Law and Order, dated May 22, 2003 ("Rule 9019 Decision/Order") at 13.

JURISDICTIONAL STATEMENT

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

FACTUAL AND PROCEDURAL BACKGROUND

For a more detailed account of the procedural and factual background of this adversary proceeding and the related bankruptcy case of BFG, the Court refers readers to its Rule 9010 Decision/Order and its Memorandum Decision, Findings of Fact, Conclusions of Law and Order, dated February 9, 2004 ("Allocation Decision"), as well as the following decisions: *Ades-Berg Investors v. Breeden (In re Bennett Funding Group, Inc.)*, 439 F.3d 155 (2d Cir. 2006); *Breeden v. Sphere Drake Ins., PLC (In re Bennett Funding Group, Inc.)*, 270 B.R. 126 (S.D.N.Y. 2001) ("2001 Standing Decision"), *aff'd sub nom. Breeden v. Ades Investor Group (In re Bennett Funding Group, Inc.)*, 60 Fed.Appx. 863 (2d Cir. 2003); *Breeden v. Sphere Drake Ins., PLC (In re Bennett Funding Group, Inc.*, 258 B.R. 67 (Bankr. N.D.N.Y. 2000); *Breeden v. Sphere Drake Ins., PLC (In re Bennett Funding Group, Inc.)*, No. 97-70049, 2000 Bankr. Lexis 1693 (Bankr. N.D.N.Y. Mar. 3, 2000); *Breeden v. Sphere Drake Ins., PLC (In re Bennett Funding Group, Inc.)*, No. 97-70049, 1999 Bankr. Lexis 1857 (Bankr. N.D.N.Y. Aug. 6, 1999). The Court will presume familiarity with these opinions and set forth only those facts most pertinent to the matter currently under consideration.

On February 24, 1997, the Trustee commenced an adversary proceeding against, *inter alia*, Sphere Drake Insurance PLC ("Sphere Drake") in this Court. On June 20, 2000, the Court recommended that reference be withdrawn and that the litigation be tried in the district court. On January 25, 2001, the United States District Court for the Northern District of New York (Kahn, D.J.) adopted this Court's recommendation, allowing the adversary proceeding to be adjudicated along with a class action instituted by various BFG investors against Sphere Drake in the United States District Court for the Southern District of New York.

In his complaint, the Trustee asserted five separate causes of action against Sphere Drake, including one based on breach of contract for Sphere Drake's alleged failure to make payment under a certain claims paying agent agreement to TPC, who was identified as the loss payee; another seeking declaratory judgment that TPC and/or the bankruptcy estate had a superior interest in any proceeds of the insurance policy; and another for damages based on allegations against Sphere Drake of aiding and abetting the fraud perpetrated on BFG by Patrick Bennett, Chief Financial Officer of BFG.[3] The Ades and Berg Group Investors were among other defendants who claimed rights to the proceeds of the Sphere Drake reinsurance policy. On December 3, 2001, the Southern District of New York District Court dismissed a cross-claim filed by the Ades and Berg Group Investors against Sphere Drake for lack of standing based on a finding that the reinsurance contract conferred no rights on them as insureds as none of them "either had a Declaration or was named anywhere as a Loss payee." *See* 2001 Standing Decision at 129. The court also found that they had "neither a contractual right to the Policy proceeds nor a direct right of action against Sphere Drake." *Id.* at 128 n.1. The Southern District of New York

[3] After two separate criminal trials, Patrick Bennett was found guilty on 49 counts, including perjury, obstruction of justice, securities fraud and money laundering

District Court also dismissed their Counterclaim against the Trustee in which they asserted a "beneficial interest" in the policy proceeds on the basis that the Trustee could only hold such funds in a constructive trust running in their favor. *Id.* at 132. However, the Southern District of New York District Court's dismissal of their Counterclaim was "without prejudice to being renewed in an appropriate Bankruptcy Court proceeding."[4] *Id.* The decision was affirmed by the Court of Appeals for the Second Circuit in a decision issued on March 13, 2003. *Breeden v. Ades Investor Group*, 60 Fed.Appx. 863. The Second Circuit concurred with the district court that "the Ades defendants' claim of constructive trust raises issues of creditor priority and is more appropriate for the Bankruptcy Court." *Id.* at 866.

