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

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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 before the Court are five motions (collectively, the "Motions") filed on July 22, 1996 by First National Bank of Carmi (the "Bank"), individually and as agent for Henry Absher, Henry Absher d/b/a Henry Absher Oil Company, Jane Absher and Ron Absher (collectively, the "Abshers"), respectively, for an order (1) granting relief from the automatic stay pursuant to sections 362(d)(1) and (d)(2) of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Code") to allow for the exercise of certain rights and remedies said to exist by virtue of various equipment leases which were allegedly sold or collaterally assigned to the Bank, individually or as agent for one of the Abshers, by The Bennett Funding Group, Inc. ("BFG") and Resort Funding, Inc., now

known as Resort Service Company, Inc. ("RSC")[1]; (2) allowing the Bank to set off certain funds; and (3) requiring abandonment of the equipment leases pursuant to Code § 554.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over this contested matter by virtue of 28 U.S.C. §§1334(b), 157(a), (b)(1), (b)(2)(A), (G) and (O).

BACKGROUND

BFG and RSC (sometimes collectively referred to herein as the "Debtors") are two of several companies which were established and controlled by the Bennett family of Syracuse, New York. On March 29, 1996, BFG and three other Bennett companies voluntarily filed petitions for relief under chapter 11 of the Code. On April 18, 1996, the United States Trustee appointed Richard C. Breeden (the "Trustee") as trustee of those estates pursuant to Code § 1104, and his appointment was approved by the Court that same day. Subsequent to the filings of the original four debtors, chapter 11 cases were commenced by or against five other Bennett companies,

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[1] The Bank claims that it purchased these leases, while the Trustee claims that the leases were pledged to the Bank. As the Court has done in connection with other motions in this case, it will consider the Bank's Motions without making an adjudication as to whether the leases were sold or pledged. For purposes of the discussion herein, the Court will refer to the Bank as asserting security interests in the leases and their proceeds. In doing so, the Court notes that, as discussed more fully herein, the leases consist primarily of chattel paper and accounts, sale of which is subject to Article 9 of the New York Uniform Commercial Code ("NYUCC"). *See* NYUCC § 9-102(b).

including RSC which voluntarily filed on April 19, 1996. The Trustee's appointment to serve as trustee in, *inter alia*, the RSC case, was approved by the Court on May 15, 1996. The Trustee now serves as trustee of eight of the nine Bennett estates, which eight estates were substantively consolidated by Order of the Court dated July 25, 1997.

Prior to filing, the Debtors were primarily in the business of originating, purchasing and selling commercial leases of copy machines and other small ticket office equipment. The Debtors financed their operations in part by compiling certain of these leases into portfolios which were then sold or assigned to banks as collateral for loans. Shortly after the respective petition dates, numerous banks filed motions for relief from the automatic stay alleging interests in various leases. On April 26, 1996, the Court *sua sponte* issued an Omnibus Order deferring the final hearings on all motions for relief to August 15, 1996.[2] That Order has been extended *sua sponte* from time to time without objection by any party in interest.

On May 13, 1996, the Bank filed motions (the "Segregation Motions") seeking the entry of orders compelling the Trustee to, *inter alia*, segregate rental payments from leases in which the Bank asserted an interest. On June 11, 1996, the Court entered an Order Protecting Lease

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[2] In the Omnibus Order, the Court noted that it had been advised that approximately 200 banks had claimed a security interest in various equipment leases and that thousands of investor creditors had also claimed interests in some of the same leases. The Court concluded that there were compelling circumstances "based on their numerosity and the burden said motions place on the Debtors and/or the Trustee at this stage of the case . . ." for extending the time for the final hearings. It turns out that approximately 240 banks have filed motions for relief from the automatic stay and/or claimed interests in various equipment leases. The Trustee asserts that he has reached settlements with approximately 200 banks having claims aggregating approximately $130,000,000, and that he continues to litigate against 47 banks having claims aggregating approximately $51,000,000. *See Trustee's Trial Memorandum of Law in Further Opposition to the Motion for Relief From the Automatic Stay by First National Bank of Carmi, Individually and as Agent for Henry Absher, Henry Absher d/b/a Henry Absher Oil Company, Jane Absher and Ron Absher (the "Trustee's Memorandum of Law"), filed January 21, 1998* at 2 n.2.

Payments (the "Segregation Order"), which required the Trustee to, *inter alia*, deposit all prepetition and postpetition lease rentals into segregated accounts.

On July 22, 1996, the Bank filed the instant Motions, to which the Trustee filed objections on August 19, 1996. In the wake of "a status conference to address various factual and legal matters common to most, if not all, of the [various] [b]ank's motions," the Court issued on October 22, 1996 a Memorandum-Decision, Findings of Fact, Conclusions of Law and Order (the "October 1996 Decision"), which, *inter alia*, set forth guidelines for establishing perfection of security interests in the leases and lease payments based upon the filing of a financing statement. *See In re The Bennett Funding Group, Inc.*, 203 B.R. 30, 32 (Bankr. N.D.N.Y. 1996). In the October 1996 Decision, the Court also ordered the Trustee to file a "particularized response" to each bank's Code § 362(d) motion. *See id*. at 39. The Trustee filed Particularized Responses to the Bank's Motions on December 26, 1996.

On June 25, 1997, the Court issued an Order Scheduling Evidentiary Hearing and Requiring Presentation of Evidence by Declarations/Depositions with respect to the Bank in its individual capacity. The Court issued similar orders with respect to the Motion of the Bank as agent for Ron Absher on June 30, 1997 and with respect to the Motions of the Bank as agent for Jane Absher, Henry Absher and Henry Absher d/b/a Henry Absher Oil Company on July 7, 1997. By these Orders, the Court directed that each party present the direct testimony of its witnesses through the submission of written declarations or transcribed depositions, under penalty of perjury, in a form admissible under the Federal Rules of Evidence. As a condition of the admissibility of such testimony, the declarant/deponent was required to be present at the evidentiary hearing on the Motions and subject to live cross-examination. The parties were also

afforded the opportunity to file evidentiary objections to the declarations/depositions, as well as a pre-hearing memorandum of law.

The numerous motions for relief from the automatic stay filed in this case have for the most part presented similar, and in some cases identical, factual and/or legal issues. For various reasons, however, it has not been possible to implement an omnibus procedure for fully disposing of these motions, and it has proven necessary to conduct individual hearings and to issue individual rulings with respect to each movant. As a result, certain legal arguments and/or issues common to all movants have arisen piecemeal.

During the Spring of 1997, the Court conducted hearings on 11 motions for relief filed by various banks. Thereafter, the Court issued a decision on each motion, including a decision dated May 30, 1997 denying Marine Midland Bank, N.A.'s ("Marine's") motion for relief from the automatic stay. *See Marine Midland Bank v. The Bennett Funding Group, Inc. (In re The Bennett Funding Group, Inc.)*, No. 96-61376-79, Adv. Pro. 96-70061 (Bankr. N.D.N.Y. May 30, 1997). The Marine decision was significant because it precipitated the filing by Marine of a motion for reconsideration (the "Marine Motion for Reconsideration") which was the first motion to fully implicate, *inter alia*, the question of whether a bank's security interest in certain equipment lease proceeds could be perfected by operation of Code § 546(b). The Court granted Marine's request for reconsideration and, by Memorandum-Decision, Findings of Fact, Conclusions of Law and Order dated August 11, 1997, ruled that Marine's security interests in certain lease proceeds had been perfected pursuant to Code § 546(b) and granted Marine relief from the automatic stay. *See Marine Midland Bank v. The Bennett Funding Group, Inc. (In re The Bennett Funding Group, Inc.)*, No. 96-61376, Adv. Pro. 96-70061 (Bankr. N.D.N.Y. Aug.

11 1997) (the "Marine Reconsideration Decision").

By Order to Show Cause dated August 21, 1997 the Trustee and the Official Committee of Unsecured Creditors (the "Committee") sought an order staying further hearings on motions for relief pending final disposition of the Trustee's and the Committee's respective appeals of the Marine Reconsideration Decision. The Court denied that request. Thereafter, the Trustee, the Committee, the Bank, and 21 banks which have not had evidentiary hearings on their motions (collectively, the "Intervening Banks") entered into a stipulation dated September 25, 1997 (the "Omnibus Stipulation") in which it was agreed that, *inter alia*, the Intervening Banks (1) could participate as intervenors in the hearing on the Bank's Motions and in any appeals related thereto, and (2) would be bound by the Court's rulings on the Bank's Motions with respect to certain issues deemed by the parties to be common to the Intervening Banks' motions. *See Stipulation Regarding Lift-Stay Litigation by Bank of Carmi and Banks Identified Below That Have Not Yet Had Evidentiary Hearings Regarding Transactions With The Bennett Funding Group, Inc. ("BFG"), dated September 25, 1997.* The Omnibus Stipulation allowed for the submission of certain supplemental evidentiary declarations and objections, and also allowed each Intervening Bank to submit a pre-hearing memorandum of law.[3] *See id.* at ¶¶ 8, 15. The Court approved the

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[3] The positions of the Bank and the Intervening Banks with respect to common issues are substantially the same, and the Intervening Banks do not raise any arguments not also substantially raised by the Bank. *See Joint Trial Brief Submitted on Behalf of Hancock & Estabrook Banks; Memorandum of Law filed on behalf of Security Bank, Story County Bank & Trust, The Commercial Bank, Amcore Bank of Rockford, N.A. and First Federal Savings & Loan Association of Galion; Trial Brief of Farmers State Bank, AmercianTrust Federal Savings Bank and State Bank & Trust Company of Sequin; Brief on Behalf of Intrevenor-Metrobank, N.A. in Support of Motion by Bank of Carmi to Modify the Automatic Stay; Memorandum of Law of Deposit Bank in Support of Motion for Relief From the Automatic Stay or, in the Alternative, for Adequate Protection; Tucker Federal Savings & Loan Association's Trial Brief on Common Issues Raised in the Carmi Hearing* (all filed on January 21, 1998). Likewise, the positions of

Omnibus Stipulation by Order dated October 17, 1997.

The hearing on the Bank's Motions (hereinafter, the "Hearing") was held on January 28, 1998, and the matter was submitted for decision at the close of evidence that day.

FACTS

From December 4, 1991 to April 21, 1995, the Bank, either in its individual capacity, or as agent for one of the Abshers, entered into 26 financing transactions with BFG and 2 financing transactions with RSC. In connection with each transaction, BFG or RSC executed and delivered to the Bank, *inter alia*, a promissory note in the amount advanced, *see Exhibits 2, 18, 34 and 50 attached to Carmi Exhibit 1; Exhibits A2, A18, A34, A50, A66, A85 and 101 attached to Carmi Exhibit 3; Exhibits A2, A17, A32 and A44 attached to Carmi Exhibit 5; Exhibits A2, A18, A34, A50, A66 and A82 attached to Carmi Exhibit 7; Exhibits A2, A18, A34, A49, A64, A84 and A100 attached to Carmi Exhibit 9*, as well as an "Assignment of Contracts," pursuant to which BFG or RSC assigned to the Bank all of its right, title and interest in and to certain equipment leases (the "Leases"), including all rental payments due under the Leases (the "Lease Payments") and the underlying equipment subject to the Leases (the "Equipment"),[4] *see Exhibits 4, 20, 36 and*

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the Committee and the Trustee are substantially the same. *See Memorandum of Law Submitted by the Official Committee of Unsecured Creditors in Opposition to the Motions Filed by First National Bank of Carmi for Relief From the Automatic Stay*, filed January 21, 1998.

[4] In connection with each transaction, BFG or RSC entered into a "Servicing Agreement" pursuant to which BFG or RSC was to collect from the lessees rental payments owing under the Leases. *See Exhibits 7, 23, 39, 55 attached to Carmi Exhibit 1; Exhibits A7, A23, A39, A55, A72, A90, A106 attached to Carmi Exhibit 3; Exhibits A7, A22, A37, A49 attached to Declaration of Carmi Exhibit 5; Exhibits A7, A23, A39, A55, A71, A87 attached to Carmi Exhibit 7; Exhibits A7,*

52 attached to Carmi Exhibit 1; Exhibits A4, A20, A36, A52, A68, A87 and A103; attached to Carmi Exhibit 3; Exhibits 4, 19, 34 and 46 attached to Carmi Exhibit 5; Exhibits A4, A20, A36, A52, A68 and A84 attached to Carmi Exhibit 7; Exhibits A4, A20, A36, A51, A66, A86 and A102 attached to Carmi Exhibit 9.

In an effort to perfect its security interests in the Leases, Lease Payments and Equipment, the Bank filed UCC-1 financing statements ("UCC -1s") with the New York Department of State (the "Secretary of State") and the Onondaga County Clerk's office in connection with each transaction. *See Exhibits 9, 10, 25, 26, 41, 42, 57 and 58 attached to Carmi Exhibit 1; Exhibits A9, A10, A25, A26, A41, A42, A57, A58, A74, A75, A92, A93, A108 and A109 attached to Carmi Exhibit 3; Exhibits A9, A10, A24, A25, A39, A40, A51 and A52 attached to Carmi Exhibit 5; Exhibits A9, A10, A25, A26, A41, A42, A57, A58, A73, A74, A89 and A90 attached to Carmi Exhibit 7; Exhibits A9, A10, A25, A26, A41, A42, A56, A57, A72, A73, A91, A92, A107 and A108 attached to Carmi Exhibit 9.* Each UCC-1 purports to cover all of BFG's or RSC's right, title

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A23, A39, A54, A70, A89, A105 attached to Carmi Exhibit 9. Upon collection, BFG or RSC was required to pay all taxes, assessments and other charges levied or assessed against the Leases and/or Equipment and remit to the Bank all amounts due under each promissory note in accordance with the amortization schedule attached thereto.

Schedule "A" to each Assignment of Contracts identifies the assigned Leases by lease number, lessee, original term, remaining term and monthly payment. The Trustee asserts that the amount of the monthly payments identified on Schedule A to each Assignment of Contracts (the "Schedule A Payments") is equal to the monthly payments due the Bank under each promissory note and does not include amounts earmarked for taxes and other assessments. The Trustee therefore disputes the Bank's contention that its security interests in the Lease Payments extend to all amounts collected under each Lease, and argues that the Bank's security interests secure only the Schedule A Payments. As has been previously indicated in connection with other bank motions in this case, the Court shall consider the Bank's Motions as seeking relief to enforce its security interests in the Lease Payments only to the extent of the outstanding Schedule A Payments. Without prejudice to any party, the Court will not at this time render a decision with respect to that portion of each Lease Payment in which the Bank's security interests are disputed, nor with respect to the Equipment in which the Bank claims perfected security interests.

and interest in and to certain Leases listed on an attached schedule, all substitutions and replacements thereto, and all proceeds thereof.

The Bank now seeks relief from the automatic stay to obtain, *inter alia*, the Lease Payments which have been collected and held by the Trustee, and to obtain future Lease Payments directly from the lessees. The Bank also seeks authority to set off a portion of its claim against certain of the funds which were deposited at the Bank by the Debtors prepetition. The Bank maintains that it is entitled to relief under Code § 362(d)(1) because its interests in the Leases/Lease Payments are not adequately protected, and further, that it is entitled to the relief under Code § 362(d)(2) because there is no equity in the Leases/Lease Payments and the Leases/Lease Payments are not necessary to an effective reorganization. *See* 11 U.S.C. §§ 362(d)(1) and (d)(2). The Trustee and the Committee dispute both of these contentions, but most significantly, argue that in connection with 16 transactions with BFG, the Bank failed to perfect security interests in Leases/Lease Payments because UCC-1s were filed in the name of "Aloha Leasing, a Div. of the Bennett Funding Group, Inc.," rather than in the name of "The Bennett Funding Group, Inc." The Trustee further argues that, even if the Bank is found to have a perfected interest in any Lease Payments, the Court should use its discretionary power to limit the scope of the Bank's security interest pursuant to Code § 552(b), based upon the "equities of the case." *See* 11 U.S.C. § 552(b). The Trustee asserts that this is warranted because the Bank failed to act in a reasonably prudent manner in monitoring the prepetition activities of BFG and RSC and because the estate has incurred costs in collecting Lease Payments for the benefit of the Bank which should be reimbursed. The Trustee opposes the Bank's request for allowance of a setoff.

DISCUSSION

Code § 362(e) requires an expedited hearing on a motion to lift the automatic stay in the absence of compelling circumstances requiring that the time for the hearing be extended. *See* 11 U.S.C. § 362(e). At the same time, "[i]n reorganization cases, the stay is particularly important in maintaining the status quo and permitting the debtor in possession or trustee to attempt to formulate a plan of reorganization." 3 COLLIER ON BANKRUPTCY ¶ 362.03[2] at 362-14 (Lawrence P. King, 15th ed. 1997). The Bank's Motions were filed on July 22, 1996. Thereafter, the Court granted interim relief in order to allow the Trustee an opportunity to establish some order from the initial chaos that reigned over the Debtors' estates. The Trustee retained Coopers & Lybrand, L.L.P. to perform forensic accounting work and to assist in the stabilization of the Debtors' operations. In the Court's view, to have granted any of the Motions early on in this case would have caused further disruption to the Debtors' operations to the detriment of all of the thousands of the Debtors' creditors. Based upon the information elicited at the various status conferences and the testimony of the Trustee at the Hearing, it is clear to the Court that the situation has now stabilized to the point where it is appropriate to dispose of the Bank's Motions.

I. ANALYSIS OF SECURITY INTERESTS

A. Most of the Leases are Chattel Paper

A creditor is generally not entitled to relief from the automatic stay unless it can establish that it possesses a perfected security interest in the property in question. *See, e.g., In re Hunt's*

Pier Assocs., 143 B.R. 36, 50 (Bankr. E.D.Pa. 1992).[5] The Bank asserts that it has a perfected security interest in the Leases and in the Lease Payments, which, as the Court indicated in the October 1996 Decision, are two separate types of collateral. *See In re The Bennett Funding Group, Inc.*, 203 B.R. at 38. Pursuant to the Omnibus Stipulation, the Trustee's representatives inspected the original Leases and other documentation attending each transaction (the "Transaction Documents") prior to the Hearing. The parties do not appear to dispute that, for the most part, the Leases constitute chattel paper, which is generally defined as a writing or group of writings which evidence both a monetary obligation and a security interest in specific goods. *See* NYUCC § 9-105(b); *see also, e.g., National Westminster Bancorp v. ICS Cybernetics, Inc.*

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[5] The Bank appears to be domiciled in Illinois, while the Debtor appears to be a New York corporation, thus raising issues as to which state's law to apply in determining the extent of the Bank's interest in the Leases/Lease Payments. Some courts, following *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941), hold that, in the absence of a compelling federal question, a bankruptcy court must apply the choice of law rules of its forum state. *See, e.g., Lindsay v. Beneficial Reinsur. Co. (In re Lindsay)*, 59 F.3d 942, 948 (9th Cir. 1996), *cert. denied*, 116 S.Ct. 778, 133 L.Ed.2d 730 (1996); *Limor v. Weinstein & Sutton (In re SMEC, Inc.)*, 160 B.R. 86 (M.D.Tenn. 1992). The federal and New York choice of law rules each require application of the law of the jurisdiction having the greatest interest in the litigation. *See Koreag, Controle et Revision S.A. v. Refco F/X Assoc., Inc. (In re Koreag, Controle et Revision S.A.)*, 961 F.2d 341, 350 (2d Cir. 1992). The Court need not decide which of the foregoing tests is more appropriate because, under either test, New York law would apply to questions of perfection. New York has a more significant interest in this matter than does Illinois, given the fact that the Debtors are located in New York, the UCC-1s were filed in New York and New York's policies of ensuring predictability in commercial transactions and providing notice to potential creditors are at issue. *See generally Hong Kong & Shanghai Banking Corp. v. HFH USA Corp.*, 805 F. Supp. 133, 140 n.3 (W.D.N.Y. 1992). Applicable New York law is in this case NYUCC § 1-105, which provides that NYUCC § 9-103 governs choice of law questions relating to perfection of security interests in multiple state transactions. *See* NYUCC § 1-105(2). While the Assignments of Contracts provide that they are to be construed in accordance with the law of the state in which the Bank is located, *i.e.*, Illinois, without giving effect to principles of conflicts of law, choice of law provisions do not pertain to issues of perfection or nonperfection because "UCC § 9-103 cannot be abrogated by agreement as it exists to protect the interests of third parties." *See Phillips v. Ball and Hunt Enters., Inc.*, 933 F. Supp. 1290, 1294 n.9 (W.D.Va. 1996).

(In re ICS Cybernetics, Inc.), 123 B.R. 467, 475-76 (Bankr. N.D.N.Y. 1989) (finding equipment leases to be chattel paper). However, the Trustee asserts that some of the Leases in the Bank's portfolios do not identify "specific goods" because they do not contain serial numbers identifying the goods/equipment. Many of the Leases objected to by the Trustee on this ground are for office equipment (such as a photocopier) for which a serial number is listed, and which also itemize accessories (such as sorting bins, trays and stands) for which no serial number is listed. The Bank argues that these Leases, either alone or taken together with accompanying writings, identify the underlying equipment by model and serial number, and that it is unnecessary to identify the accessories by serial number.

Generally, under the NYUCC any description of personal property which reasonably identifies what is described is sufficient whether or not it is specific. *See* NYUCC § 9-110. The Official Comment to NYUCC § 9-110 states that "[u]nder this rule courts should refuse to follow the holdings . . . that descriptions are insufficient unless they are of the most exact and detailed nature, the so-called 'serial number' test." Official Comment to NYUCC § 9-110. However, when the collateral is chattel paper, there is a requirement that there be evidence of specific goods. *See* NYUCC § 9-105(b). To determine whether specific goods have been identified, consideration must be given to the nature of the equipment and its description on a case-by-case basis.

A determination of whether a lease transaction is evidenced by chattel paper is not necessarily limited to a review of the lease itself, and may be based upon all the documents which are relevant to the particular transaction. *See Lease-A-Fleet, Inc. v. University Cadillac, Inc. (In re Lease-A-Fleet, Inc.)*, 152 B.R. 431, 437 (Bankr. E.D.Pa. 1993); *see also Funding Systems*

Asset Management Corp., 111 B.R. 500, 515-16 (Bankr. W.D.Pa. 1990). Additional documents that may be considered include lease orders, monthly invoices, guarantees, delivery receipts and in-service reports. *See Lease-A-Fleet, Inc. v. University Cadillac, Inc. (In re Lease-A-Fleet, Inc.) (on reconsideration)*, No. 91-12996S, Adv. No. 92-1269S, 1993 WL 128146, at *1-*2 (Bankr. E.D.Pa. Apr. 22, 1993).