In the interim, on February 26, 2002, the Southern District of New York District Court transferred the Trustee's declaratory judgment action, based on his assertion that he was the sole and rightful recipient of the policy proceeds, back to the Northern District of New York District Court. In turn, on July 30, 2002, that action was then transferred to this Court and reinstated on August 16, 2002 (Adv.Pro. Docket No. 440). That portion of the adversary proceeding seeking recovery from Sphere Drake remained in the Southern District of New York District Court.

In December 2002 various parties, including the Trustee, Sphere Drake, and the members of the class action entered into a Stipulation and Agreement of Settlement. Among the terms of the Settlement was the requirement that an order be issued by this Court approving the Settlement

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[4] On June 25, 2003, the Ades and Berg Group Investors filed their Renewal of Counterclaim to Third Amended Adversary Complaint and Demand for a Jury Trial. *See* Trustee's Exhibit D (Adv. Pro. Docket No. 443). The Ades and Berg Group Investors seek a declaration that the Settlement Proceeds are not property of the estate and request that the Court direct the Trustee, as trustee of a constructive trust, to pay them the Settlement Proceeds. On February 27, 2004, the Trustee filed his Reply to Renewal of Counterclaim to Third Amended Adversary Complaint. *See* Trustee's Exhibit E (Adv. Pro. Docket No. 453).

and authorizing the Trustee to consummate it. A similar order was required to be entered in the Southern District of New York District Court.

On March 13, 2003, the Trustee filed a motion pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P.") seeking authorization for him to consummate the Settlement Agreement (Case Docket No. 10303). On March 26, 2003, the Ades and Berg Group Investors filed an objection to the Trustee's motion. (Case Docket No. 10331). On May 22, 2003, the Court issued its Rule 9019 Decision/Order (Trustee's Exhibit B) in which it authorized the Trustee to enter into the Settlement Agreement based on the finding that it was fair and reasonable and in the best interest of the Debtors' Estates (Case Docket No. 10399).[5] On June 17, 2003, the Ades and Berg Group Investors filed a motion seeking to alter or amend the Rule 9019 Decision/Order pursuant to Fed.R.Bankr.P. 9023 or, alternatively, pursuant to Fed.R.Bankr.P. 9024 (Case Docket No. 10424). This Court concluded that the motion, to the extent that it was based on Fed.R.Bankr.P. 9023, was untimely, and that the Ades and Berg Group Investors had not established a basis for reconsideration based on Fed.R.Bankr.P. 9024. The Court also concluded that the Ades and Berg Group Investors' request for an extension of time to file a notice of appeal of the Rule 9019 Decision/Order pursuant to Fed.R.Bankr.P. 8002(c) was untimely, as well. In a decision issued on January 31, 2005, the Northern District of New York District Court affirmed this Court's conclusion that the appeal was untimely. On February 24, 2006, the Court of Appeals for the Second Circuit affirmed the decision of the District Court. *See Ades-Berg Investors v. Breeden*, 439 F.3d 155.

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[5] In his motion, the Trustee also sought approval of a pro rata distribution of the Settlement Proceeds. The Court, in its Rule 9019 Decision/Order, adjourned that portion of the motion to the Court's May 29, 2003 motion calendar in Utica, New York.

In the meantime, as indicated at Footnote 5, this Court in its Rule 9019 Decision/Order adjourned the hearing on that portion of the Trustee's motion seeking approval of a pro rata distribution of the Settlement Proceeds of $27.5 million to May 29, 2003. The Trustee argued that the proceeds should be distributed equally among all of the unsecured creditors. A group of investors, who had received certificates or other documentation from BFG that allegedly created the impression that Sphere Drake insured their investments, argued that there should be a special pool established for them, which would permit a greater pro rata distribution to be made to them (Case Docket Nos. 10350 and 10372. The Ades and Berg Group Investors expressed support for a targeted allocation of the Settlement Proceeds to only the "Sphere Drake insured investors but argued that before any allocation was made, that the Court adjudicate their Counterclaim for a constructive trust (Case Docket No. 10331). It was their position that if successful on their Counterclaim, the Settlement Proceeds would be distributed solely to them and allocation would be unnecessary. In its Allocation Decision, the Court concluded that there should be a special pool allocation for those who had purchased the alleged Sphere Drake-insured investments. *See* Allocation Order at 10 (Trustee's Exhibit A) (Case Docket No. 10753). At the same time, the general unsecured creditors were also entitled to a share of the Settlement Proceeds, noting that they had borne the substantial cost of litigating and settling the Trustee's claim in the adversary proceeding. *Id.* In approving the allocation, the Court directed the Trustee not to distribute the Settlement Proceeds until the counterclaim of the Ades and Berg Group Investors has been adjudicated. It is that issue for which the Trustee seeks judgment on the pleadings.

ARGUMENTS

Although captioned as a "Renewal of Counterclaim,"[6] the Court observes that the Ades and Berg Group Investors have actually identified two counterclaims therein. In their "Wherefore Clause," they ask that the Trustee's Complaint be dismissed and that the Court (1) declare that the "proceeds of the Sphere Drake Guaranty Policy" are not property of the Debtors' Estates and (2) direct the Trustee, as trustee of a constructive trust, to account for and pay over the proceeds to them. It is the current position of the Ades and Berg Group Investors that they are entitled to the Settlement Proceeds based on a constructive trust theory. They argue that their equitable interest in the Sphere Drake reinsurance policy was superior to the right of any other party, including the Trustee. Thus, the Ades and Berg Group Investors assert that the property of the estate does not include any equitable interest they might have in the Settlement Proceeds. They contend that the general unsecured creditors would be unjustly enriched if the Settlement Proceeds were to be distributed according to the Allocation Decision. They argue that the allocation scheme is only valid in the event that this Court determines that those monies are property of the estate.

In support of his motion, the Trustee contends that the Counterclaim should be dismissed as it raises issues of creditor priority already decided by this Court in its Allocation Decision. The Trustee points out that the United States Court of Appeals for the Second Circuit decided that the Trustee, rather than the Ades and Berg Group Investors, was entitled to pursue contract claims under the Sphere Drake reinsurance policy, based on a finding that none of the Ades and Berg Group Investors were loss payees. Furthermore, the Trustee draws a distinction between proceeds of the reinsurance policy and the "settlement" proceeds. The Trustee makes the

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[6] For purposes of this decision, the Court will simply refer to it as "the Counterclaim."

argument that a variety of claims were resolved as part of the Settlement Agreement. It was not simply a matter of the Trustee asserting a loss under the reinsurance policy for which he sought recovery.

In addition, the Trustee argues that the Ades and Berg Group Investors cannot establish the elements of a constructive trust. In particular, the Trustee contends that the Court should prevent the inequitable result of allowing the Ades and Berg Group Investors to receive all of the Settlement Proceeds by granting the Trustee's motion and denying the constructive trust Counterclaim. The Trustee contends that the Ades and Berg Group Investors are simply general unsecured creditors entitled to their share of the Settlement Proceeds, as allocated by this Court in its Allocation Decision upon a finding that the distribution scheme set forth therein was fair and equitable to all concerned.

In response to this particular argument, the Ades and Berg Group Investors assert that to find that they are simply unsecured creditors is to revert to the viewpoint of the United States Court of Appeals for the Sixth Circuit in *In re Omegas Group, Inc.*, 16 F.3d 1443 (6th Cir. 1994). In *Omegas* the Sixth Circuit found that "[a] constructive trust is fundamentally at odds with the general goals of the Bankruptcy Code." *Id.* at 1451. The Ades and Berg Group argue that the United States Court of Appeals for the Second Circuit is more amenable to the idea of a constructive trust in the bankruptcy context and, in this regard, has recognized that a debtor's estate is limited to assets in which the debtor has *both* a legal and equitable interest. *See Sanyo Elec., Inc. v. Howard's Appliance Crop. (In re Howard's Appliance Corp.)*, 874 F.2d 88, 93 (2d Cir. 1989), citing *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.10 (1983). In this case, it is the position of the Ades and Berg Group Investors that the Trustee does not hold an

equitable interest in the Settlement Proceeds and, accordingly, they are not property of the estate available for distribution to the general unsecured creditor body.

DISCUSSION[7]

The standard for addressing a motion for judgment on the pleadings pursuant to Rule 12(c) of the Federal Rules of Civil Procedure ("Fed.R.Civ.P."), made applicable to adversary proceedings pursuant to Fed.R.Bankr.P. 7012(b), is the same as a Rule 12(b)(6) motion to dismiss for failure to state a claim. *Cleveland v. Caplaw Enters.*, 448 F.3d 518, 521 (2d Cir. 2006). Accordingly, the Court must accept the allegations contained in the Ades and Berg Group Investors' Counterclaim as true and draw all reasonable inferences in their favor. "A [counterclaim] will only be dismissed under Rule 12(c) if it appears beyond doubt that the [nonmoving party] can prove no set of acts in support of his claim which would entitle him to relief." *Patel v. Searles*, 305 F.3d 130, 135 (2d Cir. 2002), *cert. denied*, 538 U.S. 907 (2003). It is intended to dispose of a claim on the underlying merits and defenses set forth in the pleadings when the material facts are not in dispute and only matters of law remain for decision by the Court. *In re Garcia*, 340 B.R. 680, 685 (Bankr. D. P.R. 2006).