Upon examination of the challenged Leases and the additional relevant documentation, the Court concludes that, generally speaking, accessories need not be identified by serial number. Thus, the following Leases do not sufficiently identify the leased equipment, and are deemed to be accounts rather than chattel paper[6]: Nos. 91071204, 91080606, 91100464, 91060201A, 91060201B (12-4-91 Bank of Carmi, individually, transaction); 93010649[7] (2-25-93 Bank of

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[6] An account is defined as "any right to payment for goods . . . leased . . . which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance." *See* NYUCC § 9-106. A security interest in an account can be perfected only by filing a financing statement, unless "the assignment . . . does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor." *See* NYUCC § 9-302(1)(e). The Bank argues that the Leases which constitute accounts are a *de minimus* percentage of all of BFG's total accounts and that the Bank therefore need not have filed financing statements to perfect its security interests in such accounts. *See Trial Brief of First National Bank of Carmi, et al. filed January 21, 1998 ("Bank's Memorandum of Law")* at 17, n.33. Whatever the merits of this argument might otherwise be, "the authorities are clear that where the assignee is regularly engaged in commercial financing and routinely accepts assignments of accounts, perfection by way of filing under the U.C.C. is required regardless of the actual amount of the accounts assigned." *Larkin v. Wood (In re Wood)*, 67 B.R. 321, 324 (W.D.N.Y. 1986) (citing *In re B. Hollis Knight Company*, 605 F.2d 397 (8th Cir. 1979). The Bank appears to be a commercial lender regularly engaged in the business of taking assignments of accounts, as a result of which it is not exempt from the general requirement of having to file a financing statement in order to perfect a security interest in accounts. Thus, the Bank has failed to perfect a security interest in any account which is not covered by Properly Filed UCC-1s, as defined below.

[7] This Lease covers a photocopier for which a serial number is listed, and a facsimile machine for which no serial number is listed. The Lease is an account to the extent that it covers the facsimile machine, but is chattel paper with respect to the photocopier.

Carmi, individually, transaction); 91040243, 91040301, 91050106 (6-3-91 Ron Absher transaction); 920050175 (7-24-92 Ron Absher transaction); 94062041 (8-10-94 Ron Absher transaction); 91041153, 91050310 (6-6-91 Jane Absher transaction); 92030760 (6-5-92 Jane Absher transaction); 92041046, 92041318 (7-24-92 Jane Absher transaction); 91020240, 91020417 (3-28-91 Henry Absher transaction); 91040864 (6-3-91 Henry Absher transaction); 93011545 (3-3-93 Henry Absher transaction); 94061896[8] (8-10-94 Henry Absher transaction); 91081120 (12-18-91 $244,481.94 Henry Absher d/b/a Absher Oil Co. transaction); 91101017 (12-18-91 $255,189.42 Henry Absher d/b/a Absher Oil Co. transaction); 92041956 (7-24-92 Henry Absher d/b/a Absher Oil Co. transaction); 94053289, 94061361 (8-10-94 Henry Absher d/b/a Absher Oil Co. transaction).

The Trustee has also renewed objections initially raised in his Particularized Responses to several Leases (and Transaction Documents) which he contends do not contain a lessee signature, which bear upon whether such Leases are chattel paper. *See Trustee's Objections to Transaction Documents Presented by Various Banks, filed November 20, 1997 (the "Trustee's Objections").*[9] NYUCC § 1-201(39) provides that the term "[s]igned includes any symbol

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[8] This Lease covers a facsimile machine for which a serial number is listed, and a computer and printer for which no serial numbers are listed. The Lease is an account to the extent that it covers the computer and the printer, but is chattel paper with respect to the facsimile machine.

[9] The Trustee objected that certain Leases and/or Transaction Documents were not original documents. Pursuant to a stipulation dated December 9, 1997 by and between the parties, the Trustee and the Committee agreed in pertinent part that copies of such Leases and Transaction Documents could be provided to the Court at the Hearing, on the condition that, *inter alia*, the originals be provided "at such time designated by the Court . . ." *See Stipulation Regarding Lift-Stay Litigation by Bank of Carmi and Banks Identified Below That Have Not Yet Had Evidentiary Hearings Regarding the Transactions with The Bennett Funding Group, Inc. ("BFG") at ¶ 3.* In response to an inquiry from the Court concerning the need for production of

executed or adopted by a party with the present intention to authenticate a writing." NYUCC § 1-201(39). The Official Comment to NYUCC § 1-201(39) provides:

> The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentication may be printed, stamped or written; it may be by initials or thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible authentications can be completed and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with the present intention to authenticate the writing."

NYUCC § 1-201(39), Official Comment 39 (McKinney's 1997). Similarly, section 46 of the New York General Construction Law ("NYGCL") defines "signature" as "any memorandum, mark or sign, printed, stamped, photographed, engraved, or otherwise placed upon any instrument or writing with intent to execute or authenticate such instrument or writing." NYGCL § 46

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original Leases and Transaction Documents, the Trustee indicated in a letter dated April 3, 1998 that the issue with respect to such documents "is not whether a signature on the document is original or a photocopy. Rather, the issue is the legal effect of a lack of signature or signatures on these documents." *Letter to Court From William T. Russell, Jr., Esquire, dated April 3, 1998.*

The Trustee has also raised objections to numerous Leases which he maintains do not contain the original signature of the lessor. Some of these objections were raised for the first time in the Trustee's Objections to Transaction Documents. Unless raised in a Particularized Response, the Trustee has waived any objections to the Leases of which he was previously provided access to copies. *See Marine Midland Bank v. The Bennett Funding Group, Inc. (In re The Bennett Funding Group, Inc.)*, No. 96-61376-79, Adv. Pro. 96-70061 (Bankr. N.D.N.Y. May 30, 1997), slip op. at 28. Such objections which have not been waived are nevertheless overruled because an enforceable lease need not contain the signature of the lessor. *See* NYUCC § 2-201(1); *Consarc Corp. v. Marine Midland Bank, N.A.*, 996 F.2d 568, 572 (2d Cir. 1993); *Whirlpool Corp. v. Regis Leasing Corp.*, 288 N.Y.S.2d 337 (1968). The Trustee also objects to certain Assignments of Contracts and other Transaction Documents on the basis that they do not contain the signature of a Bank representative. The Bank, however, has proven that it gave consideration for the Debtors' execution and delivery of these documents, and they are therefore enforceable despite the fact that they were not signed by a Bank representative. *See Consarc Corp. v. Marine Midland Bank, N.A.*, 966 F.2d at 972-73.

(McKinney's 1951 & Supp. 1997). With this in mind, the Court concludes that the only disputed Lease lacking a lessee signature is Lease 91030513 (Ron Absher 6-3-91 transaction). Because Lease 91030513 lacks a lessee signature, it cannot be said to evidence a security interest or monetary obligation for purposes of the NYUCC, and is therefore neither chattel paper, an account nor an instrument, but rather a general intangible. *See* NYUCC § 9-106.[10]

B. Perfection of Security Interests in Leases

Attachment

NYUCC § 9-203(1) provides that "a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless: (a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral . . . ; (b) value has been given; and (c) the debtor has rights in the collateral." NYUCC § 9-203(1). With the exceptions noted below, there does not appear to be any legitimate dispute that the Bank's security interests in the Leases attached within the meaning of NYUCC 9-203(1). The Bank is in possession of the original Leases and security agreements signed by the Debtors identifying certain Leases; the Bank is in possession of the original promissory notes executed by the Debtors indicating that value was given; and the Debtors have rights as lessors under the Leases.

The Trustee's Objections and the Bank's Responses thereto indicate that there were some

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[10] A security interest in a general intangible must be perfected by filing. *See* NYUCC § 9-302(1). The Court finds that the Bank perfected its security interest in Lease 91030513 by filing UCC-1s in the name of "The Bennett Funding Group, Inc." with the Secretary of State and the Onondaga County Clerk. *See Exhibits A9 and A10 attached to Carmi Exhibit 9.*

transactions for which no "Security Agreement" was executed, as a result of which the Trustee appears to argue that security interests in Leases not covered by a "Security Agreement" have not attached. These arguments are untenable because NYUCC § 9-203(1)(a) requires a secured party to show either that the debtor has signed a security agreement which contains a description of the collateral or that the secured party possesses the collateral pursuant to agreement. *See* Official Comment to NYUCC § 9-203 (stating, "Subsection (1)(a), therefore, dispenses with the written requirement - and thus with the signature and description - if the collateral is in the secured party's possession."). There does not appear to be any dispute that the Bank obtained the Leases pursuant to some form of agreement(s) with the Debtors. This agreement is embodied in the Assignments of Contracts. Neither a grant of a security interest nor attachment depends upon whether a document formally denominated as a "security agreement" was executed. All that is required is that there be some written expression containing "granting" language sufficient to demonstrate a present intent to pledge collateral. *See In re Modafferi*, 45 B.R. 370, 372-73 (S.D.N.Y. 1985). Such an expression may be deduced from a variety of documents considered as a whole. *See King v. Tuxedo Enterprises, Inc.*, 975 F. Supp. 448, 452 (E.D.N.Y. 1997).

Closely connected to the Trustee's objection concerning missing security agreements is his argument that security interests in certain substituted collateral have not attached and are not perfected. Pursuant to the Servicing Agreements, the Debtors were each required to "substitute a new [Lease] for, or pay all principal and interest on, any defaulted or prepaid [Lease]." The Trustee argues that the Bank has not established that its security interests in any of the leases which were so substituted (the "Substituted Leases") attached because none of the Substituted Leases are specifically described in any Assignment of Contracts, which make no reference to

substitutions. As noted above, however, a security agreement can be found in a variety of documents, and here the Servicing Agreements provide that the Debtors "will substitute a new [lease] for . . . any defaulted or prepaid [Lease] as provided for in the Guarantee and/or any other agreements between [the Debtor[s] and the Bank] dated even date herewith." *See generally Servicing Agreements* at ¶ 15; *see also various guarantee agreements executed and delivered by Debtors to Bank* at ¶ 2. At the time the Assignments of Contracts were executed, it is doubtful whether it was known which, if any, particular leases (if such leases were even in existence) might later become Substituted Leases. It is unclear whether the Trustee is arguing that the security agreement had to specifically itemize the Substituted Leases, as opposed to simply referring to "substitutions," but any such argument must be rejected. Upon their substitution, the Substituted Leases became a form of after-acquired collateral. *See* NYUCC § 9-204(1). "By including an after-acquired property clause in the security agreement . . . a creditor may obtain a security interest in all manner of collateral which 'does not yet exist,' as long as the after-acquired collateral fits within one of the general categories of collateral described in the security agreement and financing statement." *United States v. Smith*, 832 F.2d 774, 777 (2d Cir. 1987).[11]

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[11] The Trustee also argues that if the Bank does have security interests in the Substituted Leases, those security interests are not perfected because the Substituted Leases are not adequately described in the UCC-1s. The UCC-1s cover "[a]ll of debtor's right, title and interest in and to the contracts set forth in Schedule 'A' attached hereto annexed, and all substitutions and replacements thereto and all proceeds from the same exchange, collection or disposition thereof." NYUCC § 9-402(1) provides that a description contained in a financing statement is sufficient if it is "a statement indicating the types, or describing the items, of collateral." *See* NYUCC § 9-402(1); *see also* NYUCC 9-110 (any description of personal property is sufficient "whether or not it is specific if it reasonably identifies what is described"). "The clear purpose of § 9-402(1) is to provide the minimum information necessary on a financing statement for a UCC-1 searcher to be on notice that a creditor may have a security interest in the described collateral." *In re Kelton Motors, Inc.*, 117 B.R. 87, 90 (Bankr. D.Vt. 1990) (construing Vermont's version of the UCC) (citations omitted). Thus, the UCC-1s sufficiently describe the Substituted Leases by type

Based upon the foregoing, the Court finds that the Bank's security interests in the Leases, including the Substituted Leases, have attached.

Perfection by Possession

A security interest in chattel paper may be perfected either by filing a financing statement, *see* NYUCC § 9-304,[12] or by the secured party's taking possession of the chattel paper, *see* 810 ILL. COMP. STAT. ANN. 5/9-305 (West 1997);[13] *see also In re Keneco Financial Group*, 131 B.R. 90, 96 (Bankr. N.D.Ill. 1991). The Bank has provided evidence that it is in possession of the ink-signed original Leases and has therefore shown that it perfected its security interests in the Leases pursuant to ILUCC § 9-305. The Bank also argues that it perfected its security interest in the Leases by filing UCC-1s, which, as explained below, is in this case relevant to whether the Bank has perfected its security interest in the Lease Payments.

Perfection by Filing

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of collateral. While NYUCC § 9-402(4) refers to filing amended financing statements to cover "added collateral," that section "refers to additional types of collateral. A security interest on additional units of a type of collateral already described can be created under an after-acquired property clause or new security agreement." NYUCC § 9-402, Official Comment 4.

[12] In a multistate transaction involving a *non-possessory* security interest in chattel paper or a security interest in accounts, the law of the state where the debtor is located governs, which in this case is New York. *See* NYUCC §§ 9-103(4) and 9-103(3)(b).

[13] In a multiple state transaction, perfection of a *possessory* security interest in chattel paper is "governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected." *See* NYUCC §§ 9-103(3) and 9-103(1)(b). Thus, the Illinois version of the Uniform Commercial Code (the "ILUCC") governs with respect to the Bank's assertion that it perfected its security interest in the Leases by possession because it appears that the Bank perfected its security interest in the Leases by virtue of possession of the Leases at its offices in Carmi, Illinois.

With certain exceptions not applicable here, the place to file a financing statement in order to perfect a security interest is "in the department of state and in addition, if the debtor has a place of business in this state and in only one county of this state, also in the office of the filing officer of such county." NYUCC § 9-401(c). The Bank argues that it has filed proper UCC-1s with both the Secretary of State and the Onondaga County Clerk. The Trustee asserts that, with respect to 16 transactions with BFG, the Bank has not perfected its security interest in the Leases by filing because each of the UCC-1s filed in connection with such transactions in Onondaga County identify the debtor as "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." rather than as "The Bennett Funding Group, Inc." Although the UCC-1s filed with the Secretary of State also identify BFG in this fashion, the Trustee focuses exclusively on the validity of the UCC-1s filed in Onondaga County, arguing that as a result of the indexing system utilized by the Onondaga County Clerk, the UCC-1s do not sufficiently apprise the public of the Bank's security interest.

The October 1996 Decision contained a lengthy discussion concerning whether a financing statement identifying BFG by its trade name "Aloha Leasing" and its corporate name "The Bennett Funding Group, Inc." was effective to perfect a security interest in leases. The Court commented that "[w]hether the trade name precedes or follows the legal name of the debtor should not make a difference, particularly in this age of computer indexing." *In re The Bennett Funding Group, Inc.*, 203 B.R. at 37. The Court reasoned that if a search was performed under the name "Bennett Funding Group, Inc.," the computer would generate a list of those UCC-1s filed under the name of "Aloha Leasing, a Div. of The Bennett Funding Group, Inc.," on the assumption that both the corporate name and the trade name would be indexed as a single entry.

In rendering its decision, however, the Court did not have the benefit of testimony provided at the Hearing that, prepetition, the computer system utilized by the Onondaga County Clerk did not permit a full search of the text as it appeared in the "debtor box" on the financing statement. *See Declaration of Jacqueline A. Dacey admitted into evidence as Trustee's Exhibit Dacey I ("Dacey Declaration")* at ¶ j, Exhibits D, E & F. Instead, the indexing was purely alphabetical and required exactness on a letter by letter basis. *See id.* A prepetition search for UCC-1s filed in the name of "Bennett Funding Group" at the Onondaga County Clerk's office would have generated a list of those financing statements which correctly spell "Bennett Funding Group" letter by letter. *See id.*[14]

The Bank argues that the UCC-1s became effective when they were presented to and accepted by the Onondaga County Clerk because NYUCC § 9-403(1) provides that "[p]resentment for filing of a financing statement and tender of the filing or processing fee or acceptance of the statement by the filing officer constitutes filing under this Article." NYUCC § 9-403(1). Under NYUCC § 9-403(1), "the secured party does not bear the risk that the filing officer will not properly perform his duties: under that section the secured party has complied with the filing requirements when he presents his financing statement for filing and the filing fee has been tendered or the statement accepted by the filing officer." Official Comment 1 to

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[14] Some of the Intervening Banks filed a declaration which shows that a July 1997 search under "Bennett" in the Onondaga County Clerk's office yielded a list of UCC-1s filed under "Aloha Leasing, A Div. of The Bennett Funding Group, Inc." *See Declaration of Jo Ann Mitchell admitted into evidence as Hancock Exhibit 1.* The results of such a search in July 1997, more than 15 months after this case was commenced, are irrelevant. As testified by M. Ann Chiarapelli, who was Acting County Clerk in Onondaga County from January 1996 to January 1997, no automatic cross-referencing system was in place prepetition. *See Deposition of Maude Chiarapelli admitted into evidence as Trustee's Exhibit Gamble A*, at 7-8, 20, 23, 44; *Declaration of James G. Gamble admitted into evidence as Trustee's Exhibit Gamble B.*

NYUCC § 9-407. The Bank's argument is untenable because, as discussed herein, the Bank did not file UCC-1s which were sufficient to perfect a security interest in the assets of BFG. "Though receipt of the financing statement and the fee by the filing officer is 'filing', the security interest is perfected only if the financing statement is substantially correct." *Weill v. United Bank of Chattanooga (In re Poteet)*, 5 B.R. 631, 635 (Bankr. E.D.Tenn. 1980). As explained by the court in *In re Poteet*,

> "Filing is defined as presentation of the financing statement and the required fee to the filing officer. UCC § 9-403(1). Filing is not defined as presentation of a correct financing statement. But the courts have consistently held that filing, as defined, does not necessarily perfect a security interest. A financing statement is supposed to give notice. To that end it must meet certain accuracy requirements imposed by Article 9. If it fails to do so because of the secured party's mistakes, then the "filing" does not perfect the security interest. UCC § 9-402(5).

Id. at 635 (citations omitted); *see also Grabscheid v. Calvert Sales, Inc. (In re C.J. Rogers, Inc.)*, 157 B.R. 600, 604 (E.D.Mich. 1993) (stating that § 9-403(1) of Michigan's UCC "requires presentation of a *properly executed* financing statement for filing" (emphasis in original)), *aff'd* 39 F.3d 669 (6th Cir. 1994); *McMillin v. First Nat'l Bank & Trust Co. of Ponca City (In re Fowler)*, 407 F. Supp. 799, 803 (quoting 4 Anderson, Uniform Commercial Code, 2nd ed. 9-403:5: "The secured party does not bear the risk of an improper filing or indexing by the filing officer, *as long as the secured party has not by his own conduct caused the error by misleading the filing officer*." (emphasis added)); *In the Matter of John W. Smith*, 205 F. Supp. 27, 29 (E.D.Pa. 1962) (stating that the court's interpretation of section 9-403(1) "is that it refers to the presentation for filing of a financing statement which substantially complies with the Code's formal requirements for financing statements . . ."); *cf. In the Matter of May Lee Industries, Inc.*,

380 F. Supp. 1, 3 (S.D.N.Y. 1974) (finding that by virtue of NYUCC § 9-403(1) secured party had no duty to insure proper filing and indexing of financing statements, and stating that "[t]he cases cited by the debtor [to the contrary] are inapposite inasmuch as the financing statements in those cases were illegible, confusing, or erroneous whereas in the instant case there is nothing improper on the face of the financing statement"), *aff'd* 501 F.2d 1407 (2d Cir. 1974) (per curiam); *Chemical Bank v. Barron*, 663 F. Supp. 367, 369 (S.D.N.Y. 1987) (finding that pursuant to NYUCC § 9-403(1) financing statement had been filed at the time it was first presented to the Department of State, and thus granting cross-motion for summary judgment, but stating that "[w]ere there any indication that the Telewide statement was improper as to form when it was first presented to the DOS, the matter might best await trial for resolution.").

Enmeshed with the Bank's argument concerning NYUCC § 9-403(1) is the notion that the Onondaga County Clerk failed to properly index the Bank's UCC-1s and/or should have discerned what BFG's corporate name was and indexed the UCC-1s under the corporate name. The Bank argues that the Office of the Onondaga County Clerk had either a duty to file under BFG's legal name, or to cross-index the UCC-1s. *See Bank's Memorandum of Law* at 26-30. An additional fee would have had to have been paid for a UCC-1 naming the debtor as "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." to have been cross-indexed under debtors whose names begin with "B" as well as under debtors whose names begin with "A." *See* NYUCC § 9-403(5)(c); *Dacey Declaration* at ¶¶ d, e & f, Exhibit B. No evidence was presented that such a fee was paid. "Cross-indexing is not automatic in New York but is available pursuant to § 9-403(5)(c) for a fee of [$.75]." *Maremont Marketing, Inc. v. Centennial Industries, Inc. (In re Centennial Industries, Inc.)*, 3 B.R. 416, 417 n.1 (Bankr. S.D.N.Y. 1980). The case of *In re*

Pasco Sales Co., Inc., 52 A.D.2d 138, 140 (2d Dep't 1976) involved a financing statement that listed a debtor's trade name followed by its legal corporate name: "Pacific Supply Co., a division of P.S.C. Products Corp." The court ruled that the filing officer, "in literal compliance with the statute, filed the statement only as it appeared in the financing statement and did not cross-index it against the corporate name." Even though the Secretary of State had cross-indexed the financing statement, "although not required by law so to do," the court held that the local filing officer "did exactly what he was called upon to do" and that the security interest was unperfected. *See id.* at 140-42; *accord John Deere Co. v. William C. Pahl Construction Co.*, 310 N.Y.S.2d 945, 949 (4th Dep't 1970) (UCC filing officer, "[a]s a ministerial officer . . . was required to index the statement under the name he found in it and not engage in 'some second guessing.'"). *Compare In re Atlas Technologies, Inc.*, 78 B.R. 394, 400 (Bankr. E.D.N.Y. 1987) (making no express reference to whether the fee required by NYUCC § 9-403(5)(c) had been paid, but finding that financing statement which was not cross-indexed under proper debtor name was nevertheless properly filed by virtue of NYUCC § 9-403(1). The Onondaga County Clerk' office properly indexed the UCC-1s under "Aloha Leasing." In the absence of direction and the additional filing fee from the Bank, it was under no duty, statutory or otherwise, to cross-index the UCC-1s under "Bennett Funding Group, Inc." Thus, the UCC-1s were not properly filed in Onondaga County -- not because the Onondaga County Clerk's office did not cross-index the UCC-1s, as some of the Intervening Banks have suggested, *see Trial Brief of Farmers State Bank, AmericanTrust Federal Savings Bank and State Bank & Trust Company of Sequin* at 27, n.14, but because the UCC-1s failed to sufficiently identify the true debtor.

It is now clear to the Court that a reasonably diligent search by a creditor in the corporate

name of BFG would not have revealed the Bank's filed UCC-1s in the name of "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." While the Bank argues that "a prudent creditor seeking to perfect a security interest in the Leases by filing would have searched the Clerk's Office records under the name 'Aloha Leasing,'" *Bank's Memorandum of Law* at 30, the Trustee, as a hypothetical lien creditor, is not charged with knowledge of BFG's use of a trade name. *See Northern Comm'l Corp. v. Friedman (In re Leichter)*, 471 F.2d 785, 787 (2d Cir. 1972).