In this case, the material facts are not in dispute. The question is whether or not a

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[7] As an initial matter, the Court notes that the Ades and Berg Group Investors, in their Renewal of Counterclaim to the Trustee's Third Amended Adversary Complaint, have made a demand for a jury trial. However, if the Court grants the Trustee's motion for judgment on the pleadings, that determination would dispose of the adversary proceeding as a matter of law. *See Allegheny Intern., Inc. v. Allegheny Ludlum Steel Corp.*, 920 F.2d 1127, 1129 (3d Cir. 1990). Accordingly, it would be inappropriate at this stage of the proceeding to issue what would be, in effect, an advisory opinion concerning the defendants' entitlement to a jury trial under the Seventh Amendment.

constructive trust is applicable to the matter herein. The Court of Appeals for the Second Circuit reaffirmed its 1989 holding in *Howard's,* as cited by the Ades and Berg Group Investors, concerning the applicability of the constructive trust doctrine in the context of a bankruptcy case. *See In re First Cent. Fin. Corp.*, 377 F.3d 209, 217 (2d Cir. 2004). However, it emphasized that the "obligation to apply New York constructive trust law does not diminish the need to 'act very cautiously' to minimize the conflict with the goals of the Bankruptcy Code. . . . In light of the fact that these goals can be compromised by the imposition of a constructive trust, 'bankruptcy courts are generally reluctant to impose constructive trusts *without a substantial reason to do so.*" *Id.* (emphasis supplied). Indeed, the Second Circuit, in noting the difference between constructive trust claims in the context of a bankruptcy case and a non-bankruptcy case, acknowledged the Sixth Circuit's view in *Omegas* that "'the equities of bankruptcy are not the equities of the common law.'" *Id.* at 218, quoting *Omegas*, 16 F.3d at 1452. Ultimately, the Second Circuit in *First Central Financial* affirmed the district court's decision not to impose a constructive trust on monies held by the chapter 7 trustee in that case "[b]ecause the Trustee does not hold property 'under such circumstances that in equity and good conscience he ought not to retain it.'" *Id.*, *quoting Simonds v. Simonds*, 45 N.Y.2d 233, 242 (N.Y. 1978). The Second Circuit also recognized that "by creating a separate allocation mechanism outside the scope of the bankruptcy system, 'the constructive trust doctrine can wreak . . . havoc with the priority system ordained by the Bankruptcy Code.'" *First Cent. Fin.*, 377 F.3d at 217, quoting *In re Haber Oil Co.*, 12 F.3d 426, 436 (5th Cir. 1994).

It is in this context that the Court must examine the Counterclaim of the Ades and Berg Group Investors. It is their position that the Settlement Proceeds are not property of the Debtors'

Estates and should not be available for distribution to the general unsecured creditors in this case as provided for in the Allocation Decision. Rather, they argue that the Settlement Proceeds are being held by the Trustee in trust for them. In support of their position, they cite to the Supreme Court's holding in *Whiting Pools* in which the court observed that "Congress plainly excluded property of others held by the debtor in trust at the time of the filing of the petition." *Whiting Pools*, 462 U.S. at 205 n.10. However, in this case the proceeds in which the Ades and Berg Group Investors claim an interest were not held by BFG at the time of its filing although the cause of action based on the relationship between the Debtors and Sphere Drake certainly existed at the time the petitions were filed. The monies were recovered by the Trustee in the context of the adversary proceeding pursuant to the Settlement Agreement, approved by this Court in its Rule 9019 Decision/Order on May 22, 2003, some seven years postpetition.

Under the circumstances, the Court believes it appropriate to examine the four elements applicable to the imposition of a constructive trust to the Settlement Proceeds under New York law: (1) a confidential or fiduciary relationship; (2) a promise, expressed or implied; (3) a transfer made in reliance on that promise; and (4) unjust enrichment. *Sharp v. Kosmalski*, 40 N.Y.2d 119, 121 (N.Y. 1976). A constructive trust serves as a remedy, imposing a duty on the individual that has acquired or retained property to convey it to the true owner of the property because further retention of it would unjustly enrich the present holder. *See In re Vichele Tops, Inc.*, 62 B.R. 788, 790 (Bankr. E.D.N.Y. 1986). The courts view the elements as "flexible considerations" which need not be rigidly applied given the fact that the constructive trust doctrine is equitable in nature. *Counihan v. Allstate Ins. Co.*, 194 F.3d 357, 362 (2d Cir. 1999); *see also In re McLean Indus., Inc.*, 132 B.R. 271, 286 (Bankr. S.D.N.Y. 1991) (stating that "the lack of one of the four

factors will not necessarily defeat a constructive trust"). Particular consideration, however, is given to the last element since the underlying purpose of a constructive trust is prevention of "unjust enrichment." *See Counihan*, 194 F.3d at 362 (noting that "[w]hat the New York courts do insist upon is a showing that property is held under circumstances that render unconscionable and inequitable the continued holding of the property and that the remedy is essential to prevent unjust enrichment").

With respect to the first element, there is no question that the Trustee is a fiduciary for all of the unsecured creditors, including the Ades and Berg Group Investors. *See, generally*, *Commodity Futures Trading Com'n v. Weintraub*, 471 U.S. 343, 355 (1985). The Settlement Proceeds being held by the Trustee were acquired by him in resolution of litigation, which, in part, involved allegations of a breach of the insurance contract between certain of the Debtors and Sphere Drake. The Trustee argues that there was never any promise made by him to the Ades and Berg Group Investors on which they relied. However, it is the promise made by BFG that is the focus of the arguments being made by the Ades and Berg Group Investors. It is their position that in purchasing an interest in various equipment lease contracts belonging to BFG and/or related debtor entities, they were promised that their investments were insured. Based on that promise, they invested in the lease contracts.

It is important to remember that a constructive trust is an equitable remedy that "will be erected whenever necessary to satisfy the demands of justice ... [I]ts applicability is limited only by the inventiveness of men who find new ways to enrich themselves unjustly by grasping what should not belong to them." *Simonds, supra*, 45 N.Y.2d at 241 (quoting *Latham v. Father Divine*, 299 N.Y. 22, 27, 85 N.E.2d 168, 170 (N.Y. 1949)). In the context of this bankruptcy case, the

Trustee is presently holding monies he recovered based on the prepetition relationship between the Debtors and Sphere Drake. The real issue for the Court is the question of unjust enrichment under the particular circumstances, i.e, whether it would be unjust for the Trustee to retain the Settlement Proceeds on behalf of the Debtors' estates for distribution to the unsecured creditors.

"'A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.'" *In re Koreag, Controle et Revision S.A.*, 961 F.2d 341, 351 (2d Cir. 1992) (citations omitted). The Court must consider whether distributing the $27.5 million to the general unsecured creditors pursuant to the Allocation Decision, which includes a special pool of monies to be allocated to individuals such as the Ades and Berg Group Investors, would unjustly enrich those other creditors.

The Ades and Berg Group Investors rely on *McLean and Counihan* to support their position that where an entity comes into insurance proceeds in which it has no equitable interest, the courts have found the imposition of a constructive trust appropriate. This Court observes that *Counihan* did not involve a debtor in bankruptcy. In *Counihan* the government sought the imposition of a constructive trust in its favor on benefits paid under an insurance policy. The government had commenced a forfeiture action against Counihan based on allegations that she knew of prior drug activity at the subject property. *Counihan*, 194 F.3d at 359. In July of 1990, the jury returned a verdict in favor of the government. While the decision was on appeal, arson destroyed the property in November 1990, and Counihan asserted a claim to the insurance proceeds against Allstate Insurance Company. *Id.* In November 1995 the district court granted

the government's motion to intervene in the insurance action. *Id.* at 360. The same court determined that the government was entitled to the insurance proceeds under a theory of constructive trust. *Id.* The Second Circuit affirmed the district court, stating that it had "no hesitation in finding that the circumstances revealed here call for 'the imposition of a constructive trust . . . ." *Id.* at 362-63.