Having been presented with evidence of the actual indexing system utilized by the Onondaga County Clerk's office, the Court finds that the assumptions it relied upon in rendering the October 1996 Decision, which were based in large part on the arguments of the banks' counsel, were incorrect at least with respect to the filing system in Onondaga County. If Onondaga County had utilized a system which permitted a search of the full text of BFG's name, the Court's prior conclusions with respect to the inclusion of the Debtor's trade name would have had merit. Confronted with the actual operative facts, the Court must re-examine its position. The Court concludes that the UCC-1s filed by the Bank in the Onondaga County Clerk's office under the name "Aloha Leasing, a Div. of the Bennett Funding Group, Inc." were ineffective in that they failed to provide a creditor with notice sufficient to warrant further inquiry concerning the Leases. *See Dietrich-Post Co. of Washington Inc. v. Alaska Nat'l Bank of the North (In re McCauley's Reprographics, Inc.)*, 638 F.2d 117, 119 (9th Cir. 1981) (stating, "[w]hen the name of the debtor has been erroneously listed on the financing statement, the dispositive question is usually whether or not a reasonable search under debtor's true name would uncover the filing"). A reasonable search for financing statements filed under the name "Bennett Funding Group, Inc." would not have revealed financing statements filed in the name "Aloha Leasing, a Div. of The

Bennett Funding Group, Inc." Therefore, the Bank failed to file proper UCC-1s in Onondaga County with respect to the 16 transactions for which it filed UCC-1s in the name "Aloha Leasing, a Div. of The Bennett Funding Group, Inc."

Second Place of Business

Alternatively, the Bank argues that notwithstanding the deficient filings in Onondaga County, it perfected several of its security interests in Leases/Lease Payments by filing proper UCC-1s with the Secretary of State because BFG had a place of business in more than one county in New York. *See* NYUCC § 9-401(c). The Bank asserts that from December 1, 1992 through August 31, 1994, BFG had a place of business in Westchester County, New York, because during that time Aloha Leasing's Director of Sales for the Northeast Region, Josephine A. Fava ("Fava"), worked out of a converted bedroom in her parents' home at 21 Church Street in Bedford Hills, New York. As Director of Sales for the Northeast Region, Fava was one of eleven regional sales directors employed by BFG and was responsible for marketing Aloha Leasing products to office equipment dealers and manufacturers in a nine state geographic area stretching from Pennsylvania to Maine. *See Redacted Transcript of Deposition of Josephine A. Fava Attached as Exhibit "A" to Declaration of James D. Dati admitted into evidence as Carmi Exhibit 18 ("Dati/Fava Deposition")* at 40-41. As a result of Fava's marketing efforts, Aloha Leasing would typically purchase office equipment from a dealer and then lease that equipment to a lessee which had been procured by the dealer. *See id.* at 33-34. According to Fava, BFG's Northeast Sales Region generated approximately $1,500,000 in monthly sales, or $18,000,000 annually. *See id.* at 37.

During the time in question, Fava did not live in her parents' home, but voluntarily paid her mother $200 per month for use of the converted bedroom, for which she was not reimbursed by BFG. *See Redacted Transcript of Deposition of Josephine A. Fava Attached to Declaration of Maurice H. Hartigan III admitted into evidence as Trustee's Exhibit Hartigan 2B ("Hartigan/Fava Deposition")* at 61-62, 67. The converted bedroom was equipped with a telephone, a telecopier/facsimile machine, a photocopier, a computer and a printer, all of which were provided and paid for by Aloha Leasing. *See Dati/Fava Deposition* at 10-11, 43. Fava testified that she spent only a day or a day and a half per week working at her parents' home, *see id.* at 17, and that much, if not most, of her time was spent traveling and visiting dealers and manufacturers, *see id.* at 30. Approximately once a week, Fava would receive at her parents' home a package from Aloha Leasing containing company information, supplies and/or marketing materials known as "dealer packages." *See id.* at 17. As part of her marketing efforts, Fava would either mail or hand deliver dealer packages to various dealers and manufacturers, but she did not meet with dealers or manufacturers at her parents' home. *See Hartigan/Fava Deposition* at 68-69. The dealer packages contained, *inter alia*, documentation for various leasing arrangements offered by Aloha, a "rate card" detailing rental rates offered by Aloha, and a listing of various Aloha sales representatives and sales directors across the country (the "Territory Listing").[15] *See Dati/Fava Deposition* at 50; Exhibits 3 & 4. The Territory Listing indicated that

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[15] The Court reserved decision on the Trustee's objections to the admission of the Territory Listing, Fava's business cards and a telephone listing for BFG, referred to below. The Trustee asserts that each constitutes inadmissible hearsay. *See Trustee's Evidentiary Objections to Initial Declarations of First National Bank of Carmi, et al., filed August 25, 1997.* While these documents would be admissible as non-hearsay admissions of BFG, *see* F.R.E. 801(d)(2), such admissions are not binding upon the Trustee as a party-opponent because F.R.E. 801(d)(2) "'rejects privity as a ground for admissibility by making no provision for it.'" *Anaconda-*

Fava was Aloha's Northeast Sales Director and listed the telephone number of her office at her parents' home as Aloha's Northeast Region office telephone number.

Ericsson, Inc. v. Hessen (Matter of Teltronics Services, Inc.), 29 B.R. 139, 165 (Bankr. E.D.N.Y. 1983) (quoting 4 Weinstein's Evidence 801-1165 (1979) and citing *Calhoun v. Baylor*, 646 F.2d 1158 (6th Cir. 1981); *Huff v. White Motor Corp.*, 609 F.2d 286 (7th Cir. 1979)). The documents are therefore not admissible as admissions of a party-opponent. However, to the extent that the business cards can be deemed to be statements by Fava, they are admissible under the former testimony exception to the hearsay rule, under which deposition testimony of an unavailable witness may be admitted if the party against whom it is offered had an opportunity and similar motive to develop the testimony by direct, cross or redirect examination. *See* F.R.E. 804(b)(1). A witness is considered to be unavailable if, *inter alia*, she is absent from the hearing and the proponent of her statement has been unable to procure her attendance by process or other reasonable means. *See* F.R.E. 804(a)(5). Paragraph 9 of the Omnibus Stipulation provides in pertinent part: "The parties shall not object to the admission of the transcript of all or any portion of the deposition of Josephine A. Fava . . . on the grounds that Ms. Fava is not present at the Carmi Hearing. The parties may object to specific portions of Ms. Fava's testimony on any *other* grounds consistent with the stipulations entered into at the time of the deposition. The parties agree that Ms. Fava shall not be subpoenaed to appear to the Carmi Hearing." *Omnibus Stipulation at ¶ 9 (emphasis added).* Thus, the Court finds that Fava is an unavailable witness. At her deposition, she was deposed by, *inter alios*, the Bank as well as the Trustee, who had every opportunity to develop her testimony contained in, or relating to, the business cards. As a result, the business cards, to the extent that they are Fava's statements, are admissible as former testimony pursuant to F.R.E. 804(b)(1).

The Territory Listing, the telephone listing and the business cards are admissible under the residual exception to the hearsay rule contained in F.R.E. 807 because they each have sufficient circumstantial guarantees of trustworthiness and (a) they are each offered as evidence of a material fact, (b) they are each statements which are more probative on the issue of the knowledge of probable potential creditors/customers than any other evidence which the Bank could procure through reasonable efforts, and (c) the general purposes of these rules and the interests of justice will best be served by their admission into evidence. *See generally Russell, Bankruptcy Evidence Manual, 1998 Ed.*, § 803.36. In order for a statement to be admitted under Rule 807, a proponent intending to admit the statement must notify any adverse party of this intention sufficiently in advance of trial to allow the adverse party to prepare to meet or contest the use of the statement. *See* F.R.E. 807. While the notice requirement is generally enforced, it "may be dispensed with when the need for the hearsay statement arose on the eve of trial, or in the course of trial, if no prejudice to the opponent is apparent." *Russell, Bankruptcy Evidence Manual, 1998 Ed.*, § 803.36 (citing *Lloyd v. Professional Realty Services, Inc.*, 734 F.2d 1428, 1433-34 (11th Cir. 1984)). Under the present circumstances, the Court finds that the Trustee is not prejudiced by a lack of notice of the use of Rule 807 to admit the Territory Listing, the telephone listing and the business cards.

The Territory Listing did not list an address for Fava or Aloha. However, Fava testified that she included her business card with each dealer package. There were essentially two variations of Fava's business card during the period in question. Initially, Fava used a business card which listed her parents' home address of 21 Church Street in Bedford Hills:[16]

JoAnn Fava
Director of Sales
Northeast Region

ALOHA LEASING
A Division of The Bennett Funding Group, Inc.
Regional Office: (914) 242-0460 Facsimile (914) 242-0467
21 Church Street Bedford Hills, NY 10507
Headquarters: 1-800-247-2846 Voicemail Ext.# 605
Facsimile 1-800-65-FAX IT
(1-800-653-2948)

See Exhibit 1 to Dati/Fava Deposition. Sometime thereafter, Fava began using another business card setting forth BFG's Syracuse address, rather than the Bedford Hills address, but which still referenced the Bedford Hills telephone and telecopier numbers:

JoAnn Fava
Director of Sales
Northeast Region

ALOHA LEASING
A Division of The Bennett Funding Group, Inc.
Two Clinton Square Syracuse, New York 13202
Headquarters: 1-800-247-2846 Voicemail Ext.# 605
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Fava explained the reason for the change: "There was a concern expressed with the outside salespeople with regard to our home address . . . [E]very once in a while what would happen is

[16] Actually, Fava first used a business card which listed her parents' home address as being 17 Church Street in Bedford Hills until the Town changed the address to 21 Church Street in connection with a "911 reconfiguration of street addresses." *See id.* at 13-14; Exhibit 1.

correspondence would be mailed directly to that home address instead of the Aloha office. So -- but more importantly, I thought, I didn't want my home address on the business card." *Hartigan/Fava Deposition* at 15-16.

In addition to being listed on the Territory Listing and on Fava's business cards, the Bedford Hills telephone number was also listed under the name "Aloha Leasing" in the NYNEX Yellow Pages for the New Rochelle Area with White Pages for Westchester/Putnam, February 1994- January 1995. *See Dati/Fava Deposition* at Exhibit 2. However, the number most frequently used by vendors contacting Fava was the "800" number listed as "Voicemail" on the Territory Listing and as the "Headquarters" number on the business cards. *See Hartigan/Fava Deposition* at 69-70. The "800" number was a Syracuse number through which calls were routed to Fava in Bedford Hills. *See id.* at 69.

Fava corresponded in writing with dealers and manufacturers using Aloha letterhead which did not contain the Bedford Hills address. *See id.* at 20. Fava testified that she included her business card with such correspondence, *see Dati/Fava Deposition* at 20, but she also testified that she would frequently send facsimile transmissions to dealers from her parents' home, *see id.* at 39, and it does not appear that she included a copy of her business card with such transmissions. Fava further testified that she distributed her business card to "dealers, branches, representatives, pretty much everyone [she] came into contact with respect to business." *Id.* at 16.

The term "place of business" is not defined by the UCC. White and Summers state in their treatise that there are two plausible tests for determining what constitutes a place of business within the meaning of UCC § 9-401(c):

> One might simply measure the quantity of business work accomplished at a place: how much revenue is attributable to that place, what is its permanence, how many letters were sent there, how many letters were sent from there, how many employees were there, etc. The alternative test focuses on "notoriety": to what extent do creditors and others regard the debtor as doing business at the place in question?

See J. White and R. Summers, Uniform Commercial Code, § 31-16, p. 191 (4th ed. 1997). In *Credit Men's Adjustment Bureau, Inc. v. C.I.T. Corp. (In the Matter of Mimshell Fabrics, Ltd.)*, 491 F.2d 21 (2d Cir. 1974), the United States Court of Appeals for the Second Circuit adopted a variation of the notoriety test. There, the Second Circuit held that a debtor's salesroom contained within another corporate entity's offices, at which there were no outside physical indicia of the debtor's presence (such as letterhead, a telephone listing or entry in a building directory), constituted a place of business within the meaning of NYUCC § 9-401(c) because it "was widely known among those who dealt with [the debtor]" that the debtor had operations there. *See id.* at 23. In so holding, the Second Circuit stated, "it seems sufficient for perfection that the class of probable creditors know of the second place of business." *Id.*

The *Mimshell* case has been interpreted as having formulated a two part hybrid of the quantity test and the notoriety test which asks "1) was the debtor actually doing business at the location in question as evidenced by its frequent use by the debtor in the production of revenue? . . . and 2) was such use notorious, *i.e.*, was there a ' (sic) class of probable potential creditors (who knew) of the second place of business?" *See Alsted Automotive Warehouse, Inc. v. Ford Motor Co. (In re Alsted Automotive Warehouse, Inc.)*, 16 B.R. 926, 929 (Bankr. E.D.N.Y. 1982) (citing *In re Mimshell Fabrics, Ltd.*, 491 F.2d at 23) (other citations omitted); *see also Trans Union Leasing Corp. v. Alithochrome Corp. (In re Alithochrome Corp.)*, 31 B.R. 352, 354-55

(Bankr. S.D.N.Y. 1983), *vacated to permit appeal*, 34 B.R. 354 (Bankr. S.D.N.Y. 1983). *Compare In the Matter of Enark Industries, Inc.*, 86 Misc.2d 985, 383 N.Y.S.2d 796 (1976) (indicating that the "notoriety" test prevails in New York) (citations omitted); *In re Woodfield Furniture Clearance Center of Suffolk, Inc.*, 102 B.R. 327, 332 (Bankr. E.D.N.Y. 1989) (indicating that "whether or not a place of business exists is a question of fact to be decided on pragmatic grounds"). The class of potential creditors referred to in the second part of this test includes "those who deal with the debtor [such as] creditors, customers and people in the trade." *In re Alithochrome Corp.*, 31 B.R. at 355 (citing *In re Mimshell Fabrics, Ltd.*, 491 F.2d at 21; *Litton Industries Credit Corp. v. Airequipt, Inc. (In the Matter of Airequipt, Inc.)*, 1 B.C.D. 1494 (S.D.N.Y. 1975)).

The Court finds, and it does not appear to be seriously disputed by the Trustee, *cf. Trustee's Memorandum of Law at 43* (stressing that a "place of business" is not synonymous with "doing business"), that BFG was actually doing business at Fava's parents' home in Bedford Hills from December 1, 1992 through August 31, 1994, as evidenced by Fava's regular use each week of the home to generate sales revenue.[17] The issue is whether Fava's use of her parents' home was notorious to those with whom Aloha Leasing dealt.

Of the cases construing UCC § 9-401(c)(1), *In re John Adams Henry, Inc.*, 5 U.C.C. Rep. Serv. 795 (S.D.N.Y. 1968) is perhaps the most factually analogous to the present case. In the *John Adams Henry* case, the debtor "was engaged in the business of supplying fresh and frozen

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[17] The Trustee correctly asserts that "Ms. Fava never dealt with, met with, or spoke with any bank, investor or other source of financing for the Debtor," *see Trustee's Memorandum of Law at 42*. However, financing was only one aspect of BFG's business; marketing was another. Fava's business at the Bedford Hills location was marketing.

fruits and vegetables and grocery items to the hotel, restaurant and institutional trade . . ." *Id.* at 798. The debtor maintained a central office in New York County which was open from 8:00 a.m. to 5:00 p.m., and also employed salesmen who worked from their homes outside of New York County. *See id.* at 799-800. The nature of the debtor's business required the company to be open 24 hours a day, and the court found that "salesmen used their homes as places of business of John Adams Henry, Inc. in order to maintain a smoothly functioning operation." *Id.* at 800. The debtor's salesmen solicited business extensively by telephone from their homes, and two of them also occasionally stored merchandise at their homes and/or made deliveries of merchandise outside of New York County. *See id.* at 799-800. The salesmen's business cards carried their home telephone number. *See id.* at 799. Thus, the court concluded that the homes of each of the salesmen constituted places of business of the debtor for purposes of NYUCC § 9-401(c). *See id.* at 800-01.

The Trustee argues that the "work performed by the salespeople in the *John Adams Henry,* case is in marked contrast to Joann Fava's duties." *See Trustee's Memorandum of Law* at 45. In support of this argument, the Trustee correctly asserts:

> As established at her deposition, Ms. Fava had no authority to negotiate [or] quote [non-standard] rates . . . with vendors. Vendors submitted credit applications directly to Syracuse and submitted invoices directly to Syracuse . . . [A]ll vendor paperwork had to be approved and signed in Syracuse. Moreover, all vendors were aware that transactions had to be consummated through Syracuse. Fava Deposition at 73-75.

Id. However, it does not appear that the salesmen in the *John Adams Henry* case had any authority to independently negotiate transactions either. Rather, it appears that all orders "were cleared through the office in Manhattan." *See In re John Adams Henry, Inc.*, 5 U.C.C. Rep. Serv.

at 799. The *John Adams Henry* case has been interpreted as simply having held that "putting the home telephone number of the debtor's salesmen on their business cards, together with . . . [*inter alia*, extensive solicitation of business by telephone from the salesmen's homes], was sufficient to make the homes of these salesmen additional places of business of the debtor." *See In re Sterling Wood Products, Inc.*, 34 B.R. 183, 189 (Bankr. E.D.N.Y. 1983).

The case of *In re McQuaide*, 5 U.C.C. Rep. Serv. 802 (D.Vt. 1968), *aff'd* 6 U.C.C. Rep. Serv. 419 (D.Vt. 1969), involved the question of whether a private residence constituted a place of business within the meaning of the provision of Vermont's UCC then in force governing the proper place to file UCC-1s. There, the debtor operated a feed and farm supply business under a fictitious name. *See In re McQuaide*, 5 U.C.C. Rep. Serv. at 803. The debtor maintained three warehouses and an office in Bellows Falls, Vermont, *see id.*, where all of the physical work relating to his business was conducted, supplies were kept and sales were made, *see id.* at 804. Additionally, all business mail originated from Bellows Falls. *See id.* at 803. The debtor, with his wife's assistance, performed the business' bookkeeping and certain billing functions at his home in a town outside of Bellows Falls. *See id.* at 804-05. The billing letterhead listed the debtor's fictitious business name and the Bellows Falls address. *See id.* at 803. Almost all payments were mailed to the Bellows Falls office. *See id.* The business telephone, with a Bellows Falls number, was connected so that it also rang at the debtor's home. *See id.* at 804. None of the products sold by the debtor were kept at his house, and, significantly, "the [debtor] never informed his creditors of any business address other than at Bellows Falls, Vermont." *Id.*

The *McQuaide* court determined that a "place of business" "is one which has notoriety; a place where customers and creditors of the debtor would normally resort to or communicate

with by mail or otherwise to trade with the debtor or engage in commercial transactions; a place where persons dealing with the debtor would normally look for credit information." *Id.* at 806. Thus, the court concluded that the debtor's home did not constitute a place of business because "the endeavor at the house was a private arrangement between the [debtor] and his wife, unknown to his creditors or any other parties dealing with him in his business." *Id*. at 807. The court held:

> The only place of business of the [debtor] was at Bellows Falls . . . , where he had his physical plant, kept his merchandise, engaged in commercial transactions with his customers. It was known to his creditors and debtors, through his letterheads, as the location where they could deal with him. Bellows Falls met the test of notoriety required to establish it as a "place of business." [The debtor's home] did not.

Id.

Like the debtor in *In re McQuaide*, Fava performed paperwork at her parents' home in Bedford Hills which was unknown to any parties with whom BFG or Aloha Leasing dealt. Fava testified that she coordinated her travel schedule, maintained expense reports and dealer files in Bedford Hills, *see Dati/Fava Deposition* at 25, which, standing alone, would be insufficient evidence of a place of business. *See, e.g., In re McQuaide*, 5 U.C.C. Rep. Serv. at 806-07. But Fava did more than internal paperwork in Bedford Hills. She mailed dealer packages to vendors, *see Dati/Fava Deposition* at 18, 20, 24; she sent and received correspondence to and from vendors via mail and facsimile transmission, *see Hartigan/Fava Deposition* at 15-16; *Dati/Fava Deposition* at 28, 39; she telephoned vendors and received telephone calls from vendors on the Bedford Hills line; and, perhaps most significantly, she routinely distributed to vendors a business card which, for an unknown portion of the time in question, listed Aloha Leasing's

address as being at Bedford Hills, but which at all times listed the Bedford Hills telephone number. Additionally, the Bedford Hills telephone number was listed under Aloha Leasing in the local telephone book for at least a portion of the time in question. All of this leads the Court to conclude that, as a class, the equipment vendors with whom Fava dealt knew that Aloha Leasing had operations at the Bedford Hills location.[18]

Whether the equipment vendors' knowledge is sufficient for the Bedford Hills location to be a place of business within the meaning of NYUCC § 9-401(1)(c) is another question. The Trustee indirectly touches upon a possible additional aspect of the notoriety requirement by citing *In re Sterling Wood Products, Inc.*, 34 B.R. 183 (Bankr. E.D.N.Y. 1983). *See generally Trustee's Memorandum at 44 (quoting In re Sterling Wood Products, Inc*., 34 B.R. at 188). There, the court, discussing the rationale behind NYUCC § 9-401(1)(c), noted that the Second Circuit in the *P.S. Products* case "refused to deem the location listed in a corporation's Certificate of Incorporation to be a 'place of business' on the ground that to do so would frustrate the legislative purpose . . . [of affording to local creditors the convenience of relying on a local search]." *In re Sterling Wood Products, Inc.*, 34 B.R. at 188 (citing *P.S. Products Corp. v. Equilease Corp.*, 435 F.2d 781, 783 (2d Cir. 1970)). The court in *In re Sterling Wood Products, Inc.* stated:

> Patently, a local creditor would be far more inconvenienced if, before he could rely on local filing records, he were required to

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[18] The Trustee asserts that "[t]he Debtor never paid any rent, insurance, taxes or utility bills in connection with Ms. Fava's parents' home," that "[t]he Debtor did not make any mortgage payments on Ms. Fava's parents' home, and that Fava did not declare the $200 in monthly rent she paid to her mother as a business deduction on her tax returns. *See Trustee's Memorandum of Law at 42*. None of these factors are relevant to whether probable potential creditors or customers would be aware that BFG had operations at Fava's parents' home.

> engage in a careful study and analysis of his corporate debtor's warehousing practices or its relation with its subsidiaries in order to determine if they were of such a character as to make the warehouse or the subsidiary a place of business of the debtor. Unless the debtor has in some way permitted it to become generally known that he is doing business at a place other than that known to his local creditors, they should be able to rely on a local file search.

Id.

Thus, an argument might be made that BFG's potential local Onondaga County creditors, for whose benefit NYUCC § 9-401(1)(c) was enacted, had to have been aware of the Bedford Hills office in order for that office to constitute a place of business within the meaning of the statute. In *Mimshell Fabrics*, the Second Circuit stated:

> There is no doubt that the purpose of N.Y.U.C.C. § 9-401(1)(c) was to preserve the convenience of local filing for the benefit of potential local creditors as indeed the 'Official Comments' to that section suggest. This convenience has been strictly protected by this court. *In re P.S. Products Corp.*, 435 F.2d 781 (2d Cir. 1970). However, it seems sufficient for perfection that the class of probable potential creditors know of the second place of business.

In the Matter of Mimshell Fabrics, Ltd., 491 F.2d at 23 (emphasis added). The *Mimshell* case speaks in terms of "*the* class of probable potential creditors," which implies that a debtor has only one class of probable potential creditors, and thus that a location must be notorious to all or substantially all such creditors in order to constitute a place of business for purposes of NYUCC § 9-401(1)(c). *See id.* In *Mimshell*, it appears that such a condition was satisfied insofar as the location which was found to constitute a place of business was "widely known among those who dealt with Mimshell." *See id.* In the *John Adams Henry* case, it appears (although it is not entirely clear) that a substantial portion of the debtor's customers who dealt with the main office

in Manhattan was aware that the debtor had at least two places of business. *See generally In re John Adams Henry, Inc.*, 5 U.C.C. Rep. Serv. at 795.

Conversely, in *In the Matter of Airequipt, Inc.*, 1 B.C.D. 1494 (S.D.N.Y. 1975) there was "no evidence that any of Airequipt's creditors or customers knew of the company's dealings in the Bronx, except [the assignee of a company which had delivered machines purchased by Airequipt to Airequipt's subcontractor there and an Italian firm which addressed correspondence to Airequipt's independent consultant there]," *see id.* at 1495-96. With respect to the Italian firm, the court stated, "It would seem . . . that this single additional party's awareness of Airequipt's presence in the Bronx falls short of the general knowledge of 'the class of potential creditors' that the concept of notoriety requires." *Id.* at 1496 (citing *Mimshell*, 491 F.2d at 23); *see also In the Matter of Enark Industries, Inc.*, 86 Misc.2d at 986, 383 N.Y.S.2d at 797 (stating, "The mere fact that only a 'couple' of the assignor's customers knew of the New York residence of the assignor's president as opposed to all the other facts indicating a place of business in Farmingdale, N.Y. establishes that the assignor maintained only one place of business . . .").

The case of *In re Alsted Automotive Warehouse, Inc.*, citing *Mimshell*, indicates that a location may be deemed to be a place of business if, *inter alia*, "*a* '(sic) class of probable potential creditors" is aware of the location. *See* 16 B.R. at 930 (emphasis added) (citing *In the Matter of Mimshell Fabrics, Ltd.*, 491 F.2d at 23).[19] The phrase "*a* class of probable potential creditors" is not necessarily synonymous with the phrase "*the* class of probable potential

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[19] The *Sterling Wood Products* court misquotes *Alsted Automotive Warehouse* as referring to "*some* 'class of probable potential creditors (who knew) of the second place of business'" *See* 34 B.R. at 188 (misquoting *In re Alsted Automotive Warehouse, Inc.*, 16 B.R. at 929-30) (emphasis added).

creditors" articulated in *Mimshell*; it connotes the possibility that a debtor may have more than one class of probable potential creditors, only one of which needs to be aware of the debtor's activities at a location in order for that location to constitute a place of business.

In the present case, BFG was engaged in a nationwide leasing business. In New York, while many equipment vendors dealt with Fava, some - especially any in Onondaga County, may have dealt directly with Syracuse without any knowledge of the Bedford Hills operation. There is no evidence in the record that BFG's actual or potential Onondaga County creditors, *i.e.*, those financial institutions and/or investors who might have had reason to search the local filing records, would have been aware of the Bedford Hills location. As stated in *Mimshell*, the Second Circuit purports to "strictly protect" the legislative purpose of convenience to local creditors behind NYUCC § 9-401(1)(c). *See* 491 F.2d at 23. However, in *In re Alithochrome Corp.*, 751 F.2d 88 (2d Cir. 1984), the Second Circuit affirmed (without much elaboration) the decision of the district court, which had rejected a variation of the argument that local creditors must be aware of a debtor's presence at a location in order for that location to constitute a place of business. The district court in *In re Alithochrome Corp.* stated:

> Trans Union argues that since UCC § 9-401(1)(c) was enacted to protect local creditors, a showing that local creditors were aware of Alithochrome's presence in Springfield is required before § 9-401(1)(c) should be deemed applicable. While the argument has some surface appeal, on closer examination we think it flawed principally because the statute itself nowhere states that local filing will only be required if local creditors perceive the debtor's local presence. The statute requires local filing if the debtor has only one place of business in the state. As noted, the cases have found the test of whether a debtor has a place of business to be a question of frequency and notoriety; notoriety depends on whether the debtor's actual or probable potential creditors were or would have been aware of that place. In short, there is no reason to think that, as in our case, just because a corporation is headquartered in

> a place other than the local place of business and therefore may not even have "local" creditors that § 9-401(1)(c) should not apply.

40 U.C.C. Rep. Serv. 301 (S.D.N.Y. 1984) (construing Massachussetts law), *aff'd* 751 F.2d 88 (2d Cir. 1984).

While a plausible argument can be made to the contrary in light of the legislative purpose of NYUCC § 9-401(1)(c), the Second Circuit's affirmance in *In re Alithochrome* leads this Court to conclude that it is not necessary for BFG's potential Onondaga county customers and/or creditors to have been aware of the Bedford Hills location in order for that location to constitute a place of business within the meaning of the statute. It suffices in this instance that the equipment vendors with whom Fava dealt were so aware. Therefore, the Court finds that BFG maintained, in addition to its headquarters in Syracuse, a place of business within the meaning of NYUCC § 9-401(1)(c) at Fava's parents' home in Bedford Hills, Westchester County, New York from December 1, 1992 through August 31, 1994.

Because it had more than one place of business in New York from December 1, 1992 through August 31, 1994, BFG was required to, *inter alia*, file UCC-1s only with the Secretary of State during that period in order to perfect its security interests in certain Leases. Like many of the UCC-1s filed in Onondaga County, the UCC-1s filed with the Secretary of State during this period, with the exception of those filed against RSC, identify the debtor as "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." The Bank and a group of the Intervening Banks introduced respective Certified Information Request Responses from the Department of State relative to official inquiries as to whether any financing statements were on file with the Secretary of State naming "Bennett Funding Group, Inc." as debtor. *See Declaration of Celeste*

A. Rosetti admitted into evidence as Carmi Exhibit 13; Mitchell Declaration. In contrast to the evidence presented concerning the filing system utilized in Onondaga County, the Secretary of State apparently utilizes a computerized cross-indexing system because most of the approximately 1,200 financing statements listed on each Certified Information Request Response identify the debtor as "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." *See id.* Although each Certified Information Request Response relates to a postpetition inquiry, the Trustee does not argue that the UCC-1s filed under "Aloha Leasing, a Div. of The Bennett Funding Group, Inc." fail to sufficiently identify BFG as the secured party for purposes of NYUCC § 9-402(7). The Court therefore finds that the Bank perfected its security interests in Leases covered by the UCC-1s filed with the Secretary of State from December 1, 1992 through August 31, 1994 (together with UCC-1s filed in the name of "The Bennett Funding Group, Inc." and "Resort Funding, Inc.," the "Properly Filed UCC-1s") by filing as well as by possession.[20]

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[20] Apart from his objections that certain of the UCC-1s do not sufficiently identify the debtor, the Trustee raised various objections concerning the validity of the UCC-1s which, with one exception, were later withdrawn pursuant to a stipulation dated December 10, 1997 between the Trustee and the Bank. *See Stipulation Regarding Lift-Stay Litigation by Bank of Carmi and Banks Identified Below That Have Not Yet Had Evidentiary Hearings Regarding the Transactions With The Bennett Funding Group, Inc. ("BFG") dated December 10, 1997.* The Trustee continues to object to the validity of a UCC-1 allegedly filed with the Secretary of State in connection with the transaction dated March 28, 1991 with the Bank as agent for Henry Absher on the grounds that the this UCC-1 is not signed by a Bank representative and lacks a date-stamp or other indication that it was filed. *See id.* at ¶ 2b. This UCC-1 and the corresponding UCC-1 filed in Onondaga County correctly identify the debtor as "The Bennett Funding Group, Inc." *See Exhibits A9 and A10 attached to Carmi Exhibit 3.* Section 9-402(1) of the NYUCC was modified in 1977 to omit the requirement that a financing statement be signed by the secured party. *See* L.1977, c. 866, § 26. However, the Court agrees with the Trustee that there is no evidence that a UCC-1 was filed with the Secretary of State in connection with the March 28, 1991 transaction with the Bank as agent for Henry Absher. As a result, the Court finds that the Bank did not perfect its security interests in the Leases assigned to it in that transaction by filing. The term "Properly Filed UCC-1s" shall hereafter exclude the UCC-1s filed in connection with the March 28, 1991 transaction with the Bank as agent for Henry Absher, and include only the

C. Perfection in Lease Payments

The Lease Payments are "proceeds" of the Leases within the meaning of NYUCC § 9-306.[21] *See* NYUCC § 9-306; *see also In re Funding Systems Asset Management Corp.*, 111 B.R. at 519 (citing *Feldman v. Philadelphia Nat'l Bank*, 408 F. Supp. 24, 37 (E.D.Pa. 1976) (rental

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UCC-1s filed in connection with the following transactions: 12-4-91 (Bank of Carmi, individually, transaction); 2-25-93 ($250,353 Bank of Carmi, individually, transaction); 2-25-93 ($199,564Bank of Carmi, individually, transaction); 6-3-91 (Ron Absher transaction); 12-4-91 (Ron Absher transaction); 3-3-93 (Ron Absher transaction); 11-10-93 (Ron Absher transaction); 8-10-94 (Ron Absher transaction); 12-4-91 (Jane Absher transaction); 6-5-92 (Jane Absher transaction); 3-3-93 (Jane Absher transaction); 8-10-94 (Jane Absher transaction); 6-3-91 (Henry Absher transaction); 12-4-91 (Henry Absher transaction); 8-11-93 (Henry Absher transaction); 8-10-94 (Henry Absher transaction); 12-18-91 ($244,482 Henry Absher d/b/a Absher Oil Co. transaction); 12-18-91 ($255,189 Henry Absher d/b/a Absher Oil Co. transaction); 8-10-94 (Henry Absher d/b/a Absher Oil Co. transaction).

[21] It appears that under either a federal interest-based choice of law analysis of New York choice of law rules, New York would have the dominant interest in having its law be determinative of the Bank's interest in any Lease Payments because the Lease Payments apparently will be located in New York. *Cf. Kunstsammlungen Zu Weimar v. Elicofon*, 536 F. Supp. 829, 846 (E.D.N.Y. 1981) (quoting comment a to § 246 of the Restatement (Second) of Conflict of Laws (1971) for the proposition that "'[t]he state where a chattel is situated has the dominant interest in determining the circumstance under which an interest in the chattel will be transferred . . .'"), *aff'd*, 678 F.2d 1150 (2d Cir. 1982). Pursuant to NYUCC § 9-103(1)(b), perfection of a security interest in cash proceeds is to be determined "by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected." NYUCC § 9-103(1)(b). By virtue of the Servicing Agreements, the Lease Payments will be in New York at the time the Bank asserts its security interests therein will become perfected, as a result of which New York law governs questions of perfection in the Lease Payments. The Bank argues that if its security interests in the Leases are deemed to be perfected solely by possession, then Illinois law (which would be more favorable to the Bank) controls questions of perfection in the Lease Payments because NYUCC § 9-306(3) states that "a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this Article for original collateral of the same type." *See* NYUCC 9-306(3). Whatever its merits might otherwise be, this argument must be rejected because the Lease Payments are or will be money, which is not the same type of collateral as the Leases, which are chattel paper.

payments under an equipment lease were proceeds of chattel paper)). Perfection of a security interest in proceeds is governed by NYUCC § 9-306(3). Generally, in order to maintain perfection of a security interest in proceeds, a properly filed financing statement must cover the original collateral, *see* NYUCC § 9-306(3)(b), or the security interest in proceeds must be separately perfected as if the proceeds were the original collateral, s*ee* NYUCC § 9-306(3)(c). It is clear that, by virtue of the Properly Filed UCC-1s, the Bank has perfected its security interests in certain of the Lease Payments to the extent that such Lease Payments are identifiable. *See* NYUCC § 9-306(3)(b). The Bank, however, advances several arguments that its security interests in *all* of the Lease Payments are perfected irrespective of the Properly Filed UCC-1s.

The Bank appears to argue that its security interest in the Lease Payments became automatically perfected when it took possession of the Leases. *See Bank's Memorandum of Law* at 48-50. The Bank cites, *inter alia*, *In re Commercial Management Service, Inc.*, 127 B.R. 296 (Bankr. D.Mass. 1991) in support of its assertion that "a lease is the embodiment of the underlying payment stream, and that [the Bank's] rights in and to the leases and the lease payments are inviolate without regard to § 552 of the Code." *See Bank's Memorandum of Law* at 48 n.124. In the *Commercial Management Service* case, the court held that a right to payment under an equipment lease is property which can be perfected by possession of the underlying chattel paper because the "necessary implication of [UCC] Section 9-305 is that delivery of chattel paper operates to transfer the claim that the paper represents . . ." *Id.* at 302 (quoting Amelia H. Boss, *Lease Chattel Paper: Unitary Treatment of a "Special" Kind of Commercial Specialty*, 1983 Duke L.J. 69, 92-93 (1983) (emphasis added)). The Bank, however, incorrectly

equates a right to receive the Lease Payments with the Lease Payments themselves. "A contractual right to obtain money at some future time is not the same thing as money itself." *Vienna Park Properties v. United Postal Savings Ass'n (In re Vienna Park Properties)*, 976 F.2d 106, 116 (2d Cir. 1992). The *Commercial Management Service* case does not expressly address perfection in proceeds, which is governed by NYUCC § 9-306(3).

The Bank also relies generally upon the statement of the court in *Keneco Financial Group, Inc.* that "[i]n accordance with § 9-306(3) of the Uniform Commercial Code, Courts have consistently found that if a creditor has a perfected security interest in a lease, then the 'rent' generated by that lease constitutes 'proceeds' in which the creditor also has a perfected security interest." 131 B.R. at 94 (citations omitted); *see also In re Funding Systems Asset Management Group*, 111 B.R. at 520. Thus, the Bank appears to argue that it has a perfected security interest of indefinite duration in the Lease Payments simply by virtue of having taken possession of the Leases. It is true that, pursuant to NYUCC § 9-306(3), perfection in original collateral results in perfection in proceeds - but, as more fully explained below, perfection in the proceeds lasts only for ten days after the proceeds are received by the debtor unless certain additional steps are, or have been, taken to perfect in the proceeds. *See* NYUCC § 9-306(3). One such step is to have filed proper UCC-1s covering the original collateral, *see* NYUCC § 9-306(3)(b), which the Bank did with respect to only some of the Leases. Another such step is to separately perfect in the proceeds as if the proceeds were original collateral, which the Bank claims it has done pursuant to Code § 546(b).[22]

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[22] The Bank also argues that, under the Servicing Agreements, the Debtors were the Bank's agents or bailees for purposes of taking possession of the Lease Payments pursuant to NYUCC § 9-305, and that the Trustee has succeeded to that status. *See* NYUCC § 9-305. The

Collateral Estoppel

As mentioned above, the Court ruled in the Marine Reconsideration Decision (and in subsequent decisions) that Code § 546(b) may be utilized to perfect security interests in lease payments. The Bank generally asserts that, by virtue of the doctrine of collateral estoppel, certain findings of fact and conclusions of law contained in the Court's earlier decisions are binding upon the Trustee here (but not upon the Bank because it was not a party to those earlier decisions), including, presumably, the legal conclusion that Code § 546(b) may be used to perfect a security interest in lease payments. *See generally Bank's Memorandum of Law* at 6-7.

The Bank is seeking to invoke "offensive" collateral estoppel, which "permits a plaintiff to foreclose the relitigation of an issue previously lost by a defendant in an action with another party." *Coleco Industries, Inc. v. Universal City Studios, Inc.*, No. 84-Civ. 2596 (RWS) 1986 WL 1809, *3 (S.D.N.Y.) (citing *Parklane Hosiery v. Shore*, 439 U.S. 322, 99 S.Ct. 645, 58 L.Ed.2d 552 (1979)). A trial court has broad discretion to allow the use of offensive collateral estoppel, *see id.*, but its use should be prohibited "where the plaintiff could have easily joined in

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Court rejects this argument. While NYUCC allows a security interest in, *inter alia*, money, to be perfected by an agent's possession, the "debtor or a person controlled by him cannot qualify as such an agent for the secured party." NYUCC § 9-305, Official Comment 2; *see also In re Atlantic Computer Systems, Inc.*, 135 B.R. 463, 466 (Bankr. S.D.N.Y. 1992) (collecting cases for the proposition that "cases have consistently held that there can be no perfection by possession under § 9-305 where the bailee in possession is the debtor or a party closely aligned with the debtor); *Singer Products Co., Inc. v. First American Bank of New York (In re Singer Products Co., Inc.)*, 102 B.R. 912, 924 (Bankr. E.D.N.Y. 1989) (for collateral to be perfected under § 9-305 by an agent, the agent must not be controlled by the debtor and the agent's possession must prevent the debtor from having control of or access to the collateral). Pursuant to Code § 558, the Trustee has "the benefit of any defense available to the [Debtors]," *see* 11 U.S.C. § 558, which precludes him from being the Bank's agent or bailee for purposes of NYUCC § 9-305. The Court also rejects the argument that the Trustee is the Bank's agent or bailee by virtue of Code § 363.

the earlier action, or where application of this doctrine would be 'unfair' to the defendant." *United States Securities & Exchange Commission v. Monarch Funding Corp.*, 983 F. Supp. 442, 446 (S.D.N.Y. 1997). Examples of unfairness to the defendant include situations in which 1) the defendant had little incentive to vigorously defend the first suit, particularly if future suits are not foreseeable, 2) estoppel would be based upon a judgment which is itself inconsistent with an earlier judgment in favor of the defendant, and 3) previously unavailable procedural opportunities could readily allow for a different result than was reached in the first action. *See id.* (citing *Parklane Hosiery Co. v. Shore*, 439 U.S. at 330-31, 99 S.Ct. at 651; *United States v. International Broth. of Teamsters*, 905 F.2d 610, 621 (2d Cir. 1990)).

Realistically, the Bank could not have joined in the Marine Reconsideration Motion. The Bank did not take a "wait and see" attitude which application of the joinder factor is meant to guard against. *See GAF Corp. v. Eastman Kodak Co.*, 519 F. Supp. 1203, 1215-16 (S.D.N.Y. 1981). The Trustee vigorously argued the Code § 546(b) issue in connection with the Marine Reconsideration Motion. When rendered, the judgment of the Marine Reconsideration Decision was not only inconsistent with the judgment of the first Marine decision, dated May 30, 1997, but also with the judgment of at least one other previously rendered decision. *See Wilber Nat'l Bank v. The Bennett Funding Group, Inc. (In re The Bennett Funding Group, Inc.)*, No. 96-61376, Adv. Pro. No. 96-70064A (Bankr. N.D.N.Y. June 4, 1997). This other previously rendered decision has since been reconsidered and modified to reflect the legal conclusions contained in the Marine Reconsideration Decision. *See Wilber Nat'l Bank v. The Bennett Funding Group, Inc. (In re The Bennett Funding Group, Inc.)*, No. 96-61376, Adv. Pro. No. 96-70064A (Bankr. N.D.N.Y. March 23, 1998). The Court therefore finds that the Marine

Reconsideration Decision is not inconsistent with any previous Code § 362 judgments, as modified. The Court concludes that the Bank's use of offensive collateral estoppel would not be unfair to the Trustee in this situation, and that if the elements necessary to the application of collateral estoppel are established here, the Trustee can be precluded from relitigating the question of whether Code § 546(b) is applicable.

"Under collateral estoppel, once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973, 59 L.Ed.2d 210 (1979) (citations omitted). In order for collateral estoppel to apply,

> (1) the issues in both proceedings must be identical, (2) the issue in the prior proceeding must have been actually litigated and actually decided, (3) there must have been a full and fair opportunity for litigation in the prior proceeding, and (4) the issue previously litigated must have been necessary to support a valid and final judgment on the merits.

United States Securities & Exchange Commission v. Monarch Funding Corp., 983 F. Supp. at 446-47 (quoting *Gelb v. Royal Globe Ins. Co.*, 798 F.2d 38, 44 (2d Cir. 1986) and also citing *Levy v. Kosher Overseers Assoc., Inc.*, 104 F.3d 38, 41 (2d Cir. 1997)). Pendency of an appeal does not deprive a judgment of its preclusive effect. *See United States v. All Right, Title & Interest In Real Property & Building Known as 303 West Universal City Studios, Inc.*, 901 F.2d 288, 292 (2d Cir. 1990) (citations omitted). The Trustee was a party to the Marine Reconsideration Motion, in connection with which he had a full and fair opportunity to litigate the question of whether Code § 546(b) could be utilized to perfect a security interest in lease

payments. As explained in more detail below, the Code § 546(b) issue was actually litigated in connection with the Marine Reconsideration Motion.[23] The Court's resolution of that question was necessary and essential to its ultimate decision to grant Marine relief from the automatic stay. Thus, the relevant question here is whether the legal questions in these earlier decisions concerning the applicability of Code § 546(b) are identical to the legal question now before the Court concerning the applicability of Code § 546(b).

In *Commissioner of Internal Revenue v. Sunnen*, the Supreme Court adopted what has come to be known as the "separable facts" doctrine, stating:

> [I]f the very same facts and no others are involved in the second case . . . the prior judgment will be conclusive as to the same legal issues which appear . . . But if the relevant facts in the two cases are separable, even though they be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case. Thus, the second proceeding may involve an instrument or transaction identical with, but in a form separable from, the one dealt with in the first proceeding. In that situation, a court is free in the second proceeding to make an independent examination of the legal matters at issue . . . Before a party can invoke the collateral estoppel doctrine in these circumstances, the legal matter raised in the second proceeding must involve the same set of events or documents and the same bundle of legal principles that contributed to the rendering of the first judgment.

333 U.S. 591, 601-02, 68 S.Ct. 715, 721, 92 L.Ed. 898 (1948). Here, the Trustee would not be collaterally estopped under the separable facts doctrine from relitigating the Code § 546(b) issue for the simple reason that the transactions and documentation to which the Bank is a party are not the same transactions and documentation to which any banks in earlier proceedings were parties. However, in *ITT Corp. v. United States*, 963 F.2d 561, 564 (2d Cir. 1992) the Second Circuit

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[23] The Code § 546(b) issue was actually litigated only in connection with the Marine Motion for Reconsideration and one other bank's motion for relief from the stay.

noted that the Supreme Court's decision in *Sunnen* has been modified, although not overruled, by *Montana v. United States*, 440 U.S. at 147, 99 S.Ct. at 970, 59 L.Ed.2d at 210, which held that collateral estoppel requires substantial, rather than direct, identity of issue. *Compare Peck v. Commissioner*, 904 F.2d 525, 527-28 (9th Cir. 1990) (noting that the District of Columbia Circuit and the Fifth Circuit have concluded that the *Sunnen* separable facts doctrine is not good law after *Montana*, but that there is conflicting Ninth Circuit authority on the issue).

In *Montana*,

> the Supreme Court allowed a judgment predicated upon one set of contracts to estop litigation of legal issues in another case dealing with a similar, though unrelated, set of contracts, because there had been no 'changes in facts essential to (the) judgment.' The first ruling had not been "predicated" on facts peculiar to the contracts there in issue, so that differences in the documents were not of 'controlling significance.'"

American Medical Int'l, Inc. v. Secretary of Health, Education and Welfare, 677 F.2d 118, 120 (D.C.Cir. 1980) (citing *Montana v. United States*, 440 U.S. at 159-160, 99 S.Ct. at 976-77, 59 L.Ed.2d at 220-21). In reaching its decision, the Supreme Court established a three-part test to determine whether collateral estoppel was applicable:

> "[F]irst, whether the issues presented by the [second] litigation are in substance the same as those resolved [in the first]; second, whether controlling facts or legal principles have changed significantly since the [first] judgment; and finally, whether other special circumstances warrant an exception to the normal rules of preclusion."

ITT Corp. v. United States, 963 F.2d at 564 (quoting *Montana v. United States*, 440 U.S. at 155, 99 S.Ct. at 974); *see also Niagara Frontier Tariff Bureau, Inc. v. United States*, 826 F.2d 1186, 1190 (2d Cir. 1987) (same).

With the foregoing in mind, the Court finds that the legal question of whether the Bank can utilize Code § 546(b) to perfect its security interests in the Lease Payments is substantially the same issue upon which the Court ruled against the Trustee in the Marine Reconsideration Motion. The Leases are in all material respects the same as the leases which were the subject of the Marine Reconsideration Motion. Because there are no special circumstances which would warrant an exception to the normal rules of preclusion, the Court holds that the Trustee is collaterally estopped from relitigating the legal issue of whether Code § 546(b) can be used to perfect the Bank's security interests in the Lease Payments.

While the Trustee is collaterally estopped on the legal issue of whether Code § 546(b) applies, a discussion (much of which will admittedly be *dicta*) of the Code § 546(b) issue is warranted here to (1) provide the context for certain of the Court's ultimate conclusions herein, and (2) address the Trustee's argument that Code § 546(b) is inapplicable with respect to security interests in property which is not in existence as of the petition date, such as the postpetition Lease Payments at issue here. *See Trustee's Memorandum of Law* at 51-52. This argument raises the fundamental question of when, if ever, the Bank's security interests in the Lease Payments did or will attach. Surprisingly, this issue was not expressly raised in connection with the Marine Reconsideration Motion. The Court, recognizing the difficult nature of the issue, treated the Trustee as having conceded the issue, and did not expressly address the issue in the Marine Reconsideration Decision. Implicit in the Marine Reconsideration Decision was the Court's conclusion that Marine's security interests in the lease payments had attached or would attach, because resolution of that threshold question was necessary to the Court's ultimate decision to grant relief to Marine. Thus, the Trustee is collaterally estopped, not only with

respect to the larger issue concerning the general applicability of Code § 546(b), but with respect to the issue of attachment because "'[a]n issue that was necessarily implicit in a larger determination is given preclusive effect.'" *Raytech Corp. v. Official Committee of Unsecured Creditors*, No. 89-00293, Adv. Pro. No. 96-5181, 1998 WL 63125 *6 (Bankr. D.Conn.) (quoting 18 James Wm. Moore et al., Moore's Federal Practice § 132.03[3][e] at 132-99 (3d ed. 1997) and citing *BBS Norwalk One, Inc. v. Raccolta, Inc.*, 117 F.3d 674, 677 (2d Cir. 1997) (construing New York law)). Specifically, the Court finds that the attachment issue was actually litigated in connection with the Marine Reconsideration Motion because "'an issue that was clearly litigated may include the litigation of a connected issue by implication.'" *Id.* at *9 (quoting 18 Moore's Federal Practice § 132.03[2][d] at 132-82). Nevertheless, as mentioned above, the fundamental nature of the attachment issue warrants its discussion here.

Code § 546(b)

Section 552(a) of the Code generally provides that property acquired by a debtor postpetition is not subject to a lien created by a security agreement entered into prepetition. *See* 11 U.S.C. § 552(a). Exceptions to the general rule contained in Code § 552(a) are found in § 552(b). Relevant to the instant case is Code § 552(b)(1), which validates a postpetition security interest in, *inter alia*, proceeds, if the security agreement entered into prepetition extends to proceeds. Section 552(a) generally does not affect a creditor's right to claim an interest in property acquired by the debtor postpetition to the extent that such property can be regarded as "proceeds" of the creditor's collateral. *See, e.g., Unsecured Creditors Committee v. Marepcon Financial Corp. (In re Bumper Sales, Inc.)*, 907 F.2d 1430, 1436 (4th Cir. 1990). However, if

the security interest in proceeds is unperfected as of the commencement of the case, it may potentially be avoided by the trustee pursuant to Code § 544. *See* 11 U.S.C. § 544, 552(b)(1).

The automatic stay generally prohibits "any act to create, perfect, or enforce any lien against property of the estate." 11 U.S.C. § 362(a)(4). Code § 362(b)(3) creates an exception to the automatic stay and allows "any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under § 546(b) of this title." 11 U.S.C. § 362(b)(3). Section 546(b) of the Code provides:

> (b)(1) The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that---
>
> > (A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or
> >
> > (B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation.
>
> (2) If--
>
> > (A) a law described in paragraph (1) requires seizure of such property or commencement of an action to accomplish such perfection, or maintenance or continuation of perfection of an interest in property; and
> >
> > (B) such property has not been seized or such an action has not been commenced before the date of the filing of the petition;
>
> such interest in such property shall be perfected, or perfection of such interest shall be maintained or continued, by giving notice within the time fixed by such law for such seizure or such commencement.

11 U.S.C. § 546(b).

Section 546(b) "allows creditors with certain types of liens to avoid the potential prejudice of section 362's automatic stay by allowing for post-bankruptcy-petition perfection of these liens." *Miner Corp. v. Hunters Run Ltd. Partnership (In re Hunters Run Ltd. Partnership)*, 875 F.2d 1425, 1428 (9th Cir. 1989) (citing *In re Electric City, Inc.*, 43 B.R. 336, 340 (Bankr. W.D.Wash. 1984)). Essentially, Code § 546(b) "establish[es] an exception to the bar of the automatic stay where a creditor has a pre-petition interest in property that can be perfected under state law within a given time." *Makoroff v. City of Lockport*, 916 F.2d 890, 892 (3rd Cir. 1990), *cert. denied*, 499 U.S. 983, 111 S.Ct. 1640, 113 L. Ed. 2d 735 (1991).

The legislative history of Code § 546(b) explains in part:

> [I]f an interest holder against whom the trustee would have rights still has, under applicable nonbankruptcy law, and as of the date of the petition, the opportunity to perfect his lien against an intervening interest holder, then he may perfect his interest against the trustee. If applicable law requires seizure for perfection, then perfection is by notice to the trustee instead. The rights granted to a creditor under this subsection prevail over the trustee only if the transferee has perfected the transfer in accordance with applicable law, and that perfection relates back to a date that is before commencement of the case . . . The purpose of the subsection is to protect, in spite of the surprise intervention of [the] bankruptcy petition, those whom state law protects by allowing them to perfect their liens or interests as of an effective date that is earlier than the date of perfection.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 371 (1977); S. Rep. No. 95-989, 95th Cong., 2nd Sess. (1978), U.S. Code Cong. & Admin. News 1978, p. 5787.

In connection with the Marine Reconsideration Motion, Marine argued that "applicable law" within the meaning of Code § 546(b) includes NYUCC § 9-306, which, in the absence of bankruptcy, would allow for perfection of an interest in certain lease proceeds through

possession.[24] Marine argued that because it would have been allowed to perfect its security interest in lease payments by seizure under state law, Code § 546(b) allowed it to perfect its interest in lease payments postpetition by giving notice to the Trustee. Marine contended that the filing of its Code § 362(d) motion constituted the notice contemplated by Code § 546(b).

As noted above, perfection of a security interest in proceeds is governed by NYUCC § 9-306(3), which provides:

> The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless
>
> > (a) a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected in the office or offices where the financing statement has been filed . . .; or
> >
> > (b) a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds; or
> >
> > (c) the security interest in the proceeds is perfected before the expiration of the ten day period.
>
> Except as provided in this section, a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this chapter for original collateral of the same type.

NYUCC § 9-306(3).

In the Marine Reconsideration Decision, the Court found that, because Marine had not

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[24] Pursuant to Code § 546(b)(2), if applicable law requires seizure or commencement of an action to accomplish perfection or maintenance of perfection, then perfection shall be by notice instead. The Trustee argued that NYUCC § 9-306 does not "require" seizure because that statute presents the option of perfecting either by seizure or by filing, and that therefore notice cannot be used to maintain perfection of a security interest in lease payments. The Court rejected this argument. NYUCC § 9-305, as incorporated by NYUCC § 9-306(3)(c), clearly requires seizure.

perfected its security interest in leases or lease payments by filing, under state law it could perfect its security interest in lease payments beyond the ten day period referred to in NYUCC § 9-306(3), if at all, only pursuant to NYUCC § 9-306(3)(c). Here, it is undisputed that the Lease Payments are cash proceeds in the form of money. A security interest in Lease Payments of Leases not covered by the Properly Filed UCC-1s can be perfected only in the manner and under the circumstances that a security interest in money as original collateral would be perfected. With certain exceptions not applicable here, a security interest in money can be perfected only by possession. *See* NYUCC §§ 9-304(1), 9-305.

The Trustee asserted that NYUCC § 9-306 is not "applicable law" within the meaning of Code § 546(b). The Trustee steadfastly maintained that Code § 546(b) can only be used in conjunction with a law which allows perfection to relate back to a time prepetition, and that NYUCC § 9-306 is not such a law. Marine took the position that Code § 546(b) does not contain a relation-back requirement, and that even if it did, NYUCC § 9-306(3) unambiguously indicates that the security interest in proceeds is a continuously perfected security interest from the time the security interest in the original collateral is perfected. Marine asserted that it had a perfected security interest in the lease proceeds dating from the time it perfected its security interest in the leases by possession, which had occurred prepetition.

The Trustee countered by citing NYUCC § 9-305, which provides in pertinent part that "[a] security interest is perfected by possession from the time possession is taken *without a relation back* and continues only so long as possession is retained, unless otherwise specified in this Article." NYUCC § 9-305 (emphasis added). The Trustee effectively argued that a security interest in proceeds which is perfected by possession can only be continuously perfected from

the date of possession by the debtor and not from the date the security interest in the original collateral was perfected. Marine responded by asserting that there are exceptions to the general prohibition against relation back of possessory security interests, as indicated by the "unless otherwise specified by this Article" language of NYUCC § 9-305, and that one such exception obtains when perfection of an interest in proceeds is accomplished by possession pursuant to NYUCC § 9-306(3)(c). To this, the Trustee pointed to Official Comment 3 to NYUCC § 9-305, which provides in pertinent part:

> This section now brings state law into conformity with the overriding federal policy: where a pledge transaction is contemplated, perfection dates only from the time possession is taken . . . The *only* exception to this rule is the short twenty-one day period of perfection provided in Section 9-304(4) and (5) during which a debtor may have possession of specified collateral in which there is a perfected security interest.

See Official Comment 3 to NYUCC § 9-305 (emphasis added).

Against this backdrop, the Court found that it did not need to address the question of whether NYUCC § 9-306 allows for perfection to relate back because resolution of that issue was not necessary in order to determine whether the Trustee could avoid Marine's security interest in the lease payments. The Trustee, however, now makes an additional argument which warrants discussion of whether NYUCC § 9-306 is a relation-back statute.

The Trustee argues that "since the actual payments in question did not come into being until post-petition, they did not exist and were not identifiable within the meaning of the UCC until they were made post-petition. Not being identifiable until post-petition means that there was no attached security interest in the unmade actual payments that existed at the time of

bankruptcy and, by virtue of UCC § 9-203(1), no interest in the unmade payments enforceable against the debtor or third parties existed at bankruptcy." *Trustee's Memorandum of Law* at 51. The Trustee further asserts that "[t]he plain words of § 546(b) -- 'the maintainence or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation' . . . -- requires that the property itself must exist at the date of the commencement of the bankruptcy case." *Id.* at 51-52.

The Trustee's interpretation of Code § 546(b) is incorrect. Under NYUCC § 9-306(3), the Bank's security interests in the Lease Payments will be automatically perfected for ten days after their receipt by the Debtors. NYUCC § 9-306(3) allows for maintenance or continuation of that perfection by, *inter alia*, seizure. If maintenance or continuation of perfection is effected, the security interests will be effective, pursuant to NYUCC §§ 9-312(5) and (6), or NYUCC § 9-301(1), against an entity (such as a lien creditor), that might acquire rights in the Lease Payments during the ten day period (or earlier than the time at which the proceeds are received by the debtor) prior to seizure. Thus, as more fully explained below, Code § 546(b)(2) allows for maintenance or continuation of the Bank's security interests in the Lease Payments. Because of the ten day automatic perfection feature of NYUCC § 9-306(3), the applicability of Code § 546(b)(2) is not conditioned upon the Lease Payments being in existence upon the commencement of this case.

The issue of whether NYUCC § 9-306 is a relation-back statute is implicated by the Trustee's argument concerning the need for Lease Payments to be in existence upon commencement of the case in order for Code § 546(b) to be operative. Logic dictates that in

order for a security interest in proceeds to be "continuously perfected," it must first be "perfected." A security interest is generally not perfected before, *inter alia*, it has attached. *See* NYUCC § 9-303(1). Attachment cannot occur unless, *inter alia*, the debtor has rights in the collateral. *See* NYUCC 9-203(1)(c). As explained below, a secured party does not always have rights in proceeds at the time it perfects a security interest in the original collateral.

The phrase "rights in collateral" is not defined by the NYUCC and relatively few courts have considered the issue of when a debtor acquires rights in collateral. As one court has stated, reported cases for the most part "do not expressly treat 'attachment' of a security interest to incorporeal or intangible forms of collateral such as a right to a stream of payments. Rather, they assume that such security interest has attached and go on to decide whether the security interest is 'perfected' under the UCC." *In re Hayes*, 168 B.R. 717, 724 (Bankr. D.Kan. 1994). The same is true with respect to proceeds. *See, e.g., Matter of Karl A. Neise, Inc.*, 31 B.R. 409, 413-14 (Bankr. S.D.Fla. 1983).

The question of when a security interest in proceeds attaches implicates what one court has termed (without embracing) the "security interest interruption theory." *See American Nat'l Bank v. United States (In re Hawn)*, 149 B.R. 450, 455-56 (Bankr. S.D.Tex. 1993). This theory posits that a security interest in proceeds is not a continuation of the security interest in the original collateral, but a separate and distinct security interest which effectively attaches only when the proceeds come into existence. *See id.*

It appears that the few federal courts to have considered the security interest interruption theory have rejected it, although in a context different than that presented here. The case of *PPG Industries, Inc. v. Hartford Fire Ins. Co.*, 531 F.2d 58 (2d Cir. 1976) involved the questions of

whether a security interest created under state law in insured property extended to insurance proceeds, and if so, whether the security interest in the insurance proceeds primed a federal tax lien which had been perfected after creation of the original security interest but before generation of the proceeds. In order to take priority over the federal tax lien, the security interest which had been created under state law had to meet the federal definition of "security interest," which requires that the property subject to such security interest be in actual existence at the time the tax lien is perfected. *See id.* at 61-62 (citing 26 U.S.C. §§ 6323(a) and 6323(h)(1)). Although the insurance proceeds did not come into existence until after the notice of federal tax lien had been filed, the Second Circuit concluded that the state law lien took priority because, as the district court had concluded, "the proceeds of the insurance [were] merely the collateral in another form." *Id.* at 62.

The Second Circuit's decision in *PPG Industries* was largely adopted by the Fifth Circuit in *Paskow v. Calvert Fire Ins. Co.*, 579 F.2d 949 (5th Cir. 1978), another case involving the priority of a security interest in insurance proceeds versus a federal tax lien. In holding that a security interest in insurance proceeds attached before the proceeds came into existence and was perfected and superior to the federal tax lien, the Fifth Circuit stated, "we regard the insurance fund and the original collateral as one and the same property for the purpose of determining when the property came into existence." *Id.* at 954 (footnote omitted).

The *Paskow* and *PPG Industries* cases largely involve insurance proceeds and construction of federal tax lien statutes.[25] Some commentors, however, appear to support the

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[25] In 1977, the definition of "proceeds" in NYUCC § 9-306 was amended to include "[i]nsurance payable by reason of loss or damage to the collateral . . ." *See* L.1977, c.866, § 19. The *Paskow* and *PPG Industries* cases were each decided under a version of § 9-306 which did

security interest interruption theory relative to UCC § 9-306:

> The proceeds theory is fatally flawed if the rights of a secured party are not violated when the buyer makes payment for original collateral to someone other than the secured party. Inextricably linked to the legality of the buyer's payment is the time at which a security interest first attaches to proceeds, for the secured party cannot prevail on a misdirection of proceeds theory unless he can demonstrate that the consideration was subject to his security interest when the buyer transferred it. Whether the secured party can prove this depends largely on the interpretation of section 9-306(2), which provides that a security interest continues only in 'identifiable proceeds including collections received by the debtor.' If 'received by the debtor' modifies not just 'collections,' but also 'proceeds,' then the property given in exchange for the original collateral is not subject to the security interest until the proceeds are paid to and received by the debtor--and the secured party is not entitled to possess them until receipt occurs. Because the secured party has no security interest in the proceeds before this time, he has no legitimate claim against the buyer for paying the proceeds to the debtor.
>
> A more fundamental reason for denying the secured party's claim is that property given in exchange for collateral simply cannot be 'proceeds' before the property is received by the debtor. A security interest continues in payments under section 9-306(2) only if they are 'proceeds' as section 9-306(1) defines that term: 'whatever is received upon the . . . disposition of collateral or proceeds.' Courts seldom consider specifically whether property given in exchange for collateral must be 'received' before it can be proceeds with a continuing security interest . . .

STEVE H. NICKLES, ET AL., COMMON LAW AND EQUITY UNDER THE UNIFORM COMMERCIAL CODE, ¶ 25.02[4][a] at 25-33 and 25-34 (Warren, Gorham & Lamont) (1985);

> Under Article 9's proceeds theory, the secured party receives a new transfer every time Article 9 proceeds come into existence. This is because proceeds are the same as after-acquired property, from the perspective of the debtor's estate. That is, a security interest in proceeds cannot attach until the debtor has rights in the proceeds, and this does not occur until the exchange or disposition occurs. Section 9-306(2) provides some opposition to this conclusion. The key sentence in this section provides: a security interest . . . continues in any identifiable proceeds including collections received by the debtor. The word "continues" might lead one to believe that the same security interest that encumbered the old collateral "continues" without interruption into the proceeds, so that no new

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not include insurance within the definition of proceeds.

> security interest is created. This is untenable, however. Surely no security interest exists in the proceeds until the debtor obtains the right to the proceeds as a result of exchange or other disposition. Hence, proceeds must be viewed as a species of after-acquired property.

Jeannne L. Schroeder & David Gray Carlson, *Security Interests Under Article 8 of the Uniform Commercial Code*, 12 CARDOZO L. REV. 557, 618-19 (1990);

> Another possible answer is to insist, through bad metaphysics, that the original collateral and the cash proceeds are not different things but the same thing. Thus, U.C.C. section 9-306(2) declares that "a security interest . . . continues in any identifiable proceeds . . ." If cash proceeds are the same thing as the original collateral, then the creation of cash proceeds is not an after-acquired property interest at all. The trustee therefore cannot purport to recover both the original collateral and the new cash proceeds because these two things are, through dogmatic insistence, the same thing, not different things. Anyone contemplating the collateral (say, a machine) and the cash proceeds of the machine (a check or currency) will see that these two things are not the same. They have different molecular structures and different time-space coordinates. Ordinary sense perception, then, requires that the original collateral and the proceeds must be viewed as separate transfers to the secured party.

David Gray Carlson, *Security Interests in the Crucible of Voidable Preference Law*, 1995 U. ILL. L. REV. 211, 255 (1995).

The foregoing commentary leads the Court to conclude that a security interest in proceeds is not necessarily perfected from the time the interest in the original collateral is perfected. If it were understood that UCC § 9-306 provides for perfection of a security interest in proceeds to date from the time of perfection in the original collateral, there would presumably be no reason for that proposition to be restated in UCC § 9-312(6), which deals with determining the priority of competing security interests. *See* UCC § 9-312(6).[26] If perfection in proceeds dated from the

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[26] The Bank asserts that "§ 9-312(6) of the NYUCC, standing alone, determines that perfection of a security interest in proceeds dates back to the perfection in the primary collateral, in this case, the Leases." *Bank's Memorandum of Law* at 53, n.142. Section 9-312(6), however, applies only when determining the priority of competing security interests in the same collateral.

time of perfection in the original collateral, the issue of attachment would be irrelevant with respect to proceeds as long as the security interest attached to the original collateral. For all of the foregoing reasons, the Court must reject any contention that a security interest in proceeds is continuously perfected from the time of perfection in original collateral. A security interest in proceeds is only continuously perfected from, at the earliest, the time that the security interest in such proceeds has attached.

As the foregoing commentary suggests, "[n]ormally, a secured party's security interest in proceeds of collateral does not attach until the proceeds are created." Edwin E. Smith, *Article 9 in Revision: A Proposal for Permitting Security Interests in Nonassignable Contracts and Permits*, 28 Loy. L.A. L. Rev. 335, 344 (1994); *see also Trans World Airlines, Inc. v. Travellers Int'l AG. (In re Trans World Airlines, Inc.)*, 180 B.R. 389, 397 (Bankr. D.Del. 1994) (construing the NYUCC and stating, "Travellers did not have enforcement rights against the "collateral" as the collateral did not exist"), *aff'd in part*, *rev'd in part*, *on other grounds*, 203 B.R. 890 (D.Del. 1996), *rev'd* 134 F.3d 188 (3rd Cir. 1998). At first glance there might appear to be some authority for the proposition that a security interest in cash proceeds of a contractual right to payment can attach before the proceeds come into existence. In *In the Matter of Chase Manhattan Bank, (N.A.) v. State of New York*, 48 A.D.2d 11, 367 N.Y.S.2d 580, *aff'd* 40 N.Y.2d 590, 357 N.E.2d 366, 388 N.Y.S.2d 896, the court held that a security interest in proceeds of a right to payment under an existing contract attached, not at the time proceeds of the contract had apparently come into existence, but earlier when the right to payment was earned under the

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See NYUCC §§ 9-312(5) & (6). The Trustee, of course, is not vested with a "security interest," but rather a judicial lien, *see* 11 U.S.C. § 544(a)(1), the priority of which is governed not by NYUCC § 9-312, but by NYUCC § 9-301(1).

contract, *see id.* at 13, 583. Similarly, in *Feldman v. Philadelphia Nat'l Bank*, the court stated that "[m]oney, checks and the like are also proceeds in which the secured party has a perfected security interest when arising under a contract right to payment." 408 F. Supp. at 37-38. These cases, however, ignore the distinction between a right to payment of money and money itself. Section 9-306(1) in effect when these cases were decided expressly defined "proceeds" to include "the account arising when the right to payment is earned under a contract right," which may have tended to blur this distinction. *See id.* at 37; NYUCC § 9-306(1) (McKinney 1972). More likely, however, is that the distinction between the right to payment of money and the money itself was for all intents and purposes insignificant in the absence of a bankruptcy trustee in those cases. At any rate, the Court concludes that a security interest in proceeds cannot attach until the proceeds are created. Thus, NYUCC § 9-306 does not, at least in this instance, allow for relation-back of a security interest in proceeds.[27]

With the foregoing in mind, the Court will now address the question of whether Code § 546(b) can be used only in conjunction with a relation-back statute. Code § 546(b) has not been uniformly interpreted by the courts. A majority of the caselaw surrounding Code § 546(b)

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[27] The vast majority of Leases which have been submitted to the Court expressly provide that the obligation of the lessees to make rental payments is unconditional and cannot be terminated by the lessee. These unequivocal provisions mandate that the lessee must make rental payments, regardless of whether the lessor defaults and notwithstanding any valid defense to payment which the lessee might otherwise have. *See In re O.P.M. Leasing Services, Inc.*, 21 B.R. 993, 1006-008 (Bankr. S.D.N.Y. 1982) (granting summary judgment in favor of the lessor's assignee under a lease containing the lessee's unconditional promise to pay because no facts submitted or to be submitted by the lessee opposing summary judgment were in any way relevant to the lessee's unequivocal liability). Assuming, *arguendo*, that a security interest in proceeds of a right to payment under an existing contract could attach when the right to payment is earned, it is worth noting that the Debtors appear to have earned absolute rights to payment of most of the Lease Payments either at the time certain Leases were executed/assigned or, at the latest, when certain leased Equipment was delivered.

appears to indicate that §546(b) can only be invoked to effect perfection or the maintenance or continuation of perfection of an interest in property obtained prepetition if such perfection relates back to a time prepetition. Some cases expressly state as much. *See Casbeer v. State Federal Savings & Loan Ass'n of Lubbock (In re Casbeer),* 793 F.2d 1436, 1443 (5th Cir. 1986); *In re Westport-Sandpiper Assocs.*, 116 B.R. 355, 358 (Bankr. D.Conn. 1990); *Drummond v. Farm Credit Bank of Spokane (In re Kurth Ranch)*, 110 B.R. 501, 507 (Bankr. D.Mont. 1990); *Northwestern Nat'l Life Ins. Co. v. Metro Square (In re Metro Square)*, 93 B.R. 990, 999 (Bankr. D.Minn. 1988), *rev'd on other grounds*, 106 B.R. 584 (D.Minn. 1989); *In re TM Carlton House Partners, Ltd.*, 91 B.R. 349, 356 (Bankr. E.D.Pa. 1988); *In re Association Center Ltd. Partnership*, 87 B.R. 142, 146 (Bankr. W.D.Wash. 1988), *In re Pritchard Plaza Assocs. Ltd. Partnership*, 84 B.R. 289, 301 (Bankr. D.Mass. 1988), *Turner v. Emmons & Wilson, Inc. (In re Minton Group, Inc.)*, 28 B.R. 789, 792 (Bankr. S.D.N.Y. 1983). Some of the cases expressly holding that Code § 546(b) requires "relation back" are based, at least in part, upon other caselaw which might at first glance support such a conclusion, but which, when carefully read, do not indicate that "relation back" is required by Code § 546(b).

For example, the decision of the United States Court of Appeals for the Third Circuit in *Makoroff v. City of Lockport*, 916 F.2d at 890, has been cited as support for the relation back requirement. *See, e.g, Matter of Perona Bros., Inc.*, 186 B.R. 833, 837 (D.N.J. 1995). *Makoroff*, however, does not state that Code § 546(b) can only be utilized in conjunction with a "relation-back" statute. Rather, *Makoroff* appears to stand for, *inter alia*, the proposition that when §546(b) is used to accomplish postpetition perfection pursuant to a "relation-back" statute, such perfection is not a violation of the automatic stay. *See also Equibank, N.A. v. Wheeling*

Pittsburgh Steel Corp., 884 F.2d 80, 85 (3rd Cir. 1989); *Yobe Electric, Inc. v. Graybar Electric Co, Inc. (In re Yobe Electric, Inc.),* 728 F.2d 207 (3d Cir. 1984) (adopting bankruptcy judge's opinion at 30 B.R. 114 (Bankr. W.D.Pa. 1983)).

The Second Circuit's decision in *Lincoln Savings Bank, FSB v. Suffolk County Treasurer (In re Parr Meadows Racing Ass'n, Inc.)*, 880 F.2d 1540 (2d Cir. 1989), *cert. denied*, 493 U.S. 1058, 110 S.Ct. 869, 107 L.Ed.2d 953 (1990), has also been cited as support for the relation-back requirement. *See Town of Colchester v. Hinesburg Sand and Gravel, Inc. (In re APC Constr., Inc.)*, 112 B.R. 89, 112-13 (Bankr. D.Vt. 1990), *aff'd* 132 B.R. 690 (D.Vt. 1991). In *Parr Meadows*, the Suffolk County Treasurer attempted to utilize Code § 546(b) to perfect certain tax liens postpetition. There, the issue as it related to Code § 546(b) was not whether perfection of the tax liens related back to a prepetition date, but whether the Suffolk County Treasurer had obtained interests in the debtor's property prepetition which could be perfected postpetition. *See Parr Meadows,* 880 F.2d at 1546. The Second Circuit held that the automatic stay prohibited the creation and perfection of a tax lien against estate property unless Suffolk County had a prepetition interest in such property for a given tax year. *See id.* at 1548. The Second Circuit in *Parr Meadows* did not address whether perfection need relate back to a time prepetition, presumably because Suffolk County's valid tax liens primed competing interest holders as a matter of statute, without regard to date of perfection.

In *Klein v. Civale & Trovato, Inc. (In re Lionel Corp.)* 29 F.3d 88 (2d Cir. 1994), the Second Circuit again considered Code § 546(b). There, a creditor had performed construction work on property leased by the bankruptcy debtor. The creditor had filed a notice of mechanic's lien against the property prepetition. The New York Lien Law required the creditor to serve

notice of its mechanic's lien filing on the property owner within 30 days after filing. When the creditor attempted to serve such notice postpetition, the debtor and the owners argued that it violated the automatic stay. *See id.* at 90. The Second Circuit summarized the debtor's and the owners' arguments and stated:

> Appellees claim that CTI cannot take advantage of . . . [§546(b)] absent a specific provision of law permitting the perfection to "relate-back" to an earlier time. Appellees argue that because CTI filed too late to take advantage of New York Lien Law's relation-back provision, CTI cannot be saved by § 546(b). This analysis was adopted by both the bankruptcy court and the district court. We take a different view. We see nothing in § 546(b) indicating that it applies only when the lienor fits within a "relation-back" statute. As long as an "applicable law" authorizes perfection after another party has acquired interests in the property, a lienor fits within the exception.

Id. at 93.

The mechanic's lien creditor in *Lionel* was able to invoke Code § 546(b) because its lien prevailed over a hypothetical judicial lienor under state law, even in the absence of a relation-back statute. The Second Circuit observed that under the relevant provisions of the New York Lien Law,

> CTI's lien was created at the time it filed its notice of lien and, as of that date, took priority over any subsequently filed interest. CTI achieved this superior status even before it complied with § 11's requirement that it serve its notice of lien and file proof of such service . . . . In other words, while complying with § 11 is necessary to keep a lien alive, it is not a prerequisite to establishing the lien's initial validity, and hence, priority.

Id.; *accord Vanderbilt Mortgage and Finance, Inc. v. Griggs (In re Griggs)*, 965 F.2d 54, 58 (6th Cir. 1992) (creditor's security interest prevailed over trustee because Code § 546(b) allowed creditor to perfect security interest in mobile home postpetition by obtaining certificate of title containing notation of lien, and Kentucky statute provided that perfection dated from time financing statement had been filed prepetition).

This Court agrees with, and is in any event bound by, the Second Circuit's determination in *Lionel* that Code § 546(b) can allow for postpetition perfection in the absence of a "relation-back" statute. However, a distillation of caselaw, read in conjunction with the statute and its legislative history, leads the Court to conclude that in many, if not most, cases, a "relation-back" requirement is a *fait accompli* to the utility of Code § 546(b) because a creditor invoking § 546(b) must somehow be able to defeat the rights of an intervening hypothetical lien creditor under state law, whether through a relation-back statute or otherwise.

As one court has observed in rejecting a relation-back requirement under Code § 546(b), "'the proper focus of § 546(b) is whether the entity invoking § 546(b) defeats the rights of a hypothetical entity that earlier acquires rights in the property in dispute.'" *First American Bank of Virginia/WNB Corp. v. Harbour Pointe Ltd. Partnership (In re Harbour Pointe Ltd. Partnership)*, 132 B.R. 501, 503-504 (Bankr. D.D.C.. 1991) (quoting *In re 1301 Connecticut Ave. Assocs.*, 117 B.R. 2, 10 (Bankr. D.D.C. 1990, *aff'd,* 126 B.R. 1 (D.D.C. 1991)); *see also In re Microfab, Inc.*, 105 B.R. 152, 158 (Bankr. D.Mass. 1989) (finding that Code §546(b) "applies to any lien . . . that has the effect of priming an earlier perfected interest in the property"); *In re 1350 Piccard Ltd. Partnership*, 148 B.R. 83, 85 (Bankr. D.D.C. 1992) (declining to adopt a relation-back requirement under Code §546(b)). *Compare In re Kearney Hotel Partners v. Richardson (In re Kearney Hotel Partners)*, 92 B.R. 95, 105 (Bankr. S.D.N.Y. 1988) (ultimately finding a relation-back requirement but admitting that "[t]he language of § 546(b) might facially appear to permit perfection if priority over a lien creditor is thereby achieved").

Leases as Indispensable Embodiment of Right to Receive Lease Payments

As noted above, in order for a security interest in proceeds of collateral to be continuously perfected, the security interest in the original collateral must be perfected. *See* NYUCC § 9-306(3). The Bank perfected its security interest in the Leases by possession prepetition. The assignment or transfer of a lease document also effects a transfer of, *inter alia*, the right to receive payment evidenced by the lease, on the theory that a lease is quasi-negotiable because, *inter alia*, it is the indispensable embodiment of the right to lease rentals. *See* Boss, *Lease Chattel Paper: Unitary Treatment of a "Special" Kind of Commercial Specialty,* 1983 Duke L.J. at 69. Thus, the court in *In re Commercial Management Serv., Inc.* held that a right to payment under an equipment lease is a right which can be perfected by possession of the underlying chattel paper. *See* 127 B.R. 296 (Bankr. D.Mass. 1991). The court in *Commercial Management Serv., Inc.,* quoting from Professor Boss' article, stated:

> [t]aking possession of the collateral, the chattel paper itself, would be meaningless unless the paper represented the underlying rights which were transferred by a transfer of the paper. Therefore, the necessary implication of Section 9-305 is that delivery of chattel paper operates to transfer the claim that the paper represents . . .
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> [S]ection 9-305 bestows on leases an important element of negotiability: a lease is treated as the embodiment of the rights it represents such that these rights are transferred by the transfer of the lease document.

Id. at 302 (quoting Boss at 92-94 and omitting footnotes); *see also* WILLIAM D. HAWKLAND, ET AL., UNIFORM COMMERCIAL CODE SERIES § 9-106:01(Clark, Boardman, Callaghan) (1997) (stating that "[t]he Code drafters were careful to ensure that obligations evidenced by . . . chattel paper would be treated not as intangibles but as part of the . . . chattel paper"); Steven O. Weise, *U.C.C. Article 9 - Personal Property Secured Transactions*, 47 Bus.Law. 1593, 1609 (opining

that *Commercial Management Service, Inc.* was correctly decided); *compare Talmadge v. United States Shipping Board, Emergency Fleet Corp.*, 54 F.2d 240, 243 (2d Cir. 1932) (stating "[b]ut the company, having assigned its interest in the cheques as security, it would defeat the purpose to exclude the purely ancillary right to collect in case of their dishonor. Hence it seems reasonable to hold that the two passed together.").

Based upon the foregoing, the Bank obtained a perfected security interest in the right to receive future Lease Payments at the time it took possession of the Leases. Because this occurred prepetition, the Trustee cannot avoid the Bank's security interest in the right to receive the Lease Payments.

Continuation of Perfected Security Interest in Lease Payments

Simultaneously with the conversion of a portion of each Lease into Lease Payments, there exists a perfected security interest in identifiable Lease Payments which continues for ten days. However, if no steps are taken to continue the perfection of the security interest in any identifiable Lease Payments, the security interest becomes unperfected ten days after receipt by the Debtor. *See* NYUCC § 9-306.

In order to continue its perfected security interest in the Lease Payments as they are received by the Debtor, the Bank must give proper notice under Code § 546(b). "'Section 546(b) provides little guidance as to what constitutes the requisite notice.'" *In re Coated Sales, Inc.*, 147 B.R. 842, 846 (S.D.N.Y. 1992) (quoting *In re Sampson*, 57 B.R. 304, 309 (Bankr. E.D.Tenn. 1986)). One court has stated that "notice is sufficient if it informs the court or the possessor of the property that the creditor intends to enforce his lien." *In re Gelwicks*, 81 B.R. 445, 448

(Bankr.N.D.Ill. 1987). Another court has stated that appropriate notification can only occur if the notice is filed in the bankruptcy court. *See In re Coated Sales, Inc.*, 147 B.R. at 846 (citations omitted). Thus, the filing of a motion for relief from the automatic stay has been held to constitute sufficient notice under Code § 546(b). *See In re Casbeer*, 793 F.2d at 1442-43; *Federal Nat'l Mortgage Ass'n v. Dacon Bolingbrook Assocs. Ltd. Partnership (In re Federal Nat'l Mortgage Ass'n)*, 153 B.R. 204, 212-13 (N.D.Ill. 1993); *see also Virginia Beach Fed. Sav. and Loan Ass'n v. Wood (In re Wood)*, 901 F.2d 849, 853 (10th Cir. 1990) (filing of notice of claim to cash collateral sufficient §546(b) notice); *In re C.G. Chartier Constr., Inc.*, 126 B.R. 956, 959 (E.D.La. 1991) (finding motion for adequate protection filed in bankruptcy court sufficient to provide Code § 546(b) notice); *In re Coated Sales, Inc.*, 147 B.R. at 846 (concluding that filing of secured claim in bankruptcy court provided sufficient Code § 546 notice). *But see In re Village Properties, Ltd.*, 723 F.2d 441 (5th Cir. 1984), (indicating that motion for relief from stay was insufficient Code § 546(b) notice because there was no indication of intention to pursue rent payments), *cert. denied,* 466 U.S. 974, 104 S.Ct. 2350, 80 L.Ed.2d 823 (1984).

In the Marine Reconsideration Decision, the Court concluded that Marine's Code § 362(d) motion was sufficient notice under Code § 546(b) because it gave notice of Marine's intent to pursue recovery of the lease payments. Here, the Bank argues that the Segregation Motions, filed on May 13, 1996, more than two months before the Bank's Motions were filed, each constituted sufficient notice under Code § 546(b).[28] Each Segregation Motion states the Bank's intention to

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[28] The Bank argues that it first gave the requisite Code § 546(b) motion by virtue of a letter dated May 10, 1996 allegedly sent by the Bank's counsel to the Trustee's counsel. Counsel for the Bank testified: "[O]n May 10, 1996, on behalf of the Bank, I wrote the Trustee's counsel and demanded that the Trustee segregate and account for cash collateral in which the Bank claimed an interest, including lease proceeds. Attached and incorporated by reference as Exhibit

move for relief from the automatic stay to, *inter alia*, terminate its Servicing Agreements "and collect all payments under the sold and assigned leases." The Court concludes that the Segregation Motions provided notice under Code §546(b) to the Trustee of the Bank's intent to enforce its security interests in the Lease Payments generated and/or received subsequent to the filing of the Segregation Motions. This notice was effective to take possession of any identifiable Lease Payments received by the Debtor within ten days prior to the date the Segregation Motions were filed on May 13, 1996.

In connection with the Marine Reconsideration Motion, the Trustee argued that Code § 546(b) cannot be read to establish a federal rule of perfection or to give a creditor more protection than would exist under state law. The Trustee argued that notice given under Code § 546(b) cannot apply prospectively because such notice must be given "within the time fixed by [state] law for such seizure . . . ," and the time for seizure under state law cannot begin until lease payments exist. The Trustee cited *Parr Meadows*, 880 F.2d at 1547, for the proposition that Code § 546(b) cannot be exercised repeatedly during a bankruptcy case.

E is a true and correct copy of the letter." *Declaration of James Dati dated October 30, 1997 admitted into evidence as Bank's Exhibit 28 at ¶ 7.* The Trustee objected to the admissibility of the letter on the ground that, *inter alia*, it was irrelevant because there was no evidence that it had ever been sent by the witness or received by the Trustee. *See, inter alia, Trustee's Evidentiary Objections to Supplemental Declarations of Various Banks at ¶ 17.* The Court reserved decision on the Trustee's objection. A presumption that a letter was received by mail can be established "*either* by the testimony of the person who actually mailed the letter *or* by indirect evidence such as a showing that the mail was sent through regular office procedures." *In re O.W. Hubbell & Sons, Inc.*, 180 B.R. 31, 34 (N.D.N.Y. 1995) (emphasis in original) (citing *Capital Data Corp. v. Capital Nat'l Bank*, 778 F. Supp. 669, 675 (S.D.N.Y. 1991)). There is no such evidence here. The Bank's counsel testified only that he wrote the letter, not that he actually mailed it or routed it into the mail through regular office channels. *Compare In re O.W. Hubbell & Sons, Inc.*, 180 B.R. at 34-35 (finding that affidavit of service was sufficient evidence of mailing). The Trustee's objection is therefore sustained, and the contents of the letter will not be considered by the Court.

The Trustee's arguments might have merit if it were true, as a general statement of law, that Code § 546(b) cannot be applied more than once in a given case. In *Parr Meadows*, the Second Circuit stated:

> [W]e question whether 546(b) was ever intended to apply repeatedly during a prolonged bankruptcy. Section 546(b) was enacted to aid the creditor who, "surprise[d] [by the] intervention of [the] bankruptcy petition", is prohibited by the automatic stay from perfecting its interest in the debtor's property, but who otherwise would still be permitted to perfect that interest under state law. The section was "not designed to give the States an opportunity to enact disguised priorities in the form of liens that apply only in bankruptcy cases."
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> Instead of interpreting § 546(b) as a one-time exception for the creditor who gave value but has not yet perfected its lien, the county would have us create a rotating exception, which, every December 1, would add another lien at the front of the priority line, enabling the county to effectively collect on all its claims as if no bankruptcy petition had ever been filed. Such an interpretation would effectively remove the taxing arms of local government from the controlling provisions of the bankruptcy code, a result clearly contrary to the intent of congress.

Id. at 1547 (citations omitted).

In the foregoing passages from *Parr Meadows*, the Second Circuit questioned whether § 546(b) could be repeatedly used to effectively allow postpetition tax liens to be, not simply perfected, but also *created. See id.* In contrast, the Bank is here seeking to utilize Code § 546(b) not to create liens, but only to perfect existing liens on Lease Payments. In the absence of the automatic stay, the Bank would have been able to seize Lease Payments on an ongoing basis. The Second Circuit's statements in *Parr Meadows*, quoted above, are arguably *dicta* and, in any event, were made in a context which is not factually analogous to the present case. Clearly, Code § 546(b) is not by its text limited to a one-time invocation during a bankruptcy case.

With these considerations in mind, the Court concludes that the Bank's Segregation

Motions served as notice for all Lease Payments generated and/or received subsequent to their filing. *See Jones v. Salem Nat'l Bank (In re Fullop)*, 6 F.3d 422, 431 (7th Cir. 1993) (citations omitted) (allowing bank's departure from prepetition routine of remitting to debtor excess installment payments received from debtor's assignee to constitute Code § 546(b) notice to perfect lien on multiple, and apparently future, installment payments). To conclude otherwise would allow for the patent absurdity of the Bank repeatedly having to serve notices at least every ten days until all Lease Payments have been received.

The fact that the Bank provided the Debtor with notice of its intent to seize the Lease Payments is ineffective unless the Lease Payments are identifiable. *See* NYUCC §9-306(2). In the Marine Reconsideration Decision, the Court found that while lease payments were not rendered identifiable by virtue of the filing of Marine's Code § 362(d) motion, certain lease payments were identifiable as a result of having been segregated by the Trustee pursuant to a segregation order. The Court concluded that postpetition lease payments received prior to the date of the segregation order were not identifiable because the Trustee had asserted that they had been deposited into a "honeypot" of funds from various sources, and Marine had not provided any evidence that such funds were identifiable, whether by tracing under principles of trust accounting or otherwise. Here, the Bank argues that all postpetition Lease Payments are identifiable by virtue of the voluminous Lease payment history reports which are in evidence. *See Exhibits E, F & G to Declaration of Daniel Casey admitted into evidence as Trustee's Exhibit Casey H.* These reports are generally receivable aging reports and computer printouts of cash collections applied to each portfolio. The reports indicate when certain payments were received, but do not indicate where they were deposited after receipt by the Debtors. Thus, the

Bank asserts that "[t]here is no question that the Debtor and now the Trustee were and are able at all times to trace the Lease Payments, and these records prove that the Trustee did, in fact, trace the funds." *Bank's Memorandum of Law* at 57.

In this situation, the "intermediate balance rule" must be used to trace any commingled Lease Payments. In *P.T. Tirtamas Majutama v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 142 B.R. 633 (S.D.N.Y. 1992), the court stated:

> When a bankrupt debtor is acting as trustee of a constructive trust and money held in trust has been commingled with other funds, the so-called "intermediate balance rule" may be applied to determine how much money the beneficiary can actually recover. This is a legal fiction to deal with the problem of identification and to prevent subsequent additions to the fund by other creditors from being used in satisfaction of the constructive trust."

Id. at 637. The *Drexel Burnham* court, quoting COLLIER ON BANKRUPTCY, explained:

> The bankruptcy court will follow the trust funds and decree restitution where the amount of the deposit has at all times since the intermingling of funds equaled or exceeded the amount of the trust funds. But where, after the appropriation and mingling, all of the moneys are withdrawn, the equity of the cestui is lost, although moneys from other sources are subsequently deposited in the same account. In the intermediate case where the account is reduced to a smaller sum than the trust fund, the latter must be regarded as dissipated, except as to the balance, and funds subsequently added from other sources cannot be subjected to the equitable claim of the cestui que trust. If new money is deposited before the balance is reduced, the reduction should be considered to be from the new money and not from the monies held in trust.

Id. (quoting 4 COLLIER ON BANKRUPTCY ¶ 541.13, at 541-79-541-80 (Lawrence P. King 15th ed. 1992)) (other citation omitted). Tracing of commingled funds requires, *inter alia*, evidence of the aggregate balance at relevant points in time of the account in which the funds in question have been deposited. *See, e.g., American Hull Ins. Syndicate v. United States Lines, Inc. (In re*

United States Lines, Inc.), 79 B.R. 542, 545 (Bankr. S.D.N.Y. 1987). While each Segregation Order required the Trustee to deposit Lease Payments into segregated accounts "whether such proceeds were received prior to the date of [the Segregation Order] or thereafter," the Trustee could only segregate those Lease Payments which the Debtors had not commingled into the "honeypot" account, or which could be traced. The Bank has presented no evidence concerning the balance of the honeypot at any point in time, and it therefore cannot be determined whether any of the Lease Proceeds received prior to June 11, 1996, the date of the Segregation Orders, are identifiable. *See In re Drexel Burnham Lambert Group, Inc.*, 142 B.R. at 638 (stating "'[t]he generally adopted view denies the remedy of tracing where the proof of the beneficiary-claimant merely shows the receipt of trust property by the defendant and makes no case as to its subsequent history or its existence among the present assets of the defendant . . .'" (quoting 14 Bogert, *Trusts and Trustees* § 921 at 367-69 (2d ed. rev. 1982 & Supp.1991))). The Bank alleges that all postpetition Lease Payments are identifiable by virtue of Code § 363(c)(4) which, *inter alia*, requires that Trustee to "be accountable for all property received . . ." *See* 11 U.S.C. § 363(c)(4). While the Trustee acknowledges that he complied with Code § 363(c)(4) by segregating Lease Payments, there was no evidence presented at the Hearing to indicate when that occurred. Certainly it did not occur before April 18, 1996, when the Trustee's appointment in BFG's case was approved, or May 15, 1996, when his appointment in RSC's case was approved. *Compare Cargocaire Engineering Corp. v. Dwyer (In re Gemel Int'l, Inc.)*, 190 B.R. 4, 10 (Bankr. D.Mass. 1995) (holding that secured creditor was not automatically entitled to replacement lien on commingled proceeds and declining to follow *Freightliner Market Development Corp. v. Silver Wheel Freightliners, Inc.*, 823 F.2d 362, 368-69 (9th Cir. 1987) for

the proposition that debtor's improper use of cash collateral served to shift burden of proof on issue of tracing to trustee).[29] The Trustee does not dispute that the Lease Payments became identifiable as a result of his compliance with the Segregation Orders. Therefore, based upon the evidence before it, the Court finds that the Lease Payments received by the Trustee on and since June 11, 1996 are identifiable.

D. Rights of the Trustee as a Judicial Lien Creditor under Code § 544

None of the foregoing analysis directly answers the question of priority between the Bank and the Trustee as to the Lease Payments. Pursuant to NYUCC § 9-301(1)(b), an unperfected security interest is subordinate to the rights of a person who becomes a "lien creditor" before the security interest is perfected. The term "lien creditor" is defined by NYUCC § 9-301(3) to mean "a creditor who has acquired a lien *on the property involved* by attachment, levy or the like and includes . . . a trustee in bankruptcy from the date of the filing of the petition . . . . " (emphasis added). It remains to be seen whether a lien creditor could obtain a lien on future Lease Payments before the Bank's security interest therein becomes perfected.

The Trustee generally has the rights and powers of a lien creditor as of the petition date

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[29] Upon the commencement of a bankruptcy case, a perfected security interest in proceeds received prepetition extends only to, *inter alia*, (1) "identifiable cash proceeds in the form of money which is neither commingled with other money nor deposited in a deposit account prior to the insolvency proceedings," NYUCC § 9-306(4)(b), and (2) certain amounts received within ten days before institution of the insolvency proceedings in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, see NYUCC § 9-306(4)(d). Section 9-306(4) "is considered to have supplanted whatever tracing rights the secured party would have had prior to the insolvency proceedings." ROBERT H. BOWMAR, SECURED TRANSACTIONS IN NEW YORK, 274 (Lawyers Cooperative Publishing) (1991 & Supp. 1996). The application of NYUCC § 9-306(4) is limited to proceeds received prepetition. *See In re Bumper Sales, Inc.*, 907 F.2d at 1438.

pursuant to Code § 544, which provides in pertinent part:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by---

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists . . .

11 U.S.C. § 544(a)(1).

Pursuant to Code § 544(a)(1), a trustee has the rights and powers of a hypothetical creditor with a judicial lien on "all property on which a creditor on a simple contract could have obtained such a judicial lien" on the petition date. Thus, a bankruptcy trustee endowed with the "strong arm" powers of Code § 544 has been described as "'the ideal creditor, irreproachable and without notice, armed *cap-a-pie* with every right and power which is conferred by the law of the state upon its most favored creditor who has acquired a lien by legal or equitable proceedings,'" *see Havee v. Belk*, 775 F.2d 1209, 1218 n.15 (4th Cir. 1985) (quoting *In re Kravitz*, 278 F.2d 820, 822 (3d Cir. 1960)), and as "the perfect litigant without flaw." *See Rinn v. First Union Nat'l Bank of Maryland*, 176 B.R. 401, 413 (D. Md. 1995) (quoting *In re Barnett*, 62 B.R. 638, 640 (Bankr. D. Md. 1986)).

As the court observed in *Rinn v. First Union Nat'l Bank of Maryland*,

> [While] it is the federal law which provides the trustee with his "strong-arm" power, his exercise of such power and its extent are governed entirely by the applicable state law . . . [the strong-arm section] confers on the trustee no "greater rights than those accorded by the applicable [state] law to a creditor holding a lien by legal or equitable proceedings."
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> *Havee v. Belk*, 775 F.2d at 1218-19, quoting 4A COLLIER ON BANKRUPTCY, 604 (14th ed. 1976) (emphasis added); *accord*

> *Angeles Real Estate Co. v. Kerxton*, 737 F.2d 416, 418 (4th Cir. 1984) ("A trustee in bankruptcy stands in the shoes of the bankrupt and succeeds only to the bankrupt's interest in property [as a judgment lien creditor] . . . Thus, if under applicable state law a judgment lien creditor would prevail over an adverse claimant, the trustee in bankruptcy will prevail; if not, he will not."); *Eastern Shore Bldg. v. Bank of Somerset*, 253 Md. 525, 253 A.2d 367, 370 (1969) ("A judgment creditor ' (sic) stands in the place of his debtor, subject to the equitable charges to which it was liable in the hands of the debtor, at the time of the rendition of the judgment.").

Rinn, 176 B.R. at 412 n.14.

"Once the trustee has assumed the status of a hypothetical lien creditor under § 544(a)(1), state law is used to determine what the lien creditor's priorities are." *See In re Kors, Inc.*, 819 F.2d 19, 22-23 (2d Cir. 1987) (citations omitted). It appears that under either a federal interest-based choice of law analysis or New York choice of law rules, Illinois would have the dominant interest in determining the Trustee's rights and powers under Code § 544(a)(1) with respect to obtaining a lien on the Debtors' rights to receive the Lease Payments. *Cf. Kunstsammlungen Zu Weimar v. Elicofon*, 536 F.Supp. at 846 (quoting comment a to § 246 of the Restatement (Second) of Conflict of Laws (1971) for the proposition that "[t]he state where a chattel is situated has the dominant interest in determining the circumstances under which an interest in the chattel will be transferred . . ."); *see also Hassett v. Far West Fed. Sav. and Loan Ass'n (In re O.P.M. Leasing Servs., Inc.)*, 40 B.R. 380, 399 (Bankr. S.D.N.Y. 1984) (suggesting general rule that New York applies law of situs of personal property in determining claims to such property) (citations omitted); *accord* 5 COLLIER ON BANKRUPTCY ¶ 544.02 at 544-5 (15th ed. 1997) (stating that trustee's rights under Code § 544(a) are "measured by the substantive law of the jurisdiction governing the property in question.") (citations omitted). *Compare Crichton v.*

McGehee, 20 N.Y.2d 124, 228 N.E.2d 799, 281 N.Y.S.2d 811 (1967) (rights of New York domiciliary to intangible personal property of her deceased husband located in Louisiana were governed by New York law because New York had interest in regulating the rights of married persons domiciled in New York).

With respect to intangible property, the general rule has long been that the situs of such property follows the domicile of the owner. *See, e.g., In re Brown's Estate*, 247 N.Y. 10, 18, 8 N.E.2d 42, 44 (1937), *rev'd on other grounds sub nom. Graves v. Elliott*, 307 U.S. 383, 59 S.Ct. 913, 83 L.Ed.2d 1256 (1939). An exception to this rule exists for intangible property, such as a right to payment, which is embodied in a document such as a personal property lease. "Such documents and the personal property merged or embodied in them have, like tangible chattels, a situs apart from the domicile of the owners." *Hutchison v. Ross*, 262 N.Y. 381, 390, 187 N.E.65, 69 (1933); *accord* Boss, *Lease Chattel Paper: Unitary Treatment of a "Special" Kind of Commercial* Specialty, 1983 Duke L.J. 69. Because the Leases appear to be in Illinois, the extent of the Trustee's hypothetical lien on the Debtors' rights to receive Lease Payments must be determined under Illinois law.

In Illinois, a judgment creditor generally acquires a lien on a debt due the judgment debtor by serving a garnishment summons on a "garnishee," *i.e.*, a person who owes a debt to the judgment debtor. *See* 735 Ill. Comp. Stat. Ann. 5/12-701, 5/12-707 (West 1992 & Supp. 1997); *In re Schweke*, 164 B.R. 751, 752 (Bankr. N.D.Ill. 1994). Illinois law does not allow a lien creditor to obtain a lien on property not yet in existence.[30] *See, e.g., Roth v. Kaptowsky*, 333

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[30] The Trustee, citing the New York Court of Appeals' decision in *ABKCO Industries, Inc. v. Apple Films, Inc.*, 39 N.Y.2d 670, 385 N.Y.S.2d 511, 350 N.E.2d 899 (1976), appears to argue that, as of the petition dates, he became vested with a judicial lien on all future Lease

Ill.App. 112, 118, 76 N.E.2d 786, 789 (1st Dist.1948) (stating that "garnishee proceedings will tie up a debt and render it subject to the attaching creditor's lien *when due*") (emphasis added), *aff'd* 401 Ill. 424, 82 N.E.2d 661 (1948); *accord* 735 Ill.Comp.Stat.Ann. 5/12-707 (West 1992 & Supp. 1997) (stating that the "balance due . . . becomes a lien on the *indebtedness* and other property held by the garnishee at the time of the service of the garnishment summons and remains a lien thereon pending the garnishment proceeding") (emphasis added); 735 Ill.Comp.Stat.Ann. 5/12-713 (West 1992 & Supp. 1997) (stating that judgment shall not be entered against the garnishee until the debt from the garnishee to the judgment debtor is due). At most, a judgment

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Payments. Assuming, *arguendo*, that New York law would apply here, the *ABKCO Industries* case held that a contingent receivable, *i.e.* a debt or right to payment, was leviable as "property which could be assigned or transferred" within the meaning of CPLR § 5201(b). *See id.* at 676, 514, 902. Generally, a right to payment can be assigned only if it is sufficiently choate. *See Capital Nat'l Bank v. McDonald's Corp.*, 625 F. Supp. 874, 879 (S.D.N.Y. 1986). "'A court of equity gives effect to assignments of contingent interests having no present actual existence but resting in possibility only.'" *In re Mucelli*, 21 B.R. 601, 604 (Bankr. S.D.N.Y. 1982) (quoting 20 N.Y. JUR.REV., Equity § 50 (1980) and citing *Field v. City of New York*, 6 N.Y. 179 (1852)). More specifically, "there is no doubt that the assignment of a truly future claim or interest does not work a present transfer of property. It does not because it cannot; no property yet exists. However equity has long recognized such a purported transfer as an agreement or promise to transfer when the capacity to transfer arises--hence, one form of the equitable assignment enforceible (sic) in equity with the inchoate right receiving no or only limited recognition at law." *Stathos v. Murphy*, 26 A.D.2d 500, 276 N.Y.S.2d 727 (2d Dep't 1966), *aff'd* 19 N.Y.2d 883, 227 N.E.2d 880, 281 N.Y.S.2d 81 (1967); *see also Don King Productions v. Thomas*, 945 F.2d 529, 534 (2d Cir. 1991) (construing New York law). It appears to be the law in New York that a right to payment is choate and capable of assignment if it is grounded upon a contract in existence at the time the assignment is made. *See Lincoln Rochester Trust Co. v. Marasco Steel, Inc.*, 66 Misc.2d 295, 297 (N.Y.Co.Ct. 1971) (citing CPLR § 5205(a)(1); *Kniffin v. State of New York*, 257 App.Div. 43, 12 N.Y.S.2d 422 (3d Dep't 1939), *mod.* 283 N.Y. 317 (1940), *rearg. denied* 284 N.Y. 593 (1940), *cert. denied* 312 U.S. 690 (1941); *Stathos v. Murphy*, 26 A.D.2d at 500)). The Second Circuit has observed that "[t]he vagaries in the development and application of the law of assignment of future rights and interests have led one court to the frank admission that the cases cannot all be reconciled." *Law Research Service, Inc. v. Martin Lutz Appellate Printers, Inc.*, 498 F.2d 836, 838 n.4 (2d Cir. 1974) (citing *Stathos v. Murphy*, 26 A.D.2d at 500, 276 N.Y.S.2d at 727).

lien creditor can only obtain a lien on a right to property to be received in the future. This lien would be subordinate to the Bank's previously perfected security interest in the right to payment under each Lease because "[a] judgment creditor in Illinois has no greater rights in an asset than does the judgment debtor." *Pacific Reinsurance Management Corp. v. Fabe*, 929 F.2d 1215, 1219 (7th Cir. 1991) (citing *Seidmon v. Harris*, 172 Ill.App.3d 352, 122 Ill.Dec. 284, 286, 526 N.E.2d 543, 545 (1st Dist.1988); *Bank of Homewood v. Gambella*, 48 Ill.App.2d 316, 199 N.E.2d 293 (1st Dist.1964)); *see also, e.g., Marcheschi v. P.I. Corp.*, 84 Ill.App.3d 873, 879, 40 Ill.Dec. 138, 143, 405 N.E.2d 1230, 1235 (1st Dist. 1980) (same); *Liberty Leasing Co., Inc. v. Crown Ice Machine Leasing Co., Inc.*, 19 Ill.App.3d 27, 29, 311 N.E.2d 250, 252 (1st Dist. 1974) (same). In this case, the Debtors' rights to payment of the Lease Payments on the petition dates were subject to the Bank's liens, which cannot be primed by the Trustee as an attaching creditor.

By virtue of its superior rights to the Leases, it would be anomalous to conclude that the Bank did not also have a superior interest in the Lease Payments as they are received by the Debtors. Yet, the UCC requires perfection in proceeds of various forms of original collateral, including various forms of rights to payment, notwithstanding perfection in the original collateral. Therefore, for the reasons set forth herein, the Bank's perfected security interest in the Leases is meaningless if the Bank cannot take steps to continue its perfected security interest in the Lease Payments within ten days after their receipt by the Debtors.

Here the Trustee's argument concerning attachment resumes its significance. The Trustee's argument that the Bank's security interest in the Lease Payments does not attach until the Lease Payments come into existence implies that (1) as of the respective petition dates, the Bank and the Trustee would each have a lien on the right to payment of future Lease Payments,

and (2) the automatic stay would prevent the Bank's liens from attaching to the Lease Payments as proceeds of such rights to payment, while the Trustee would effectively obtain a lien on such Lease Payments as they were created. In *Parr Meadows*, the Second Circuit indicated that the perfection of tax liens by operation of law, without any affirmative act, would constitute a violation of the automatic stay. *See In re Parr Meadows Racing Ass'n, Inc.*, 880 F.2d at 1545 (citations omitted). However, the same conclusion with respect to proceeds would severely, if not completely, emasculate Code § 552(b)(1). *See* 11 U.S.C. § 552(b)(1).[31] As a result, the Court does not read Code § 362(a) as preventing passive attachment of a security interest in proceeds

[31] Code § 552(b)(2) expressly states that "notwithstanding section 546(b) of this title," certain postpetition effect will be given to prepetition security interests in rents and hotel room revenues. See 11 U.S.C. § 552(b)(2). Code § 552(b)(1) does not contain the "nothwithstanding section 546(b)" language. Thus, the Trustee asserts: "Whereas paragraph (2) § 552(b) is specifically intended to permit certain post-petition real estate proceeds to come within a party's security interest recognized in bankruptcy notwithstanding the failure to perfect with respect to those proceeds under state law, Congress did not, however, grant in paragraph (1) of § 552(b) -- the personal property paragraph -- that blanket exemption from state law perfection with respect to the personal property proceeds at issue here." *Trustee's Memorandum of Law* at 63 (emphasis in original). As noted above, Code § 552(b)(1) provides that in specified circumstances a prepetition security interest in proceeds "extends to" proceeds received postpetition "to the extent provided by [the] security agreement and applicable nonbankruptcy law." *See* 11 U.S.C. § 552(b)(1). The legislative history of Code § 552(b) states that "'extends to' as used here would include an automatically arising security interest in proceeds, as permitted under the 1972 version of the Uniform Commercial Code . . ." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 377 (1977). "[A]pplicable nonbankruptcy law" as used in Code § 552(b)(1) means the law which governs the extent of the security interest, *i.e.*, the property covered by the security interest, as opposed to questions of perfection. Nothing in Code § 552 requires that a security interest in postpetition proceeds be perfected only in accordance with applicable nonbankruptcy law in order for the security interest to be immune from attack by virtue of Code § 552(b). *See Matter of Fullop*, 6 F.3d at 429-431 (Code § 546(b) used to perfect security interest in non-Article 9 proceeds in case involving former Code § 552(b)); *see also generally* 5 COLLIER ON BANKRUPTCY ¶ 552.02-03 at 552-6 to 552-21 (Lawrence P. King, 15th ed. 1998).

of collateral in which a security interest was perfected prepetition.[32]

As of June 11, 1996, then, attachment was all that remained to occur in order for the Bank's security interests in future Lease Payments to become perfected. The extent of the Trustee's rights and powers with respect to the Lease Payments would appear to be governed by New York law because it appears that, by virtue of the Servicing Agreements, the Lease Payments exist, or will exist, in New York, where BFG's offices are. *See* NYUCC § 9-103(1)(b). The Trustee broadly asserts that "[a]n unperfected security interest is avoidable by a bankruptcy trustee." *See Trustee's Memorandum of Law* at 24, n.33 (citation omitted). While that is true, in order to exercise Code § 544(a) avoidance power, the Trustee must first obtain the status of a lien creditor with respect to the Lease Payments, *see* 11 U.S.C. § 544(a)(1), and must do so before the Bank's security interests therein become perfected, *see* NYUCC § 9-301(1)(b).[33] As explained above, the earliest the Trustee could obtain the status of a lien creditor with respect to postpetition Lease Payments would be when such Lease Payments come into existence. The best the Trustee can do here is to obtain the status of a lien creditor at the exact moment that the Bank's security interests attach, which would not be "before" the Bank's security interests attach, as is required by NYUCC § 9-301(1)(b) for the Bank's security interests to be voidable. *See*

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[32] It is therefore unnecessary to consider whether the exception to the automatic stay codified in Code § 362(b)(3) would allow the Bank's lien to attach in the time set forth in Code § 547(e)(2)(A). *See* 11 U.S.C. §§ 362(b)(3); 547(e)(2)(A); *see also In re Planned Protective Services, Inc.*, 130 B.R. 94 (Bankr. C.D.Cal. 1991) (finding that Code § 547(e)(2)(A), as incorporated in Code § 362(b)(3), could not be utilized to validate a lien voidable under Code § 544(a)(3)).

[33] While NYUCC § 9-301(3) defines "lien creditor" to include "a trustee in bankruptcy *from the date of the filing of the petition* . . .," NYUCC § 9-301(3) (emphasis added), Code § 544(a)(1) confers hypothetical judicial lien creditor status only to the extent that "a creditor on a simple contract could have obtained such a judicial lien . . .," *see* 11 U.S.C. § 544(a)(1).

Grain Merchants of Indiana, Inc. v. Union Bank and Savings Co., Bellevue Ohio, 408 F.2d 209, 213 (7th Cir. 1969) (where secured creditor had security interest in future accounts receivable, the court was faced "with a situation where as soon as an account receivable comes into existence and is sought to be attached by a lien creditor, it has already become subject to a perfected security interest . . .," and stated that "a secured creditor who has duly filed a financing statement covering after-acquired collateral is entitled to priority over a subsequent lien creditor seeking to levy on the same property").

Thus, a lien creditor's rights and powers with respect to the Lease Payments must be subject to the Bank's right to be paid those Lease Payments. As Professor Siegel states,

> For purposes of execution after judgment as well as attachment before judgment, the judgment creditor's . . . right to a given item of property is deemed co-extensive with--the same as--the judgment debtor's . . . own interest in it. The theory is that the judgment creditor steps into the shoes of the judgment debtor. If the item is subject to any outstanding commitment honestly incurred (i.e., without fraud on creditors), the judgment creditor is bound by it and can assert an interest in the item only to the extent that an interest remains after the commitment is subtracted. If the item is subject to a mortgage, or to a pledge, or to any senior lien, and the same is binding on the judgment debtor, it binds the judgment creditor as well.

Siegel, Practice Commentaries, McKinney's Cons. Laws of NY, Book 7B, C5201:15, at 4.

Stated another way, "to the extent property is subject to a perfected security interest, the monetary *value* of such security interest is an '. . . equitable interest in such property that the debtor does not hold.'" *In re Green*, 64 B.R. 462, 465 (Bankr. S.D. Ind. 1986) (emphasis in original) (quoting 11 U.S.C. § 541(d)); *see also In re Drexel Burnham Lambert Group, Inc.*, 120 B.R. 724, 736 (Bankr. S.D.N.Y. 1990). As a result, at least one court has indicated that a creditor cannot effect a levy on fully encumbered property. *See William Iselin & Co., Inc. v. Burgess &*

Leigh Ltd., 52 Misc.2d 821, 276 N.Y.S.2d 659 (N.Y.Sup.Ct. 1967). *But cf. ABKCO Industries, Inc. v. Apple Films, Ltd.*, 39 N.Y.2d at 675, 385 N.Y.S.2d at 514, 350 N.E.2d at 902 (stating: "We know of no threshold requirement that the attaching creditor show the value of the attached property or indeed that it has any value. Correlatively, we know of no theory on which the debtor or the garnishee is entitled to a vacatur of the attachment if it can be established that the property in question is valueless."). In the present situation, while the debt owing under the Leases is encumbered by the Bank's perfected security interests, realization of the value of those security interests is dependent upon the Bank taking steps to continue its perfected security interests in the Lease Payments once they are received. In other words, there is potential value which can be levied upon by the lien creditor for whatever it may be worth. In this case, however, to the extent that the Bank perfected in the Lease Payments there is no value for a hypothetical creditor to levy upon. The Trustee is unable to avoid the Bank's security interests in those Lease Payments received on or after June 11, 1996.[34]

II. RELIEF FROM THE AUTOMATIC STAY, ABANDONMENT AND SETOFF

A. Code § 362(d)

The Court must next address the issue of whether to modify or lift the automatic stay pursuant to Code § 362(d) to allow the Bank to receive the Lease Payments in which it has or will

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[34] Neither the Bank nor any of the Intervening Banks have cited, and the Court need not address, those cases which hold that Code § 544(a) gives a trustee the status of a hypothetical lien creditor only with respect to property in existence as of the commencement of the case, not with respect to property acquired by the estate postpetition. *See Northern Acres, Inc. v. Hillman State Bank (In re Northern Acres, Inc.)*, 52 B.R. 641, 647 (Bankr. E.D.Mich. 1985); *Weiman v. Stopher (In re Weiman)*, 22 B.R. 49 (9th Cir.BAP 1982).

have a perfected security interest. Code § 362(d) provides alternative bases on which a creditor may obtain relief from the automatic stay. Code § 362(d)(1) allows for relief upon a determination that "cause" exists. Under Code § 362(d)(2) relief is possible if there is a lack of equity in the collateral *and* the collateral is not necessary to the debtor's effective reorganization. The decision to modify or lift the automatic stay is within the discretion of the Court and is to be determined on a case-by-case basis. *See In re Robbins*, 964 F.2d 342, 345 (4th Cir. 1992); *see also Sonnax Indus., Inc. v. Tri Component Prods. Corp. (In re Sonnax Indus., Inc.*), 907 F.2d 1280, 1286 (2d Cir. 1990) (citations omitted).

The Bankruptcy Code does not define what constitutes "cause" within the meaning of Code § 362(d)(1), other than to indicate that a lack of adequate protection may serve as one basis. Normally the issue of a debtor's reorganization is addressed pursuant to Code § 362(d)(2). In certain circumstances, however, the lack of an intent to reorganize utilizing the specific collateral may constitute "cause" under Code § 362(d)(1).

Under Code § 362(d)(2) the question of whether the collateral is necessary for an effective reorganization requires an initial finding that the debtor intends to reorganize. In this case, whether or not there is a reasonable possibility for a successful reorganization of the Debtor standing alone is not entirely clear. The Trustee's testimony at the Hearing was consistent with his testimony at past hearings. The Trustee did not present any testimony to the effect that the Lease Payments themselves, as distinguished from the *collection* of the Lease Payments, are to be utilized in any reorganization of the Debtor. The Trustee has never sought authorization to use the Lease Payments. The focus of the Trustee's testimony concerned the servicing and collection operations of The Processing Center ("TPC"), also a chapter 11 debtor. *See generally*

Declaration of Richard C. Breeden admitted into evidence as Trustee's Exhibit Breeden B. His testimony in large part centered not on the Debtor's reorganization but on the continued viability and future growth of Resort Funding, Inc. ("RFI"), a related nondebtor, which utilizes the services of TPC. *See id.* The Trustee indicated that the key to expansion of RFI, as distinguished from BFG, rested in large degree on being able to maintain an efficient and cost effective operation for collecting and servicing the lease accounts. *See id.* at ¶ 49. He did, however, allude to the possibility that the Debtor may ultimately become involved with additional leasing operations in connection with the resort timeshare industry. *See, e.g., id.* at 52.

The Court finds that the lack of an *intent* to reorganize the Debtor utilizing the Lease Payments constitutes cause under Code § 362(d)(1) to grant relief from the automatic stay. *Compare In re Drexel Burnham Lambert Group, Inc.*, 113 B.R. 830, 837-38 (Bankr. S.D.N.Y. 1990) (holding that the fact that debtor may not need property for its reorganization does not constitute cause for relief under Code § 362(d)(1)). To conclude otherwise would allow the Trustee to withhold non-essential collateral simply because that collateral is worth more than the balance due on the obligation it secures. In addition, there is the possibility that further delay in requiring the Trustee to turn over the Lease Payments to the Bank may increase the Bank's secured claim, should it be determined that the Bank is oversecured, to the further detriment of the investor creditor body. The Court concludes that the stay should be modified to require the Trustee to turn over the Lease Payments to the Bank, subject to the limitations set forth below.[35]

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[35] As he has in connection with previous bank motions in this case, the Trustee argues that the Motion for Relief must be denied as a result of the operation of Code § 502(d), which generally mandates disallowance of a claim against the estate by an entity who has not turned over property recoverable by the trustee pursuant to Code §§ 544, 547, 548 and 550. *See* 11 U.S.C. § 502(d). On January 21, 1998, the Trustee filed an adversary complaint against the Bank,

B. Code § 554(b)

Closely connected to the Bank's request for relief from the automatic stay is its request for an order that the Trustee abandon the estate's interest in the Leases pursuant to Code § 554(b). The Bank asserts that the estate lacks equity in the Leases and the Leases are not necessary for any reorganization. As a result, the Bank maintains that the Leases are burdensome or of inconsquential value and benefit to the estate, *see* 11 U.S.C. § 554(b), and that the Trustee

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as amended by an adversary complaint filed March 27, 1998 ("Adversary Proceeding No. 98-70028A"). Adversary Proceeding No. 98-70028A asserts, *inter alia*, 29 causes of action in which the Trustee alleges that the Bank received from the Debtor(s) transfers in the aggregate amount of $315,373.11 that he contends are avoidable and recoverable pursuant to Code §§ 547 and 550. Rather than make a determination concerning the merits of these causes of action, the Court will allow the Trustee to continue to hold and segregate $315,373.11, pending entry of a final order in Adversary Proceeding No. 98-70028A. The Trustee also asserts in Adversary Proceeding 98-70028A two causes of action alleging that certain payments received by the Bank are avoidable and recoverable pursuant to Code §§ 544(b) and/or 548(a) and 550. One such cause of action seeks recovery of certain payments alleged to have been received by the Bank within one year prior to BFG's filing. The Trustee has not indicated the amounts of any transfers alleged to have been received by the Debtor(s) within one year prior to their respective petition dates, and he is therefore not entitled to withhold any monies on account of that cause of action. The other such cause of action seeks avoidance and recovery of at least $6,692,141.90 alleged to have been received by the Bank within six years prior to BFG's filing (the "Code § 548/Ponzi Cause of Action"). Unlike the Trustee's Code § 547 causes of action, there is some question as to whether the Code § 548/Ponzi Cause of Action states a claim upon which relief can be granted. *See Merrill v. Abbott (In re Independent Clearing House Co.)*, 77 B.R. 843 (D.Utah 1987) (holding that, where evidence established existence of a Ponzi scheme, debtors did not receive reasonably equivalent value for payments made to investors in excess of principal investments). The Court will not resolve that question here, and will not allow the Trustee to withhold any monies on account of the Code § 548/Ponzi Cause of Action.

The Trustee commenced a separate adversary proceeding against the Bank on March 27, 1998 ("Adversary Proceeding No. 98-70510A"), in which he alleges that the Bank has received (in addition to the transfers which are the subject of Adversary Proceeding No. 98-70028A) transfers totalling at least $491,000 alleged to be avoidable and recoverable pursuant to Code §§ 544(b), 547, 548 and 550. Because Adversary Proceeding 98-70510A was commenced after the date of the Hearing, the Court will not consider the Trustee's Code § 502(d) argument in connection with that proceeding. *See In re The Bennett Funding Group, Inc.*, No. 96-61376 (Bankr. N.D.N.Y. January 8, 1997).

should therefore not be allowed to continue servicing the Leases.

The Court has serious concerns about the potentially adverse impact on the Debtors' operations if the Court were to modify the stay or order abandonment to allow the Bank to collect Lease Payments directly from the Lessees. The Court received testimony from Daniel Casey ("Casey"), the Director of Collections for TPC, who has managed the collection of delinquent lease payments for the Debtor since May 1996. *See generally Declaration of Daniel Casey admitted into evidence as Trustee's Exhibit Casey H.* Casey testified that a number of lessees have multiple leases which have been assigned to a number of different banks and/or private investors. In Casey's opinion, if individual banks were allowed to collect directly from the lessees, lessees which are currently forwarding a single monthly payment to the Debtor covering several leases would be faced with having to send several payments to several different lenders, which would lead to confusion and increased rates of default. *See id.* at ¶ 45. Casey also expressed concern that there might be a disruption in the servicing of the leased equipment because servicing fees are a component of the lease payments and servicers would therefore have a difficult time keeping track of whether service payments on specific equipment had been made to various banks. Casey envisioned payment delays and/or defaults if lessees were to experience problems getting their equipment serviced. According to Casey, direct collection by the banks would also create problems in collecting that portion of the monthly lease payments which are earmarked for remittance to taxing authorities. *See generally id.* at ¶¶ 46-48.

Allowing the Bank to service its portfolios not only would put at risk the collection of servicing payments and tax payments, and it also has the potential for negatively impacting on any profit or spread the Trustee might be able to generate for payment to private investors, of

which there are allegedly thousands. Therefore, the Court concludes that the Trustee should be allowed to continue the servicing and collection of the Bank's lease portfolios in order to minimize the serious disruption that will likely occur to the detriment of secured and unsecured creditors alike if the servicing and collection functions are returned to individual lenders such as the Bank. As a result, the Bank's request that the Trustee be ordered to abandon the Leases pursuant to Code § 554 is denied.

C. Code § 552(b)

The Trustee argues that pursuant to Code § 552(b), the Court "should make the hard and imperfect decision of adjusting the equities among all those -- bank and non-bank individuals -- hurt by the Ponzi scheme" and limit the scope of any security interests in the Lease Payments which the Bank is found to possess. *See Trustee's Memorandum of Law* at 89. In connection with this argument, the Trustee does not maintain that the Bank's conduct was in any way fraudulent, merely less than prudent. The Trustee has made this so-called "equities of the case" argument in response to each of the Code § 362(d) motions upon which the Court has ruled in this case. In each instance the Court has rejected this argument, stating that the law does not condition enforcement of a security interest on the secured party's prudence in advancing funds and monitoring prospects for repayment. Thus, the Court refused to admit the testimony of the Trustee's expert, George L. Davis, on this issue, on the ground that such testimony was irrelevant.[36] Similarly, the Court finds that the Trustee is barred by the doctrine of collateral

[36] Davis'testimony would have been generally aimed at showing that the Bank did not prudently administer its lending relationship with the Debtors and, as a result, unwittingly assisted the Debtor in perpetrating what has been characterized by the United States Securities

estoppel from relitigating the legal question of whether the equities of the case provision of Code § 552(b) may be successfully invoked on the basis that the Bank did not act prudently. The Court has previously ruled in this case that, as a matter of law, that provision of Code § 552(b) cannot be so invoked.

The Court has examined the legislative history and case law addressing Code § 552(b). As one court has noted,

> "The purpose of the equity exception is to prevent a secured creditor from reaping benefits from collateral that has appreciated in value as a result of the trustee's/debtor-in-possession's use of other assets of the estate (which would normally go to general creditors) to cause the appreciated value."

In re Airport Inn Associates., Ltd., 132 B.R. 951, 959 (Bankr. D. Colo. 1990) (quoting *Delbridge v. Production Credit Assn. and Federal Land Bank*, 104 B.R. 824, 826 (E.D. Mich. 1989) (emphasis added); *see also In re Patio & Porch Systems, Inc.*, 194 B.R. 569, 575 (Bankr. D. Md. 1996) (indicating that the "provision is intended to prevent secured creditors from receiving windfalls and to allow bankruptcy courts broad discretion in balancing the interests of secured creditors against the general policy of the Bankruptcy Code, which favors giving debtors a 'fresh start") (citations omitted)). As has been the case with other banks against whom the Trustee has raised the equities of the case argument, there is no evidence that the Bank's collateral has in any way appreciated in value since the commencement of the case or that the Bank will receive a windfall as a result of the Trustee's actions. The fact that the amount of money held by the Trustee in the segregated account has increased is simply the result of the Trustee's compliance with the Segregation Orders requiring the deposit of the Lease Payments as they are received by

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and Exchange Commission as the largest Ponzi scheme in United States history.

the Debtor. Because each Lease is of limited duration and term, as the right to payment is converted into actual Lease Payments and deposited by the Debtor/Trustee, there is a resultant decrease in the number of payments remaining under the Lease and the value of each Lease is reduced accordingly. Based upon the foregoing, the Court will not limit the scope of the Bank's security interest in the Lease Payments.

The Trustee also invokes the equities of the case provision of Code § 552(b) to argue that, if the Court determines that the Bank has a perfected security interest in the Lease Payments, a portion of the Lease Payments should be used to cover the costs incurred by the Trustee in collecting the Lease Payments. The Trustee maintains that such costs are between $6.30 and $6.50 of the Lease Payments per lease per month, plus outside professional fees which bring the total cost to over $12.00 per lease, per month. *See Declaration of Robert J. Darefsky admitted into evidence as Trustee's Exhibit D (Darefsky Declaration)* at ¶¶ 23-25; exhibit D .

Assets of the estate have been used to collect and service the lease portfolios of the Bank. "As the House Report to the most recent amendments to 11 U.S.C. § 552 notes, 11 U.S.C. § 506(c) permits a broad range of operating expense to be deducted from pledged revenues, including those that may be subject to postpetition security interests." *See Patio & Porch* Systems, 194 B.R. at 575 (citing H.R. Rep. 103-834, 103d Cong., 2d Sess. 27-29; 140 Cong. Rec. H 10768 (Oct. 4, 1994). Rather than rely on Code § 552(b), the Court will allow the Trustee to recover some of the expenses incurred by the estate in the collection and servicing of the Leases pursuant to Code § 506(c). Although expenses incurred in the administration of a debtor's estate generally are the responsibility of the estate and not chargeable to the secured creditors, Code § 506(c) allows the estate to recover such expenses to the extent that "they are reasonable,

necessary costs and expenses of preserving . . . such property to the extent of any benefit to the holder of such claim." 11 U.S.C. § 506(c); *see General Electric Credit Corp. v. Levin & Weintraub (In re Flagstaff Foodservice Corp.)* 739 F.2d 73, 76 (2d Cir. 1984). The Trustee has asserted that as of the commencement of these cases, the various Bennett companies were parties to approximately 50,000 active leases. *See Trustee's Memorandum of Law* at 22. In the view of the Court, allowing the Trustee to continue servicing the leases and collecting the lease payments has prevented disruption and chaos which would have occurred if the all of the banks had attempted to redirect the lease payments and begin the collection process on their own. The Court concludes that, under the unique circumstances of this case, the expenditures of the Trustee in servicing the Leases and collecting the Lease Payments have been necessary to preserve the value of the Leases/Lease Payments and that such expenditures have benefitted the Bank. *Cf. Pettigrew v. Consultants United, Inc. (In the Matter of Specialcare, Inc.)*, 209 B.R. 13, 19-20 (Bankr. N.D.Ga. 1997) (stating, "Collection agency commission and payroll for persons employed for the sole purpose of collecting the accounts receivable fit clearly within Collier's category of section 506(c) expenses."); *Tavormina v. Capital Factors, Inc. (In re Jarax Int'l, Inc.)*, 164 B.R. 180, 183-84 (Bankr. S.D.Fla. 1993)(same). As Casey testified, the Trustee had collected $1,473,871.71 on the Leases through July 31, 1997, including $1,157,512.52 in Schedule A Payments. *See Casey Declaration* at ¶ 62. Based upon the evidence in the record, *see Darefsky Declaration* at ¶ 23; exhibit D, the Court concludes that $6.37 per lease per month, is a reasonable charge that should be borne by the Bank pursuant to Code § 506(c) in connection with the collection of the Lease Payments in which the Court has determined it has a valid

security interest.[37]

D. Setoff

As mentioned above, the Bank also seeks to set off the monies held in one or more advance payment accounts (the "Payment Accounts"), established and maintained pursuant to Payment Account Agreements prepared, executed and presented by the Debtor in connection with each transaction. *See Exhibits 8, 24, 40, 56 to Carmi Exhibit 1; Exhibits A8, A24, A40, A56, A73, A91, A107 to Carmi Exhibit 3; Exhibits A8, A23, A38, A50 attached to Carmi Exhibit 5; Exhibits A8, A24, A40, A56, A72, A88 attached to Carmi Exhibit 7; Exhibits A8, A24, A 40, A55, A71, A90, A106 attached to Carmi Exhibit 9.* The Payment Accounts were meant to provide a convenient mechanism for repayment of the amounts owing to the Bank under the Promissory Notes. Pursuant to the Payment Account Agreements, the Debtor apparently deposited monies into the Payment Account and, in some of the Payment Account Agreements, granted the Bank a security interest in monies on deposit equal to one month's advance payment due under respective Notes. It appears that the Bank would then automatically deduct monthly payments owing under the Promissory Notes from the Payment Account each month when due.

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[37] In some of the first rulings on Code § 362(d) motions rendered in this case, the Court, consistent with the evidence presented, awarded the Trustee $6.31 per lease, per month. In subsequent decisions, the Court, consistent with the evidence presented, awarded the Trustee $6.37 per lease, per month. The Bank argues that the Trustee is now collaterally estopped from charging more than $6.31 per lease, per month. *See Bank's Memorandum of Law* at 63. The Court rejects this argument because, among other reasons, offensive collateral estoppel should not be invoked to preclude litigation of issues upon which inconsistent determinations have been made. *See Jack Faucett Assocs. v. American Telephone & Telegraph Co.*, 744 F.2d 118, 130 (D.C. Cir. 1984) (holding that, in addition to inconsistent judgments, inconsistent determinations may preclude use of offensive collateral estoppel).

The Bank seeks relief from the stay to setoff, pursuant to Code § 553, the amounts in the Payment Accounts against the amounts which it is owed by the Debtor. The Trustee argues that the Bank is not entitled to exercise any right of setoff because the debts in question are not "mutual debts" within the meaning of Code § 553. The Trustee further argues that, even if the debts in question are mutual, setoff is precluded by Code § 553(a)(3), because a portion of the funds in the Payment Accounts constitute debts incurred for the purpose of obtaining a right of setoff against the Debtor, because the Debtor intentionally declined to exercise its right to withdraw funds from the Payment Accounts during the 90 days preceding the Petition Date.[38] *See Trustee's Memorandum of Law* at 97-99.

The Debtor's financing transactions with many, if not all, of the banks in this case are characterized by the establishment of advance payment accounts pursuant to payment account agreements which are similar, if not identical, to the Payment Account Agreements now in question. On facts and arguments largely identical to those now being presented here, the Court, by Memorandum-Decision, Findings of Fact, Conclusions of Law and Order dated November

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[38] Code § 553 provides in pertinent part:

(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor that arose before the commencement of the case, except to the extent that--

. . .

(3) the debt owed to the debtor by such creditor was incurred by such creditor---

(A) after 90 days before the date of the filing of the petition;

(B) while the debtor was insolvent; and

(C) for the purpose of obtaining a right of setoff against the debtor.

. . .

(c) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

15, 1996 (the "November 15, 1996 Decision"), granted Manufacturers and Traders Trust Company ("M&T") relief from the automatic stay to setoff funds held in an advance payment account against funds owing from the Debtor. The Court's November 15, 1996 Decision was affirmed on September 12, 1997 by the United States Bankruptcy Appellate Panel for the Second Circuit (the "Bankruptcy Appellate Panel"). *See Breeden v. Manufacturers and Traders Trust Co. (In re The Bennett Funding Group, Inc.)*, BAP Nos. 96-50040 and 96-50041(2d Cir. BAP Sept. 12, 1997) (the "M & T Decision").[39] In the M & T Decision, the Bankruptcy Appellate Panel concluded that mutual debts existed in that "the Bank remained indebted to the Debtor for the amounts deposited into the payment account in excess of the required Collateral, and the Debtor remained indebted on the Promissory Notes and Guarantees which it had executed to the Bank." *See id.* at 22. Also, the Bankruptcy Appellate Panel expressly rejected the contention that the funds in the payment accounts had been intentionally built-up for the purpose of obtaining a right of setoff. *See id.* at 24-25. Based on the foregoing, and for the reasons more fully set forth in this Court's November 15, 1996 Decision and in the M & T Decision, the Court will grant the Bank relief from the automatic stay to setoff any funds which may be in the Payment Accounts.[40] The Court makes no determination, however, as to the amount, if any, of funds in

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[39] This was a consolidated appeal. The Trustee filed his notice of appeal on November 25, 1996 (BAP 96-50040); the Official Committee of Unsecured Creditors filed its notice of appeal on December 3, 1996 (BAP 96-50041).

[40] In Adversary Proceeding No. 98-70028A, the Trustee alleges that the Bank transferred to itself $219,155.95 from the Payment Accounts, and that such transfers are avoidable and recoverable pursuant to Code §§ 547 and 550. The Court is not prepared to make a determination as to the merits of this claim in the context of the instant Motion. In view of the Bankruptcy Appellate Panel's ruling and the fact that some of this $219,155.95 may comprise some of the $315,373.11 allegedly paid by the Debtor(s) to the Bank prepetition, *see* note 35, *supra*, the Court will not require the Bank to continue to escrow any of the monies currently held in the Payment

the Payment Accounts, but notes that the Trustee does not appear to dispute the existence of funds in the Payment Accounts. Based on the foregoing, it is hereby

ORDERED that pursuant to Code § 362(d)(1), the automatic stay is hereby modified to the extent that the Trustee is required to turn over to the Bank that portion of the segregated account that represents Schedule A Payments collected on the Bank's Leases since June 11, 1996, with the exception of those Leases which are deemed to be accounts not covered by the Properly Filed UCC-1s, exclusive of any interest earned thereon, within thirty (30) days of the date of this Order, and to turn over on a monthly basis as of the date of this Decision all Schedule A Payments collected on those Leases in which the Bank has established a perfected security interest consistent with the discussion herein, without prejudice to the Bank's right to assert a claim for interest and attorney's fees at the time of confirmation of a plan or at such other time as the Court may deem appropriate.[41] Said payments shall not exceed, however, the principal amount of the Bank's claims as of March 29, 1996[42]; it is further

ORDERED that the Trustee, utilizing TPC, shall continue to service and collect on the Leases subject to the Bank's security interest and shall also continue to provide the Bank with

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Accounts.

[41] Because the Court has found cause to grant the Bank's Motion for Relief pursuant to Code § 362(d)(1), the Court has made no finding concerning whether the Debtor has any equity in the Leases/Lease Payments pursuant to Code § 362(d)(2)(A). Nor has the Court made any finding with regard to any interest the Bank might have in collateral other than the Lease Payments as defined herein. To the extent that the Court has heard valuation testimony, the Court will utilize it in ultimately determining the full amount of the Bank's secured claim pursuant to Code § 506(a) and whether or not the Bank is oversecured under Code § 506(b), at confirmation or such time as the Court determines it to be appropriate.

[42] In light of the Court's rulings herein, it is unnecessary to address the Bank's request for adequate protection in much detail. To the extent that the Bank possesses interests in non-Schedule A Payments, those interests are adequately protected at present.

monthly reports which shall detail and support said collections; it is further

ORDERED that pursuant to Code § 506(c), the Trustee shall be permitted to deduct from the remittance of monthly Lease Payments already collected, as well as those to be collected, the cost of servicing/collecting on the Leases at the rate of $6.37 per Lease per month, subject to being adjusted upon a later order of the Court, with the proviso that if the monthly collection on any single lease is not sufficient to pay the Bank the full amount of its Schedule A Payment, the rate for servicing that particular Lease will be reduced proportionately[43]; it is further

ORDERED that the Trustee provide the Bank with a monthly accounting which shall indicate the manner in which the amount of the monthly check has been calculated by the Trustee; it is further

ORDERED that the Trustee shall withhold from the Lease Payments collected on behalf of the Bank the sum of $315,373.11, which is alleged in Adversary Proceeding 98-70028A to equal the amount of certain transfers said to be recoverable by the Trustee; it is further

ORDERED that to the extent that the Bank has monies on deposit in the Payment Account, it shall be entitled to set off those monies against the principal amount of the Bank's claims as of March 29, 1996 without prejudice to the Trustee to seek disgorgement of any monies the Court may later find to be recoverable by the Trustee; and it is

ORDERED that the Bank's motion for an order compelling the Trustee to abandon the Leases pursuant to Code § 554(b) is denied; and it is finally

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[43] For example, if the lease payment to be made to the Bank on a single lease is $100 and Trustee has sufficient collections to permit the payment of $80.00 or 80% of what is due the Bank, then Trustee shall deduct only $5.10 (80% x $6.37) from the lease payment of $80.00 for that particular lease.

ORDERED that with regard to any monies currently being collected by the Trustee on the Leases which may be subject to the Bank's security interest not addressed in this Order, said monies shall continue to be collected and held or disbursed in accordance with the prior Orders of this Court.[44]

Dated at Utica, New York

this 6th day of May 1998

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge

[44] These include, *inter alia*, payments for the servicing and maintenance of the leased Equipment and payments due to tax entities.