The decision of the court in *McLean* was in the context of a chapter 11 bankruptcy case. In that case, a secured creditor, Chemical Bank, N.A., commenced an adversary proceeding to recover insurance proceeds payable as a result of damage to a cargo ship in July 1986 on which it held a mortgage. Chemical Bank had been listed on the insurance policy as a loss payee in 1985 when it first obtained its security interest in the vessel. *McLean*, 132 B.R. at 275. The debtor changed insurance coverage to another company in March 1986 and in May 1986 Chemical was sent certain certificates of insurance, which were revised in June 1986 to show that Chemical was an "assured" as the second mortgagee. *Id.* at 275-76. Ultimately, the underwriters issued policies in September 1986 which did not include the revised loss payee and assured clauses set forth in the June certificates. *Id.* at 276. The debtor argued that Chemical was not entitled to any of the insurance proceeds. *Id.* Among its arguments, the debtor asserted that the court should not impose a constructive trust, as suggested by Chemical. *Id.* at 285. The court concluded that Chemical, along with the first mortgagee, were the intended beneficiaries of the insurance proceeds. Accordingly, the court imposed a constructive trust on the insurance proceeds in order to prevent unjust enrichment by the debtor and the unsecured creditors who were never the intended beneficiaries of the insurance. *Id.* at 286-87.

The Court finds that because *Counihan* did not involve a debtor in bankruptcy, its

application to the matter herein is inapplicable, except to the extent that it discusses the standards for applying the constructive trust doctrine. To the extent that *McLean* involved a chapter 11 debtor, the Court finds it of some relevance; however, the Court is also mindful that the entity ultimately awarded the insurance proceeds was a secured creditor and named loss payee. As discussed above, the Second Circuit previously found that the Ades and Berg Group Investors were not loss payees; rather TPC was the named loss payee. Nor were the Ades and Berg Group Investors secured creditors. There is also the fact that the *res* in this case is not strictly insurance proceeds. As the Trustee correctly points out, the *res* consists of Settlement Proceeds involving other claims or causes of action.

The Settlement Agreement resolved all of the Trustee's causes of action asserted in his Third Amended Adversary Complaint against Sphere Drake and others. While the Ades and Berg Group Investors question the likelihood that the Trustee would have been successful with his causes of action for aiding and abetting the fraudulent activities leading up to the Debtors' demise, the Court can only conclude that it was but one factor which led the parties to agree to settle for $27.5 million.[8] No allocation was specifically made in the Settlement Agreement for the portion of the proceeds attributable to the Trustee's causes of action based on breach of contract. Indeed, there were allegations made by Sphere Drake that the maximum lease payment shortfall to which insurance coverage would have applied was $9,393,340. *See* Allocation Decision at 11. In addition, as this Court previously noted, "all general unsecured creditors have borne the substantial cost of litigating and settling TPC's claim." *Id.* at 10.

As the Second Circuit acknowledged in *First Central*, "[w]hile [First Central Financial's]

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[8] The Trustee had originally sought damages in excess of $400 million under both contract and tort theories. *See* Rule 9019 Decision at 6.

estate may have been enriched, it was not unjustly enriched. . . . '[e]nrichment alone will not suffice to invoke the remedial powers of a court of equity.'" *First Central*, 377 F.3d at 218, quoting *McGrath v. Hilding*, 41 N.Y.2d 625, 629 (N.Y. 1977). In this case, the Trustee has acted in accordance with the Bankruptcy Code in marshaling and preserving estate assets. There is nothing inequitable or unconscionable, under these circumstances, in allowing the Trustee to distribute the Settlement Proceeds in accordance with the Allocation Decision. As stated by the Second Circuit in *First Central*, "this is not injustice, it is bankruptcy." *Id.* at 217.

Based on the foregoing, it is hereby

ORDERED that the Trustee's motion seeking judgment on the pleadings with respect to the constructive trust Counterclaim of the Ades and Berg Group Investors is granted, thereby dismissing it, and it is further

ORDERED that the Trustee forthwith disburse the Settlement Proceeds, which are determined to be property of the bankruptcy estate,[9] in accordance with the Court's prior Allocation Decision of April 12, 2004.

Dated at Utica, New York

this 23rd day of October 2006

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[9] The Court's conclusion that the Settlement Proceeds are property of the estate, by implication, also resolves the Trustee's claim against the Ades and Berg Group Investors seeking a declaratory judgment that they have neither a legal and/or equitable interest in the Settlement Proceeds, except as general unsecured creditors. As noted previously, the Trustee's claim was severed and transferred by the United States District Court for the Southern District of New York District Court on February 26, 2002, to the United States District Court for the Northern District of New York, which in turn transferred it to this Court on July 30, 2002 for final resolution.

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge